

# Client Alert.

January 10, 2012

## Third Circuit Addresses Important Unclaimed Property Issues and Confirms New Jersey's "Third Priority Rule" Is Invalid

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On January 5, 2012, the Third Circuit issued two decisions that affirmed in full District Court decisions granting preliminary injunctions that prevent New Jersey from enforcing two provisions in New Jersey's recent unclaimed property legislation, 2010 N.J. Laws Chapter 25 ("Chapter 25") against holders ("Holders") of unclaimed property, while denying requests for preliminary injunction as to certain other Chapter 25 provisions. *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).

*New Jersey Retail Merchants Association* has significant implications, since it confirms that only two "priority" rules exist in determining the state to which unclaimed property is to be deposited—the address of the owner (the "First Priority Rule") and the state of the issuer's domicile (the "Second Priority Rule"). The Third Circuit rejected New Jersey's attempt to employ a "Third Priority Rule" based on the state where the transaction takes place, concluding that such a rule would contravene U.S. Supreme Court precedent. Delaware, the state that benefits most from the Second Priority Rule—unclaimed property is the third largest source of Delaware's revenue—is probably breathing a sigh of relief. Issuers of stored value cards ("SVCs") redeemable for merchandise or services are likewise relieved—at least with respect to SVCs issued before the date of Chapter 25.

In *New Jersey Retail Merchants Association*, the Third Circuit agreed that all four conditions for granting a preliminary injunction were met with respect to: (1) the retroactive application of Chapter 25 to SVCs redeemable for merchandise or services; and (2) prospective enforcement of Chapter 25's "place-of-purchase presumption" or "Third Priority Rule."<sup>1</sup> However, the Third Circuit agreed that preliminary injunctions should not be issued with respect to Chapter 25's implementation of a two-year dormancy period for SVCs, or its data collection requirement.

The Third Circuit held that the Holders were likely to succeed on the merits of their Contracts Clause claim because retroactively requiring that SVCs redeemable only for merchandise or services to transfer cash to the State in the amount of the unused balances, called "breakage," would substantially impair the contractual relationships of the issuers of the SVCs, by requiring that the issuers forgo their expected profits on the unredeemed merchandise or services. The court concluded that while there is a "significant and legitimate public purpose" for unclaimed property provisions, "Chapter 25 does not reasonably accommodate the rights of the contracting parties in light of the State's public purpose because it fails to allow SVC issuers to collect their bargained-for expected profits or merchant fees." Since sovereign immunity

<sup>1</sup> The four conditions are whether: (1) the movants have a likelihood of success on the merits; (2) the movants would suffer irreparable harm if the injunction were not issued; (3) if the preliminary injunction is issued, the nonmoving party would suffer greater harm; and (4) granting preliminary injunction is in the public interest.

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would bar holders from claiming refunds of such SVC breakage if the provision is later declared unconstitutional, the “irreparable harm” condition was met. The court found that New Jersey would not suffer greater harm if a preliminary injunction were issued, since the State “does not have an interest in enforcement of an unconstitutional law.” Enforcement of an unconstitutional law was also found not to be in the public interest.

The court also upheld the preliminary injunction issued by the District Court with respect to the place-of-purchase presumption, which would require that, if the address of the purchaser or owner were unknown, SVCs sold in New Jersey would escheat to New Jersey. The court held that U.S. Supreme Court precedent provided for only two priority rules, and that Chapter 25’s place-of-purchase presumption and the Treasurer’s implementing guidance with respect to that presumption “directly contradicts” the Second Priority Rule. The Third Circuit concluded that New Jersey’s place-of-purchase presumption provision was improper because it would allow New Jersey to receive the property even though “it lacked a clear connection to the owner or issuer.” The court rejected New Jersey’s argument that it should be allowed to retain the abandoned property to prevent a “windfall” to SVC issuers, recognizing that states’ sovereign right to escheat “necessarily entails the ability not to escheat” and the U.S. Supreme Court did not intend a result that “would give states the right to override other states’ sovereign decisions regarding the exercise of custodial escheat.”

The court viewed the data collection language of Chapter 25, requiring issuers of SVCs to collect names and addresses of the owners or purchasers or, at a minimum, to retain zip code information of the owners or purchasers, to be severable from the place-of-purchase presumption. The court also found that the data collection purpose served a legitimate state interest—protecting consumers—even though simply collecting zip codes would not enable the Treasurer to return unclaimed property to owners. The Third Circuit rejected the Holders’ argument that collecting information regarding the purchaser of an SVC does not foster the priority rules or facilitate the reuniting of the unused balances to the owners, since SVCs are often purchased to be gifted.

The Third Circuit also rejected Holders’ claim that Chapter 25’s two-year dormancy period for SVCs was either expressly or implicitly preempted by the federal Credit Card Act of 2009 (“Card Act”), finding that since consumers could access their unused SVC balances “in cash in perpetuity” Chapter 25 provided “greater protection” than, and was therefore not preempted by, the Card Act.

Holders’ substantive due process challenges to Chapter 25 were also rejected by the Third Circuit. The court found that the State’s proffered basis for enacting the legislation—consumer protection and modernization of the State’s unclaimed property laws—served legitimate State interests, and that such purposes were furthered by Chapter 25. Even if such purposes were subsidiary, and the primary purpose of the legislation was to raise revenue, the State’s stated purposes passed the rational basis test. Similarly, the two-year dormancy period for SVCs, and the exemptions provided for issuers of less than \$250,000 of SVCs and for gift cards issued under promotional or consumer loyalty programs, were found to serve legitimate State interests and have rational bases.

In the second decision, *American Express Travel Related Services*, the Third Circuit affirmed the District Court’s decision not to enjoin the Treasurer’s enforcement of Chapter 25’s shortened dormancy period for traveler’s checks—three years instead of the previous 15 years—and rejected Holders’ Due Process, Contract, Takings, and Commerce Clause claims, holding that they were unlikely to be successful.

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Given state legislatures' recent predilection of using unclaimed property laws as states' personal piggy banks, by expanding the breadth of property subject to escheat and decreasing dormancy periods, these decisions raise critical issues that impact many holders and owners of property subject to escheat. Since these decisions only address the substantive merits in the context of preliminary injunction motions, the issues are far from over and may eventually find their way to the U.S. Supreme Court.

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