Some States Escheating Unredeemed Gift Cards Ignore Federal Laws

by Ethan D. Millar and John L. Coalson Jr.

Introduction

In 1965, in *Texas v. New Jersey*, the U.S. Supreme Court established two fundamental rules for determining when a state has the right and jurisdiction to take unclaimed property. The first of those “priority” rules provides that the state in which the “last known address” of the owner of the property is located has the primary right to take the property. However, if the holder has no record of the owner’s last known address, or if the state in which the address is located does not provide for escheat of the property, the state of the holder’s domicile (generally, its state of incorporation) may take the property.

While states generally follow those priority rules, many states have attempted to carve out exceptions or otherwise deviate from those rules in their unclaimed property statutes. The latest, and most blatant, way in which states have departed from the federal priority rules is through the use of a “deemed owner address” provision. That provision, which has been adopted by several states (including Maine, Nevada, and Texas), generally states that if the holder of an unredeemed gift card does not have a record of the card owner’s last known address and the card was sold in that state, that address is presumed to be the address of the state treasurer or other state official.

The deemed owner address provisions are both bad law and bad policy. They are unconstitutional because they directly conflict with the Supreme Court’s federal priority rules.

379 U.S. 674 (1965).

3The most well-known of those deviations is the “third-priority rule,” and it has been adopted by 35 states, as well as the District of Columbia. The third-priority rule generally provides that if the state of domicile of the holder does not provide for escheat of the property, the state in which the transaction giving rise to the unclaimed property occurred has the right to claim the property.

33 Maine Rev. Stat. Ann., section 1958(2)(B-1) (“the address of the owner of the gift obligation or stored value card is... presumed to be that of the address of the Treasurer of State unless the person who sells or issues the gift obligation or stored-value card obtains and maintains the address of the owner.”); Nev. Stat. Ann., Title 10, Chapter 120A, section 120A.520(2) (“If a gift certificate is issued or sold in this State and the seller or issuer does not obtain and maintain in his records the name and address of the owner of the gift certificate, the address of the owner of the gift certificate shall be deemed to be the address of the Office of the State Treasurer in Carson City.”); Texas Stat. Ann., Property Code, Title 6, Chapter 72, subchapter B, section 72.1016 (“If the person who sells or issues a stored value card in this state does not obtain the name and address of the apparent owner of the card and maintain a record of the owner’s name and address and the identification number of the card, the address of the apparent owner is considered to be the Austin, Texas, address of the comptroller.”). Connecticut previously had a provision in its law that stated: “In the absence of a record of the address of the owner of the gift certificate, the address of the owner shall... be presumed to be the address of the Treasurer.” That provision was repealed in 2005 via 2005 Ct. SB 123, approved effective October 1, 2005.
because they directly conflict with the Supreme Court’s federal priority rules. They are poor public policy because unredeemed gift cards are not a type of property that should be subject to escheat in any event, at least if the cards are redeemable only for merchandise and services and not for cash.

Deemed Owner Address Provisions Are Unconstitutional

The supremacy clause (Article VI, section 2) of the U.S. Constitution provides as follows:

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof... shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, anything in the Constitution or Laws of any State to the Contrary notwithstanding.

The Supreme Court has held that a state law is preempted under the supremacy clause, and therefore unconstitutional, if the state law either actually or impliedly conflicts with a federal law. Federal common law preempts state law to the same extent as a federal statute. In general, federal common law is defined as case law that is judicially fashioned by federal courts, rather than interpretive of existing state or federal rules. The Court’s decision in Texas v. New Jersey, in which it established the federal priority rules for taking custody of unclaimed property, constitutes federal common law because it did not involve the interpretation or application of any state or federal statutory or constitutional provision. Rather, the Court fashioned entirely new rules for determining, in any given situation, which state has the right to take custody of unclaimed property. The Court’s later decisions in Pennsylvania v. New York and Delaware v. New York, in which the Court reaffirmed its priority rules and declared that “no State may supersede them by purporting to prescribe a different priority under state law,” also constitute federal common law for the same reason.

Even a cursory review of the deemed owner address provisions is sufficient to understand that the provisions directly conflict with the federal common law priority rules. The federal rules provide that if the holder of unclaimed property does not have an address of the property owner, the state of domicile is the only state that has the right to claim the property. The Nevada and Texas deemed owner address provisions completely disregard that rule, instead providing that—in the very same circumstance (that is, when the holder lacks a record of the owner’s address)—the state in which the gift card is sold has the right to claim the unredeemed card balance. The Maine provision is not even limited to cards sold in the state, and thus apparently would require that

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10See also The Supreme Court and the Post-Erie Federal Common Law, 31 L. Ed. 2d 1006, section 3 (“Federal decisional law has been held to constitute ‘laws’ within the meaning of the statute conferring federal question jurisdiction on the Federal District Courts, within the meaning of the removal statute, and most important, within the meaning of the supremacy clause of the Federal Constitution, so as to make the post-Erie federal common law supreme over state law.”). The creation of federal common law is subject to some restraints: “In deciding whether rules of federal common law should be fashioned, normally the guiding principle is that a significant conflict between federal policy or interest and the use of state law in the premises must first be specifically shown.” Id. An overriding federal interest is grounds for the creation of federal common law: “The need for uniformity is the most frequently cited reason for the fashioning of federal common law.” Id.

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11Allowing the state in which the card is sold to claim the unredeemed card balance under the first-priority rule is problematic not only because it may deprive the state of domicile of such unredeemed balances, but also because card issuers are often domiciled in states that entirely exempt gift cards from escheat. Therefore, from a holder’s perspective, the question is not simply to which state to escheat the property, but whether the property needs to be escheated at all. The deemed owner address provisions thus often attempt to circumvent the laws adopted by the state of domicile that entitles the holder to keep the property. Since the state of domicile has a federally recognized claim to the property that is clearly greater then that of the state in which the card was sold, such an attempt raises not only the preemption issue discussed above, but also violates the full faith and credit clause of the U.S. Constitution, U.S. Const. art. IV, section 1. See also Hughes v. Fetter, 341 U.S. 609, 612 (1951) (states must generally recognize property interests created or recognized by the statutes of sister states).
any unredeemed gift card balance must be remitted to Maine if the holder does not have the owner’s address, even if the holder sells no cards in Maine or conducts any other business in the state. Thus, in addition to being constitutionally defective, Maine’s rule is also illogical and internally inconsistent.12

Further, the Supreme Court has already considered, and rejected, an almost identical rule in Pennsylvania v. New York.13 In that case, Pennsylvania sought to escheat unredeemed money orders sold in the state based on the presumption that the owners of the unredeemed checks were located in the state in which the money orders were sold. Pennsylvania urged the Court to amend its prior holding in Texas v. New Jersey to substitute a transaction-based priority rule for the “state of domicile” rule when the holder did not keep records of the last known addresses of the property owners. Pennsylvania claimed that such a rule would be fairer than permitting the state of domicile to receive a “windfall” in this case. The Court disagreed, however, pointing out that, in Texas v. New Jersey, it had considered the possibility that the holder may not have the owner’s records, and had determined that the state of domicile should have the right to escheat in that situation.

The rules of Texas v. New Jersey must be strictly construed, even if the result is a windfall for the state of domicile of the holder and regardless of the particular facts involved.

The Court reminded Pennsylvania that its objective in creating the priority rules was to create an equitable, uniform, and easy-to-administer set of rules for determining when a state may take custody of unclaimed property. The Court had previously rejected a transaction-based rule in Texas v. New Jersey on the basis that it did not meet those criteria. The Court had stated that “similar uncertainties [to those created by an escheat rule based on the principal place of business of the holder] would result if we were to attempt in each case to determine the State in which the debt was created and allow it to escheat. Any rule leaving so much for decision on a case-by-case basis should not be adopted unless none is available which is more certain and yet still fair.”14 Indeed, particularly in this day and age of e-commerce transactions, it is often difficult to determine in which state a particular transaction may have occurred. In addition to rejecting the transaction-based rule specifically, the Court also emphasized generally that it wanted to avoid “decid[ing] each escheat case on the basis of its particular facts or . . . devis[ing] new rules of law to apply to ever-developing new categories of facts.”15 Thus, the rules of Texas v. New Jersey must be strictly construed, even if the result is a windfall for the state of domicile of the holder and regardless of the particular facts involved.

The only real difference between Pennsylvania’s claim and the deemed owner address provisions is that the former involved money orders and the latter involves gift cards. Accordingly, if there was any doubt regarding the validity of such rules after Texas v. New Jersey, that doubt was eliminated by the Court’s decision in Pennsylvania v. New York.

Gift Cards Are Not a Type of Property That Should Be Subject to Escheat as a Matter of Policy

The deemed owner address provisions adopted by Maine, Nevada, and Texas are directed at unredeemed gift cards. As discussed above, those provisions are unconstitutional no matter what types of property are involved. However, by focusing on gift cards, the statutes are also contrary to the fundamental principles and policies underlying state unclaimed property laws.

Unclaimed property laws are principally designed to provide a procedural mechanism to return missing property to its rightful owner. When a state claims unclaimed property from a holder, it does so as custodian for the owner, who may reclaim it from the state at any time. As custodian, the state acts on behalf of the true owner of the property and derives its rights to claim the property from that owner. That fundamental principle has become known as the “derivative rights doctrine.”16

A gift card represents an obligation to provide merchandise or services to the owner of the card. The cardholder typically does not have the right to demand cash from the issuer of the card. Since the state “steps into the shoes” of the owner for purposes of claiming unclaimed property, the state should also not be entitled to demand cash from the card issuer. Otherwise, the state would have an interest in the

12A law is internally inconsistent if the law would require the same property to be subject to escheat in multiple states if all states adopted the same law. If all states adopted Maine’s deemed owner address provision, the address of an “owner unknown” gift card would be deemed to be the treasurer (or other state official) in every state.


14379 U.S. at 680.

15Id. at 679.

16See, e.g., State v. Standard Oil Co., 74 A.2d 565, 573 (1950), aff’d, 341 U.S. 428 (1951). (“The State’s right is purely derivative: it takes only the interest of the unknown or absentee owner.”)
property that is greater than that of the owner. Also, if a state were allowed to claim cash for an unredeemed gift card, there would be nothing to stop the owner, on whose behalf the state acted, from claiming that cash back from the state, thereby accomplishing indirectly (that is, through the unclaimed property provisions) what he could not do directly based on his rights under the gift card contract. Unclaimed property laws were never intended to enlarge the rights of property owners vis-à-vis holders in this manner.

A state’s escheat of gift cards is also counter to public policy because the escheat deprives the card issuer of its profit from the sale of the card.

A state’s escheat of gift cards is also counter to public policy because the escheat deprives the card issuer of its profit from the sale of the card. If the gift card is redeemable only for merchandise and services, and not for cash, the issuer has made a profit on the sale of the card equal to the profit margin of the merchandise or services for which the card will ultimately be redeemed. Thus, although the card issuer may not know the exact amount of profit that it will make on the sale of the card, it knows it will make some profit. However, if a state were allowed to escheat the amount paid or face value of the gift card, the state would be depriving the issuer of the expected profit from the sale of the gift card, thus making the issuer worse off than it would have been had the gift card actually been redeemed by the owner. Unclaimed property laws were not intended to rewrite history by erasing a retailer’s sales of gift cards. Again, those laws were designed simply to return missing property to its rightful owners.

Finally, the escheat of gift cards is also poor public policy because, in most cases, the holder (that is, the card issuer) does not have a record of the owner’s last known address. Thus, if a state were allowed to escheat the amount paid or the face value of a gift card, the state would have no way of returning the property to its rightful owner. Further, by escheating the card’s value, the state eliminates the holder’s obligation to honor the card (otherwise, the holder could be required to redeem the same card twice). A cardholder who is no longer able to use his card (because the value has been escheated) may, of course, request reimbursement from the state for the amount escheated. However, it is doubtful that a cardholder would go through the trouble, and even if he did, it is unclear whether he would be able to satisfy the state’s requirements for claiming the property, since the only information the state would have would be the escheated card number and not the name or address of its owner. By contrast, if the state is not permitted to escheat gift cards, the cardholder may redeem the card with the retailer at his convenience.\(^\text{18}\)

The escheat of gift cards injures both owners and holders.

That the deemed owner address provisions are designed to apply when the holder has no record of the gift card owner’s name or address suggests that the provisions are nothing more than an attempt by the states to appropriate retailers’ profits on gift card sales, with no desire, intent, or capability of actually returning the property to its rightful owner.

Conclusion

The deemed owner address provisions that have been adopted by Maine, Nevada, and Texas are transparent attempts to circumvent the federal rules for taking custody of unclaimed property, as set forth by the Supreme Court. The Court has made it clear that states may not adopt custody rules that differ from the federal rules. Yet, the deemed owner address provisions directly conflict with the federal priority rules by stating that, if the holder has no record of a gift card owner’s address, the state in which the card is sold — rather than the state of domicile of the holder — may take custody of the unredeemed gift card balance. The Court rejected

\(^{18}\)That assumes, of course, that the card does not expire. Many states, as well as the federal government, have imposed restrictions on the use of expiration dates on gift cards, and as a result, few closed-loop gift cards still include expiration dates. In any case, if a state wants to prevent gift cards from expiring, the proper avenue is through the state’s consumer protection laws rather than its unclaimed property laws.

\(^{17}\)See, e.g., Service Merchandise Co. v. Adams, 2001 WL 34384462 (Tenn. Ch.). In this case, the court interpreted Tennessee’s unclaimed property laws requiring the escheat of unredeemed gift certificates (redeemable only for merchandise and services) to require only that the issuer “deliver to the custody of the State of Tennessee copies of the gift certificates or other memoranda which account for and memorialize the intangible promise of the Plaintiff (Holder) to deliver merchandise to the Owner” and held that “the statute does not require the Plaintiff to deliver to the State cash for the unredeemed gift certificates.” Id. at *5. The court also held that if the statute could be interpreted to require the holder to pay the state cash in the full amount of the gift certificate, the statute would violate both the takings clause and contracts clause of the U.S. Constitution. The court concluded that “Therefore, the court holds, as a matter of law, that the Plaintiff, upon the sale of a gift certificate, retains a contractually created property right in its anticipated gross profit.” Id.

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the use of a transaction-based custody rule in general in *Texas v. New Jersey* and invalidated a rule almost identical to the deemed owner address provisions in *Pennsylvania v. New York*. For those reasons, the deemed owner address provisions are not good law.

They are also bad policy. The escheat of such gift cards injures both owners and holders — the former by reducing the likelihood that the owner will be able to redeem his card and realize its benefit and the latter by depriving the holder of its expected profit on the sale of a gift card, thereby making the holder worse off than it would have been had the card actually been redeemed in full. Also, in most cases, the escheat of gift cards cannot serve the most basic and important function of state unclaimed property laws, which is to return missing property to its rightful owner. Because most holders of unredeemed gift cards lack records of the owners of those cards, it is practically impossible for most escheated gift card balances to be returned to their owners. Further, to do so would grant the gift card owner a right — the right to receive cash — which most gift card owners do not now possess. That enlargement of the rights of owners vis-à-vis holders of unclaimed property is contrary to the purposes and objectives of state unclaimed property laws.

Audit + Beyond, a column on state tax audits and the resolution of disagreements between business taxpayers and state revenue departments, is written by members of the Alston & Bird LLP state and local tax group. This column is by Ethan D. Millar and John L. Coalson Jr., who are both partners at Alston & Bird, LLP, where they specialize in unclaimed property and state and local taxation. Millar is also chair of the unclaimed property subcommittee of the business law section of the American Bar Association. The authors would like to thank Sam Schaunaman at Thomson Reuters for his helpful comments regarding this article.