

To: Our Clients and Friends

January 27, 2012

## Third Circuit Issues Opinion In New Jersey Abandoned Property Litigation

The Third Circuit issued a long-awaited decision in the New Jersey Abandoned Property litigation, *NJ Retail Merchants Association v. Andrew Sidamon-Eristoff*. The court affirmed the District Court's decision in this important escheat case with broad implications for members of the prepaid industry.

**BACKGROUND** - In 2010 New Jersey passed a new abandoned property law that, if upheld, would have been devastating for gift card and prepaid card issuers doing business in New Jersey.

- o First, the new law shortened the dormancy period for prepaid cards and gift cards from being not even subject to escheat, to requiring escheat after 2 years of inactivity (a shorter period than other states, and far shorter than the required 5 years validity under the CARD Act).
- o Second, the new law also required prepaid card issuers to retroactively escheat all funds from inactive prepaid cards sold in the last 5 years.
- o Third, the new law required sellers of prepaid cards (both open and closed loop cards) to collect the name and address of the purchaser, or at the very least, the purchaser's zip code. Later this requirement was modified so that only collection of the purchaser's zip code was "mandatory."
- o Fourth, if the purchasers name and address (or zip code) was not known or collected, the purchaser's address would be deemed to be the address of the store where the card was purchased.

**NOTE** - The reason New Jersey wants sellers to collect purchasers' name and address, or otherwise wants to "deem" the purchasers' address to be in New Jersey, is because under the uniform abandoned property laws, unused funds from gift cards and other prepaid cards would be paid to the state of the last known address of the purchaser. But if the last known address of the purchaser is not known

(which is the case for virtually ALL gift cards), then the unused funds are paid to the state where the card issuer is domiciled. New Jersey's new law, deeming purchasers' addresses to be in NJ, or otherwise requiring collection of zip code data from purchasers, was intended to make sure that more of the unused funds escheat to NJ rather than to other states where the card issuers are domiciled. Since many prepaid card issuers are domiciled in states that don't require escheat, the imposition of NJ's new law as initially passed, with retroactivity, could have had serious consequences for many prepaid card programs.

### Bottom Line

The Third Circuit's Opinion represents both good news and bad news for the gift card and prepaid card industry. See details below.

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## NJ Abandoned Property Litigation - Detailed Analysis

### A. Two-year dormancy period - bad news

- o The 2-year dormancy period requiring escheat after 2 years of inactivity was upheld. The court held that the shorter period was not expressly preempted by the CARD Act and has a rational purpose of protecting consumer property.
- o Allowing card issuers not to honor gift cards, after they have been escheated to the state in 2 years, is also not impliedly preempted by the requirement in the CARD Act that all gift cards remain valid at least 5 years. The law does not thwart Congress' intentions because consumer funds will be protected well beyond the 5 years in the CARD Act, in perpetuity. This supposedly is good for consumers. The Court stated that the fact that a consumer might have to go to the state of NJ to get his or her gift card funds back after 2 years doesn't make it less beneficial for consumers.

### B. Retroactive application with respect to cards sold/distributed in the past - good news (mostly)

- o The retroactive application of the abandoned property law against prepaid cards usable for goods/services that have already been sold violates the Constitution's Contracts Clause and cannot be enforced.
  - o A contract exists between cards issuers and the card purchasers, and card issuers have a right to earn a profit and get the benefit of their bargain.
  - o Previous law did not require escheat and to retroactively apply it would impair existing contracts with card purchaser.
- o BUT this favorable decision on retroactivity only applies with respect to cards usable *solely for goods/services*.

- o No arguments were raised to show that a contract exists between the cash-accessible card issuers and purchasers and thus the Contract Clause arguments regarding cash-accessible prepaid cards were “waived.”
- o Moreover, the Court suggests that the decision on retroactivity might have been different if the NJ law had taken only a percentage (such as 60%) of the funds and allowed the card issuers to earn some profit from the gift cards.
- o Because the Court affirmed the preliminary injunction based on the Contracts Clause, the Court declined to address the other arguments raised, such as the Takings Clause and Derivative Rights Rule.

**C. The Place of Purchase Presumption (or “third priority rule”) - good news**

- o New Jersey’s attempt to require escheat of unused prepaid card funds to the Place of Purchase if the Cardholder’s address is not known, and if the issuers’ state of domicile does not escheat the property, was held to be unenforceable.
- o The Place of Purchase Presumption was preempted by Federal common law - because the presumption departs from the two priority rules set forth by the US Supreme Court.
- o Even if the issuer gets a “windfall” because the issuer’s domicile does not require escheat - that does not merit departing from the settled priority rules set forth in *Texas v. New Jersey*.
- o A state should be able to choose whether or not to escheat; otherwise it violates principles of state sovereignty.

**NOTE** - This is one of the most valuable and important rulings by the Court. Roughly 30 states have passed what is known as the “third priority rule,” a rule which, like New Jersey’s, would purport to require unused funds to be escheated to the state where the purchase was made or the transaction occurred, if the purchasers’ name/address is not known, *and* if the card issuer is domiciled in a state that doesn’t require escheat. The validity of the “third priority rule” has been debated for years, but this is the first time it has been litigated in this context. This decision is welcome news to any gift card or prepaid card issuer that has established a special purpose gift card entity in a state with favorable gift card laws. It means it is less likely now that New Jersey and other states will succeed in asserting their “third priority rule” with respect to unused gift card funds.

**D. The Data Collection (Name, Address and/or Zip Code) requirements - bad news.**

- o The Court upheld the NJ law’s requirement that name, address or zip code be collected from purchasers, finding that the data collection requirements further a legitimate state goal of wanting to reunite purchasers with their property.

- o The Court noted that the fact that the purchaser of a gift card may not be the end user/recipient is not relevant. Collecting the last know address of the purchaser has been authorized by *Texas v. New Jersey* and other similar cases.
- o The section of the NJ law that requires data collection can be separated from the unenforceable portions of the law and can still be enforced.
- o The data collection requirements are not preempted by Federal common law and there are rational legitimate reasons for doing so - *including determining which state has the right to escheat the property under the first priority rule* (that is, based on which state the purchaser resides in).

**NOTE** - The concern about this part of the decision isn't just that it's burdensome or invasive of privacy to collect such data. The concern is that once NJ requires collection of name, address, or zip code, and such address is in NJ, then NJ has a "first priority claim" that takes precedence over the second priority claim of the card issuer's domicile. So for gift card or prepaid card issuers that have established special purpose gift card entities in a state with favorable escheat laws, that gift card entity will not protect you from a NJ claim. Unless this portion of the ruling is changed, it appears you'll have to escheat to New Jersey but ONLY for cards purchased in New Jersey. The bigger concern is what happens if other states follow suit.

## CONCLUSION

We understand that the New Jersey Treasury has indicated they do not intend to enforce immediately the data collection obligations, but will be issuing new guidance in the future.

Of course it is possible that either the state or the plaintiffs will attempt further legal proceedings, either by petitioning for a rehearing, or by petitioning for certiorari to have the matter appealed to the US Supreme Court. Whether the parties will pursue this case further is currently unknown. In the meantime, gift card issuers and sellers may wish to consider how to implement the collection and retention of purchaser's name, address and /or zip code for gift card sales in New Jersey.

A copy of the opinion may be found at: <http://www.ca3.uscourts.gov/opinarch/104551p.pdf>.

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Should you have questions, feel free to contact us:

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