

# Card Issuers Trapped Between New Jersey and Delaware

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Although they are neighboring states, New Jersey and Delaware have not always seen eye to eye. In 2008 New Jersey sued Delaware in the U.S. Supreme Court over a border dispute, and the Court held in favor of Delaware.<sup>1</sup> Tempting fate, New Jersey's recent unclaimed property legislation creates a new clash between the two states that could again require Supreme Court resolution. Even if the states avoid a collision, there are enough other problems with the new law to cause even the calmest unclaimed property professionals to whinge. This article identifies the issues on which holders should focus and highlights areas for improvement for New Jersey politicians.<sup>2</sup>

## Background

On June 30, as part of New Jersey's many desperate moves to fix its budget and debt crisis, the state enacted significant changes to its unclaimed

property laws.<sup>3</sup> The most significant changes relate to stored value cards. The state's previous law did not include unclaimed gift certificate balances as unclaimed property subject to state custody. That exclusion was based on a state court decision interpreting the then-existing New Jersey statute.<sup>4</sup> The new law reversed that decision retroactively and imposes additional compliance burdens on issuers of stored value cards. Because the law was introduced and adopted all in a period of less than five days, numerous problems and controversies immediately erupted in the aftermath of its passage.

## New Stored Value Card Provisions in New Jersey Unclaimed Property Law

### Stored Value Cards as Property Subject to Unclaimed Property Remittance

New Jersey's new unclaimed property law makes the balance of stored value cards subject to remittance to the state once the cards have been deemed abandoned. Stored value cards are defined as "any record that evidences a promise, made for monetary or other consideration, by the issuer or seller of the record that the owner of the record will be provided, solely or a combination of, merchandise, services, or cash in the value shown in the record, which is pre-funded and the value of which is reduced upon each redemption."<sup>5</sup> Stored value cards thus include gift cards, electronic gift cards, store cards, rebate cards, and paper gift certificates.

Unlike the 1995 Model Uniform Unclaimed Property Act (1995 Model Act) and many other state statutes, New Jersey law deems that the full amount of the remaining balance of the stored value card is abandoned and subject to remittance to the

<sup>1</sup>*New Jersey v. Delaware*, 552 U.S. 597 (2008).

<sup>2</sup>A representative who voted for the bill recently publicly stated that he did not think the law would be retroactive, despite the unequivocal provision in the law applying its provisions to stored value cards issued before the law's effective date.

<sup>3</sup>Original revenue estimates that have been reported reach almost \$80 million in the first or second year after adoption, falling off after that once retroactive remittances are no longer being made.

<sup>4</sup>Matter of November 8, 1996, Determination of State, Dept. of Treasury, Unclaimed Property Office, 309 N.J. Super. 272, 706 A.2d 1177 (Mar. 10, 1998).

<sup>5</sup>New Jersey Bill A 3002, section 1(t).

state. Many state laws provide that only a portion of the remaining balance of a stored value card is abandoned property. The 1995 Model Act provides that a gift certificate is presumed abandoned once the dormancy period has expired, but if the gift certificate is “redeemable in merchandise only, the amount abandoned is deemed to be [60] percent of the certificate’s face value.” This is outlined in section 2 (7)(brackets in original). Even Delaware’s law provides the state escheater the discretion to accept “an amount in money representing the maximum cost to the issuer of merchandise represented by the certificate.”<sup>6</sup>

### Exemptions

The new stored value card provisions contain some exemptions from the unclaimed property law requirements. For instance, the new provisions do not apply to any cards that are “distributed under a promotional or customer loyalty program or a charitable program for which no monetary or other consideration has been paid” by the owner (section 5e). The exemptions generally apply to a card and not to an issuer. An exemption also exists for small businesses and provides that the new stored value card provisions do not apply to cards sold by issuers who in the preceding year sold stored value cards with a face value totaling \$250,000 or less. This exemption was targeted primarily at many of the local restaurants in the state.<sup>7</sup>

Importantly, the bill also allows for the treasurer to grant exceptions from the stored value card provisions if good cause for that exemption is demonstrated. The discretion available to the treasurer came into play once the bill was enacted.

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The definition of stored value cards is broad, and this breadth is affecting some industries in a way that may not have been intended. For example, the definition of stored value cards in the new law explicitly includes prepaid phone cards, but after the

<sup>6</sup>12 Del. Code section 1198(11).

<sup>7</sup>Unfortunately, a technical reading of the statutory language of this small business exemption would actually apply the new stored value card provisions solely to issuers that sold only stored value cards with individual face values of more than \$250,000; we assume that that is not really what the State Legislature meant. The exemption reads “this section does not apply to a stored value card issued by any issuer that in the past year sold stored value cards with a face value of \$250,000 or less.”

law was passed, the telecommunications industry immediately began work to exclude prepaid phone cards from the law — either through the treasurer’s office or through amending legislation. The issues surrounding prepaid phone cards go to the heart of what the term “abandoned property” should cover and whether abandoned property should ever be considered a way to fix a state’s budget problems.

As explained by representatives of the telecommunications industry, prepaid phone cards do not just represent a medium that holds value for later purchases. Instead, the purchase of such a card requires an immediate commitment of resources — such as the assignment of a unique phone number — by the issuer. This immediate commitment of finite resources on the purchase, rather than redemption of a prepaid phone card, suggests that those cards should never be unclaimed property. A bill to exempt prepaid phone cards is now in the General Assembly Appropriations Committee. Because a legislative fix for the telecommunications industry may not move as fast as the original unclaimed property bill, the treasurer’s office recently released guidance that issuers of prepaid phone cards redeemable for minutes are exempt from the provisions of the bill “until further notice.”<sup>8</sup> The Office of the State Treasurer intends to review and analyze the effects of the law on prepaid phone cards before coming to a final determination of how they should be treated. Perhaps other types of stored value cards also deserve a similar exercise of the treasurer’s discretion.

The new unclaimed property law for stored value cards repeals the New Jersey consumer protection provisions governing gift certificates *unless* the gift certificate is covered by one of the exemptions noted above.<sup>9</sup> Thus, granting an exemption to prepaid phone cards would lead to the application of the existing consumer protection statute to those cards.

### Name and Address Collection

The new law requires issuers and sellers to collect the names and addresses of the purchasers or owners of each stored value card issued or sold.<sup>10</sup> At minimum, issuers must maintain a record of the ZIP code of the owner or purchaser. If the issuer does not

<sup>8</sup>State of New Jersey Treasury Announcement FY 2011-03 (Sept. 23, 2010).

<sup>9</sup>New Jersey Bill A 3002, section 5(g).

<sup>10</sup>This data collection provision was initially slated to take effect on July 1, 2010. On that initial effective date, the Office of the State Treasurer of New Jersey released its first announcement stating that issuers were exempted from the requirements of section 5(c) until September 1, 2010. On August 26, the department released Treasury Announcement FY 2011-02 further extending the exemption from compliance with section 5(c) through October 1, 2010. The treasury department indicated that it needs to review current processes, technologies and reporting practices, and develop specific industry guidance. The treasury department further

(Footnote continued on next page.)

collect or maintain the required information, the address of the owner or purchaser is assumed to be the place where the card was purchased or issued. The result of these requirements is that if the place of business where the card was purchased or issued is in New Jersey, under the new law any unclaimed value attached to unused cards for which no purchaser's address information has been maintained should be reported to New Jersey.

The treasurer's office recently released guidance regarding this data collection requirement.<sup>11</sup> Although the guidance is not specific, it does provide some general safe harbors for companies, though companies will still find compliance difficult under some circumstances. In the guidance, the treasurer said that issuers will be exempt from collecting names and addresses if they do not otherwise obtain names and addresses of purchasers in the ordinary course of business, as long as the issuer obtains the ZIP code of the purchaser.<sup>12</sup> Further, if the issuer of a stored value card requires registration or activation of that card, the issuer must obtain the name and address of the purchaser at that time.<sup>13</sup>

#### New Jersey Versus Delaware

Of equal, if not greater, importance to the immediate compliance issues of collecting the name and address of card purchasers are the compliance issues and potential litigation resulting from the conflict between New Jersey's rules and Delaware's rules. Part of New Jersey's new law provides for a supercharged "transaction test." The transaction test is part of the rules of priority to determine which state may take possession of unclaimed property. Only two rules are known for certain. Property must first go to the state of the owner's last known address. If the holder does not have the address information, the property is to be remitted to the state of the holder's incorporation.<sup>14</sup>

Under the 1995 Model Act and many state unclaimed property statutes, if the holder does not have a last known address for the owner of deemed abandoned property and the holder is incorporated in a state that does not provide for escheatment of that property, the transaction test is used to determine to which state the property should be remitted. Under most states' transaction tests, the property is to be remitted to the state in which the transaction

creating the property occurred. There is significant controversy as to whether the transaction test is a valid exercise of a state's power. U.S. Supreme Court cases have established only two priority rules — the state of the last known address and the holder's state of incorporation. The Court specifically rejected the transaction test that was proposed by a special master appointed by the Court, so many unclaimed property professionals have interpreted these cases to conclusively disallow the use of the transaction test in any situation in which a state unclaimed property law covers a type of property, even if that law exempts the property from the remittance requirements. Other unclaimed property activists assert that because the Supreme Court cases involve only conflicts between states over custody of the same property, the cases are not dispositive of the priority rules as between a state and a holder. The validity of the transaction test remains in limbo.

***New Jersey's new law not only adopts the controversial transaction test, but also actually elevates the transaction test above the state of incorporation rule.***

Despite that controversy, New Jersey's new law not only adopts the controversial transaction test, but also actually elevates the transaction test above the state of incorporation rule. That puts New Jersey directly at odds with Delaware, which requires that if the actual last known address of the owner is unknown, the property is to be remitted to the state of the incorporation of the holder.

For many stored value card issuers, the state of incorporation is, or was at one time, Delaware. Delaware's treasury department is active and sophisticated when it comes to escheatment, and it has seen the problems with New Jersey's process. On September 1 the Delaware escheator issued an e-mail to the president of the Unclaimed Property Professionals Organization, saying the state had received inquiries about how to reconcile New Jersey's new law (the e-mail did not actually name the state in question) with Delaware's law. The Delaware escheator stated:

Any state legislation or regulation that attempts to vary the Supreme Court's priority rules and establish a different priority scheme in our eyes is contrary to law and unenforceable. For instance, a priority rule based on the place that a transaction occurred has already been rejected by the Supreme Court. It is a holder's obligation to correctly report abandoned property to the appropriate state under the well known priority rules. If a demand is

extended the section 5(c) exemption through October 31, 2010. State of New Jersey Treasury Announcement FY 2011-03 (Sept. 23, 2010).

<sup>11</sup>State of New Jersey Treasury Announcement FY 2011-03 (Sept. 23, 2010).

<sup>12</sup>*Id.*

<sup>13</sup>*Id.*

<sup>14</sup>*Texas v. New Jersey*, 379 U.S. 674 (1965); *Delaware v. New York*, 507 U.S. 490 (1993).

made on holder by a state to report property that is inconsistent with the Court's priority rules and Delaware's rights are implicated by this demand, the holder should contact the undersigned prior to payment and Delaware will address the issue with the other state.

New Jersey's unclaimed property law does not provide for indemnity for companies that have remitted property to another state. Thus, holders incorporated in Delaware with unclaimed stored value cards originally sold in New Jersey must choose between Scylla — a horrible monster with six necks, each with a head with three rows of teeth — and Charybdis — a sea demon with a face that is nothing but a huge ship-eating mouth. We leave it to the reader to decide which state is the six-headed monster and which is the massive-mouth ship-sucker.

**One of the more subtle and devious results of this New Jersey legislation is the application of Financial Accounting Standard 5 to retailers who may be required to accrue a loss contingency reserve for unredeemed store value cards.**

New Jersey's recent announcement described above, which relaxes some provisions of the name and address collection requirement, provided some guidance to companies on how to resolve this conflict for stored value cards purchased in New Jersey but already escheated to the issuer's state of incorporation. However, prospective compliance remains a serious issue. In the recent guidance, the treasurer partially allows the state of incorporation/second priority rule to govern for cards sold before the date of the announcement, as long as the state of incorporation actually requires escheatment of the stored value cards. For companies domiciled in New Jersey that did not collect names and addresses or ZIP codes before the law change, the treasurer has announced that the stored value card property should be escheated to New Jersey. For companies domiciled in other states, the property should be escheated to the state of domicile of the holder, regardless of where the card was purchased. However, as more fully explained below, the treasurer specifically provided that for companies not domiciled in New Jersey, if their state of domicile exempts stored value cards from remittance as unclaimed property and no purchaser names and

addresses were maintained, the property should be escheated to New Jersey if the card was sold in New Jersey.<sup>15</sup>

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### **Profit Percentage**

Further complicating compliance with New Jersey's supercharged transaction rule is the question of what to do if the issuer decides to follow the second priority rule but the state of incorporation requires only a percentage of the value of the card to be escheated to the state. As mentioned above, New Jersey's new requirement that the entire value of a deemed abandoned stored value card must be remitted as unclaimed property is in stark contrast to other states' laws. To the extent that an issuer sells a card in New Jersey, is not required to collect the name and address of the purchaser, and decides that the appropriate compliance is to remit that property to its state of incorporation, a question arises if the state of incorporation allows the issuer to keep a part of the value of the card: Must the issuer nevertheless remit that remaining value to New Jersey, the state of the transaction?

### **Gift Card Companies**

The new law is retroactive in the sense that it applies to all outstanding stored value cards issued before July 1, 2010 (as well as all cards issued in the future). If that retroactive application is valid,<sup>16</sup> companies that incorporated a gift-card-issuing company in a state that exempts gift cards from the unclaimed property law will now have to escheat the value of cards sold in New Jersey to New Jersey. In many instances, the value of those cards could be significant, and it is likely that the issuer already took the value of the card into income for both financial-statement and income-tax purposes.

### **Elimination of Dormancy Fees**

Just so stored value card issuers do not feel singled out, the New Jersey law also adds a little "gift" for many other businesses that hold unclaimed property. Dormancy fees for stored value cards, credit balances, overpayments, security deposits,

<sup>15</sup>State of New Jersey Treasury Announcement FY 2011-03 (Sept. 23, 2010).

<sup>16</sup>Recently, Kentucky tried to cut their dormancy period from 15 to 7 years. A federal court held that the bill violated the due process clause. The bill failed rational basis review because it was designed to raise revenue, instead of reuniting citizens with lost property. *American Exp. Travel Related Services Co., Inc. v. Hollenbach*, 630 F.Supp.2d 757 (E.D. Ky. 2009).

unused tickets, refunds, credit memoranda, and similar instruments are now prohibited. Under New Jersey's previous law, a dormancy fee could be imposed on inactive instruments for payment if there were a valid enforceable contract between the issuer and the owner of the instrument. This fee would have been subject to federal laws regulating the amount of those fees and when they could be imposed. The bill eliminates all dormancy fees, even if there is an enforceable contract between the issuer and the owner. The treasurer's recent announcement reinforces that elimination.<sup>17</sup>

### Effective Date

Because of the hastiness with which this legislation was adopted and the resulting sloppiness of some of the language in the law, there is a real question whether, absent a correcting amendment, New Jersey will collect any of the anticipated stored value card revenue in the current budget year. Holders of abandoned property must file an annual report with the state, declaring the property that was deemed abandoned during the report period and remitting that property to the state.<sup>18</sup> Reports are due November 1 and cover the reporting period from July 1 of the previous year to June 30 of the year the report is filed.<sup>19</sup> The new law is effective July 1, 2010, and applies to "travelers checks, money orders, stored value cards, credit balances, customer overpayments, security deposits, refunds, credit memoranda, unused tickets, or similar instruments outstanding on and after the [sic] July 1, 2010, including, but not limited to, those outstanding instruments issued before July 1, 2010."<sup>20</sup> Thus, because the bill becomes effective July 1, but the unclaimed property reporting year ended June 30, the state may not actually receive the anticipated revenue until November 1, 2011 — the first reporting date that includes the day on which the law became effective. At the New Jersey Assembly's September 13 hearing on the new law before the Consumer Affairs Committee, one witness said that he had a legal opinion that the covered property did not have to be remitted until 2011.

### Pending Lawsuits

Two lawsuits challenging the bill have already been filed in U.S. District Court in New Jersey.

<sup>17</sup>"No dormancy charge or fee, abandoned property charge or fee, escheat charge or fee, inactivity charge or fee, or any similar charge, fee or penalty for inactivity with respect to the property is permitted. This is regardless of the terms on the stored value card." State of New Jersey Treasury Announcement FY 2011-03 (Sept. 23, 2010).

<sup>18</sup>New Jersey Stat. section 46:30B-46.

<sup>19</sup>New Jersey Stat. section 46:30B-49.

<sup>20</sup>New Jersey Bill A 3002, section 9.

One lawsuit, filed by American Express Co.<sup>21</sup> and similar to the lawsuit the company won in Kentucky,<sup>22</sup> challenges the new law's drastic reduction in the abandonment period for traveler's checks. The complaint describes several causes of action:

- the bill violates the due process clause because the short abandonment period is not rationally related to any legitimate governmental purpose;
- the bill violates the issuer's rights under the contracts clause because it deprives the issuer of the benefit from its contract with its customers for traveler's checks;
- the bill violates the issuer's rights under the takings clause by taking the issuer's property; and
- the bill violates the issuer's rights under the commerce clause because the shortened abandonment period in New Jersey, compared with the 15-year periods in all other states, discriminates against interstate commerce by forcing the issuer to change its business practices in New Jersey.

The second lawsuit, filed by the New Jersey Retail Merchants Association (NJRMA), alleges similar constitutional violations regarding due process, contracts, and the takings clause.<sup>23</sup> The NJRMA does not allege any commerce clause violations, but importantly, the NJRMA's complaint does include as an additional cause of action the charge that the law violates federal common law by disregarding the Supreme Court's established priority rules for escheating abandoned property.

### Result of New Law — Public Policy Fraud

New Jersey should not be blamed for attempting to raise revenue for the state.<sup>24</sup> There is no doubt that the state is in a desperate fiscal crisis. Recently, New Jersey was sued by the SEC for violating securities laws by issuing bonds without disclosing the state's failure to properly fund its pension fund obligations, and Moody's Corp. downgraded the state's credit rating. Everyone recognizes that New Jersey has a big budget problem and that otherwise extreme measures may be justified. However, New Jersey's action of amending its unclaimed property laws to raise additional revenue and its insincere

<sup>21</sup>*American Express Travel Related Services Company, Inc. v. Sidamon-Eristoff et al.*, Case 3:10-cv-04890-FLW-LHG, U.S. District Court for the District of New Jersey (filed Sept. 23, 2010).

<sup>22</sup>*Supra* note 16.

<sup>23</sup>*New Jersey Retail Merchants Association v. Sidamon-Eristoff et al.*, Case 3:10-cv-05059-FLW-LHG, U.S. District Court for the District of New Jersey (filed Sept. 30, 2010).

<sup>24</sup>There is, however, plenty of blame to place for allowing the state to reach the level of budget crisis with which it now routinely struggles.

assertion that the new law is meant to protect its residents and consumers<sup>25</sup> creates a dangerous precedent. Many other states, desperate for revenue, may attempt to replicate New Jersey's law, similarly under the guise of protection of their residents. Given the uncertainty of the implications of the law, expansion of such a legally controversial law would create significant problems for states and compa-

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<sup>25</sup>The introduction to the legislation provides that the new law's "primary purpose[s]" are to: "modernize" the state's unclaimed property laws and processes "relative to other states"; "protect New Jersey consumers from certain commercial dormancy fee practices"; and "enhance New Jersey's capacity to protect its residents' stored value cards from being subject to other state's [sic] escheatment process." As pointed out at the recent hearing before the Assembly's Consumer Affairs Committee, even though the law claims to be protecting consumers, the law was never heard by the committee charged with consumer protection.

nies. Despite the urge to bring in revenue, legislatures should make sure that their laws at least provide protection for issuers that try to comply with state laws that are in direct conflict. Legislatures also should give the executive branch time to implement the law and give companies time to institute compliance requirements. Finally, if a legislature wants to claim that the new law is to protect its residents and consumers, it should verify that the result will not actually be that fewer desired services are provided by businesses in the state because the new law makes those services unprofitable. ☆

*UPwords is a column about unclaimed property from Sutherland Asbill & Brennan LLP's State and Local Tax Practice. This installment is by Diann L. Smith, counsel, and Mark W. Yopp, an associate, with Sutherland's State and Local Tax Practice.*