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U.S. Court of Appeals Holds New Jersey's Retroactive Escheatment of Gift Card Abandoned Funds Unconstitutional and its Priority Rules Preempted by Federal Law

On January 5, 2012, the U.S. Court of Appeals for the Third Circuit found that New Jersey's recently enacted unclaimed property laws requiring retroactive escheatment of abandoned amounts from stored value cards (SVC or gift cards) violated the U.S. Constitution. Additionally, the court held that New Jersey's priority rules for the escheatment of SVC abandoned funds were preempted by federal common law. The court, however, sustained the new requirement that issuers obtain the name and address of the purchaser or owner of each SVC issued or sold and maintain, at a minimum, a record of the zip code of the owner or purchaser. *New Jersey Retail Merchants Assoc. v. Sidamon-Eristoff*, Nos. 10-4551, 10-4552, 10-4553, 10-4714, 10-4715, 10-4716, 11-1141, 11-1164 & 11-1170 (3d Cir. Jan. 5, 2012); *Am. Express Travel Related Servs. Co. v. Sidamon-Eristoff*, No. 10-4328 (3d Cir. Jan. 5, 2012).

Escheatment of SVCs

New Jersey's Unclaimed Property Amendment

With the enactment of 2010 N.J. Laws Chapter 25 (Chapter 25), New Jersey amended its unclaimed property statute, N.J. Stat. Ann. § 46:30B, to provide for the escheatment of SVCs for the first time. SVCs are forms of electronic payment by which a purchaser, by tendering payment for the face value of the SVC, may obtain merchandise or services equal to the remaining balance of the SVC. Once the SVC is redeemed for purchase, the SVC issuer recognizes a profit based on (i) the difference between the issuer's cost of acquiring the goods or offering the services and the retail price paid by the customer when the customer purchases the goods or services from the issuer; or (ii) a merchant fee paid by third-party retailers when the issuer purchases the goods or services from a retailer other than the issuer. The unclaimed property statute, as amended by Chapter 25, provides that an SVC is presumed abandoned after two years of inactivity, and requires issuers to transfer to New Jersey the remaining value on the SVCs (i.e., the abandoned amount) at the end of the two-year abandonment period.¹ In addition, Chapter 25 requires SVC issuers to obtain the name and address of the purchaser or owner of each SVC issued or sold, and, "at a minimum," maintain a record of the zip code of the owner or purchaser (the data collection provision).² In addition, Chapter 25 provides that if the issuer of an SVC does not have the purchaser's or owner's name or address, the place where the SVC is purchased or issued will be presumed to be the address of the SVC's purchaser or owner, and the issuer will be required to escheat the abandoned amount to New Jersey if the place of business where the SVC is sold or issued is located in New Jersey (place of purchase presumption).³

¹ N.J. Stat. Ann § 46:30B-42.1a.

² Chapter 25, § 5c.

³ *Id.*

Treasury Guidance

In order to provide guidance regarding the new law, the New Jersey Office of the State Treasurer (Treasurer) issued a Guidance that elaborates on the place of purchase presumption.⁴ The Guidance addresses abandoned amounts of SVCs issued before the announcement of the Guidance where the name and address or zip code of the purchaser or owner were not recorded, and sets forth priority rules applicable to the escheatment of these amounts.⁵ In particular, the Guidance provides that if (i) the issuer is domiciled in New Jersey, the abandoned amounts must be escheated to New Jersey; (ii) if the issuer is not domiciled in New Jersey, the amounts must be escheated to the state in which the issuer is domiciled; and (iii) if the issuer is not domiciled in New Jersey and the issuer's state of domicile exempts this type of property from escheatment, the abandoned amounts must be escheated to New Jersey if the SVCs are sold or issued in New Jersey.⁶

U.S. Court of Appeals Decision

In September 2010, several plaintiffs filed complaints in the U.S. District Court for the District of New Jersey seeking declaratory relief and injunctive relief, and filed motions for preliminary injunction to prevent New Jersey from enforcing Chapter 25 and the Guidance while the case was pending. The court preliminarily enjoined the retroactive application of Chapter 25 to SVCs redeemable for services and merchandise that were issued before the enactment of Chapter 25. In addition, the court enjoined the prospective enforcement of the place of purchase presumption under Chapter 25 and the Guidance. The court, however, declined to prospectively enjoin the data collection provision and the two-year abandonment period provision. Both the plaintiffs and New Jersey appealed the orders before the Third Circuit.

Contract Clause Challenge

In determining whether the plaintiffs' motions for preliminary injunction should have been granted, the Third Circuit analyzed the plaintiffs' likelihood of success on the merits. In doing so, the court first addressed whether Chapter 25 violated the Constitution's Contract Clause by impairing the contractual relationships of SVC issuers.⁷ The court found that (i) by requiring issuers to escheat the value of the SVCs *in cash* to the state even where the SVCs were only redeemable for services or goods, Chapter 25 forced issuers to forfeit their expected profit (i.e., the difference in price or the merchant fee);⁸ (ii) such impairment was substantial because the SVC issuers' reliance on the expected profit was vital to their contractual relationship; and (iii) Chapter 25's retroactive obligations on SVC issuers were unanticipated because New Jersey law previously had never provided for the escheatment of SVCs. In addition, the court reasoned that although Chapter 25 furthered a legitimate public purpose, the law did not reasonably accommodate the rights of the contracting parties because it failed to allow SVC issuers to collect their bargained-for expected profit.⁹

⁴ Office of the State Treasurer, State of New Jersey, Treasury Announcement FY 2011-03, Guidance on Implementation and Notice of Exemption from Certain Provisions of L. 20120 c. 25, at 3 (Sept. 23, 2010) (Guidance)

⁵ *Id.*

⁶ *Id.*

⁷ U.S. Constitution, Article 1 § 10, Clause 1.

⁸ The court cited to Ala. Code § 35-12-72(a)(17) (escheating 60% of value of gift cards redeemable only for merchandise) as an example of escheatment statutes that would not impair the issuers' profit expectation.

⁹ As previously discussed, the issuers' "expected profit" is the profit that SVC issuers recognize once the SVC is redeemed for purchase on (i) the difference between the issuer's cost of acquiring the goods or offering the services and the retail price paid by

Sutherland Observation: The court’s reasoning will not prevent the New Jersey Office of the State Treasurer from issuing regulations interpreting an “amount credited to the recipient” and providing that the abandoned amount consists of that percentage of the value of the SVC that reflects a discount based on the expected profit or merchant fee. As suggested by the court, doing so will not impair the issuers’ profit expectation.

CARD Preemption Challenge

The court also addressed whether Chapter 25’s two-year abandonment period was expressly preempted by the federal Credit CARD Act of 2009 (CARD Act).¹⁰ Under the CARD Act, a state law is not inconsistent with the Act if the protection the state law affords any consumer is greater than the protection afforded by the Act. The court found that Chapter 25 imposed no time restriction on a consumer’s right to recover his/her funds and allowed the consumer holding the SVC to receive cash back after the abandonment period, a right the holder did not possess under its agreement with the SVC issuer. In addition, the court found that Chapter 25 did not violate the CARD Act by imposing a two-year abandonment period because the Federal Reserve Board, responsible for prescribing regulations to carry out the purposes of the Act, had recognized that a state law was not preempted simply because it provided for an abandonment period shorter than the CARD Act’s five-year expiration period for redeeming SVCs. Similarly, the court held that Chapter 25 was not impliedly preempted by the CARD Act because the two-year abandonment period furthered Congress’ consumer protection objective by protecting funds in perpetuity and allowing consumers to access those funds in cash by filing a claim with the state.

Texas v. New Jersey Challenge

Finally, the court analyzed whether Chapter 25 and the Guidance were preempted by the escheat priority rules set forth in *Texas v. New Jersey*.¹¹ In *Texas*, the U.S. Supreme Court had established two rules to resolve conflicts among states over unclaimed intangible property: (i) the “primary rule,” according to which the property must be escheated to the state of the last known address of the creditor and, (ii) if the primary rule fails because there is no record of any address or because the creditor’s last known address is in a state that does not provide for escheat of that type of abandoned property, the “secondary rule,” which requires escheatment to the state in which the debtor is incorporated.

The Third Circuit applied the *Texas* ruling to New Jersey’s place of purchase presumption and held that the presumption did not comply with the Supreme Court’s decision where it required escheatment to New Jersey if the purchaser’s address was unknown and the SVC was purchased in New Jersey. Indeed, continued the court, it would impossible for an issuer not incorporated in New Jersey to comply, at the same time, with Chapter 25 and the *Texas* ruling (requiring escheatment to the state where the debtor is incorporated). In addition, the court rejected the argument that the Guidance made Chapter 25 in compliance with the *Texas* priority rules and cited the Supreme Court’s subsequent decisions in *Pennsylvania v. New York* and *Delaware v. New York*.¹² In particular, the Third Circuit stated that the Guidance’s place of purchase presumption that allowed New Jersey to escheat property by virtue of the

the customer when the customer purchases the goods or services from the issuer; or (ii) a merchant fee paid by third-party retailers when the issuer purchases the goods or services from a retailer other than the issuer.

¹⁰ 15 U.S.C. § 16931-1(c).

¹¹ 379 U.S. 674 (1965).

¹² 407 U.S. 206 (1972); 507 U.S. 490 (1993).

fact that the property was purchased in the state was similar to the “state of origin of the transaction” rule already rejected by the Supreme Court in *Pennsylvania*. Moreover, the court found that the Guidance’s place of purchase presumption that allowed New Jersey to escheat property where the state of escheatment did not impose custodial escheat violated the Supreme Court’s *Texas* ruling because it infringed upon the sovereign authority of other states. Even where states had decided not to impose escheatment requirements with the intent of allowing issuers to maintain custody of the property, New Jersey’s place of purchase presumption gave New Jersey the right to make the SVC issuers turn over the property to the state. Furthermore, the Third Circuit found that if the Chapter 25’s place of purchase presumption were to apply in New Jersey and that another state enacted a law escheating property based on the issuer’s principal place of business, the two states’ laws would collide when an SVC issuer with its principal place of business in the other state sold an SVC in New Jersey. Avoiding this result, stated the Third Circuit, was exactly the *Texas* court’s primary concern.

Severability of the Data Collection Provision

Moreover, the Third Circuit found that the New Jersey Legislature did not intend the constitutional insufficiency of the place of purchase presumption to render the data collection inoperative because the data collection provision requiring issuers to maintain records of the purchaser or owner furthered Chapter 25’s purpose. The court said that Chapter 25 was enacted to ensure that SVC owners’ rights to the funds would not be forfeited by the passage of time, and the data collection provision made it more likely that New Jersey would be able to reunite the owner with the abandoned SVC funds. In addition, the court stated that the data collection requirement was not preempted by federal common law because *Texas* authorized the states to require issuers to collect the last known address of the purchaser and to rely on that address in reuniting the creditor with the abandoned property.

Sutherland Observation: The court’s argument that the data collection requirement will make it more likely for New Jersey to reunite the owner with the abandoned SVC funds seems flawed. Indeed, New Jersey’s SVC escheatment laws require that issuers maintain, at a minimum, a record of the zip code of the owner or purchaser. The retention of solely this piece of information, however, will not assist the state in determining the rightful owner of the funds.

Substantive Due Process Claim

Finally, the Third Circuit held that Chapter 25 did not deprive SVC issuers of their property without due process of law because, among other things, (i) the state had a legitimate interest in protecting New Jersey customers and modernizing its unclaimed property laws; (ii) Chapter 25, in general, and the two-year abandonment period, specifically, furthered that interest; and (iii) the data collection provision rationally related to the legitimate state interest of protecting consumers because retaining the zip code of the purchaser or owner rationally furthered New Jersey’s legitimate interest in determining which state had the right to escheat the property under *Texas*’s first priority rule.

Based on these findings, the Third Circuit affirmed the lower court’s orders preliminarily enjoining Chapter 25’s place of purchase presumption and its interpreting Guidance, the two-year abandonment period, and the retroactive enforcement of Chapter 25 with respect to existing SVCs redeemable for merchandise or services.

Sutherland Observation: In light of the court striking down the place of purchase presumption and its interpretative guidance, it is likely that the New Jersey Office of the State Treasurer will announce new regulations expanding on the data collection requirement and, possibly, providing for new rules to determine the state of escheatment within the *Texas* framework.



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