

Litigation Alert

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The Case That Could Significantly Disrupt How Companies Manage Their Gift Card Programs and Could Create Billions of Dollars in Exposure

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Every company with a gift card program should be aware of the recently unsealed *qui tam* case in Delaware titled *State of Delaware ex rel. French v. Card Compliant, LLC, et al.*, N13C-06-289 (Superior Court of Delaware, New Castle). The complaint in *French* alleges that several Delaware corporation defendants violated the Delaware False Claims and Reporting Act by failing to pay to the State of Delaware the value of any gift cards that have been unredeemed for more than five years. The legal theory asserted in this case, however, is not only potentially applicable to other Delaware corporations not named as defendants, but also could be replicable in any of the several states that have escheatment laws similar to those in place in Delaware.

The complaint's allegations and theories first implicate Delaware's Unclaimed Property law, which generally provides that abandoned property "shall descend to the State as an escheat...." 12 Del. C. § 1197. The statute specifically includes unredeemed gift cards as property, *id.* at § 1198(11), and provides that this property is considered abandoned after five years. *Id.* at § 1198(9). The law also requires any "holder of abandoned property" to report and then deliver that property to the State. *Id.* at § 1201. The complaint in *French* alleges that the Delaware corporation defendants were the "holders" of the unredeemed gift cards, despite the fact that those corporations had allegedly entered agreements with CardFact — their gift card program manager — indicating that CardFact was the holder of the unredeemed cards.

The complaint then alleges that the Delaware corporation defendants violated two sections of Delaware's False Claims and Reporting Act, see 6 Del. C. § 1201(a)(4) and (a)(7), by failing to pay these unused balances over to Delaware. The Delaware False Claims and Reporting Act was modeled on the Federal False Claims Act, and each of the two sections at issue in the *French* case has a federal analog.

Section 1201(a)(4) imposes liability on any person who "[h]as possession, custody or control of property or money used or to be used by the Government and knowingly delivers or causes to be delivered, less than all of that money or property." Its federal analog is 31 U.S.C. § 3729(a)(1)(D).

Section 1201(a)(7) of the Delaware Act imposes liability on any person who "[k]nowingly makes, uses, or causes to be made or used a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government." This section's federal analog is 31 U.S.C. 3729(a)(1)(G), which is commonly referred to as describing a "reverse false claim," meaning that it applies to the withholding of payments due to the government, rather than procuring payment from the government by way of fraud.

To date, there is very little authority specifically construing the Delaware False Claims and Reporting Act. The decision in *State of Delaware ex rel. Higgins v. Sourcegas Distributions, LLC et al.*, 2012 Del. Super. LEXIS 216

(May 15, 2012) provides some guidance for the *French* case because the *Higgins* court specifically examined whether an alleged failure to pay abandoned property to Delaware constituted a false claim under Sections § 1201(a)(4) and (a)(7) of the Delaware False Claims and Reporting Act. One of the defendants in *Higgins* allegedly acquired an oil and gas pipeline company that had various accounts containing uncashed utility deposits and other customer payments that were allegedly owed back to the customers. In ruling on the defendant's motion to dismiss, the *Higgins* court held, among other things, that one claim under § 1201(a)(7) survived because the defendant had allegedly renamed one of the accounts containing the allegedly abandoned property to conceal the fact that it was owed to Delaware.

An important issue to consider is how the Delaware Unclaimed Property law and the Delaware False Claims and Reporting Act can potentially work in tandem to magnify the potential exposure well beyond the value of the unredeemed gift cards that should have allegedly been paid over to Delaware. Under the Delaware Unclaimed Property law, Delaware can impose a penalty ranging from 25% up to 75% (in instances involving fraud) of the amount due on any amounts that should have been paid to the state, and can charge interest on unpaid amounts. Under the Delaware False Claims and Reporting Act, potential liability is "a civil penalty of not less than \$5,500 and not more than \$11,000 for each act constituting a violation of this section, plus 3 times the amount of damages which the Government sustains because" of the violation.

Given the significant consequences that this litigation could have, companies with gift card programs should consider taking the following steps:

- **Assess potential exposure.** Given the broad implications of the *French* litigation, companies with gift card programs should assess their programs to gauge the potential for exposure under any applicable unclaimed property laws and also under any applicable state false claims act statutes. This assessment should involve an examination of the structure of the gift card program, the contract and communications with any third-party card issuers or program managers, internal communications concerning the structure of the card program or unclaimed property reporting, how gift card proceeds and unused balances were tracked and accounted for, and, for public companies especially, any public financial disclosures impacted by revenues from gift cards.
- **Monitor the litigation.** The manner in which the *French* court interprets Delaware's Unclaimed Property law could have far-reaching impacts on how gift card programs should be designed and implemented; which state's unclaimed property law applies to card programs with sponsors, issuers, and program managers in different states; and whether corporations with gift card programs should consider reporting and paying unused balances to Delaware or other states.
- **Analyze options for restructuring gift card programs.** Even in the absence of any guidance from the *French* court with respect to application of Delaware's Unclaimed Property law, companies can be proactive in analyzing options for their card programs under various legal scenarios that could emerge in the aftermath of the *French* litigation. It is all the more critical to be proactive because the strategy in the *French* case of combining false claims laws with unclaimed property laws creates powerful incentives for private individual litigants to bring *qui tam* actions on behalf of states in pursuit of prepaid card balances from corporations.
- **Consider the Delaware Voluntary Disclosure Agreement program.** Delaware has a program where holders of abandoned property that should have been previously paid to Delaware can come forward and "catch up" on their past due obligations, and potentially limit penalties, interest, and overall liability. The current **deadline for entry into this program is June 30, 2014** (although the program could be extended through legislation).

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Mintz Levin has attorneys who are experienced in False Claims Act litigation as well as all aspects of gift card and other prepaid device regulation, including the escheatment of intangible property in the context of financial and investment products and services. Please contact one of the authors or your regular attorney at Mintz Levin if your company would like to discuss the practical ramifications of the *French* litigation for its gift card programs.

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