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CIRCUIT COURT UPHOLDS CHALLENGES TO NEW JERSEY GIFT CARD LAW

In a ruling that provides at least some relief to issuers of stored value cards, a federal court of appeals has affirmed a district court decision preliminarily enjoining the retroactive application of a broad New Jersey law governing stored value cards and preliminarily enjoining the prospective application of the law's "place-of-purchase" presumption.

In July 2010, New Jersey amended its unclaimed property statute and provided for the custodial escheat of gift cards for the first time. The law presumes gift cards to be abandoned after two years of inactivity and requires issuers to transfer to the state the remaining value on the gift cards at the end of the two-year abandonment period. The law also has a "place-of-purchase presumption" that provides that, in all instances where the address of a purchaser is unknown, the address of the place of purchase is substituted for the address of the purchaser. A "data collection" portion of the law requires that issuers "obtain the name and address of the purchaser or owner of each stored value card issued or sold and shall, at a minimum, maintain a record of the zip code of the owner or purchaser."

A number of issuers challenged the constitutionality of the law. After a federal district court issued a preliminarily injunction, New Jersey appealed.

Now, the U.S. Court of Appeals has affirmed the district court's decision.

CIRCUIT COURT RULING

In its opinion, the Third Circuit explained that because the value of gift cards includes the expected profit or merchant fee, requiring issuers to turn over the entire value of the card in cash effectively transfers their expected benefits to state custody. By imposing such an unexpected obligation, the circuit court reasoned, the New Jersey law "impaired [the issuer's] contractual relationship."

That impairment was substantial, the Third Circuit found, because an issuer's reliance on the expected profit or merchant fee is vital to its contractual relationship. As the circuit court noted, these expected benefits supported the administrative cost of issuing and processing the gift cards and allowed issuers to do so without charging a purchaser additional fees beyond the face value of a card.

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THE BOTTOM LINE

The circuit court decision sends the case back to the district court for further proceedings. To date, the application of the New Jersey law has been blocked with respect to existing cards and with respect to the place-of-purchase presumption. The extent to which the New Jersey law ultimately will be enforceable, if at all, remains to be seen. While the ruling does provide some relief for gift card issuers, it seems likely that the two-year escheatment period and the data collection provision will remain in place, meaning that at least some portion of gift cards purchased in New Jersey will carry address information and thus make them escheatable to New Jersey or other states.

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New Jersey could have accommodated the issuers' expectations by, for example, requiring them to turn over a percentage of the value of the abandoned gift card, reflecting a discount based on the expected profit or merchant fee, rather than the card's entire remaining value. It did not do so, however, and the Third Circuit affirmed the district court's decision preliminarily enjoining the state from retroactively enforcing the law with respect to existing gift cards.

The appellate court then found that the place-of-purchase presumption was preempted by federal common law, which generally provides for escheat of property first to the state of the last known address of the owner of the abandoned property and, if such address is not known, then to the state in which an issuer is incorporated. As the circuit court explained, when an issuer is not incorporated in New

Jersey, it would be impossible for it to comply with both the New Jersey law's place-of-purchase presumption and the federal rule because two states cannot both escheat the same abandoned property.

The Third Circuit also affirmed the district court's decision refusing to enjoin the law's data collection provision, finding that it was severable from the place-of-purchase presumption and that, at this stage of the litigation, it could not conclude that the data collection provision was preempted by federal common law. Moreover, the circuit court rejected the issuers' argument that the federal Credit CARD Act of 2009, which provides for a five year expiration date on gift cards, preempted the two year escheatment period of the New Jersey law, concluding that the state law was permissible because it provided greater consumer protection than the federal law and did not impede its goals.

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