

State and Local Tax ADVISORY

September 14, 2011

Third Circuit Hears Oral Arguments Challenging New Jersey Gift Card Law

On September 12, 2011, the Third Circuit United States Court of Appeals in Philadelphia heard oral arguments in the litigation challenging New Jersey's attempt to retroactively claim stored value card balances as unclaimed property, pursuant to a novel jurisdictional theory. This client advisory provides a summary of the arguments made during oral argument.

Procedural History

In June of 2010, New Jersey passed legislation requiring, among other things, reporting of gift cards and implementation of a new priority rule for reporting gift cards—in the absence of owner name and address data, New Jersey will presume the address of the owner is the place of purchase. See 2010 N.J. Laws Ch. 25 (effective, July 1, 2010) (“NJ Gift Card Law”).

In September of 2010, the New Jersey Retail Merchants Association (NJRMA, or the “Plaintiffs”) filed suit in the District Court of New Jersey challenging the new Gift Card Law and requesting a preliminary injunction from enforcement of the NJ Gift Card Law. *New Jersey Retail Merchants Association v. Sidamon-Eristoff et al*, Case 3:10-cv-05059-FLW-LHG, U.S. District Court for the District of New Jersey (filed Sept. 30, 2010). On November 13, 2010, the District Court issued a preliminary injunction to the effect that the state may not use a place-of-purchase presumption to establish a first-priority claim to stored value cards that were sold in New Jersey but for which the issuer did not collect purchaser address data. *Am. Express Travel Related Servs. Co., et al v. Sidamon-Eristoff, et al.*, 2010 U.S. Dist. LEXIS 120153 (D.N.J. Nov. 13, 2010). On December 21, 2010, NJRMA appealed to the Third Circuit the District Court's November 13, 2010, denial of certain requests for preliminary injunction.

In January 14, 2011, Judge Wolfson issued an order enjoining enforcement of §5c, which includes both the place-of-purchase presumption and the zip code collection and maintenance requirements. Holders asked the judge to clarify whether she had enjoined the zip code collection requirement as well as the place of purchase presumption, and in her order dated January 14, 2011, the judge confirmed that only the place of purchase presumption was enjoined from enforcement; the zip code collection and maintenance requirement could be enforced. *N.J. Ret. Merch. Ass'n v. Sidamon-Eristoff*, 755 F. Supp. 2d 556, 2011 U.S. Dist. LEXIS 3911 (D.N.J. 2011).

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On January 20, 2011, the Plaintiffs moved for injunctive relief of such requirement to the Third Circuit Court of Appeals; the Court of Appeals issued a temporary injunction preventing enforcement of the zip code collection and maintenance requirement on January 31, 2011, when review by the full panel of the Third Circuit was pending. On February 8, 2011, the full panel of the Third Circuit issued an injunction preventing enforcement of the zip code requirement. On February 17, 2011, the Court of Appeals set a briefing schedule for the remaining outstanding issues.

The most recent step in the review by the Third Circuit was the oral argument that occurred Monday in Philadelphia. The case was argued before a three-judge panel consisting of Judges Scirica, Fisher and Smith, the same judges who ruled on the Plaintiffs' successful Motions for Temporary Injunction to enjoin enforcement by New Jersey of the zip code collection requirement pending resolution of the appeal. Alston & Bird's unclaimed property team attended the oral arguments and presents the following summary of the oral arguments. Below, we provide as background a brief overview of the District Court's decision and reasoning, as well as each of the issues argued by the parties points made during oral argument.

Preemption of New Jersey Gift Card Law by the Federal CARD Act

District Court's Analysis

The District Court rejected the Plaintiffs' argument that the NJ Gift Card Law was preempted by the Federal CARD Act (federal consumer protection law applied to Gift Cards, 15 USC § 1693I). The District Court found that the NJ Act did not impermissibly conflict with the Federal CARD Act because it provides greater protection to consumers than the Federal CARD Act, and it is possible for an issuer to comply with the requirements of both by continuing to honor for not less than five years stored value cards (SVCs) that had previously been escheated to New Jersey after two years of inactivity, and seeking reimbursement from the state for amounts so honored on previously escheated cards.

Oral Argument

In oral arguments to the Third Circuit, the Plaintiffs stressed that following the new statutory regime would require the issuer of the SVC to "pay twice"—i.e., to escheat the unredeemed value of the SVCs to New Jersey, and then to subsequently provide goods or services equal to such value to the cardholder who presents it for redemption within five years of issuance. The Plaintiffs argued that requiring the issuer to escheat the value of the cards and then still honor that value for goods and services violates due process. Furthermore, the Plaintiffs noted that the New Jersey unclaimed property statute provides that a "holder" of unredeemed balances who escheats the value of such balances is relieved of any further liability to the owner of the card and need not honor it if presented, which is in direct violation of the requirement of the CARD Act that the issuer honor such cards for at least five years. Consequently, the Plaintiffs argued, the NJ Gift Card Law directly conflicts with the terms of the CARD Act and is pre-empted under the Supremacy Clause of the U.S. Constitution.

Preemption of New Jersey Place of Purchase Presumption by Federal Law

District Court's Analysis

The District Court held that the “place of purchase presumption” in the NJ Gift Card Law did violate the priority rules and was therefore unconstitutional. The New Jersey Assistant Attorney General argued to the Third Circuit that the priority rules of *Texas v. New Jersey* apply only to cases in which there are conflicting claims by multiple states to the same property. That is the context in which *Texas v. New Jersey* and the two subsequent Supreme Court decisions were rendered, and is consistent with the Article III jurisdiction of the Supreme Court to hear and resolve cases involving claims between or among the States.

Oral Argument

The parties devoted a fair portion of the oral argument to the issue of whether the NJ Gift Card Law was pre-empted by federal common law because it conflicts with the priority rules adopted by the United States Supreme Court’s decision in *Texas v. New Jersey*. The state argued that its application of the place of purchase presumption and the third priority rule in circumstances where no other state is asserting a claim to the unredeemed balances is constitutional, and that New Jersey may constitutionally take custody of property in such circumstances until another state with a higher priority right comes forward to assert a claim to the property. The Plaintiffs argued that the place of purchase presumption conflicts with the second priority rule articulated by the Supreme Court and would render it meaningless, as the District Court held. The Plaintiffs also argued persuasively that allowing a third priority rule to be added to the two priority rules expressly created by the Supreme Court would complicate a priority scheme intentionally designed by the Supreme Court for general application and ease of administration.

The Plaintiffs further argued that the “data collection” requirements of the Act (i.e., the statutory requirement that issuers obtain name and address information of purchasers of SVCs and retain at least the zip code) are “inextricably intertwined” with the place of purchase presumption and that, under New Jersey law, unless the court could find that the New Jersey Legislature “clearly” would have enacted the data collection provisions in the absence of the place-of-purchase presumption, the data collection provisions must fail in the event the place-of-purchase presumption is unconstitutional. The state argued that the provisions, though contained in the same statutory section, operate independently and that the data collection provisions will operate prospectively to permit first priority reporting of unredeemed balances without the place-of-purchase presumption ever coming into play. The state also emphasized that the Supreme Court has twice stated that if states wanted to require the collection of purchaser name and address information, they could do so.

New Jersey Act Violated Substantive Due Process

District Court's Analysis

The District Court ruled that so long as revenue raising was not the only basis for this legislation,

it is not the court's role to decide whether the legislature's judgment is sound. Rather, the court's substantive due process inquiry is limited to whether the state has put forth a conceivable rational basis for its action. The court found that the state did put forth a *conceivable* rational basis for its action.

Oral Argument

The Plaintiffs argued that the NJ Gift Card Law violated substantive due process because the legislature enacted it as a revenue raising provision, while the unclaimed property law that the NJ Gift Card Law amends is a regulatory statute designed to protect consumers' interest in their property. The state countered that although raising revenue may have been *one* of the motivating factors behind the legislation, the stated legislative purpose of the statute was to modernize the state's unclaimed property law and to better protect the property of owners. Since these would be rational reasons to support the NJ Gift Card Law, its enactment does not violate substantive due process.

Retroactive Escheat Requirement Violates Contracts Clause

District Court's Analysis

The District Court ruled that application of the NJ Gift Card Law retroactively to permit escheat of balances on cards issued prior to the NJ Gift Card Law that are redeemable solely for goods or services and not for cash violates the Contracts Clause of the U.S. Constitution. The District Court held that the retroactive application of the NJ Gift Card Law's provisions to such previously issued cards improperly impairs the contracts between issuers and purchasers.

Oral Argument

The Plaintiffs argued to the Third Circuit that the District Court was clearly correct—that the terms of the contract between the issuers and purchasers was that the cards could be redeemed solely for goods or services and not cash; and that the NJ Gift Card Law, by requiring the issuers to turn over cash for unredeemed balances, changes the terms of the existing contracts between purchasers and issuers. The state argued that the issuers had no right to assume that card balances would not be made escheatable, and that the adoption of such provisions does not impermissibly impair contracts, but rather represents appropriate regulation of an activity within the state's regulatory authority.

Conclusion of Oral Argument: Procedural Matters/Timing of Decision

At the conclusion of the arguments, the judges asked about the status of the matter before the District Court and were advised that the proceedings were stayed pending a decision from the Third Circuit. The judges also advised the parties that they wanted to order a transcript of the proceedings before the District Court and have the parties share the cost of preparation of such transcript. Based on these two actions, we believe it is very unlikely that a decision will be forthcoming quickly on the appeal. It will likely be at least late October or November before we have a decision from the Third Circuit, and possibly longer.

Alston & Bird offers clients unparalleled experience dealing with issues involving state unclaimed property/escheat laws. Our five senior attorneys with unclaimed property expertise together have more than 85 years of experience advising major corporations on unclaimed property matters. We assist our clients in analyzing complex legal issues, obtaining legal opinions, conducting multistate/multi-entity internal compliance reviews, designing corporate compliance policies, advising clients on planning and related restructurings, negotiating voluntary disclosure agreements, defending single-state and multistate audits, litigating unclaimed property issues and influencing unclaimed property policy and administration.

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