NBPCA WHITE PAPER

Abandoned Property Laws and Network Branded Prepaid Cards: Questions and Concerns Raised When Trying to Fit Cards into the Existing Abandoned Property Legal Framework

Executive Summary

Prepaid Cards are innovative and beneficial products that have undergone significant growth in recent years. While the legal framework for these products has also undergone change and development, state abandoned property laws have not kept up, leaving issuers uncertain, without direction and at risk of inadvertently violating such laws and incurring substantial economic fines and penalties.

This White Paper outlines the following points:

- The background and history of abandoned property law
- Current state of escheat law
- Challenges applying abandoned property laws to prepaid cards:
  - Current laws do not contemplate prepaid cards
  - Current laws do not distinguish between network branded prepaid cash accessible cards, network branded cards usable for goods/services, and closed loop, retailer issued cards
  - Difficulty in deciding which state and how much to pay
  - Difficulty in knowing when property is truly abandoned
  - Anticompetitive consequences of abandoned property laws
  - Special issues raised by reward and incentive cards
  - Problems raised by the Third Priority Rule and “deemed address” provisions
- Penalties and risks of non-compliance

We hope the attached White Paper will serve to demonstrate the difficulties facing the industry in complying with state abandoned property laws, and will encourage appropriate action to address these concerns.

- - NBPCA Editors, February 28, 2009

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Introduction

In recent years, the growth rate of the prepaid card market has dramatically increased. While store branded gift cards remain the most common prepaid card product, many other types of prepaid cards have been gaining popularity as well, such as payroll cards, government benefit cards, health care spending cards, corporate incentive/rebate cards, and general purpose reloadable cards. According to a study sponsored by the Network Branded Prepaid Card Association (NBPCA),[1] more than 68% of those surveyed received a gift card during the 2007 holiday season and, of those who received gift cards, almost 42% received at least one card that was a “network branded prepaid card” - that is, a card issued by a financial institution and bearing the logo of one of the four payment brands, American Express, Discover, MasterCard or Visa. Network branded prepaid cards are useable not at just one retailer but at millions of unaffiliated retailers that accept that card brand.

In the wake of prepaid cards’ popularity, some have questioned how such products should be treated under state “abandoned property laws.” These are the laws that require that funds in abandoned bank accounts, funds underlying certain unused gift certificates, and funds underlying uncashed checks be paid over to the states. While the majority of prepaid cardholders use all the funds on their prepaid cards shortly after obtaining the card,[2] there are nevertheless unused funds remaining on some cards, which has created significant uncertainty in the industry. Some state abandoned property laws address what happens to those funds that remain unclaimed after an extended period of time. For the most part, however, these state laws (known as abandoned property laws, unclaimed property laws or escheat laws) are either unclear or inconsistent in how they apply to today’s prepaid card products.

This White Paper recounts the history of state abandoned property laws and discusses how today’s laws may impact gift cards and other prepaid card products. It then explains why the current laws do not adequately address the prepaid card market and explores the various difficulties that card issuers face in complying with such laws. Finally, the White Paper describes how the legal uncertainty creates compliance risks as well as potential negative consequences for both consumers and businesses as well.

To understand the impact of abandoned property laws, it is important to first acknowledge the wide range of prepaid card products currently available in the marketplace.

- There are “closed-loop” or “retailer” gift cards - those useable solely to purchase goods or services from a single retailer or retail chain (i.e., a “Best Buy” gift card or a “Home Depot” gift card.)

- Then there are “open-loop” network branded prepaid cards, issued by a bank or financial institution, containing the brand of a payment network (American Express, Discover, MasterCard or Visa).

- Some network branded prepaid cards are gift cards usable at multiple unaffiliated retailers but not usable to obtain cash; other network branded prepaid cards are

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1 *See* Attitudes and Purchasing Behaviors of Recipients of Network Branded Gift Cards; A Survey of 8,000 Gift Card Recipients, May 2008 (“NBPCA Survey”).

2 For example, according to the NBPCA Survey, 77% of network branded prepaid cardholders, and 73.5% of store cardholders, depleted the original value of the card within seven weeks.

reloadable and provide cash access at ATMs. Some of these are cards loaded with funds necessary to consumers' day-to-day lives (such as "payroll cards" loaded by employers with an employee's wages or salary, or cards holding child support payments, workers' compensation, or funds dedicated to healthcare benefits) ; others are "general purpose reloadable" cards that can be reloaded by the cardholder from a variety of sources.

For a description of the wide range of uses of network branded prepaid cards, visit the NBPCA Website at http://www.nbpca.com/docs/NBPCA-New-Fin-Sols-Choices.pdf.

Network branded prepaid cards cover a vast array of possible uses including cards issued by governments for government benefits, teen cards, travel cards, reward and incentive cards, corporate expense management cards and insurance claim cards. Part of the problem facing the prepaid card industry is the realization that "one size doesn't fit all" when it comes to these varied and singular products. That is why some existing legal frameworks, including those that govern abandoned or unclaimed property, may not fit many prepaid cads.

I. BACKGROUND

This section provides an overview of the evolution of escheat law including creation of the Uniform Acts to address continuity for multi-state commerce and the U.S. Supreme Court's priority rulings. The purpose of this section is to establish the basis for understanding today's complex escheat environment and the challenges of applying escheat law to gift cards and other card-based prepaid products.

A. How We Got Where We Are Today: A Brief History of Escheat Law

Abandoned property laws date back to the Roman Empire. But most sources cite England's feudal system as the root of contemporary unclaimed property law. Under English common law, escheat was based on the right of the "Sovereign" to certain tangible property. That is, if a person died without heirs, his property ultimately devolved, or *escheated*, back to the Sovereign.

In the United States, the concepts underlying England's escheat law helped shape the framework of early state statutes dealing with unclaimed property. Originally, state statutes applied exclusively to real property. As the U.S. economy grew during the 19th and 20th centuries, however, many states expanded their statutes to include tangible personal property (such as the contents of a safe deposit box), as well as intangible personal property (such as funds underlying uncashed checks in a checking account). Concurrently, businesses expanded the geographic regions in which they operated, giving rise to multiple conflicting state claims attached to the same intangible property.[3]

To understand the issues that arise out of abandoned property laws, it is important to keep in mind the three parties involved: the consumer or business who is the "owner" of the property, the financial institutions or business who is the "holder" of the property, and the state to which funds may be escheated. In the gift card context for example, the "holder" is the retailer or the bank that issues the card and the gift card recipient or purchaser is the "owner".

1954: NCCUSL addresses coordination needed for multi-state commerce

In response to these conflicts, the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 1954 proposed its first uniform act (Uniform

3 Michael Houghton *et al.*, *Unclaimed Property*, 74-2nd C.P.S. (BNA).

Act) for creating more interstate coordination in the law for individuals conducting business in multiple states. The commissioners wanted to establish general guidelines for states charged with serving as custodians of abandoned funds and to meet the following objectives:

- **Convenience.** Establish one place for an owner to search for funds;
- **Protection.** Safeguard the owner's property until collected;
- **Accessibility.** Provide a mechanism for reuniting an owner with his/her property;
- **Public use of funds.** Enable citizens of the state to benefit from the unclaimed funds (vs. the holder) until such amounts are reunited with the rightful owner;[4] and
- **Fairness.** Prevent an unjust windfall to the holders of the property.

To date, there have been four versions of the Uniform Act approved by the NCCUSL. With few exceptions, all states have adopted a version or modified version.[5] Each version is custodial in nature, meaning it does not result in the loss of the owner's rights but provides for transfer of custody of property that is presumed to be abandoned or unclaimed from the holder to the state, to hold until and unless such property is claimed by the owner.[6]

B. The Evolution of the Uniform Acts

The Uniform Act has evolved over time to reflect new needs, technologies and ways of thinking about abandoned property. The following descriptions of the four acts include notable issues arising from them, leading to a subsequent Uniform Act:

- ***Uniform Disposition of Unclaimed Property Act (1954).*** The Uniform Disposition of Unclaimed Property Act was approved by the NCCUSL in 1954 (1954 Act), although it was withdrawn from recommendation for enactment in 1984 when it was superseded.[7] Both California[8] and Connecticut continue to use the 1954 Act, albeit in a substantially modified version.[9]

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4 *Id.*

5 The states that have not adopted some version of one of the Acts are as follows: Delaware, Kentucky, Massachusetts, New York, Ohio, and Texas. *See* David J. Epstein *et al.*, Unclaimed Property Law and Reporting Forms (2004).

6 Houghton, *supra*, note 1.

7 8A Uniform Laws Annotated 231 (2003).

8 In *Douglas Aircraft Co. v. Cranston*, California Justice Traynor opined that "[t]he objectives of the act are to protect unknown owners by locating them and restoring their property to them and to give the state rather than the holders of unclaimed property the benefit of the use of it, most of which experience shows will never be claimed." *Douglas Aircraft Co. v. Cranston*, 374 P.2d 819, 821 (Cal. 1962). Anthony L. Andreoli and J. Brooke Spotswood summed up the act by stating: (1) it was custodial in nature…; (2) it was comprehensive in scope…; (3) it was theoretically a consumer protection law…; and (4) it was a revenue measure for the enacting states." Anthony L. Andreoli and J. Brooke Spotswood, Guide to Unclaimed Property and Escheat Laws, § 3.03 (2nd Ed. 1998).

9 Epstein, *supra*, note 3.

The 1966 Act addresses specific concerns regarding money orders and traveler's checks…

- ***Uniform Disposition of Unclaimed Property Act (1966).*** In 1966, the NCCUSL approved a revised version of the 1954 Act (1966 Act).[10] The 1966 Act was drafted primarily to deal with specific problems concerning money orders and traveler's checks that had arisen under the 1954 Act. The NCCUSL restated the motivating forces behind the earlier 1954 Act: "to protect the interests of owners, to relieve the holders from annoyance, expense and liability, to preclude multiple liability, and to give the adopting state the use of some considerable sums of money that otherwise would, in effect, become a windfall to the holders thereof.[11] Illinois, Nebraska and Pennsylvania continue to use the 1966 Act, and both Mississippi and Missouri use the 1966 Act,[12] albeit with substantial modifications including provisions from the 1981 Uniform Unclaimed Property Act.).[13]

- ***Uniform Unclaimed Property Act (1981).*** Under the 1954 Act and the 1966 Act, states could claim abandoned property by asserting personal jurisdiction over the holder.[14] The problem, however, continued to be that several states asserted competing claims.[15] As a result, the NCCUSL approved a revised version of the Uniform Disposition of Unclaimed Property Act in 1981(1981 Act), which has since been adopted by 23 states and the District of Columbia.[16]

The 1981 Act specifically adds "gift certificates" to the definition of intangible property…

To resolve the potential for conflict among jurisdictions, the 1981 Act contained a reciprocity clause that allowed another state to claim abandoned property if the last known address of the claimant was in that state and if other states with contacts would forego their claims. The success of this clause depended on uniform enactment by competing states. Such agreement was not forthcoming, and the assertion of competing claims by states continued.[17]

Most importantly for our purposes, the 1981 Act for the first time added provisions for the specific inclusion of "gift certificates" in the definition of

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[10] The 1966 Act, like the 1954 Act, has been withdrawn from recommendation for enactment since it was superseded by later version of the Act. 8a Uniform Laws Annotatedat 229.

[11] Uniform Unclaimed Property Act (1966), Commissioners' Prefatory Note.

[12] Epstein, *supra*, note 3.

[13] Uniform Unclaimed Property Act (1981).

[14] Houghton, *supra*, note 1.

[15] The Prefatory Note to the 1981 Act discusses the problem: The 1954 and 1966 Acts basically tied the enacting state's claim to abandoned property to the ability of that state's courts to assert personal jurisdiction over the holder. The basic jurisdictional test . . . for a presumption of abandonment bears a direct relationship to events taking place within the state. The thrust of this "contacts" test generally is to allow any state with jurisdiction over the holder, i.e., the debtor, to take unclaimed property.

[16] Houghton *supra*, note 1. Those states that have adopted the 1981 Act include: Alaska, Colorado, Florida, Georgia, Idaho, Iowa, Maryland, Michigan, Minnesota, New Hampshire, New Jersey, North Dakota, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Virginia, Washington, Wisconsin, and Wyoming.

[17] 1981 Act, Commissioners' Prefatory Note.

"intangible property."[18] Before such time, merchants had historically been permitted to retain the breakage, which helped to cover the cost of doing business.

- ***Uniform Unclaimed Property Act (1995).*** In 1993, the Supreme Court addressed competing jurisdictional claims regarding unclaimed property in *Delaware v. New York*.[19] Although the Court made no change to the rules of priority (*see* Section C below), it clarified that the identity of the "holder" (i.e., the intermediary holding the property in its own name) is made by reference to the state law that creates the property interest, not the original obligor, which has satisfied its obligation by transmitting payment to the intermediary.[20] The Supreme Court also explained that no State may supersede the Court's priority rules by seeking to establish different priorities under state law.[21]

The 1995 Act expands the concept of "property" to cover almost any general ledger item—including prepaid cards…

Two years later, in light of the Supreme Court's ruling, the NCCUSL revised the Uniform Act again; this time significantly departing from earlier versions in terms of organization and effect (1995 Act).[22] One noteworthy change involved the definition of "property," which covers tangible property and a multitude of various types of intangible property subject to the Act.[23] Due to the drafter's broad sweep of the definition of "property" in the 1995 Act (as well as the catch-all provisions contained in the earlier versions of the Uniform Act), the states and their auditors have been allowed to characterize almost any general ledger item as property subject to escheat including prepaid cards. To date, 14 states have adopted the 1995 Uniform Act.[24]

C. U.S. Supreme Court Establishes Priority Rules

As the Uniform Act and state escheat statutes continued to evolve, conflicts arose regarding which state could assert jurisdiction over unclaimed property. In several notable decisions — *Texas v. New Jersey (1965)*,[25] *Pennsylvania v. New*

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[18] 1981 Act.

[19] *Delaware v. New York*, 507 U.S. 490 (1993).

[20] 1995 Act, Commissioners' Prefatory Note.

[21] 507 U.S. 490.

[22] Houghton,*supra*, note 1.

[23] 1995 Act, § 3. Specifically, intangible property is defined to include, but not limited to: (i) money, a check, draft, deposit, interest, or dividend; (ii) credit balance, customer's overpayment, gift certificate, security deposit, refund, credit memorandum, unpaid wage, unused ticket, mineral proceeds, or unidentified remittance; (iii) stock or other evidence of ownership of an interest in an business association or financial organization; (iv) a bond, debenture, note, or other evidence of indebtedness; (v) an amount due and payable under the terms of an annuity or insurance policy, including policies providing life insurance, property and casualty insurance, workers' compensation insurance, or health and disability insurance; and/or (vi) an amount distributable from a trust or custodial fund established under a plan to provide health, welfare, pension, vacation, severance, retirement, death, stock purchase, profit sharing, employee savings, supplemental unemployment insurance, or similar benefits. 1995 Act, § 1 (13).

[24] Those states that have adopted the 1995 Act include: Alabama, Arizona, Arkansas, Hawaii, Indiana, Kansas, Louisiana, Maine, Montana, Nevada, New Mexico, North Carolina, Vermont, West Virginia and the U.S. Virgin Islands. See the NCCUSL website at http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-uupa.asp.

[25] 379 U.S. 674 (1965).

York (1972)[26] and *Delaware v. New York(1993)*[27] — the United States Supreme Court, asserting original jurisdiction under Article 3, Section 2 of the Constitution, created priority rules governing the relative rights of the various states to take custody of unclaimed intangible personal property.[28]

The key premise underlying these cases is that the due process clause of the 14th Amendment prevents more than one state from claiming the same item of abandoned property. Priority is first given to the state of the last known address of the owner of the property as shown on the holder's books and records (First Priority Rule). If no last known address can be determined or if the owner's last know address is within the borders of a state whose laws do not provide for escheat of the property, then the property can be taken into the custody of the state of the holder's domicile, e.g., the state of incorporation (Second Priority Rule).[29]

These rules of priority have been incorporated into the Uniform Act and subsequently codified into each state's unclaimed property statutes. As a result, questions on how unused funds on a prepaid card must be dealt with depend on a complex analysis involving how the property is categorized under the state law, whether the cardholder's address is known and in which state the card issuer holding the funds is domiciled.

D. Gift Products First Covered in 1981

Following the explicit coverage of gift certificates in the 1981 Act, as described above, states began adding gift products, such as gift certificates, to their Uniform Acts. Previously, gift products not redeemable in monetary value generally were not considered escheatable property.

To appreciate the anomaly created by the inclusion of gift products under state abandoned property laws, it is helpful to review the history of these statutes in the United States and to understand the Derivative Rights Doctrine that underpins these laws.[30]

The original Uniform Unclaimed Property Acts of 1954 and 1966 expressly referenced only the following items of property: bank accounts, life insurance policies, utility deposits, unclaimed dividends and distributions, property held by companies in dissolutions, property held by fiduciaries and "miscellaneous intangible property," a term that was not defined. [31]

The definition of intangible property added in the 1981 Uniform Unclaimed Property Act broadened dramatically the property subject to escheat by including

[26] 407 U.S. 206 (1972).

[27] 507 U.S. 490 (1993).

[28] 1995 Act.

[29] *Id*.

[30] *See generally*, Judith Rinearson and Margo Strahlberg, Getting Your Just Rewards: A Proposal for the Treatment of Reward Cards Under State Abandoned Property Laws, 3 Journal of Payment System Laws 123 (Nov/Dec 2007). .

[31] *Id.* Significantly, neither the 1954 nor the 1966 version of the Act contained a definition of "intangible property." It was not until the 1981 Act that the term "intangible property" was first defined. The Comment to the 1981 Act asserts that the definition was "not intended as a substantive addition to the coverage of Section 9 of the prior Acts. Included as intangible property are a variety of items which are often overlooked by holders, all of which were included within the 1966 Act and are within the coverage of this Act."

"gift certificates" in miscellaneous intangible property subject to escheat and directing that the amount deemed abandoned was the "price paid."[32] This broad expansion meant that a merchant was required to pay the state for unredeemed gift certificates in *cash*, even though the merchant only was obligated to provide *goods or services* to the purchaser.

This extraordinary extension of state abandoned property laws violated the Derivative Rights Doctrine, the underpinning of all custodial unclaimed property statutes.[33] The expansion particularly affected merchants, which were deprived of the benefits of non-redemption and profits from the underlying sale. At least one court held that these laws constituted an unconstitutional taking of property from a merchant without due process.[34]

As a result, many states have refused to extend their abandoned property laws to gift certificates, gift cards or other similar products redeemable solely for goods and services, while others have repealed their laws to the extent they apply to such products. For example, Arizona law notes:

> 'Property' does not include…property that is referred to or evidenced by gift certificates, electronic gift cards, nonrefundable tickets, certificates evidencing property denominated in value other than a currency, including prepaid phone cards, frequent flyer miles, stored value cards and merchandise points.[35]

II. THE CURRENT STATE OF ESCHEAT LAW

This section categorizes the three ways states have chosen to apply escheat laws to prepaid products. Its purpose is to highlight the tremendous variation among the states' approaches.

There is little consistency among state escheat laws with respect to prepaid cards, causing confusion in the marketplace, and resulting in higher administrative costs and ultimately higher costs for consumers. While some states exempt prepaid cards, others follow one of the versions of the Uniform Act or modified versions of the Uniform Act. Furthermore, a handful of states have taken a different approach, adopting laws with idiosyncratic provisions that provide for unique treatment of prepaid cards.

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32 *Id* . *See* the 1981 Act, § 14. The Comment to this Section cited as support for its position the case of *People v. Marshall Field & Co*., 83 Ill. App. 3d 811. 404 NE 2d 368 (1980), a decision which, interestingly enough, never even discussed the seminal question of whether a merchandise-only gift certificate could be subject to escheat for "price paid" under the derivative rights doctrine.

33 *Id*. Under the Derivative Rights Doctrine, if the owner of the gift certificate has no right to receive cash, then neither does a state, since the state is literally stepping into the owner's shoes. The state could require that the gift certificates themselves be delivered to the state, and the state could redeem such certificates for goods/services. But under the Derivative Rights Doctrine, the state could not require the issuer to pay the state in cash if the certificate owner had no rights to receive cash. For a further description of abandoned property laws and the Derivative Rights Doctrine, *see* "Unclaimed Property Compliance for Financial Service Companies," Deloitte Financial Foresight (June 2007) *available at* http://www.deloitte.com/dtt/cda/doc/content/us_fsi_UnclaimedPropertyForesight_June07.pdf.

34 *See Service Merchandise Co. v. Tennessee*, Ch. Ct, Davison County (6/29/2001).

35 Arizona Uniform Unclaimed Property Act (§ 44-301 *et seq.*). Other state statutes that do not to require escheat for gift certificates, gift cards, and other similar products redeemable in goods or services include: Alabama, Michigan, Minnesota, and Virginia.

The variety of prepaid cards in the marketplace complicates the problem of applying existing escheat laws and principles. For example, most states cover escheatment of "gift certificates," but many states do not define the term. A few laws define "gift certificate" to include electronic cards, but only a minority of states identify specific types of prepaid cards such as payroll cards or network branded prepaid cards. Other types of prepaid cards — such as rewards cards, travel cards and teen cards — are simply lumped into the "gift card" or "gift certificate" category without regard to their specific make-up, purpose or functionality.

As a result, the treatment of prepaid products by the escheat laws of the 50 states is muddled, forcing attorneys and their clients to rely on a risk analysis due to the lack of clarity.

A. State Escheat Laws by Category

To fully understand the state of the law today and the underlying problems embedded in such law, a more detailed breakdown is necessary. State escheat law for prepaid cards may be classified into one of three categories:

- **States that exempt prepaid products.** States that exempt prepaid cards from their abandoned property laws do so either by an explicit exemption (typically applicable to "gift certificates," "gift cards" or some other term encompassing stored value) or by silence on the matter. States that exempt gift certificates and/or prepaid cards explicitly include Arizona,[36] Connecticut[37], Indiana,[38] Maryland,[39] Massachusetts[40] and Rhode Island.[41]

States that did *not* incorporate the 1981 Uniform Act definition of intangible property, as well as those states that *did* incorporate the Act's definition but later repealed the extension to gift certificates, have long been considered to be "pro-retailer states," intentionally protecting retailers from abandoned property claims. States with abandoned property laws that are silent with respect to any type of prepaid product or have repealed provisions regarding gift certificates from their escheat law include Kansas, Kentucky, New Jersey[42], North Dakota, Oklahoma, Oregon, South Carolina, Vermont and Wisconsin.

Regardless of terminology used (or not used, in the case of the laws that remain silent), based on the application of well-established principles of abandoned

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36 Arizona's escheat law specifically exempts stored value cards, thereby excluding network branded prepaid cards. *See* § 44-301(15).

37 Stored value cards are considered excepted property under Connecticut's escheat law. *See* § 3-73a.

38 Indiana's abandoned property law exempts gift certificates and gift cards. Neither term is defined, but it is generally accepted that network branded prepaid cards would be exempted as well. *See* § 32-24-1-1(f).

39 Maryland's Uniform Disposition of Unclaimed Property Act exempts gift certificates. The term "gift certificate" is not defined, however it is generally accepted that network branded prepaid cards are covered by this exemption. *See* § 17-101(m).

40 Under Massachusetts' law, "gift certificates" are not subject to escheat. However, gift certificates that have an expiration date of less than seven years are subject to a fine. The definition of "gift certificate" excludes network branded prepaid cards. *See* Ch. 200A, § 5D. *See also* Ch. 255D, § 1 and Ch. 266, § 75F.

41 *See* § 33-21.1-14.

42 Despite the law's silence on the matter, a New Jersey state court found that gift certificates redeemable only for merchandise and services, and not for cash, are not subject to escheat law. *See Matter of Determination of State, Dept. of Treasury*, Unclaimed Property Office, 309 N.J. Super. 272, 706 A.2d 1177(A.D. 1998).

property law, it appears that all of the states listed above exempt network branded prepaid cards from their escheat laws.

In addition to states that exempt prepaid cards in general, additional other states permit a partial exclusion by exempting certain types of prepaid products from being subject to escheat. For example, Alabama,[43] Arkansas,[44] Michigan[45] and Minnesota[46] exempt retail gift certificates and gift cards.[47] Other states exempt gift cards or gift certificates that are redeemable for goods or services (i.e., not those that allow cash access) such as Colorado[48] and Ohio.[49] Many states exempt gift cards or gift certificates that have no expiration date and/or post-sale fees.[50] Finally, some states — like Pennsylvania,[51] Montana,[52] and Nevada[53] — provide an explicit exemption for network branded prepaid cards.

- **States that follow a model Uniform Act.** The next category covers states that have adopted a version of a model Uniform Act. Many states adopted the 1981 Act, or a slightly modified version thereof, including Alaska,[54] Colorado,[55] Georgia,[56] Michigan,[57] Mississippi,[58] Missouri,[59] South Dakota,[60]

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43 *See* § 35-12-73(b).

44 *See* § 18-28-201(B).

45 Michigan's recently passed escheat law provides an exemption for gift certificates "issued for retail goods or services by a person engaged in the retail sale of goods or services." *See* § 567.235.

46 *See* § 345.39.

47 Such exemptions generally do not cover network branded prepaid cards.

48 *See* § 38-13-108.4(3). However, Colorado's Attorney General issued an opinion in 2005 stating that the state's escheat law covers all intangible property, including stored value cards.

49 Please note that Ohio's law exempts credits due to a retail customer that is represented by a gift card redeemable only for merchandise. *See* § 169.01B(2). The usage of the word "retail" does not imply that only retail cards are exempt, however, unlike the laws in Alabama, Arkansas, Michigan and Minnesota.

50 Such states include California, Hawaii, Illinois, Nebraska, Nevada, North Carolina, Pennsylvania, Tennessee, Texas and Washington. Presumably, network branded prepaid cards, which typically carry an expiration date and/or fees, would not qualify under this exemption.

51 General use prepaid cards are exempt from the presumption of abandonment. *See* § 1301.6.

52 Under Montana's Uniform Disposition of Unclaimed Property Act, gift certificates are subject to escheat. However, since the definition of "gift certificate" explicitly exempts a gift certificate usable with multiple sellers of goods or services, network branded prepaid cards are exempt from escheat. *See* § 70-9-83 and § 30-14-102(5).

53 Network branded prepaid cards are exempt from escheat so long as the expiration date is printed plainly and conspicuously on the front or back of the card. *See* § 120A.520. *See also* § 598.0921(3)(a).

54 Alaska's law requires the escheatment of "gift certificates" three years after becoming payable or distributable. The definition of "gift certificate" specifically includes stored value cards, and therefore, network branded prepaid cards are subject to escheat. *See* § 34.45 240 and § 34.45.760.

55 Gift certificates are presumed abandoned five years after becoming payable or distributable. The law exempts gift certificates issued for food, products, goods or services, however, *see supra*, note 36.

56 Gift certificates that remain unclaimed for more than five years after becoming payable or distributable are presumed abandoned. The term "gift certificate" is not defined. *See* § 44-12-205.

57 Gift certificates and gift cards are presumed abandoned five years after becoming payable or distributable. Michigan's escheat law was recently amended to provide that a gift certificate/gift card is also presumed abandoned five years after the date of the last transaction. Despite the recent revisions to the law, the term "gift certificate" is still not defined. *See* § 567.235.

and Virginia,[61] as well as the District of Columbia.[62] The 1981 Act provides that “gift certificates” are presumed abandoned a certain number of years after becoming payable or distributable, and the amount presumed abandoned is the price paid by the purchaser.

States that adopted the 1995 Act, or a slightly modified version thereof, include Alabama,[63] Louisiana,[64] Maine,[65] New Mexico,[66] New York[67] and West Virginia.[68] The 1995 Act provides that “gift certificates” escheat a set number of years after a particular date (typically December 31) of the year in which they were sold, and the amount presumed abandoned is a certain percentage of the face value (typically 60 percent).

Neither the 1981 Act nor the 1995 Act defines “gift certificate.” Some state laws, however, include a definition that appears broad enough to encompass network branded prepaid cards. Other states have definitions of “gift card” or “gift certificate” in a different section of that state’s laws – for example, under state consumer protections laws.

- **States that take a unique approach towards prepaid.** The final category includes states that neither exempt prepaid cards nor follow a Uniform Act. This includes Florida, which has a law that does not require “gift certificates” (defined to explicitly include prepaid cards) to be reported as unclaimed

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[58] Intangible personal property (which includes gift certificates) are subject to escheat five years after becoming payable or distributable. *See* § 89-12-13.

[59] Missouri’s abandoned property law requires the escheatment of gift certificates five years after becoming payable or distributable. *See* § 447.535.

[60] A gift certificate is presumed abandoned five years after becoming payable or distributable. *See* § 43-41B-15.

[61] Gift certificates are presumed abandoned five years after becoming payable or distributable. “Gift certificate” is defined broadly enough to include network branded prepaid cards. *See* § 55-210.

[62] § 41-114 sets forth that gift certificates are presumed abandoned five years after becoming payable or distributable. “Gift certificate” is not defined.

[63] Gift certificates are presumed abandoned three years after June 30 of the year in which the certificate was sold. *But see* § 35-12-73(b) for exemptions.

[64] Gift certificates are subject to escheat three years after December 31st of the year in which the certificate was sold. *See* § 9-154.

[65] Maine’s law presumes stored value cards are abandoned two years after December 31st of the year in which the obligation occurred or the most recent transaction, whichever is later. However, prefunded bank cards, i.e., network branded prepaid cards, escheat three years after December 31st of the year in which the obligation occurred or the most recent activity, whichever is later. *See* 33 MRSA § 1953(G).

[66] Gift certificates are presumed abandoned five years after December 31 of the year in which the certificate was sold. *See* § 7-8A-2.

[67] New York takes a slightly different approach by presuming gift certificates are abandoned five years from the date of issuance, rather than the year sold. (Although New York’s law does not explicitly use the term “issuance,” the New York State Office of the State Comptroller has advised that gift certificates escheat five years from the issuance date.) Please note that New York law defines “gift certificate” broadly to include single store and general-use electronic cards, however payroll cards are explicitly exempt. *See* § 1315. *See also* § 396-i(1).

[68] § 26-9-2 provides that gift certificates are presumed abandoned three years after the 31st day of December of the year in which the certificate was sold.

property.[69] Despite this provision, however, the law explicitly provides that network branded prepaid cards are subject to escheat.[70]

Another approach used by some states considers the expiration date. The laws in Tennessee, Texas and Delaware provide that gift certificates are presumed abandoned upon the earlier of the expiration date or another predetermined date such as a set number of years after the date of issuance.[71] Washington's law provides that gift certificates subject to the prohibition against expiration dates are exempt from escheat.[72] Hawaii and North Carolina laws exempt gift certificates that have no expiration date.[73] Idaho's Unclaimed Property Law states that gift certificates with an expiration date do not constitute abandoned property.[74]

Another unique approach involves states that set a monetary threshold for when the escheat law applies. Wyoming, for example, applies a threshold for gift certificates valued greater than $100,[75] and Utah requires escheatment of gift certificates greater than $25.[76]

B. Escheat and Network Branded Prepaid Cards

Regardless of which of the above categories a state's escheat law fits, the vast majority of states' abandoned property laws do not reflect the variety of prepaid products in the marketplace. Most state escheat law does not mention "stored value" or prepaid card; referring to the generic term "gift certificate." Even among states that have recently revised their abandoned property laws, many such laws apply to electronic gift cards, which (by industry standards) do not include other types of network branded prepaid cards.

Further difficulties arise under the laws that define "gift card" broadly enough to encompass network branded prepaid cards. In such cases, it is unclear whether the broadly defined term includes other types of prepaid cards such as payroll cards, travel cards, etc. For example, it is unclear whether payroll cards should be treated as gift cards or unpaid wages (which are almost always separately covered by a state's escheat law), or whether travel cards are meant to be

69 *See* § 717.1045.

70 Presumably this provision was included in Florida's unclaimed property law as a trade-off for the fact that network branded prepaid cards are exempt from Florida's consumer protection law that prohibits expiration dates and fees. *See* § 717.1045(4).

71 *See* Tennessee's Uniform Disposition of Unclaimed Property Act (§ 66-29-135(a)) and Texas's law regarding the Abandonment of Personal Property (§ 72.1016(b)). Delaware's Abandoned or Unclaimed Property Law requires the escheatment of gift certificates after the earlier of (a) five years or (b) the expiration period, if any, less one day.

72 *See* §§ 63.29.020 and 63.29.140.

73 Hawaii's current law was recently passed to replace the 1981 version of the Act with the 1995 version. The new law states that gift certificates are presumed abandoned five years after December 31 of the year in which they were sold. Hawaii's law also exempts gift certificates without any post-sale charges or fees, and "gift certificate" is defined to include network branded prepaid cards. *See* § 523A 14, North Carolina presumes electronic gift cards with an expiration date are abandoned 3 years from the date of sale. *See* § 116B-54.

74 Gift certificates without an expiration date are presumed abandoned five years after becoming payable or distributable. *See* §§ 14-502 and 14-514.

75 Wyoming's abandoned property law presumes gift certificates escheat three years after issuance. *See* § 34-24-144. The law does not define the term "gift certificate."

76 *See* § 67-4a-211.

treated as gift cards or traveler's checks (which, in most cases, are subject to a longer dormancy period). In determining how such specific prepaid products are treated under the law, the question becomes whether it is the *function* or the *form* of the prepaid product that controls.

III. CHALLENGES OF APPLYING ESCHEAT LAWS TO PREPAID PRODUCTS

This section highlights issues related to determining whether state escheat law applies to specific prepaid products and, if so, how the law is applied. Its purpose is to illustrate that the intersection of prepaid card products and existing state abandoned property laws often raise more questions than answers.

A. Escheat Laws Do Not Contemplate Today's Prepaid Products

Escheat is a challenging area of the law, regardless of the type of property involved. But it is particularly challenging when applied to prepaid cards, a relatively new innovation with hundreds of permutations and unique ownership and jurisdiction issues. Furthermore, prepaid is, perhaps, a poster child for the difficulties of applying existing laws to products or situations that were hardly imaginable when the laws were written.

These are key areas of difficulty:

- **Prepaid-specific language is lacking.** The majority of state legislatures have amended their general business or consumer protection laws to place requirements and/or restrictions on disclosures, fees and expiration dates related to prepaid cards. State legislatures, however, have not been as quick to amend their unclaimed property laws[77] to clearly address prepaid cards.

The majority of abandoned property laws have not been amended since the initial creation of prepaid cards and even fewer have been amended since the substantial growth in the variety of types of prepaid cards. Most existing escheat laws, therefore, do not contemplate prepaid cards. This legislative failing causes confusion and uncertainty for prepaid card issuers or holders of prepaid card funds, because it is difficult to "shoehorn" prepaid cards into existing unclaimed property laws so as to clearly determine which escheat obligations are applicable to prepaid cards. As a result, compliance with state laws can be difficult, and the costs of compliance and compliance risks are increased.

> **Tip:** When determining applicable escheat obligations, one must consider (in general):
>
> - The purpose of the card;
> - The type of personal property held;
> - The presumed period of abandonment for such property (i.e., the time period after which a holder of a certain type of personal property must escheat that property to a state if it has not been claimed by its owner); and
> - The amount presumed abandoned. Each of these considerations vary from state to state and are generally unclear in their application to prepaid cards.

Definition of property. The 1995 Act does not include the term "prepaid card" or any related terms (e.g., "stored value," "gift card," "reloadable card," etc.). Its definition of "property," however, includes certain enumerated items that are arguably similar to prepaid cards. Specifically, under the 1995 Act, "intangible property" includes:

[77] Notable exceptions include Florida, Montana, Texas and Washington, where the definitions from consumer protection provisions have been incorporated into the unclaimed property laws. *See*, *e.g.*, Fla. Stat. § 717.1045, Mont. Code § 70-9-802 (2007), Tex. Prop. Code § 72.1016 and Rev. Code Wash. (ARCW) § 63.29.010 (2008).

> certain interest in intangible property that is held, issued, or owed in the course of a holder's business … and all income or increments there from…property that is referred to as or evidenced by…(i) money, a check, draft, deposit, interest or dividend; (ii) credit balance, customer's overpayment, gift certificate, security deposit, refund, credit memorandum, unpaid wage, unused ticket, mineral proceeds, or unidentified remittance…[78]

There are reasonable arguments for categorizing various types of prepaid cards under one of the enumerated categories of property as well as under the Act's catchall provision. For example, since the funds underlying many prepaid cards are often held in an account at a bank, prepaid cards could arguably be categorized as money or as a deposit, especially given the FDIC's recently issued Opinion on FDIC insurance for funds underlying prepaid cards.[79] Alternatively, when a consumer receives a prepaid card, such as a gift card in connection with a retail transaction, the prepaid card could be considered a credit balance, refund or gift certificate.

- **Presumption of abandonment period.** The Uniform Act does not prescribe a presumption of abandonment period that is clearly applicable to prepaid cards. For instance, the Uniform Act establishes different presumptions of abandonment for the following categories:

> (i) traveler's checks; (ii) money orders; (iii) stock or other equity interests; (iv) debt of a business or financial organization; (v) demand, savings and time deposits; (vi) money or credits owed to a customer as a result of a retail business transaction; (vii) gift certificates; (viii) amounts owed by an insurer on a life or endowment insurance policy or annuity; (ix) property distributable by a business association or financial organization in a course of dissolution; (x) property received by a court as proceeds of a class action, and not distributable pursuant the judgment; (xi) property held by a court, government, governmental subdivision, agency, or instrumentality; (xii) wages or other compensation for personal services; (xiii) deposit or refund owed to a subscriber by a utility; (xiv) property in an individual retirement account, defined benefit plan or other account or plan that is qualified for tax deferral under U.S. income tax laws; and (xv) all other property.[80]

Clauses vi and vii, arguably, could apply to prepaid cards. Or, prepaid cards could be subject to the Act's catchall provision set forth in clause xv. It also is arguable, for example, that the three-year presumed abandonment period applicable to "money or credits owed to a customer as a result of a retail transaction" could be applicable to prepaid cards since a number of prepaid cards are purchased/loaded in connection with a retail transaction.[81] In its Comments, however, the NCCUSL notes that credits owed on consumer transactions included transactions such as return of merchandise, cancellation of

[78] 1995 Act, § 1.

[79] *See* New General Counsel's Opinion No. 8, Stored Value Cards and Other Nontraditional Access Mechanisms, FIL-129-2008 (November 13, 2008), *available at:* http://www.fdic.gov/news/news/financial/2008/fil08129.html.

[80] *See* 1995 Act, § 2.

[81] Abandonment would be presumed three years after the prepaid card obligation accrued.

layaways and various kinds of deposits.[82] Clearly, funds refunded by a merchant to a consumer via a prepaid card issued by the merchant fit into this category, but it is not clear for other types of prepaid cards such as a network branded (i.e., bank-issued) prepaid card purchased at a merchant location.

It also could be argued that the three-year presumed abandonment period for gift certificates should apply to gift cards.[83] After all, despite the many differences cited above, it can be argued that gift cards are analogous to gift certificates in purpose and use, and are often thought of as electronic gift certificates. However, this presumed abandonment period would not be applicable to all prepaid cards: network branded general purpose reloadable prepaid cards, for example, have many uses beyond gift giving purposes.

Alternatively, the Act's period of abandonment catchall provision could apply to prepaid cards for which no abandonment period has been prescribed under the statute. The Act establishes a presumption of abandonment period for five years for property not specifically addressed in the statute.[84] Should holders simply conclude that prepaid cards are not adequately addressed under the Act and, therefore, all funds underlying prepaid cards should be attributed to the "all other property" category? Or, if a state legislature has not addressed prepaid cards, should holders assume the property is not subject to abandoned property laws at all?

- **Amount presumed abandoned.** The Act expressly permits dormancy charges if there is a "valid and enforceable written contract" imposing the charge, the holder regularly imposes the charge and the amount is not unconscionable.[85] Thus, a prepaid card issuer that complies with the statute's requirements may charge a dormancy fee.[86] On the other hand, the Act mandates that, in connection with a gift certificate, the amount presumed abandoned is 60 percent of the face value of the "gift certificate.[87] Therefore, the cumulative dormancy fees assessed against a gift certificate cannot amount to more than 40 percent of its face value. The interplay between these separate provisions under the Act complicates compliance by a prepaid card issuer. The fact that the statute fails to contemplate the nuances of gift cards further complicates the issue. For example, although the Act permits the holder to keep 40 percent of the outstanding value of a gift certificate, the provision fails to account for gift cards whose value can be incrementally decreased. It could be argued that the "face amount" of the gift card is the amount available to the consumer after the last transaction conducted by the consumer with the card. However, it is not clear whether state authorities would agree with such position.

Given these areas of uncertainty and absent clear statutory or regulatory guidance, holders are operating in shades of gray with the potential for serious regulatory consequences. The need for the unclaimed property statutes, as they

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82 *See* 1995 Act, comment to § 2.

83 Under the 1995 Act, abandonment would be presumed three years after December 31 of the year in which the prepaid card was sold.

84 Abandonment would be presumed five years after the owner's right to demand the property or after the obligation to pay or distribute the property arises, which ever first occurs.

85 1995 Act, § 5.

86 However, prepaid card issuers must still comply with state consumer protection laws, which may restrict or prohibit such fees.

87 1995 Act, § 2.

exist today, to be updated to address a prepaid card issuer's compliance obligations is obvious.

B. Laws that Do Not Distinguish Between "Open Loop" Cash-Accessible Network Branded Prepaid Cards, and "Open Loop" Network Branded Cards Usable Solely for Goods and Services, and "Closed Loop" retailer-issued cards.

While there are various types of prepaid cards in the market today, state unclaimed property laws should, at a minimum, recognize the distinction between general purpose prepaid cards with cash access (cash-accessible network branded cards) and prepaid cards useable solely for goods and services (closed-loop cards). The features of these two products, and related consumer expectations, differ significantly. Further, under the Derivative Rights Doctrine, a state's right to obtain property would differ dramatically depending upon whether the owner has the right to obtain cash, as opposed to only goods and services. Accordingly, cash accessible network branded cards and closed-loop cards should be treated differently under state unclaimed property laws.

Another impact resulting from these two different products is how to establish the abandonment period. End users of cash accessible network branded cards typically use the cards in place of cash for purchases at unrelated merchants over a long period of time.[88] Consequently, a longer presumption of abandonment period would be appropriate for these cards. Further, such cards should not be subject to presumed abandonment amount applicable to gift certificates, as issuers of these types of cards may have to recoup long-term administrative fees.

On the other hand, closed-loop cards often are purchased by someone other than the end user of the card, are typically used for a limited number of transactions (at either one merchant or several merchants) and do not permit cash access. Such instruments are akin to gift certificates; therefore, it would make more sense to treat closed-loops cards as gift certificates under state unclaimed property laws.

C. Assuming that State Abandoned Property Laws Apply, Difficulty in Determining Which State and How Much to Pay

The fundamental question as to whether prepaid card funds are in fact subject to state escheat laws should be answerable by reference to state abandoned property laws themselves. But, as described above, the laws are not clear. There are arguments pro and con as to whether prepaid products are, or should be, subject to escheat. If one were to contact the state regulators and ask this question, the response would likely be "yes," because the states generally feel that they need the escheat revenue, even if the laws are not particularly clear on this issue.

The following analysis assumes that the questioner has determined that prepaid funds ARE subject to state escheat laws. Even after making such a determination, however, the way forward it not necessarily clear.

- **Which state to pay?** If you know the name and address of the property owner and the property is subject to escheat, under the first priority rule, the property escheats to the state of residence of the owner. But, most gift cards

[88] This is especially true if the cash accessible open loop card is reloadable.

are given to another person, the address of whom is not known by the issuer. If the cardholder is unidentifiable, the unused card value, if any, is escheated (under the second priority rule) to the state of incorporation or domicile of the holder of the funds.

But most network branded cards are issued by banks, and the rules for banks are less clear. When determining the locus for escheat for a bank, some have chosen to use the home state of the bank's holding company parent; others look to the principal place of business. But it can get complicated: Consider a bank chartered in Delaware with a holding company parent incorporated in Virginia, doing business in multiple states but with most of its employees in Utah. Which state receives escheated funds?

It seems many banks and their accountants seek advice from the state regulators and reach a tentative agreement to escheat in one particular state with the hope that this will deter other states from seeking the funds.

If the network branded prepaid card product is a reloadable product or meets other requirements that trigger know-your-customer (KYC) or customer-identification-program (CIP) requirements, the name and address of the cardholder is known and, therefore, presumably the holder of the funds would have sufficient data to determine the state of escheatment.

- **How does the state classify the card?** A further challenge can be determining how a card is classified for purposes of escheat. In some states, the card is likely to fall under the definition of "gift certificate" – even if it's not a gift card or gift-related product. For example, the definition of "gift certificate" under Alaska law is:

> "Gift certificate" means an obligation of a business association arising from a transaction between the business association and a consumer to provide goods or services at a future date; "gift certificate" includes a gift certificate, stored value card, gift card, online gift account, or other representation or evidence of the obligation of a business association.[89]

This broad definition appears to encompass not only gift cards but general purpose reloadable cards, payroll cards, health care cards, etc.

New York's definition of "gift certificate" also is broad and further illustrates the problem applying escheat law to prepaid cards:

> § 1. "Gift certificate" shall mean a written promise or electronic payment device that:
>
> is usable at a single merchant or an affiliated group of merchants that share the same name, mark, or logo, or is usable at multiple, unaffiliated merchants or service providers; and
>
> is issued in a specified amount; and
>
> may or may not be increased in value or reloaded; and
>
> is purchased and/or loaded on a prepaid basis for the future purchase or delivery of any goods or services; and

[89] § 34.45.110.

is honored upon presentation.

Gift certificate shall not include an electronic payment device linked to a deposit account, or prepaid telephone calling cards …. Gift certificate also shall not include flexible spending arrangements...or similar accounts from which, under the Internal Revenue Code...individuals may pay medical expenses, health care...or similar expenses on a pretax basis. Gift certificate also shall not include a prepaid discount card or program used to purchase identified goods or services at a price or percentage below the normal and customary price; provided that the expiration date of the prepaid discount card or program is clearly and conspicuously disclosed. Gift certificate also shall not include payroll cards or other electronic payment devices which are linked to a deposit account and which are given in exchange for goods or services rendered.[90]

Although the New York law excludes health care reimbursement cards, where does it stand with payroll cards or general purpose reloadable prepaid cards? The exclusion for "electronic payment devices linked to a deposit account" could, theoretically, apply to *all* network branded prepaid cards, since they are linked to a deposit account where funds are held. But, some New York regulators have advised that this exclusion is intended solely for "debit" cards linked to an individual account not a pooled account, which is how prepaid funds are typically held.[91]

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[90] General Business Law § 396-i. Acceptance of unexpired gift certificates (effective October 20, 2004).

[91] Suppose the owner of your prepaid card resides in New Mexico, one of the many states that has an abandoned property law applicable to "gift certificates" but does not define the term. In New Mexico the abandoned property law indicates that a "gift certificate" escheat after five years "after December 31 of the year in which the certificate was sold, but if redeemable in merchandise only, the amount abandoned is deemed to be sixty percent of the certificate's face value." New Mexico Uniform Property Act, § 7-8A-1. Now, while the term "gift certificate is not defined in New Mexico's abandoned property law, it is defined under New Mexico's Consumer Protection law, as follows:

A. As used in this section, "gift certificate" means a writing identified as a gift certificate that is not redeemable in cash and is usable in its face amount in lieu of cash in exchange for goods or services supplied by a seller, but does not include a gift certificate useable with multiple unaffiliated sellers or goods or services. "Gift certificate" includes an electronic card with a banked dollar value, a merchandise credit, a certificate where the issuer has received payment for the full face value for the future purchase or delivery of goods or services and any other medium that evidences the giving of consideration in exchange for the right to redeem the certificate, electronic card or other medium for goods or services of at least an equal value. "Gift certificate" does not include:

(1) gift certificates, store gift cards or general use prepaid cards distributed to a consumer for promotional, award, incentive, rebate or other similar purposes without any money or other tangible thing of value being given by the consumer in exchange for the gift certificate, store gift card or general use prepaid card;

(2) gift certificates, store gift cards or general use prepaid cards that are sold below face value or at a volume discount to employers or to nonprofit and charitable organizations for fund-raising purposes;

(3) written promises, plastic cards or other electronic devices that are: (a) used solely for telephone services; or (b) are associated with a deposit, checking, savings or similar account at a banking or other similarly regulated financial institution and that provide payments solely by debiting such account; and

- **How much to pay?** Once the issuer determines what state law controls and the category the product falls under, it may still be difficult to ascertain how much to escheat. Many states, for example, require the escheated amount to be the "face amount" of the product.

In another example, Alabama law indicates that the amount abandoned "is deemed to be 60 percent of the certificate's face value."[92] If there is no face amount on the prepaid card, does that mean there is no escheat obligation? Or, what if there is a face amount, but it has been mostly spent. Under Alabama law, one could argue that the issuer of a $100 card should escheat 60 percent or $60. But what if the card has only $5 remaining value? The law was written with a one-time-use paper gift certificate in mind and does not translate equitably to multi-use prepaid cards with a "face value" that may have no relation to the current value.

D. Difficulty Determining When Property Is Truly Abandoned

"The linchpin of modern unclaimed property legislation is the legislative presumption that an owner has abandoned or forgotten his or her claim to the property."[93] Proof that the property has been abandoned is generally based on spending and usage patterns developed over many years. There has been little or no attempt by state legislatures to determine when prepaid cards are truly "abandoned." Generally, regulators apply gift certificate rules. As noted above, usage pattern for cash accessible, network branded prepaid cards are likely to differ significantly from gift certificates or gift cards, and cards used for payroll will differ from those used for other purposes such as teen cards, travel cards and reward cards.

E. Anticompetitive and Anti-Consumer Consequences of Abandoned Property Laws

The United States is currently the world leader in the area of network branded prepaid cards. Recent efforts, however, to burden this emerging industry with

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(4) gift certificates issued by banks, savings and loan associations and their affiliates and subsidiaries, licensed money transmitters or credit unions operating pursuant to the laws of the United States or New Mexico. (§ 57-12-26)

Notably, this definition of "gift certificates" specifically excludes those cards that are issued by banks or licensed money transmitters, effectively excluding virtually all network branded prepaid cards. Can the prepaid card issuer rely on this exclusion and not escheat in New Mexico? There are some good arguments that a judge or regulator should look to other New Mexican laws when determining the meaning of a term in a different section of New Mexican law. On the other hand, the definition under New Mexico's Consumer Protection Law is limited with the introductory language "As used in this section…" The card issuer is once again placed in a no-win situation where poorly drafted laws provide no guidance. For certainty the only option is to ask the regulator for an opinion, and too often that advice is based not on what the letter of the law indicates, but on a regulators desire to collect more abandoned property funds.

A case in point: We are advised of one instance in which a bank issuer of general purpose prepaid cards was instructed by the NY Controllers' office that it should escheat abandoned funds, not under the gift certificate law at all (which category the Cards are closest to fitting), but as a "bank deposit" under an entirely separate section of NY abandoned property law. A cynic might note that perhaps what is driving that regulatory determination is not the law, but the fact that the dormancy period for bank deposits is three years, while the dormancy period for "gift certificates" is five.

[92] Alabama Uniform Disposition of Unclaimed Property Act, § 35-12-72(17).

[93] Epstein, *supra,* note 3, at §1.06[3[c].

abandoned property obligations that are not borne by their overseas competitors will certainly lead to two potential consequences:

- **Losses to foreign competition.** It is worth noting that the U.S. abandoned property laws are (except for a few Canadian provinces) unique in the global marketplace. Nowhere else do retailers lose the breakage on their gift certificates or gift cards; nowhere else do businesses forgo the benefits of uncashed checks and certificates, and pay the funds to the state as a sort of additional "tax."[94] As the industry expands to Europe, Asia and South America, the U.S. industry may face increased competition from institutions that are not subject to comparable laws.

- **Higher costs for consumers.** The other clearly obvious result from the imposition of abandoned property laws on prepaid cards is higher costs for consumers. Network branded cards are products with thin margins. Increased costs resulting from abandoned property laws result in increased fees.

F. Unique Problems Raised by Rewards and Incentive Cards

There are primarily two types of prepaid rewards or incentive cards (collectively, "rewards cards") in the market today: (i) employee rewards and incentive cards and (ii) consumer incentive cards such as loyalty rewards and consumer rebates. Rewards cards create unique challenges under state escheat laws because few state laws specifically address such cards.

As previously discussed, two primary reasons often cited for escheat laws are to (i) to protect and secure property until it can be reunited with the rightful owner and (ii) avoid an unjust windfall to the holders of the property.[95] The analysis below demonstrates that these protections are not necessary in the case of rewards cards, and, consequently, it is not appropriate to require escheatment of funds underlying rewards cards.

With respect to rewards cards, state escheat laws generally fall into the following categories:

- **Statutes that expressly exempt rewards cards.** There are a few state unclaimed property statutes that expressly exempt awards, rewards, loyalty, incentive or promotional cards, such as Texas and Virginia.[96] To take advantage of this exemption, such statutes generally require that no item of value (including money) is given in exchange for the rewards card.[97]

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[94] Moreover, unlike consumer protection laws, abandoned property laws generally do not appear to be subject to the doctrine of federal preemption. Thus all issuers, both bank and non-bank, are equally burdened by these laws. *See generally*, Epstein, *supra,* note 3, at §11.06, 11.07 and 11.08 ("Since the inspection under the abandoned property law did not interfere with the bank's business purposes, or impair its functioning, and was merely a means to enforce valid state demands, there was no conflict with federal law.").

[95] *See* Part I(A).

[96] *See* Virginia Uniform Disposition of Unclaimed Property Act, § 55-210.8:1(B); Texas Abandonment of Personal Property, §72.1016.

[97] For example, Texas' abandoned property statute references the exemption under its consumer protection law for "a stored value card that…(3) is distributed by the issuer to a person under an awards, rewards, loyalty, incentive, rebate, or promotional program and is not issued or reloaded in exchange for money tendered by the cardholder." (*emphasis*

- **Statutes that expressly exempt "gift certificates" or "gift cards."** Several state unclaimed property statutes generally exempt "gift certificates" or "electronic gift cards" from coverage.[98] In such cases, the exemption should also extend to rewards cards, considering a primary purpose of unclaimed property laws is to avoid a "windfall" to the business owner holding the property. Such windfall does not exist with respect to rewards cards; there is no reason to afford worse treatment to rewards cards where consumers have not paid for or loaded these cards with their own funds.

- **Statutes that require payment of monetary compensation.** Outside of the scope of a specific exemption, many unclaimed property statutes refer to a form of monetary consideration for property to be subject to escheat. For example, the Georgia's Disposition of Unclaimed Property Act states, in relevant part, "In the case of a gift certificate, the amount presumed abandoned is the *price paid by the purchaser* for the gift certificate."[99] Since rewards cards are not purchased, but given by businesses in connection with employee or consumer incentive or loyalty programs, it is logical to conclude that rewards cards are not subject to escheat in jurisdictions where the unclaimed property statutes refer to the payment of monetary compensation.

- **Statutes that repealed "gift certificates" or "gift cards" provisions.** Some states have repealed provisions in their unclaimed property statutes that specifically referred to escheatment of gift cards and gift certificates.[100] In such cases, it is reasonable to conclude that the state's legislature determined that gift cards, gift certificates and similar types of property should no longer be subject to escheat. Accordingly, rewards cards should also be exempt from such unclaimed property statutes.

- **Statutes that are silent.** Various state statutes are silent with respect to escheatment of gift certificates and gift cards.[101] Based on the general rule of statutory construction that an item is deemed excluded by a statute if not expressly included, it is logical to conclude that rewards cards are exempt.

- **Statutes where retail gift cards are exempt.** There are a few states that exempt gift cards or gift certificates that are issued or maintained by any person in the business of selling tangible property or services at retail.[102] However, without the express mention of coverage for other types of cards, such as network branded or rewards cards, it can be implicitly understood that such cards are not covered by such state's unclaimed property statute.

- **Statutes that include "gift certificates" but the term is not defined.** In some unclaimed property statutes, "gift certificates" are expressly subject to escheat but the term is not defined under state law. Therefore, it is unclear whether rewards cards qualify as a gift certificate under the law. In such a case, it is important to consider the Derivative Rights Doctrine, which provides unless the legislature specifically determines otherwise, the state has no greater rights than the consumer in the property that is subject to

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added). *See* Texas Abandonment of Personal Property, § 72.1016(a)(1) and Texas Business and Commerce Code § 604.002(3).

98 *See* Part III(A).

99 Georgia Disposition of Unclaimed Property Act § 44-12-205(b) (*emphasis added*).

100 *See* Part III(A).

101 *Id.*

102 For example, *see* Minnesota Uniform Disposition of Unclaimed Property Act § 345.31 *et seq.*

escheat. In the case of rewards cards with no cash access, the consumer only has the rights to purchase goods and services with the rewards cards. Therefore, such cards should not be subject to monetary escheat because the cardholder would not otherwise be entitled to receive cash.

- **Statutes where rewards cards are expressly subject to escheat.** In a handful of unclaimed property statutes, rewards cards are subject to escheat due to the broad coverage of certain key terms, such as "stored value cards" or "prefunded bank cards."[103] In these states, it is inevitable that the holder will have to escheat unclaimed property in accordance with the terms of the statute.

As one can see from the description of unclaimed property statutes above and their application to rewards cards, the argument could be easily made that rewards cards should not be subject to unclaimed property laws in most states. However, any prepaid card provider that follows this approach may be taking some risk because of the uncertainty of the application of these statutes and the fact that some state regulators take a much more expansive view of their state unclaimed property laws than others.

G. Problems Raised by the Third Priority Rule and 'Deemed Address' Provisions

As described earlier, the United States Supreme Court fashioned the first priority rule and the second priority rule to determine which jurisdiction's law applies to unclaimed property. Each state has formally codified these rules of priority established by the Court in its respective laws of unclaimed property. Some states,[104] however, have attempted to expand the rules of priority by creating a third priority: Where the owner's address is not known or the last known address is in a state which does not provide for escheat of the unclaimed property, and the holder is a domiciliary of a state that does not provide for escheat of the unclaimed property, the state where the transaction out of which the property arose has the right to the unclaimed property (<u>third priority rule</u>).[105] To permit the state to claim the unclaimed funds, a number of states have been revising their unclaimed property laws to attempt to overcome the priority rules established by the United States Supreme Court in *Texas v. New Jersey*. For example, Texas' Abandonment of Personal Property law provides:

> (c) 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*.[106]

Similarly, Nevada's Uniform Unclaimed Property Act provides:

> 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*

[103] For example, *see* Maine Uniform Unclaimed Property Act 33 MRSA § 1951 *et seq.*

[104] *See* Texas Abandonment of Personal Property Act, Title 6 § 72.1001 *et seq.*

[105] This Rule is based on an arguably flawed analysis that the Court in *Texas v. New Jersey* did not contemplate an exclusive priority scheme.

[106] Tex. Property Code Ann. § 72.1016 (*emphasis added*).

owner of the gift certificate shall be deemed to be the address of the Office of the State Treasurer in Carson City.[107]

It is unsettled as to whether or not the third priority rule is constitutional, especially in light of the fact that the Supreme Court rejected Texas's claim of jurisdiction based on the third priority rule**.**[108] Furthermore, the Court in *Delaware v. New York* also makes it clear that no state may supersede the Court's priority rules by seeking to establish different priorities under state law. Commentators believe that litigation may be necessary in order to determine if these provisions are unconstitutional under the rules set forth by the U.S. Supreme Court in *Texas v. New Jersey*.

H. Business-to-Business Exemption

There are several states that exempt amounts owed to a variety of business holders including retailers.[109] This business-to-business unclaimed property exemption arises from the theory that unclaimed property laws were established to protect consumers, not businesses that owe balances on account to other businesses. Proponents of the business-to-business exemption often argue that businesses do not generally neglect to claim payments that they are owed and any credit balances are actually the result of faulty bookkeeping.

According to many commentators, the business-to-business exemption is not very useful in practice because it generally applies only when the jurisdiction of the owner's last known address (first priority rule) and the jurisdiction of the holder's domicile (second priority rule) both exempt business-to-business transactions from the jurisdiction's unclaimed property laws. Since the business-to-business exemption has only been adopted in a handful of states and the State of Delaware has not adopted the exemption, it rarely applies in practice.

IV. COMPLIANCE RISKS

This section addresses the pitfalls of non-compliance, whether intentional or not, and touches upon other costs and burdens a business must endure in its attempt to comply with each state's abandoned property laws.

All 50 states and the District of Columbia require that holders of unclaimed property provide reports and deliver such property to the appropriate state. If unclaimed property is not reported and delivered,[110] states may apply harsh statutory provisions including (i) daily penalties, (ii) interest from the period that the property should have been delivered, (iii) damages and (iv) in certain states, criminal charges in the event that the failure to deliver property to the state is willful.

A. Interest and Penalties

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107 Nev. Rev. Stat. § 120A.520 (*emphasis added*).

108 In addition, although the Supreme Court in *Texas v. New Jersey* expressly stated that it was abandoning any sort of contacts test in favor of the First and Second Priority Rules, the effect of a Third Priority Rule is to re-introduce a form of contacts test because the holder has to determine whether or not a card was issued or sold within a particular jurisdiction.

109 Such states include Arizona, Illinois, Indiana, Iowa, Kansas, Maryland, Massachusetts, North Carolina, Ohio, Oklahoma, Tennessee, Virginia and Wisconsin.

110 How might a state know that a holder has failed to report or deliver funds? Each year, states require a report to be filed, indicating what unclaimed property a holder has and will be reporting. If a holder has nothing to report, many states require that holder to file a negative report.

It is not surprising that each state provides an interest or penalties provision modeled after one of the recent versions of the Uniform Act, although many states vary on the interest rate and some do not impose civil penalties for unintentional failure to report unclaimed property. For example, Arkansas provides that a holder who fails to report, pay or deliver property within the time shall pay percent interest above the prime bank loan rate per annum on the value of the unclaimed property, from the date the property should have been delivered.[111] In addition, the holder of the property could be responsible for a civil penalty of $200 for each day the report, payment or delivery is withheld, up to a maximum of $5,000.[112] The majority of states, however, set a minor interest rate from 10 percent to 12 percent against the value of the property for a non-willful failure to report, pay, or deliver property. The highest rates come from states assessing a high interest rate, around 18 percent, or a charge for each account not reported, such as Rhode Island, which charges a $10 penalty for each account in addition to 12 percent above the annual rate'[113] and Virginia, which charges a statutory rate of interest, a civil penalty of $100/day up to a maximum of the lesser of $10,000 or 25 percent of the value of the property, plus a civil penalty not to exceed fifty dollars for each account upon which due diligence was not performed.[114]

Although state statutes generally provide for the waiver of interest and penalties if the holder acted in good faith and without negligence, even unintentional compliance failures can result in “moderate” penalties, as determined by the state. However, when the state finds a holder’s failure is willful or fraudulent, and not in good faith, penalties may be increased substantially. Overall, so long as a holder acts with diligence and in good faith, the state will usually not assess fines and penalties on that holder.

B. Fraudulent Reports

Stricter penalties apply to holders who provides a fraudulent report or who willfully fail to report, pay or deliver property within the time prescribed. In addition to other interest and civil penalties, the 1995 Act proposes a civil penalty of $1,000 for each day the report, payment or delivery is withheld up to a maximum of $25,000 plus 25 percent of the value of any property that should have been but was not reported. The 1995 Act also charges a civil penalty of $1,000 for each day the report, payment or delivery is withheld up to a maximum of $25,000, plus 25 percent of the value of any property for a holder who makes a fraudulent report. Arkansas, the District of Columbia, Louisiana, Maine, Montana, North Carolina, Vermont, and West Virginia all follow the penalties proposed by the 1995 Act. Other states only charge $100/day for willful failure, such as New Hampshire, North Carolina and Ohio, usually accompanied by a maximum amount or a certain percentage (e.g., 25 percent). The highest monetary maximum penalty stated is held by New Jersey, which is $1,000/day up to $250,000, plus 25 percent of the value of the property not reported for willful failure to report, plus $1,000/day up to $250,000, plus 25 percent of the value of the property not reported for a fraudulent report.[115]

C. Record Retention Obligations

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111 § 18-28-224.

112 *Id.*

113 § 33-21.1-34.

114 § 55-210.26:1.

115 § 46:30B-105.1.

Another compliance issue involves the period for which records must be retained by the holder. Generally, the period is established at 10 years from the date the property was first reportable as abandoned property. Alabama, Alaska, Arkansas, the District of Columbia, Georgia, Indiana, Kansas, Louisiana, Maine, Minnesota, Montana, New Hampshire, New Mexico, North Carolina, North Dakota, Oklahoma, South Carolina, South Dakota, Tennessee, Texas, Vermont, Virginia and West Virginia are examples of states that have a 10-year retention of records period. However, many states have shortened this period. For example, Arizona, Colorado, Florida, Hawaii, Maryland, New Jersey, Ohio, Oregon, Wisconsin and Wyoming all have five-year retention of records period. Upon determination of how long the period for maintenance of records should be, the states consider such factors as the burden imposed on the holder in maintaining such records, the opportunity of returning the property, and the type of business of the holder.

D. Additional Costs

Further, many state statutes provide if an examination of an organization's records results in the disclosure of unclaimed property, the state may assess a per diem cost of the examination against the holder.[116] Also, the 1995 Act instructs the state to not assess expenses of the exam to "exceed the value of the property" and to only assess costs "against the business association or financial organization." Usually states adhere to this provision and do not assess such costs if the holder is not a business association or a financial institution, or other costs exceeding the amount of unclaimed property found to be reported. Alaska, Arkansas, Louisiana, Maine, Nevada, New Mexico, North Carolina, Vermont and West Virginia follow the 1995 Act guidelines in this respect verbatim. Other states assess a charge that is lesser than the 1995 Act, either about $100/day or the actual costs incurred during the examination.

It is important to note that one of the goals for the Supreme Court in *Texas v. New Jersey* was to restrict states from imposing possible double liability.[117] However, although the costs assessed by a state may be viewed as a penalty for failure to maintain records or failure to report, these costs are not considered penalties as they are simply considered costs incurred due to the audit.

E. Public Company Compliance

There are broader implications for non-complying public companies as it may constitute a violation of the Sarbanes-Oxley Act of 2002, which requires that companies establish and maintain internal control sufficient to comply with applicable laws and regulations. Thus, the failure to have adequate internal controls and comply with various laws could result in additional penalties for a failure to perform duties as required by the 1995 Act.

F. State Enforcement

The comments to the 1995 Act explain that the above provisions were added and updated to provide more effective enforcement and compliance. The comments mention that one major weakness of the 1966 and 1981 Acts was the relatively ineffective penalty provision. Criminal penalties, which were the sole enforcement mechanism of the 1954 Act and which were retained in the 1981

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116 The Act states that the state may "assess the cost of the examination against the holder at the rate of $200 a day for each examiner, or a greater amount that is reasonable and was incurred." 1995 Act, § 20(e).

117 379 U.S. 674 (1965).

Act, have been eliminated since they were not effective and rarely, if ever, pursued. Certain states, including Alaska, Florida, Hawaii, Illinois, Kansas, Minnesota, Missouri, Nebraska, Nevada, North Dakota and Oregon, still maintain criminal misdemeanor penalties for willful failure to report and deliver unclaimed property. However, some states, such as Georgia, Pennsylvania, Wisconsin, South Carolina, Washington, Kentucky, Maryland, Michigan, Oklahoma, Texas and Mississippi, provide for varying degrees of imprisonment for failure to pay after demand for payment by a state.

Additionally, the 1995 Act provides the states with very broad, and in the view of some, *Orwellean*, auditing rights.[118] If a state believes a holder has filed an inaccurate, incomplete or false report, the state, at reasonable times and upon reasonable notice, may examine the records of any holder to determine whether the holder has complied with the reporting requirements. The state may conduct the examination even if the holder believes it is not in possession of any unclaimed property. Any documents and working papers obtained or compiled by the state may be used by the state in the course of an action to collect unclaimed property.

To make the auditing, and the corresponding collection efforts more productive, the 1995 Act opens the door for states to work together to collect abandoned property from holders. States may enter into an agreement with other states to exchange information relating to abandoned property and may permit the other state to examine records or to seek enforcement or maintain an action on behalf of the other state to enforce the unclaimed property law in the holder's state. According to the 1995 Act comments, cooperation among states is essential if abandoned property programs are to be efficiently administered.[119] For example, there may be small claims which would not justify one state taking action, but if several states join forces in the holder's state, the effort might be administratively justified. In recent years, however, several states have joined together to audit major holders and act as collection agents for each other.[120]

Over the past several years the number of states conducting unclaimed property audits has increased, partially due to the fact that states view unclaimed property as a substantial revenue source. Given the nature and severity of the potential consequences set forth above, holders of abandoned property must pay great attention to the potential liability for failure to meet the obligation to report and deliver unclaimed property.

Conclusion

[118] How is the ability of a state to have such broad review of a business's records constitutional? The 1995 Act comments indicate inspections of commercial property are reasonable if they are necessary for the furtherance of a governmental interest. Also, since one of the purposes of escheat is the collection of revenue, it can be argued that it is not an unreasonable search to require taxpayers to produce their books and records. *See* Annot, "Constitutionality of Statutory Provisions For Examination of Records, Books, or Documents For Taxation Purposes," 103 ALR 522. Enforcement of state abandoned property laws are specifically spelled out within the codes, and at times provide for payment of attorney fees. In addition, if a holder fails to maintain/keep adequate records of its unclaimed property for the audit period, the state may estimate the amount of unclaimed property due from any available records of the holder. The 1995 Act specifically allows the use of reasonable estimation techniques. 1995 Act, § 20(f).

[119] 1995 Act, comment to § 23.

[120] See, for example, Fitzgerald v. Young America Corporation, Iowa District Court, Polk County, IA, Civil Action 6030, involving the audit of Young America by 28 states regarding escheat of uncashed rebate checks. The matter is still pending. Amended and Substituted Petition filed June 1, 2006.

Abandoned property laws can clearly be a boon to states strapped for revenues especially during economic downturns as in the present time. For many businesses and financial institutions, however, they are a bane--decreasing revenues, increasing risks and making it more difficult to compete. The purpose of this White Paper is not to advocate whether escheat laws should exist or not. The fact is, they are already here. Abandoned property laws are a part of our legal framework and are a reality with which businesses must deal with every day.

The problem demonstrated by this White Paper, however, is the difficulties that arise when regulators try to apply existing abandoned properties laws to new products or services. If escheat *MUST* apply to prepaid cards, then certainly state legislatures should develop new state laws that specifically address prepaid products in the marketplace – giving special attention to those cards that are essential to consumers' day-to-day lives – rather trying to shoehorn new prepaid products under existing laws.

Prepaid cards have the great potential to provide much needed access to the financial system to many unbanked or underserved communities. They also have the ability to help consumers, governments and businesses realize significant savings by eliminating paper checks from routine payment flows. And finally, prepaid cards have also been found to reduce fraud and identity theft risks, providing a discreet payment mechanism separate from bank accounts together with near real-time network capabilities. But as these new products age, the uncertainties and compliance problems posed from application of existing abandoned property create untenable risks that could impact the growth of these innovative and beneficial payment products.