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New Jersey U.S. District Court Temporarily Enjoins Enforcement of Portions of the State's New Unclaimed Property Law

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As we previously reported, several states have recently sought new ways to increase unclaimed property collections.¹ Perhaps the most controversial of these efforts is New Jersey Assembly Bill No. A3002. Assem. No. 3002, 214th Leg. Sess. (N.J. 2010); 2010 N.J. Laws Chapter 25 (hereafter "Chapter 25").

Chapter 25 attempts to retroactively extend the state's unclaimed property law to "stored value cards" ("SVCs"), which were previously exempt, and imposes onerous reporting and record-keeping requirements on card issuers. In Chapter 25, New Jersey also seeks to create and enforce a place-of-purchase presumption that provides that if the purchaser's or owner's name and address are not maintained by the SVC issuer, the address "shall assume the address of the place where the SVC was purchased or issued and shall be reported to New Jersey if the place of business where the SVC was sold or issued is located in New Jersey." Chapter 25, Section 5c.

Several lawsuits challenging Chapter 25 are pending in the United States District Court for the District of New Jersey. On November 13, 2010, the court issued a preliminary injunction enjoining the defendants – the New Jersey State Treasurer and the New Jersey Unclaimed Property Administrator – from enforcing portions of Chapter 25. The Chapter 25 amendments, the challenges filed in district court, the court's preliminary injunction, and New Jersey's response are discussed below.

Amendments to New Jersey's Unclaimed Property Law Applicable to SVCs

Chapter 25 was signed into law on June 30, 2010. The bill, which was fast-tracked by the New Jersey Legislature, was introduced on June 24, 2010, and referred to and reported out of the Assembly Budget Committee that same day. The bill passed in both the New Jersey Assembly and Senate on June 28, 2010, with an effective date

¹ See Julie Kaplan, *Changes in Unclaimed Property Laws Provide a Financial Windfall to New Jersey and New York, Administrative Review Passes in Delaware, and Pennsylvania Offers Amnesty*, JONES DAY STATE TAX RETURN (September 2010).

of July 1, 2010. As introduced, the new law was expected to increase state revenues by almost \$80 million in fiscal year 2011 alone. See Assembly Budget Committee Statement to Assembly, No. 3002, June 24, 2010.

Chapter 25 adds “stored value card” to the definition of “property” for purposes of New Jersey’s unclaimed property law. See N.J. Stat. Ann. § 46:30B-6(r) (2010). “Stored value card” is broadly defined as:

a 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.

Id. SVCs include, among other things, gift certificates, gift cards, electronic gift cards, rebate cards, stored value cards, and store cards. *Id.* By specifically including SVCs in the definition of “property,” Chapter 25 supersedes a 1998 New Jersey court case and considerably alters the state’s treatment of unclaimed gift cards. See *Matter of Nov. 8, 1996, Determination of State, Dept. of Treasury, Unclaimed Property Office*, 309 N.J. Super. 272, 706 A.2d 1177 (N.J. Super. Ct. App. Div. 1998).

Chapter 25 creates a two-year presumption of abandonment for SVCs. See N.J. Stat. Ann. § 46:30B-42.1(5)(a). The reportable proceeds of an SVC are the value of the card, in money, on the date the SVC is presumed abandoned. *Id.* at § 46:30B-42.1(5)(b).

Notably, New Jersey’s two-year dormancy period is shorter than the expiration-date requirements of the federal Electronic Fund Transfer Act (the “EFT Act”), which, unless certain conditions are satisfied, generally prohibits the issuance of gift certificates or cards that expire in less than five years. See 15 U.S.C. § 1693l-1(c)(2) (2010). As a result, companies issuing cards in New Jersey will be required under federal law to honor an SVC presented by a customer after the unused balance has been remitted to New Jersey. In an attempt to protect issuers that find themselves in this situation, Chapter 25 permits issuers to seek reimbursement from the state after an owner uses a card that the issuer has already escheated to New Jersey. See *id.* at § 46:30B-62. Chapter 25 also prohibits all dormancy charges on SVCs. See *id.* at § 46:30B-43.1(37).

In addition to the reporting requirements, Chapter 25 imposes burdensome record collection and retention requirements on SVC issuers. Under the new law, issuers are required to obtain the name and address of the purchaser or owner of each SVC issued or sold and must, at a minimum, maintain a record of the owner’s or purchaser’s ZIP Code. See *id.* at § 46:30B-42.1(5)(c). If the issuer does not maintain the name and address of the purchaser or owner, Chapter 25 creates a presumption that the owner or purchaser “shall assume the address of the place where the SVC was purchased or issued and shall be reported to New Jersey if the place of business where the SVC was sold or issued is located in New Jersey.” *Id.*

Notably, this “place of purchase” presumption seems to apply when the issuer maintains ZIP Codes (which appears to be all that is required under the amended statute) but fails to maintain names and addresses (which is not specifically required). Chapter 25 does not apply to an SVC that is distributed by the issuer under a promotional or customer-loyalty program or a charitable program for no monetary or other consideration or to an SVC issued by any issuer that in the past year sold SVCs with a face value of \$250,000 or less.²

Guidance Issued by the New Jersey Treasurer

Chapter 25, as enacted, had an effective date of July 1, 2010. The New Jersey Treasurer subsequently issued a series of announcements, or guidelines, delaying the application of the new law until November 15, 2010, “in the interest of sound administration.”³

In addition to delaying the application of Chapter 25, the guidances also addressed several aspects of the new law. Significantly, in Treasury Announcement FY 2011-03 (September 23, 2010), the Treasurer expounded on the record collection and retention requirements and provided that: (a) if the issuer obtains the name and address of the purchaser or owner of any SVC issued or sold in New Jersey in the normal course of its business, then the issuer shall continue to maintain that information; (b) if the issuer requires the registration of the SVC by the purchaser or owner before initial use, the name and address must be obtained at that time and maintained by the issuer; and (c) except as provided above, issuers and holders will be exempt from the requirement to maintain the name and street address of the purchaser if the purchaser’s ZIP Code is obtained. The Treasurer further provided that “it is mandatory that all businesses obtain and maintain the zip code of the purchaser’s address. Maintenance of the zip code information shall be sufficient to satisfy the address requirement of the amended Statute.” Announcement FY 2011-03.

Announcement FY 2011-03 also explains the Treasurer’s interpretation of the application of the place-of-purchase presumption. Announcement FY 2011-03 essentially provides that SVCs issued prior to September 23, 2010 (the date of the announcement), should be reported in a manner consistent with the federal priority rules

² See *id.* at § 46:30B-42.1(5)(e). For purposes of this subsection, sales of SVCs by businesses that operate either: (1) under the same trade name as, or under common ownership or control with, another business or businesses in the state, or (2) as franchised outlets of a parent business, will be considered sales by a single issuer.

³ On July 1, 2010, the Treasurer announced a temporary exemption from Chapter 25 until September 1, 2010. State of New Jersey, Office of the State Treasurer, Treasury Announcement FY 2011-01 (July 1, 2010). On August 26, the Treasurer extended this exemption to October 1, 2010. State of New Jersey, Office of the State Treasurer, Treasury Announcement FY 2011-02 (Aug. 26, 2010). On September 23, 2010, the Treasurer extended the exemption until October 31, 2010. State of New Jersey, Office of the State Treasurer, Treasury Announcement FY 2011-03 (Sept. 23, 2010). The exemption was finally extended until November 15, 2010. State of New Jersey, Office of the State Treasurer, Treasury Announcement FY 2011-04 (Oct. 26, 2010).

of *Texas v. New Jersey*, 379 U.S. 674 (1965). If the issuer is domiciled in New Jersey, the guidance provides that any unredeemed balances of cards issued prior to September 23, 2010, where the purchasers' or owners' names and addresses or ZIP Codes were not recorded should be reported to New Jersey. If the issuer is not domiciled in New Jersey, any unredeemed balances of cards issued prior to September 23, 2010, where the purchasers' or owners' names and addresses or ZIP Codes were not recorded should be reported to the state in which the issuer is domiciled. The Treasurer then states:

If the issuer is not domiciled in New Jersey and the issuer's state of domicile exempts this type of property from its unclaimed property statute, any unredeemed balances of stored value cards issued prior to [September 23, 2010] where the names and addresses or zip code of the purchasers or owners were not recorded must be reported to New Jersey if the cards were issued or sold in New Jersey. In these instances, the issuer must maintain the address of the business where the stored value card was purchased or issued.

Announcement FY 2011-03.

Finally, Announcement FY 2011-03 provides that prepaid phone cards redeemable for minutes are exempted from the requirements of Chapter 25 pending further study. Other SVCs issued by the telecommunications industry (e.g., cards redeemable for prepaid services, cash, or merchandise) are not exempt.

The Treasurer issued two additional guidances, Treasury Announcement FY 2011-05 (November 23, 2010) and Treasury Announcement FY 2011-06 (November 24, 2010), to inform issuers of current reporting obligations under Chapter 25 following the issuance of the temporary injunction by the district court. These guidances are discussed below as responses to the court's injunction.

Challenges Filed by Retailers

The passage of Chapter 25 has raised a number of concerns within the business community. Of primary concern are the administrative burdens placed on SVC issuers and the potential conflict among states created by the place-of-purchase presumption, which creates a situation in which the issuer may face two states (e.g., New Jersey and the holder's state of incorporation) that both lay claim to the same dormant SVC.

American Express Prepaid Card Management Corporation, American Express Travel Related Services Company, the New Jersey Retail Merchants Association, and the New Jersey Food Council (and others) (collectively, the "Plaintiffs") filed lawsuits in

U.S. District Court challenging Chapter 25.⁴ The Plaintiffs claim, among other things, that Chapter 25 is unconstitutional and violates the Supremacy, Takings, Contracts, and Due Process Clauses of the U.S. Constitution and similar provisions of the New Jersey Constitution.

The Plaintiffs also claim that Chapter 25 is preempted by federal law, including the EFT Act and the priority rules established by the Supreme Court in *Texas v. New Jersey*, 379 U.S. 674 (1965). The Plaintiffs seek a declaration that Chapter 25 is void as a matter of law and also ask the court to issue preliminary and permanent injunctions enjoining New Jersey from enforcing the amended laws.

The District Court Has Enjoined New Jersey From Enforcing Certain Provisions of Chapter 25 During the Pendency of the Cases

On November 13, 2010, the U.S. District Court for the District of New Jersey issued a consolidated Opinion and Order granting in part and denying in part all of the Plaintiffs' requests for a preliminary injunction and temporarily enjoining New Jersey from enforcing certain provisions of Chapter 25. Specifically, New Jersey is enjoined from enforcing the place-of-purchase presumption and from enforcing Chapter 25 retroactively against issuers of SVCs with existing contracts that require issuers to redeem the cards solely for merchandise or services. However, the court denied relief based on the Plaintiffs' argument that the EFT Act preempted Chapter 25 or that Chapter 25 violated substantive due process or the Commerce Clause. The court rejected the Plaintiffs' arguments that enforcing Chapter 25 on a prospective basis (enforcement on SVCs issued after the effective date of Chapter 25) would violate the Contracts Clause or the Takings Clause of the U.S. Constitution.⁵ The court also denied New Jersey's motion to dismiss on abstention and immunity grounds.

For each of the Plaintiffs' motions to preliminarily enjoin the implementation of the portions of Chapter 25 relating to SVCs, the court considered whether: (i) the Plaintiffs would be irreparably harmed if denied injunctive relief due to the cost burden of implementing a potentially unconstitutional statute, (ii) granting relief would cause

⁴ See *American Express Prepaid Card Management Corp. v. Sidamon-Eristoff*, Dkt. 3:10-cv-05206-FLW-DEA (D. N.J. filed Oct. 11, 2010); *New Jersey Food Council v. New Jersey*, Dkt. 3:10-cv-05123-FLW-LHG (D. N.J. filed Oct. 5, 2010); *New Jersey Retail Merchants Association v. Sidamon-Eristoff*, Dkt. 3:10-cv-05059-FLW-LHG (D. N.J. filed Sept. 30, 2010); *American Express Travel Related Services Company, Inc. v. Sidamon-Eristoff*, Dkt. 3:10-cv-04890-FLW-LHG (D. N.J. filed Sept. 23, 2010).

⁵ In its November 13 Opinion and Order, the district court refused to issue an injunction related to Chapter 25's reduced dormancy period on travelers' checks being challenged by American Express because it determined that American Express did not demonstrate a likelihood of success on any of its claims. On November 14, 2010, American Express filed a notice of appeal to the Third Circuit Court of Appeals and sought an injunction. On November 15, a judge in the Third Circuit granted temporary injunctive relief, enjoining New Jersey from enforcing Chapter 25 to the extent it shortens dormancy periods for travelers' checks, until a full panel of the court has the opportunity to review and consider the American Express motion. See *American Express Travel Related Services Company, Inc. v. Sidamon-Eristoff*, Dkt. No. 10-4328 (3rd Cir. Nov. 15, 2010).

greater harm to the state, and (iii) granting a preliminary injunction was in the public interest. Finally, the court had to examine whether the Plaintiffs showed a reasonable probability of success on the merits of their claims.

First the court addressed whether Chapter 25 violated the priority rules created by the Supreme Court in *Texas v. New Jersey*, 379 U.S. 614 (1965). Under the priority rules established in *Texas*, unclaimed property should escheat to the state of the owner's last known address (the first-priority rule) or, if the owner's address is unknown, to the holder's state of incorporation or domicile (the second-priority rule).

The court determined that New Jersey, by creating and enforcing a place-of-purchase presumption that applies when the purchaser's or owner's name and address are not maintained by the issuer of an SVC, is seeking to implement a third-priority rule based on transaction location. The court concluded that this third-priority rule is unconstitutional because it contradicts the federal common law established in the *Texas* line of cases and thus is preempted. The court cited several examples showing that the Supreme Court intended the first- and second-priority rules "to be exclusive and exhaustive" and that it "is not the province of New Jersey to create [a third-priority] rule." The court stated, notably, that "a state may serve as a 'temporary custodian' only where the holder is incorporated in that state. In other words, there is no room for a third priority position. If the secondary-rule state does not escheat, the buck stops there." The court's decision suggests that the third priority is unconstitutional categorically and not simply as applied in Chapter 25.⁶

Since the place-of-purchase presumption is based on an impermissible third-priority rule, the court concluded it violates federal common law established in *Texas*. The court granted a preliminary injunction against both the retroactive and the prospective application of the presumption, stating that the presumption would do exactly what the Supreme Court sought to prevent by permitting "New Jersey to fabricate an interest where it otherwise does not have one . . . and by usurping the right of the [issuer's] state of incorporation to rule over the [issuer]." Essentially, the presumption ignores the right of the issuer's state of domicile to escheat (or to choose not to escheat) the unclaimed SVCs if the owner's last known address is not maintained.

Next, the court addressed the Plaintiffs' Contracts Clause claims. The Contracts Clause prohibits states from passing laws that impair the obligation of contracts. U.S. Const. Art. I § 10. In determining the likelihood of success of the Plaintiffs' Contracts Clause claim, the court analyzed the existence of a contractual relationship, the potential of Chapter 25 to impair the contractual relationship, and whether any impairment would be substantial. The court found the requisite contractual relationship

⁶ Both the 1981 and the 1995 Uniform Unclaimed Property Acts, as well as a number of states, include a third-priority rule in their unclaimed property statutes. The district court's Opinion would appear to call the validity of those provisions into question. Uniform Unclaimed Property Act § 4.6 (1995); Uniform Unclaimed Property Act § 3.6 (1981).

between issuers who sold SVCs redeemable solely for merchandise or services and the card purchasers. The court determined that Chapter 25 substantially impairs the issuers' right to earn and retain profits from the sale of SVCs under these contracts by forcing the issuers to transfer the entire face value, including profits, to state custody. The court did not find a similar contractual relationship between Plaintiffs who sold SVCs redeemable solely for cash and their customers, and thus it determined that these Plaintiffs had not demonstrated a likelihood of success on a Contracts Clause claim.

Under its Contracts Clause analysis, the court enjoined only the retroactive application of Chapter 25, stating that the Contracts Clause provides protection for existing contracts, not for future contracts. In the court's view, after the effective date of Chapter 25 (November 15, 2010), issuers may choose to alter their contracts or cease to issue SVCs in New Jersey as a remedy.

The court applied a similar analysis relating to the Plaintiffs' Takings Clause claim. The Takings Clause prevents states from taking private property for public use without just compensation. U.S. Const. Amend. V, XIV. The court analyzed whether Chapter 25 affected a legally cognizable property interest and determined that it does by depriving issuers of SVCs redeemable for merchandise or services of their contractual right to earn profits in connection with the sale of the cards.

Finally, the court rejected the Plaintiffs' argument that the EFT Act preempts Chapter 25. The EFT Act is a federal consumer protection law that governs electronic fund transactions, including gift cards. The court determined that it is possible for an issuer to comply with both the EFT Act and Chapter 25 by honoring the SVC for five years as required by the EFT Act and seeking reimbursement from the state. The court also determined that Chapter 25 affords consumers greater protection than does the EFT Act. Thus, the court concluded that the Plaintiffs have not demonstrated a likelihood of success on the preemption claim.

The court also denied the Plaintiffs' substantive due-process claims based on a rational basis review. The court decided that New Jersey put forth a conceivable rational basis for changing its unclaimed property laws, and the fact that these changes also happen to substantially increase state revenue does not run afoul of any substantive due-process concerns. The court rejected the Plaintiffs' Commerce Clause arguments as well, because the Plaintiffs did not show how Chapter 25 would impede interstate commerce or how Chapter 25 regulates the sale of SVCs in other states.

New Jersey Issues New Guidance in Response to the Injunction

In response to the preliminary injunction, the Treasurer issued Treasury Announcement FY 2011-05 (November 23, 2010) and Treasury Announcement FY 2011-06 (November 24, 2010) to inform issuers of current reporting obligations under

Chapter 25.⁷ The Treasurer recognized that the court “temporarily enjoined” it from applying the place-of-purchase presumption and from retroactively collecting SVCs redeemable solely for merchandise or services. The Treasurer also indicated that should the injunction be lifted, the state will waive any interest or penalties that would otherwise attach relating to cards that should have been reported but for the injunction. The Treasurer, however, indicated that SVCs issued prior to July 1, 2008, and redeemable solely for cash must be reported to New Jersey if: (1) the address of the purchaser is known and is in New Jersey, or (2) the address of the purchaser is unknown and the issuer is domiciled in New Jersey.

In addition, the Treasurer restated the data collection and retention requirements outlined in Announcement FY 2011-03. The Treasurer also stated that the issuer is required to immediately begin obtaining and maintaining the owner’s ZIP Code for all cards sold in New Jersey.

If the issuer does not have a system or process in place to record and retain this information, the Treasurer states that the issuer is given until January 3, 2011, to install and implement any necessary systems or processes. The announcement also asserts that the Treasury may conduct audits to ensure compliance with these record-keeping requirements.⁸

Guidance for Holders – The Current Status of Chapter 25

The district court’s decision to grant in part and deny in part the Plaintiffs’ claims has resulted in a somewhat convoluted patchwork of enforceable and unenforceable pieces of Chapter 25. What is clear from the court’s lengthy decision is that New Jersey is temporarily enjoined from enforcing the place-of-purchase presumption set out in Chapter 25 and the Treasury guidances both retroactively and prospectively. New Jersey is also temporarily enjoined from collecting as unclaimed property SVCs issued prior to November 15, 2010 (the effective date of Chapter 25) that are redeemable solely for merchandise and services.

While these aspects of Chapter 25 and the Treasury’s guidance are among the most controversial for holders, the decision does leave the state free to enforce a number of other burdensome provisions from Chapter 25. Notably, the district court did not enjoin New Jersey from collecting SVCs that are redeemable for cash, whether issued before or after the effective date of Chapter 25. Under Chapter 25, the full unredeemed value of cards that fall into this category is reportable if the cards have been inactive for more than two years (currently cards issued June 30, 2008, and

⁷ State of New Jersey, Office of the State Treasurer, Treasury Announcement FY 2011-05 (Nov. 23, 2010); State of New Jersey, Office of the State Treasurer, Treasury Announcement FY 2011-06 (Nov. 24, 2010).

⁸ The New Jersey Food Council filed a letter with the district court on November 24, 2010, asking the court to strike or enjoin Treasury Announcement FY 2011-05. As of the date of this article, the court has not yet responded to this request.

earlier). New Jersey is, of course, currently prohibited from applying a place-of-purchase presumption in all cases. Thus, SVCs redeemable for cash for which the dormancy period has lapsed appear to be reportable to New Jersey if under the federal priority rules: (1) the address of the owner or purchaser is known and is in New Jersey, or (2) the address of the owner or purchaser is unknown and the issuer is domiciled in New Jersey.

Similarly, because the district court determined that going forward, the Plaintiffs could modify their contracts to account for the impact of Chapter 25 or simply stop selling cards in New Jersey, the court did not enjoin New Jersey from prospectively applying Chapter 25 to SVCs that are redeemable solely for merchandise or services. Thus, as it now stands, these types of cards apparently will be reportable to New Jersey in conformity with the federal priority rules after the two-year dormancy period lapses. Presumably a decision will be reached on the constitutionality of the place-of-purchase presumption before cards issued after Chapter 25 became effective need to be reported.

Finally, the district court did not enjoin New Jersey from enforcing the address and ZIP Code collection and retention requirements of Chapter 25.⁹ As discussed above, the Treasurer has announced that it will still require holders to collect and retain address and/or ZIP Code information and may conduct audits to ensure compliance.

In response to Announcements FY 2011-05 and FY 2011-06, American Express Prepaid Cards, Food Council, and the Retail Merchants Association filed individual motions on December 8, 2010, that all seek an order from the district court construing the November 13 Order and enjoining New Jersey from enforcing all provisions of Chapter 25 and the corresponding Treasury guidances or, in the alternative, an injunction pending appeal pursuant to Federal Rule of Civil Procedure 62(c). Such an injunction would presumably prevent New Jersey from enforcing the January 3, 2011, ZIP Code collection deadline from Announcement FY 2011-06.

On December 7, 2010, New Jersey appealed the preliminary injunction to the Third Circuit Court of Appeals in the American Express Prepaid Cards, Food Council, and Retail Merchants cases.¹⁰ Between issuing the two Treasury announcements and

⁹ It appears that the Legislature and Treasurer included the ZIP Code retention requirements in Chapter 25 and the Treasury guidances to serve as evidence of the place-of-purchase presumption, which the court has initially rejected. The connection with the presumption has led to some confusion in the district court's decision regarding the state's ability to enforce these requirements. The court's Order does state that New Jersey is enjoined from enforcing all of Section 5c of Chapter 25, which includes the ZIP Code retention requirement. In its opinion, however, the court never specifically addressed the validity of the ZIP Code retention requirement. It is likely that the court did not feel it was necessary to do so at this stage in the proceeding. Until the court rules on the December 7, 2010, motions to enjoin all enforcement of Chapter 25, the more prudent reading of the court's Order and Opinion is to limit the injunction to the place-of-purchase presumption as stated in the Opinion, leaving the ZIP Code retention requirement enforceable.

¹⁰ *American Express Prepaid Card Management Corp. v. Sidamon-Eristoff*, Dkt. 10-4553 (3rd Cir. Dec. 7, 2010); *New Jersey Food Council v. New Jersey*, Dkt. 10-4552 (3rd Cir. Dec. 7, 2010); *New Jersey Retail Merchants Association v. Sidamon-Eristoff*, Dkt. 10-4551 (3rd Cir. Dec. 7, 2010).

seeking an interlocutory appeal, New Jersey seems intent on enforcing Chapter 25, despite the fact that the district court identified serious constitutional concerns with the statute.



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