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U.S. Circuit Court affirms District Court ruling, provides limited relief from New Jersey's stored value card AUP requirements

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The U.S. Court of Appeals, Third Circuit on January 5, 2012, affirmed the orders of the U.S. District Court for the District of New Jersey barring New Jersey from enforcing a "place of purchase" presumption for stored value cards and the retroactive escheatment of cards already issued. The Appeals Court also affirmed the District Court's ruling that the "data collection provision," requiring stored value card issuers to collect and retain purchaser or owner information, was properly severable from the "place of purchase" presumption and, therefore the District Court did not abuse its discretion in denying to enjoin the data collection provision. In addition, the Appeals Court affirmed the District Court's ruling that New Jersey's two-year abandonment period is not preempted by federal law. [[*New Jersey Retail Merchants Association, et. al. v. Sidamon-Eristoff*](#), U.S. Ct. App., 3rd Cir., Nos. 10-4551, -4552, -4553, -4714, -4715, -4716, 11-1141, -1164 and -1170, 1/5/12]

Background

In 2010, New Jersey enacted legislation (2010 A.B. 3002, 2010 N.J. Laws c. 25, "Chapter 25") that made major changes to the state's abandoned and unclaimed property law. In particular, Chapter 25 required, for the first time, escheatment of "stored value cards" (e.g., gift certificates and gift cards) at 100% of face value. Under Chapter 25, issuers of stored value cards ("SVC") are required to transfer to the state the remaining value on the cards at the end of a two-year abandonment period. In



addition, issuers must obtain "the name and address of the purchaser or owner" of each SVC and, at a minimum, "maintain a record of the zip code of the owner purchaser or owner" ("data collection provision").

Chapter 25 further creates a new "priority rule" for escheatment under which, if the name and address of the purchaser is not available, the purchaser's address will be presumed to be the address of the place where the stored value card was purchased or issued. In such cases, the property "shall be reported to New Jersey if the place of business where the stored value card was sold or issued is located in New Jersey. This provision is referred to as the "place of presumption provision."

In response to Chapter 25, and subsequent Treasury announcements, multiple lawsuits were filed in the U.S. District Court seeking declaratory and injunctive relief from the enforcement of Chapter 25. The District Court enjoined the enforcement of the place of purchase presumption and the retroactive application of Chapter 25, but declined to enjoin the data collection provision. In addition, the District Court ruled that the two-year abandonment period under Chapter 25 was not pre-empted by federal law. An appeal and cross-appeal was filed in response to these rulings in the U.S. Court of Appeals, Third Circuit.

Retroactive application of Chapter 25

The Appeals Court affirmed the District Court's grant of a preliminary injunction with respect to the retroactive application of Chapter 25 as a violation the Contract Clause under Article I, Section 10, Clause of 1 of the U.S. Constitution. The Contracts Clause provides that "[n]o State shall ... pass any ... Law impairing the Obligation of Contracts." A violation of the Contracts Clause is determined to have occurred when several factors have been met, the first being a "substantial impairment of the contractual relationships of the contracting parties," which is determined by reviewing "the legitimate expectations of the contracting parties."

The Appeals Court first concluded that Chapter 25 impaired the contractual relationships of the SVC Issuers. In general, SVCs may be issued as "closed loop" cards, which are redeemable only for merchandise or services, or as "open loop" cards, redeemable at a variety of retail stores, including sites not affiliated with the issuer (e.g., Amex Prepaid cards). Issuers of closed loop cards realize a profit when the bearer redeems the card for the Issuers' merchandise or services. Issuers of open loop cards realize a profit in the form of merchant fees paid when the bearer redeems the card at retailers that accept such cards. Chapter 25 requires SVC Issuers to submit the full value of certain SVCs in cash to New Jersey after the two year abandonment period. The Appeals Court concluded that, because the state required the full value of the card to be escheated, which included the expected profits under the closed loop cards and the merchant's fee under the open loop cards, such an obligation impaired the parties' contractual expectations.

The Appeals Court next determined that the impairment to the contract "was substantial because SVC Issuers' reliance on the expected profit or merchant fee was vital to its contractual relationship." Moreover, since New Jersey had never subjected SVCs to escheatment before, the Appeals Court concluded that the unexpected obligations resulting from Chapter 25's enactment substantially impaired the Issuers' contractual relationships "where reliance was vital." The Appeals Court further noted

that New Jersey "could have accommodated the SVC Issuers' expectation to a profit by requiring them to turn over a percentage of the value of the SVC, rather than the entire remaining value, as many other states have done. Consequently, the Appeals Court concluded that "the SVC Issuers established that there was a reasonable probability that the State violated the Contracts Clause."

The Appeals Court further concluded that the SVC Issuers met the other preliminary injunction conditions and upheld the District Court's enjoinder of the retroactive application of Chapter 25.

Two year abandonment period does not violate federal Credit CARD Act of 2009

The Appeals Court concluded that the SVC Issuers failed to demonstrate a reasonable likelihood of success on the merits that Chapter 25's two year abandonment period violated the federal Credit CARD Act of 2009 ("Act"). In general, the Act provides a five year abandonment period, after which consumers have no right to recover their funds. In addition, the Act states that "[a] State law is not inconsistent with this subchapter if the protection such law affords any consumer is greater than the protection afforded by this subchapter." The Appeals Court concluded that, because Chapter 25 required the state to hold the escheated property in perpetuity for the benefit of the owner and until such property is claimed, the protection provided to consumers was actually greater than that which was provided under the federal law.

Place of purchase presumption

The SVC Issuers also asserted that the application of the "place of purchase presumption" violated the federal priority rule hierarchy, established by the U.S. Supreme Court in *Texas v. New Jersey*, which provides: (1) where the last known address of the owner of the intangible personal property is known, the state in which the owner's address is located as the right to escheat ("primary rule"); and (2) where the last known address of the owner is either unknown or in a state that does not provide for escheat of the subject property, the state in which the debtor is incorporated is awarded the right to escheat ("secondary rule"). The "place of purchase presumption" would require that, in all instances where the address of the purchaser is unknown, the address of the place of purchase is substituted for the address of the purchaser. Accordingly, when the address of the purchaser is unknown, but the SVC was purchased in New Jersey, under Chapter 25 the full value of the SVC would escheat to New Jersey.

The Appeals Court agreed that the SVC Issuers had demonstrated a reasonable likelihood of success in their assertion that the place of purchase presumption was preempted by federal law and, thus, affirmed the grant of a preliminary injunction. In particular, the Appeals Court noted that Chapter 25 and the Treasury announcements would allow the state to escheat SVCs "when it lacked a clear connection to the owner or issuer," violating both the *Texas* decision as well as subsequent supporting cases. Further, the place of purchase presumption "allows New Jersey to infringe on the sovereign authority of other states," and "when fashioning the priority rules, the Supreme Court did not intend such a result, which would give states the right to override other states' sovereign decisions regarding the exercise of custodial escheat."

Severability of data collection provision

The SVC Issuers maintained that the data collection provision of Chapter 25, found in the same subsection as the place of purchase presumption, could not stand alone given the finding that the place of purchase presumption was preempted by federal common law. However, the Appeals Court rejected this argument, relying on legislative intent, and upheld the District Court's denial of a preliminary injunction on this issue.

Specifically, the Appeals Court noted that "the consumer protection purpose of Chapter 25 evinces that the State Legislature intended the data collection provision to stand alone." Chapter 25 was enacted with a goal of reuniting customers with their property. As such, "the data collection provision requiring issuers to maintain records of the purchaser or owner furthers this purpose by making it more likely that the State will be able to reunite the owner with the abandoned" SVC funds.

PwC Observes

"While SVC Issuers had a favorable outcome on the "place of purchase presumption" and the retroactive application of Chapter 25, what they must now grapple with is the data collection provisions. It is unclear what type of address information may be required for SVC purchases going forward," notes Loredana Pfannenbecker, PwC Director in Stamford, Connecticut. "While the Act required SVC Issuers to obtain and maintain the name and address of the purchaser or owner of the SVC or, at a minimum the zip code of the purchaser or owner, the State Treasurer was provided the authority to grant exemptions from these requirements. Subsequently, the Treasury Department issued a Treasury Announcement that allowed businesses the ability to only acquire and maintain the zip codes of the purchaser or owner. Without the "place of purchase presumption," New Jersey may require the full address of the purchaser so that it would be entitled to escheat SVCs purchased by New Jersey residents within its state. This data collection requirement would be significant to many SVC Issuers and affect not only the New Jersey domiciled companies, but also foreign companies doing business in New Jersey."

"It should also be noted that there is still litigation pending with regard to traveler's checks under Chapter 25."

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