

Connecticut Law Restricting Gift Card Fees Held Enforceable

By: Keith A. Gauer

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In a decision delivered on October 19, 2007, the United States 2nd Circuit Court of Appeals upheld the application of a Connecticut law prohibiting dormancy fees on gift cards issued by a national bank to Connecticut residents. Connecticut law prohibits dormancy or inactivity fees on all gift certificates, including gift cards. Bank of America, a national bank, had entered into a contract with a SPGGC, LLC, a subsidiary of the Simon Property Group, in connection with the marketing of gift cards issued by the bank. SPGGC marketed the gift cards at various shopping malls operated by Simon Property Group and on its website. In *SPGGC, LLC v. Blumenthal*, the Court held that Connecticut's statute prohibited

the collection of dormancy fees by SPGGC.

Under the arrangement with Bank of America, SPGGC was entitled to set and keep all of the fees charged to the customer in connection with the card, including handling/loading fees, maintenance fees, replacement card fees, call center fees and dormancy charges. Bank of America received only the interchange fees paid by VISA based on card usage. When the Connecticut Attorney General threatened to bring action to enforce the state prohibition on dormancy fees, SPGGC sued asking the Court to hold that the Connecticut statutes were either preempted by the National Bank Act or in violation of the

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Capital Investment as a Path Toward Immigration

By: Timothy M. Gebhart

Much of the discussion about the country's immigration issues tends to revolve around persons in the country illegally or a shortage of visas for professional and technical occupations. One area often overlooked is the opportunity afforded foreign nationals who want to invest in businesses in the United States.

South Dakota is in the forefront of one of those areas, the EB-5 visa. Not only does this visa allow foreign nationals to

come to the United States, it allows them to obtain permanent resident status, the coveted so-called "green card." In contrast, the most common investor visas are nonimmigrant visas which do not make the individual eligible for a green card.

There are 10,000 EB-5 visas available annually to qualified individuals seeking permanent resident status on the basis of their engagement in a new commercial

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Commerce Clause of the Constitution.

The 2nd Circuit (one of 12 Courts of Appeal beneath the United States Supreme Court) rejected the preemption arguments advanced by SPGGC and upheld the enforceability of the dormancy fee prohibition. The Court in the *Blumenthal* case acknowledged that a national bank had authority to issue gift cards and that the Connecticut law would likely be preempted by the National Bank Act if Connecticut sought to enforce it against a national bank. In this instance, however, the Court upheld the prohibition based on its determination that the dormancy fee was being collected by SPGGC and not Bank of America. The Court apparently chose to ignore the fact that the cardholder agreement applicable to the Simon gift cards specifically identified the bank as the issuer of the card (and therefore the party entitled to the fees). Instead, the Court based its decision on the terms of the marketing agreement between the Bank of America and SPGGC. Since the Court determined that the economic benefit of the dormancy fee was, in fact, paid to SPGGC under the agreement and not to the Bank, the Court found that the prohibition was enforceable. Interestingly, the Office of the Comptroller of Currency (“OCC”) provided a less than supportive amicus brief in the SPGGC case and the Court relied on several statements from the OCC in its decision.

The 2nd Circuit’s decision in *Blumenthal* reached the opposite conclusion to the May, 2007, decision of the 1st Circuit Court of Appeals in *SPGGC, LLC v. Ayotte*. In the *Ayotte* case, the 1st Circuit held that a New Hampshire statute placing restrictions on gift card fees was preempted by both the National Bank Act and the Homeowners Loan Act. The OCC submitted an amicus brief in the *Ayotte* case strongly supporting the national bank’s preemption arguments. The decisions of the Courts in the *Blumenthal* and *Ayotte* cases, as well as the amicus briefs submitted by the OCC in each case, provide banks with some guidance in connection with the structure of future marketing arrangements with third parties for national stored value products. In order to be able to claim preemption of state laws

regulating card terms such as dormancy fees, a national bank will need to demonstrate its control over the card program, including the establishment and collection of the card fees. While the marketer agent can likely be paid a commission for the sales, it should probably not receive any of the cardholder fees directly. The bank should also be responsible for the processing arrangements, customer service, and dispute resolution functions, either directly or through its agents. In general, the agreement should clearly establish the bank’s primary role in the development and maintenance of the program.

Under federal law, national banks, state chartered banks, and federally chartered thrifts have the authority to export the interest rate from their home state to be applied to national credit products. National banks and federally chartered thrifts also have the authority to charge non-credit related fees or charges, including fees for deposit related services. If state laws interfere with the exercise of this authority, they are preempted. State chartered banks, however, do not generally have a right under federal law to claim preemption of statutes regulating fees and charges other than interest and fees charged in connection with extensions of credit. As such, state banks are at a disadvantage in the marketing of national stored value programs and other services not involving an extension of credit. State bank stored value card programs would likely be required to conform their card products with the divergent laws of each state in which the cards are marketed, including laws regulating the fees and charges applicable to the cards.

While the 2nd Circuit’s decision in the *Blumenthal* case does temper the broad preemption rights normally enjoyed by national banks and federally chartered thrifts, programs can be structured to comply with its terms based on the *Ayotte* decision and the OCC guidance. The *Blumenthal* decision may also be appealed to the United States Supreme Court for further consideration. DEHS

Capital Investment as a Path Toward Immigration *(continued from page 1)*

enterprise. Less than 10 percent are used each year, likely because the EB-5 is not designed for small investors. Depending on the particular circumstances, it requires a minimum investment of \$500,000 or \$1 million.

That is where South Dakota has taken the lead. In April 2004, it obtained designation of 45 counties in eastern South Dakota as a “Regional Center” for both dairy farm and heifer ranch operations in a pilot program run by the federal government. Late last year, this was expanded to include meat processing and packing operations, as well as dairy processing, beef cattle and other animal feedlots. The designation means the minimum investment is at the \$500,000 level and, depending on the industry, that there need not be as many “direct hires” resulting from the business creation.

Generally, to be eligible for an EB-5 visa, an individual must:

1. Establish a new commercial enterprise by:
 - creating an original business;
 - purchasing an existing business and restructuring or reorganizing it such that a new commercial enterprise results; or
 - expanding an existing business by 140 percent of the pre-investment number of jobs or net worth, or retaining all existing jobs in a “troubled business” that has lost 20 percent of its net worth over the past 12 to 24 months;
2. Have invested – or be actively in the process of investing – in a new commercial enterprise:
 - at least \$1 million; or
 - at least \$500,000 where the investment is in a “targeted employment area” (an area that has experienced unemployment at least 150 percent of the national average rate), a designated rural area or in the pilot program; and
3. Have their involvement in the commercial enterprise benefit the United States economy and:
 - create full-time employment for not fewer than 10 qualified individuals (this could be as low as

3 or 4 for the South Dakota Regional Center, depending on the industry); or

- where the investment is made in a “troubled business,” maintain the number of existing employees at no less than the pre-investment level for at least two years.

The investment cannot be wholly passive. The program regulations require the investor be engaged in the management of the enterprise, either through day-to-day managerial control or policy formulation. However, a limited partner in a limited partnership that conforms with the Uniform Limited Partnership Act is deemed to be sufficiently engaged in the enterprise.

One of the significant advantages to the EB-5 visa is that, once approved, the investor (and their spouse and unmarried children under 21) receive a conditional green card. Application to make the green card permanent can be made after two years and showing the requirements of the program have been met and maintained. The delay exists because of concern about potential fraud in the program. For those same reasons, the regulations require the applicant to demonstrate the capital they intend to invest was obtained “through lawful means.”

As noted, this is but one of several visas available to foreign nationals who invest in U.S. businesses. While the others do not have the green card attraction of the EB-5, capital investment is a recognized mechanism to live and work in the United States. DEHS

Davenport Attorneys File Comments on Possible Rules to Define Deceptive Practices

By: Charles D. Gullickson and Dixie K. Hieb

In 2007 financial institutions saw increased scrutiny of their trade practices and how those practices may affect consumers. Several prominent members of Congress and consumer organizations, for example, have asked whether the federal banking regulators are doing enough to exercise their power under the Federal Trade Commission Act to prevent unfair or deceptive practices.

Perhaps in response to these developments, the Office of Thrift Supervision on August 3, 2007, issued an Advance Notice of Proposed Rule-Making asking for comment on whether it should issue regulations to better define what kinds of practice may be considered unfair or deceptive. In its ANPR the OTS asked for comment on whether it should issue regulations for federally chartered thrifts that list specific acts or practices that are unfair or deceptive. The OTS also asked for comment on whether it should issue “principles-based” regulations that articulate general principles and standards for evaluating whether acts or practices are unfair or deceptive.

Generally, the Federal Trade Commission Act prohibits unfair or deceptive practices in interstate commerce. Under the FTC Act, the Federal Reserve Board has the authority to issue regulations with respect to banks to carry out the purposes of the Act, while the OTS has the authority to issue regulations applicable to federally chartered thrifts. In addition, each of the federal banking regulators has the power to bring enforcement actions against the financial institutions it regulates if it believes a violation of the FTC Act has occurred. To date, neither the Federal Reserve nor the OTS has exercised its authority to issue regulations under the FTC Act, although the Federal Reserve, the FDIC, and the OCC have issued informal guidance concerning the FTC Act as it may apply to the institutions they supervise.

Attorneys at the Davenport firm filed a comment letter in response to the ANPR issued by the OTS. The letter first urged that there is not a need for the OTS to issue additional rules with respect to unfair or deceptive practices, particularly in the area of consumer credit where there are already extensive

federal disclosure requirements to protect consumers. The Davenport letter also pointed out that the OTS has not set forth any facts or empirical information which would demonstrate a need for additional regulation in this area.

The comment letter encouraged the OTS, if it felt the need to issue additional guidance, to adopt a principles-based approach that could, as stated in the ANPR, “evolve as products, practices and services change.” The comment letter urged that any guidance adopted by the OTS should be similar to and consistent with guidance previously issued by the OCC, the Federal Reserve Board, and the FDIC. The comment letter noted that both the financial services industry and consumers benefit from consistency in rules and guidance on national products.

The ANPR issued by the OTS cited certain specific practices involving various products, such as credit cards and home mortgage lending, and asked for comment on whether the OTS should further regulate or prohibit those practices. The Davenport letter urged the OTS not to adopt that approach. Concerning the examples set forth in the ANPR that the OTS might consider as unfair or deceptive in the area of credit card lending, the comment letter provided an analysis of why those practices are, in fact, not unfair or deceptive and should not be prohibited as such.

Responses to the request for comments issued by the OTS were due in early November of 2007. To date, the OTS has not issued any public statement on its response to the comments or further steps it might take in this area. The initial ANPR issued by the OTS and all of the comments filed in response are available at the following link: <http://www.ots.treas.gov/CL.CFM?DON=73373&AN=1&catNumber=67>. DEHS

IRS Extends Amendment Deadline for Deferred Compensation Plans

By: Jean Bender

On October 22, 2007, the Internal Revenue Service issued Notice 2007-86 which generally extends to December 31, 2008 previous transition relief that was scheduled to expire on December 31, 2007. Section 409A was added to the Internal Revenue Code in October 2004. It made extensive changes to the treatment of deferred compensation arrangements. Under the final regulations, the definition of such covered arrangements is exceedingly broad, and includes bonus, severance, or deferred payment arrangements, certain employment agreements, stock appreciation rights, phantom stock, certain stock options, director's fee deferral programs, supplemental retirement income plans, and other similar arrangements. Any agreement subject to Section 409A must be carefully structured to comply with the extensive rules now governing elections to defer compensation, the time and form of payment of that compensation, and how and when payments can be further deferred.

Effective January 1, 2005, all arrangements subject to Code Section 409A were required to operate in good faith compliance with the new law. Beginning January 1, 2009, full documentary and operational compliance with the detailed rules will be required. The consequences for failure to comply with these rules are significant. Amounts deferred under a covered arrangement that do not comply with 409A are subject to current income tax, interest, and a 20% excise tax.

Notice 2007-86 also generally extends the transition relief which allows participants or companies to make new elections (subject to certain limitation) for previously deferred compensation as to both the time and form of payment. Payment elections made during 2008 can only apply to amounts payable in 2009 or later and cannot accelerate a payment into 2008 that otherwise would have been paid in a future year. Therefore new payment elections with respect to amounts otherwise payable in 2008 or to accelerate payment into 2008 that would otherwise be paid in a future year still need to be made by December 31, 2007.

It is critical that all compensation plans be reviewed for compliance with Code Section 409A. While the requirement to amend such plans and agreements to come into compliance with Section 409A has now been extended until the end of 2008, we continue to recommend our clients identify and amend such plans and agreements as soon as possible. Having properly amended plans and agreements will assist everyone in operationally complying with these complex rules. DEHS can assist you with reviewing your plans or deferred compensation practices for compliance with these new rules, address design and/or operational changes, review options available, and document the plan. Please contact Robert Thomas or Jean Bender if you have any questions about the impact of Section 409A on your deferred compensation arrangements. DEHS

Record Keeping Dilemmas?

By: Monte R. Walz

A number of our clients have expressed confusion and frustration over questions concerning which records must be kept, for how long, and in what form. There is no single federal or state law source to follow and the requirements imposed by myriad federal and state law provisions from Regulation B to Regulation Z impose a challenging compliance requirement. Electronic records, including e-mails, have only exacerbated the problem. DEHS has recently

devoted substantial effort to surveying the record keeping requirements applicable to financial institutions and would be pleased to assist you in developing a record retention (and destruction) policy. DEHS

The Revised UCC and the Strict Interpretation of the Debtor's Name Requirement

By: Robert E. Hayes and Shane Eden¹

In the world of borrowing and lending, one of the most costly mistakes a financial institution can make is to brush over the details. This is especially true in the case of secured transaction lending, in which one careless mistake can lead to potential loss of priority. With the widespread adoption of the Revised Uniform Commercial Code, many of these problem areas are unfortunately becoming even more troublesome for some lenders. One particular area of difficulty that has seen recent judicial attention is the proper identification of the debtor's name on UCC-1 financing statements.

Under Article 9 of the UCC as adopted in South Dakota, a financing statement is only sufficient if it properly provides the name of the debtor *and* either the social security number or the internal revenue service taxpayer identification number of the debtor. While the latter requirement is somewhat unique to the laws of South Dakota, the former mandate of providing the debtor's correct name has become somewhat of a hot topic of litigation for several states.

While it may seem like including a debtor's name on a financial statement is a relatively simple task, there have been a few case decisions handed down recently which illustrate why that simplicity is not all as it seems. The primary reason for this is the Revised UCC's "single search standard" for creditors who search the UCC database in order to identify previously existing security agreements between a certain debtor and other creditors. This standard for searching, promoted as a safeharbor of sorts for those who commit minor errors, puts the onus of getting the debtor's name correct squarely on the senior creditor by forcing any subsequent creditor to perform only one search using the debtor's "correct name." If this one search yields the proper results, then the senior creditor is protected. If, however, for some reason a financing statement is not found after the initial search, the second creditor is deemed to have done his or her due diligence and need not investigate further. For only if "a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if any, would dis-

close a financing statement that fails sufficiently to provide the name of the debtor in accordance with § 57A-9-503(a)," will the first financing statement be sufficient to perfect a priority lien.

In reviewing the recent judicial treatment given to these specific provisions of the Revised UCC, it is quickly apparent that a case by case analysis is no longer the approach favored by many courts, and that a strict enforcement of the debtor's name requirement is more likely. For example, in the now widely recognized *In re Kinderknecht* case, the creditor listed the debtor's name as, "Terry J. Kinderknecht," instead of his legal name of "Terrance Joseph Kinderknecht." 308 B.R. 71, 72 (B.A.P. 10th Cir. 2004). While this type of slight deviation may have been found sufficient in the past, the 10th Circuit Bankruptcy Appellate Panel found otherwise, stating that an individual debtor's name, must, for purposes of Article 9, be that person's "legal name." The Kansas Supreme Court handed down a similar ruling in 2006 by holding that a one-letter omission in a debtor's name was enough to invalidate the financing statement. *Pankratz Implement Co. v. Citizens Nat'l Bank*, 130 P.3d 57, 59 (Kan. 2006). The debtor, whose legal name was "Rodger House," was mistakenly listed on the financing statement as "Roger House." In drafting its opinion, the court in *Pankratz* noted that a new bright-line rule relating to the sufficiency of the debtor's name would more appropriately shift the burden of the searching process to the senior creditor, thereby giving any subsequent lenders more reliance on the single search method.

Individual debtor names have not been the only areas for strict construction by the courts. The name of debtors who fall into the category of registered organizations has also become a concern for lenders. In the case of *Host America Corp. v. Coastline Financial, Inc.*, a court held that a failure to include periods between the listed initials of the debtor's organizational name was enough to be seriously misleading under the UCC because a single search on the state's database using the correct punctuation of the name did not reveal the first financing statement.

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The Revised UCC and the Strict Interpretation of the Debtor's Name Requirement *(continued from page 6)*

Although the decisions mentioned above may appear to be unduly harsh, they nevertheless represent the growing trend toward strict construction of the terms of the Revised UCC when it comes to the listing of the debtor's name on the financing statement. These rulings make clear that the responsibility of filing with the correct name is placed squarely on the secured party and that little sympathy will be shown for those who fail to accurately list the debtor's correct legal name. To ensure compliance with these tight rules, it becomes necessary for a secured party in any transaction to always confirm the debtor's legal name prior to filing.

For individual debtors, the safest way to achieve certainty with regard to an individual's true legal name is to check that person's birth certificate or social security card. While the vast majority of driver's licenses or other common identifications will probably provide the proper legal name, one must not forget the great risk that is involved from making a very simple mistake. South Dakota law also presents another wrinkle to the lending process by requiring a debtor's social security number be listed on a financing statement. Although these too can be reliable in per-

forming a search, prudent lenders would be wise not to rely on single searches using *only* a debtor's social security number. Just like the harsh results senior creditors can suffer from improper name filing, failure to discover a pre-existing lien due to improper search using only an individual's social security number will not protect the priority from a junior creditor whose search fails to reveal other creditors. Only searching with the proper legal name will be truly sufficient to assure a lender of priority.

With regard to registered organizations, the best document to rely on would be the organizational "birth certificate." Whether it is Articles of Incorporation or another type of organizational document, checking with the Secretary of State's Office to determine the correct name is essential to ensuring strict compliance with the rule.

The stringent rules of Revised Article 9 of the UCC may at times seem overly burdensome and unnecessary. They do, however, advance many positive policy considerations that should help to simplify the searching process and reduce litigation for the future. DEHS

¹ 2007 Summer Associate at Davenport, Evans, Hurwitz & Smith

Employment Law News: New I-9 Form Released

By: Timothy M. Gebhart

A form all employers must fill out for new employees has been revised by the U.S. Citizenship and Immigration Services (USCIS). Known as the I-9, the form requires employers to verify that new hires are eligible to be employed in the United States.

Although the revised I-9 form will not technically become effective until notice is published in the *Federal Register*, the USCIS is asking employers to begin using it immediately. The new form eliminates five documents from the list of those acceptable in completing the form and adds one additional document that can be used. Employers may only accept documents that are listed on the form. According to the USCIS web site, the current form will be accepted only until December 7, 2007.

Employers do not need to purchase the I-9. It and a

related handbook with instructions are available for download at www.uscis.gov. Employers without online access can order the forms by calling the USCIS at 1-800-870-3676.

It is not necessary for employers to complete new I-9 forms for existing employees, only new hires. If, however, an employer is required to re-verify an existing employee's employment authorization, it should use the new form.

DEHS can assist employers with questions regarding the new form or issues that arise in the hiring process. In addition, Tim Gebhart of the law firm is available to assess, draft or review written I-9 policies, conduct full or partial audits of existing I-9 forms, or provide on-site or off-site training for those responsible for I-9 forms. DEHS

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Davenport, Evans, Hurwitz & Smith, LLP was founded in 1939. Since that time, the firm has grown steadily and is now one of the largest firms in South Dakota. For more than fifty years, the firm has assisted clients in banking and financial services matters. The firm acts as counsel to many South Dakota banks, financial institutions, and holding companies. DEHS also regularly acts as counsel to businesses who contract with banks, including various servicing and marketing firms.

The firm handles all aspects of banking law, from entity formation, acquisitions, and branching to operational issues involving lending, compliance, creditors' rights, payment processing (check, ACH, wire transfer), general commercial law, and trust administration. The firm represents banks in all phases of state and federal banking regulation and deals extensively with state and federal banking regulators. The firm understands that keeping up with new regulatory developments is a major challenge for banks today and helps its clients respond to that challenge effectively and efficiently.

South Dakota has become a major center for financial services, with approximately a half dozen credit card processing centers located in the Sioux Falls area alone. The firm has served as counsel to many of these entities and has particular experience and expertise in the areas of credit card and stored value card issuance, compliance, and receivables securitization.

The firm also represents its bank clients in bankruptcy matters and complex mediations, foreclosures, and commercial litigation on a regular basis. DEHS often acts as counsel to lenders in loan workouts and bankruptcy cases filed in South Dakota. The firm's banking and financial services lawyers, together with the firm's strong litigation practitioners, also handle commercial litigation such as bank shareholder disputes, complex lender liability cases, bank-marketer disputes, federal compliance cases, employment disputes and many other litigation cases. Our employment law attorneys assist clients with personnel issues, discrimination claims, and immigration matters. The firm's benefits lawyers develop both qualified and non-qualified benefit and retirement plans.

Numerous out-of-state and nationwide lenders also retain the firm for review of loan documents, compliance with state and federal law, and assistance in completing major real estate and commercial loans. The firm also assists out of state individuals and entities in the formation and operation of trust companies.

If you have any questions or desire assistance on any matter, please feel free to contact us at your convenience.

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