

February 10, 2012

Dear Retail Clients and Friends,

In 2010, New Jersey amended its **unclaimed** property law to require custodial escheat of stored value cards (SVCs or gift cards) and collection of address information for purchasers of gift cards. Key provisions of the law were opposed in court by retailers and other industry participants, and the Third Circuit Court of Appeals recently ruled that certain portions of the law cannot be enforced. This edition of ***Morgan Lewis Retail Did You Know?*** describes the Third Circuit's decision and its application to retailers.

Background

We have previously reported on how unclaimed property or escheat laws can impact retailers' gift card programs. In particular, state unclaimed property laws typically require the holder of unclaimed property to locate the owner within a certain period of time, called the dormancy period, or otherwise turn over or "escheat" the property to a particular state. Some states include unredeemed gift card balances as unclaimed property and require that those funds be turned over to the state. Other states exempt gift card balances.

In light of the potential value of unredeemed gift card balances, the question of which state's unclaimed property laws apply are a subject of importance to retailers with gift card programs. In a series of decisions dating from the 1960s, the U.S. Supreme Court has determined the "priority rules" that govern the state to which unclaimed property is reported. Most recently, in *Delaware v. New York*, 507 U.S. 490 (1993), the Supreme Court reaffirmed that unclaimed property is reported to the state of the owner's last-known address as it appears in the records of the holder of the unclaimed property—called the "first priority rule." If the holder's records do not disclose the last-known address, the "second priority rule" governs: the property is subject to the laws of the state of the holder's domicile—generally, the state of incorporation. For this reason, many retailers use an issuer or a subsidiary located in a state that does not require escheat of gift card balances.

The New Jersey Law

The revisions to New Jersey's unclaimed property law purported to challenge the traditional priority rules. The legislature not only made clear that gift card balances would be *retroactively* subject to its escheat laws, it required that, if the holder's records do not disclose the owner's last-known address, the property will be returned not to the place of the holder's domicile, but rather to the place of purchase—known as the "place of purchase" presumption. New Jersey also added a data-collecting requirement, instructing that retailers obtain the name and address of the purchaser or owner of each gift card and maintain, at a minimum, the last zip code for each purchaser.

The Third Circuit Decision

Several retail and industry groups challenged the New Jersey law in court and obtained a preliminary injunction barring the law's key provisions from taking effect. Recently, the Third Circuit affirmed the New Jersey District Court's decision, holding that key provisions of the law likely violate the U.S. Constitution. First, the court found that the retroactive application of New Jersey's escheat law to gift cards not redeemable for cash violated the Constitution's contracts clause by requiring gift card issuers to give up expected profits and fees from unredeemed gift cards. Second, the court held that New Jersey's "place of purchase" presumption was preempted by the Supreme Court's decisions setting forth the priority rules applicable to abandoned property. The

court did, however, find that the data collection requirements were acceptable since they were severable from the place of purchase requirement and helpful in determining which state is entitled to escheat property under the Supreme Court's first priority rule.

Practical Implications

The decision confirms the traditional priority rules applicable to unclaimed property and the value of incorporating a subsidiary to manage gift card operations in states that exempt gift card balances from their escheat laws. This may allow retailers to retain the value of unredeemed gift cards and avoid unclaimed property audits related to their gift card programs. It is important to note that the Third Circuit only addressed these issues in the context of motions for preliminary injunctions; it will be important to monitor future court decisions with respect to these issues.

The court's ruling does permit the New Jersey law's data collection requirements to go into effect. If, in the normal course of its business, a retailer obtains the name and address of the purchaser or owner of any SVC sold in New Jersey, the retailer must maintain that information. Retailers that do not typically collect address information must implement a process to at least collect the zip codes for each purchaser. There are many questions surrounding this requirement, and retailers should watch for guidance from the New Jersey Department of Treasury. Note also that in some states, such as California, privacy laws restrict the ability to collect and maintain personal information including zip codes. Thus, retailers' efforts to comply with New Jersey's data collection requirement should be restricted to New Jersey.

How We Can Help

Morgan Lewis can assist with an analysis of a retailer's gift card program and the impact of state unclaimed property laws. This can include dealing with New Jersey's requirements and assessing ways to avoid having to escheat unused gift card balances to New Jersey.

If we can be of assistance to you in these matters, please feel free to get in touch with your Morgan Lewis contact or any of our Retail Practice leaders:

Greg Parks, Litigation
Philadelphia
215.963.5170
gparks@morganlewis.com

Anne Marie Estevez, Labor & Employment
Miami
305.415.3330
aestevez@morganlewis.com

Joseph Duffy, Litigation
Los Angeles
213.612.7378
jduffy@morganlewis.com

Christopher Loeber, Litigation
Princeton
609.919.6672
cloeber@morganlewis.com

Stefanie Moll, Labor & Employment
Houston
713.890.5780
smoll@morganlewis.com

These individuals are part of our international Retail Practice. Attorneys from our 22 offices regularly represent national, regional, and local retailers in a broad array of subject matters including litigation, labor and employment, real estate, tax, transactional, and regulatory.

About *Morgan Lewis Retail Did You Know?* This message is part of our effort to educate our retail clients and friends about important legal developments. One thing we hear frequently from our retail clients is that it is hard to keep track of new and emerging laws and lawsuit trends that affect retailers. All too frequently, the first notice comes in the form of a lawsuit seeking millions of dollars. To help you be more proactive in managing legal compliance, we are providing these emails.

About Morgan, Lewis & Bockius LLP

With 22 offices in the United States, Europe, and Asia, Morgan Lewis provides comprehensive transactional, litigation, labor and employment, and intellectual property legal services to clients of all sizes—from global Fortune 100 companies to just-conceived startups—across all major industries. Our international team of attorneys, patent agents, employee benefits advisors, regulatory scientists, and other specialists—more than 3,000 professionals total—serves clients from locations in Beijing, Boston, Brussels, Chicago, Dallas, Frankfurt, Harrisburg, Houston, Irvine, London, Los Angeles, Miami, New York, Palo Alto, Paris, Philadelphia, Pittsburgh, Princeton, San Francisco, Tokyo, and Washington, D.C. For more information about Morgan Lewis or its practices, please visit us online at www.morganlewis.com.

This Alert is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius LLP. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship. These materials may be considered **Attorney Advertising** in some states.
Please note that the prior results discussed in the material do not guarantee similar outcomes

© 2012 Morgan, Lewis & Bockius LLP. All Rights Reserved.