Prepaid Cards and State Unclaimed Property Laws

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Retailers, including a large number of franchise systems, in recent years have begun utilizing electronic prepaid stored-value cards, or gift cards as they are sometimes called, as a customer convenience, as a way of increasing sales, and as a means of encouraging customer loyalty. Inevitably, a certain amount, often a statistically predictable amount, of the revenue generated from the sale of prepaid cards will ultimately go unredeemed by the consumer. This unredeemed value is commonly known as breakage. As retail card programs have become more and more common, breakage has become substantial.[1]

The laws governing retail card programs, meanwhile, are struggling to keep up with the rapid development of the prepaid card industry. Of all the legal and practical issues presented by prepaid cards, breakage remains one of the hottest topics for retailers, auditors, and lawmakers. Features such as expiration dates and dormancy fees for prepaid cards were designed and implemented to reduce the value associated with prepaid cards that become inactive and to ultimately negate any remaining obligation to the card owner. The evolving law in that area, however, emanating out of consumer protection concerns, has either restricted or banned those features in many states.

A consequence of eliminating expiration dates and dormancy fees is that unused value remains on the ledger of the program administrator in favor of an unknown owner, creating what could arguably be classified as unclaimed property. Unclaimed property laws, which have been on the books for decades, regulate the circumstances under which parties must track, report, and pay to state governments abandoned intangible property belonging to another. State unclaimed property programs are often administered through a dedicated office and/or an unclaimed property administrator. Moreover, in recent years, cash-strapped state governments, looking to increase revenues without raising taxes, have engaged in coordinated and proactive attempts to enforce unclaimed property laws by utilizing third-party auditors to investigate private entities on behalf of multiple state governments.[2]

Thus, retail prepaid card breakage and state unclaimed property enforcement efforts seem destined to collide. Franchisors administering prepaid card programs must therefore familiarize themselves with unclaimed property laws to determine what, if any, obligation they have to report and pay prepaid card breakage to state governments. This article explores the principles surrounding the question of whether (and under what circumstances) prepaid card breakage may be subject to state unclaimed property laws, and attempts to identify related issues of concern to franchisors.

Prepaid Cards

The use of prepaid cards has exploded in the past several years, especially in the retail industry. Unlike a debit card or a credit card, a prepaid retail card allows the cardholder to pay for goods and services to be purchased in the future.[3] The retail industry accounted for $42 billion of the value loaded on prepaid cards in 2003.[4]

A retail prepaid card program can have numerous features, all of which are constantly evolving.[5] The program can be a closed system, for use only at a specific retailer, or an open system, branded with a national network that allows the card to be used at various retailers. The program might track purchaser and user information to capture important marketing data, or it might be anonymous. The program might allow for the card to be reloaded in various ways, including at the retailer's location or online. The program might have features to address lost or stolen cards. The cards might have expiration dates and might be subject to a dormancy fee that subtracts value from the card for nonuse.[6]

Unclaimed Property Laws

The basic goal of unclaimed property or escheat[7] laws is to reunite various types of lost or abandoned personal property with their rightful owners. Unclaimed property laws generally require that certain types of property, typically intangible property representing funds owed, be reported and paid to the state as custodian, to be held by the state until claimed by the rightful owners.[8] Until claimed, the state and its citizens obtain the benefit of the unclaimed property.

All fifty states and the District of Columbia have enacted unclaimed property statutes detailing the circumstances under which unclaimed property must be reported and paid to the

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state.[9] Although state unclaimed property statutes are based upon one of four uniform acts prepared by the National Conference of Commissioners on Uniform State Laws,[10] many states have enacted variations to the respective uniform acts and others have enacted statutes that ignore the uniform acts altogether.[11] Consequently, any analysis of unclaimed property issues must be based upon a careful reading of the applicable state unclaimed property statute.

Terminology

Unclaimed property statutes that are based upon the uniform acts generally use certain key common terms. The person or entity in possession of or that owes the unclaimed property is referred to as the holder.[12] The owner is the person or entity to whom the holder owes the unclaimed property or who otherwise has a legal or equitable interest in the unclaimed property.[13] An apparent owner is the person or entity who appears on the holder's records as the owner of the unclaimed property, if such records are maintained by the holder.[14] Unclaimed property is presumed abandoned upon the expiration of the applicable time period specified in the unclaimed property statute, a time period that will vary depending upon the particular type of obligation owed or property involved.[15]

Property Subject to Unclaimed Property Laws

The types of unclaimed property that must be escheated to the state are identified in the unclaimed property statutes. Although the enumerated types of property that are subject to the statutes vary significantly from state to state, two general observations can be made.

First, the unclaimed property statutes do not apply to real property and generally do not apply to tangible personal property other than tangible property held in safe deposit boxes in the ordinary course of the holder's business.[16] As is stated in the official comment to Section 1 of the 1995 Uniform Act:

> The Act provides exclusively for the disposition of unclaimed intangible property and does not apply to tangible property, with one exception: Section 3 applies to tangible property contained in safe deposit boxes.[17]

It is important to note that although tangible property such as paper checks, paper gift certificates, or unused printed airline tickets are not subject to the unclaimed property statutes, the underlying obligations evidenced by those objects are or may be subject to the statutes. Thus, property is not the check, note, certificate, or other document that evidences the property interest, but the underlying right or obligation.[18]

Second, the unclaimed property statutes generally do apply to most forms of intangible property that consist of an obligation of the holder to pay or provide goods or services to the owner in the ordinary course of the holder's business. The 1981 Uniform Act, for example, contains thirteen sections dealing with either specific types of intangible property or intangible property held by specific types of holders,[19] such as checks, gift certificates and credit memos, wages, and property held by agents and fiduciaries, and a general provision covering most other types of intangible property that are held or owed in the ordinary course of the holder's business.[20] The 1995 Uniform Act, in contrast, sets forth the following general definition of the intangible property to which the Act applies:

> "Property" means . . . a fixed and certain interest in intangible property that is held, issued, or owed in the ordinary course of a holder's business.[21]

That general definition is then supplemented with a nonexclusive list of types of intangible property that are included within the definition.

Abandoned Property

The unclaimed property statutes specify various time periods after which intangible property will be presumed abandoned. These time periods vary significantly by type of intangible property and from state to state. Under the 1981 Uniform Act, the period of presumed abandonment for most types of intangible property is five years, but those periods range from a high of fifteen years (traveler's checks) to a low of one year (wages).[22] The periods of presumed abandonment under the 1995 Uniform Act were shortened in many cases, with the most common periods being either three or five years.[23]

For most types of intangible property, the period of presumed abandonment commences when the intangible property is issued by the holder[24] or when it becomes payable to the owner.[25] As a general rule, the presumption of abandonment will be operative if, throughout the period of presumption, the owner has not communicated in writing with the holder concerning the property or otherwise indicated an interest in the property.[26]

Reporting Requirements

Most state unclaimed property statutes require that once an item of property is presumed abandoned, the holder must make efforts (known as due diligence) to locate the apparent owner of the property.[27] The amount and types of due diligence that must be performed by the holder vary from state to state and, in some cases, by industry.[28] The due diligence requirement, however, generally is not applicable if the holder does not maintain a record of the addresses of the apparent owners. The authors are aware of no state that requires a specific due diligence effort with respect to retail prepaid cards. In addition, due diligence requirements typically do not apply to abandoned property that is below a minimum value. For example, both the 1981 and 1995 Uniform Acts exempt abandoned property having a value of less than fifty dollars from the due diligence requirement.[29]

Assuming that the due diligence is either not successful or not required, the holder must file a report of the abandoned property with the relevant state. Most states permit aggregate reporting of items of unclaimed property having a value of less than fifty dollars, with little or no information about the apparent owners required.[30] The format of the report and the report media (i.e., electronic or paper) are state specific. A state's reporting requirements typically are found on the website of the relevant state agency and may not be set forth, or fully set forth, in the state's unclaimed property statute.[31]

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Most states require that the holder deliver (i.e., pay) the abandoned property to the state at the time it submits its abandoned property report.[32] After receiving the abandoned property, the states undertake various due diligence activities to locate the owners, such as publishing lists of unclaimed property or posting those lists on state websites so that the owners may locate and make claim to the abandoned property.[33]

Relevant State for Reporting Purposes

Perhaps not surprisingly, the rules for determining the relevant state for reporting purposes arose out of disputes between states over abandoned property when multiple states can claim some sort of connection to the property. The basic framework for making this determination was articulated by the U.S. Supreme Court in *Texas v. New Jersey*.[34] *Texas* involved uncashed checks and other uncollected debts owed by an oil company that was domiciled (incorporated) in New Jersey, had its principal offices in Pennsylvania, but had offices in Texas that were most closely tied to the property at issue.[35] After considering the positions of the various states with an arguable interest in the unclaimed property, the Supreme Court set forth what it believed to be a roughly equitable and easily applied bright-line rule that would (it was hoped) limit such litigation among states.[36]

The Primary Rule. The *Texas* decision first provides that if the state of the last known address of the owner can be determined from the records of the holder, that state is entitled to escheat the property.[37] This later became known as the "primary rule" of priority.

Most state unclaimed property statutes require that the holder must make efforts to locate the apparent owner of the property.

Secondary Rule(s). If, on the other hand, the last known address of the owner is not known, the state of the holder's domicile (i.e., its state of incorporation), rather than the state of its principal place of business, is entitled to escheat the property.[38] This "secondary" right, however, is subject to affirmative proof by another state that the last known address of the owner falls within its borders.[39] Similarly, if the state of the owner's last known address is known, but that state's law "does not, at the time in question, provide for the escheat of the property," the state of the holder's domicile is entitled to escheat the property.[40] This, however, is also a secondary right and is subject to the state of the last known address of the owner later enacting legislation to escheat the class of property, with escheat thus occurring under the primary rule.[41] The primary and secondary rules, as set forth by the Supreme Court in *Texas*, were incorporated into the subsequent Uniform Acts and have been enacted by the majority of states.

Another Basis for Escheat. In addition to the primary and secondary rules, many states have codified a basis for collecting property when neither the primary nor the secondary rules apply. Under Section 4(6) the 1995 Uniform Act, property is escheatable to the state if, among other circumstances,

> the transaction out of which the property arose occurred in [that] state, the holder is domiciled in a state that does not provide for the escheat or custodial taking of the property, and the last known address of the apparent owner or other person entitled to the property is unknown or is in a state that does not provide for the escheat or custodial taking of the property. . . .

Section 3(6) of the 1981 Uniform Act similarly provides that property is escheatable to the state if

> the transaction out of which the property arose occurred in [that] state and . . . the last known address of the apparent owner or other person entitled to the property is unknown . . . and the holder is a domiciliary of a state that does not provide by law for the escheat or custodial taking of the property or its escheat or unclaimed property law is not applicable to the property.

Thus, all states that have enacted Section 4(6) of the 1995 Uniform Act, Section 3(6) of the 1981 Uniform Act (collectively, Section 6 for purposes of discussion), or similar provisions have a statutory basis to claim an interest in intangible property based solely on the occurrence of a transaction within its borders. We might call this the tertiary rule of priority, if only to identify it as third in rank behind the primary and secondary rules.

The transaction-based escheat embodied in Section 6 of the 1981 and 1995 Uniform Acts, unlike the primary and secondary rules, did not originate from principles announced by a decision of the Supreme Court. Section 6 may, however, be an attempt by the uniform act drafters to address issues raised in *Pennsylvania v. New York*,[42] a case in which the State of Pennsylvania asserted that it should be permitted to escheat unclaimed property because a transaction relating to the property had occurred within its borders. Pennsylvania was unsuccessful in advancing its argument,[43] however, and the Court ultimately required strict adherence to the primary rule.[44] Nevertheless, the Supreme Court did find some "surface appeal" in Pennsylvania's focus on the location of a transaction relating to the property, a fact that likely did not go unnoticed by the uniform act drafters.

The tertiary rule embodied in Section 6 has never been squarely addressed by the Supreme Court, and its enforceability, therefore, remains open to question. However, a 1989 New Jersey case, while not explicitly addressing Section 6 of the Uniform Acts, nonetheless supported the proposition that a state may claim a right to escheat based upon the place where a transaction relating to the property occurred.[45] At issue in *State v. Chubb Corp.* were uncashed checks issued by the defendant insurance group to insurance claimants.[46] There was no record of the owners' last known address for a certain number of the uncashed checks, and the primary rule was therefore inapplicable. Further, the insurer was "operating" in New Jersey but was apparently domiciled elsewhere.

New Jersey argued that it was entitled to escheat all funds associated with uncashed checks that had not been paid to any

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other state, provided it could establish personal jurisdiction over the holder.[47] The insurer, for its part, cited *Texas* in support of its assertion that New Jersey had no claim to escheat where the checks were issued to individuals in states other than New Jersey.[48]

The *Chubb* court held that the *Texas* framework applied only to disputes of priority between states and consequently felt no need to apply that decision to a dispute between a single state and a private holder.[49] This reasoning enabled the court to find its way around (without addressing) the Supreme Court's holding in *Pennsylvania*, which rejected an escheat claim based on the state's assertion that a transaction relating to the property had occurred within its borders. The court reasoned that where no other state was claiming an interest in the property, "[n]othing in *Texas v. New Jersey* or in [New Jersey's codification of the Uniform Act] prohibits a State from claiming custodial escheat of property based on the locale of the transaction or the place of business of the holder being in that State."[50] New Jersey was, therefore, permitted to take custody of the disputed funds.

In so holding, the *Chubb* court also discussed the public policy considerations underlying its decision:

> The funds belong to the owners, not defendants. The public policy supporting escheat is vastly superior to any claim defendants have, as holder, to refuse to report and to refuse to deliver all provable unclaimed funds to the custody of the State Treasurer. Defendants' interests are at odds with the general welfare. To the extent that defendants' success reduces the size of the funds they deliver to the State Treasurer, the public interest is harmed, as there will then be no source from which the true owners can collect. Thus the court concludes that the State is entitled to a partial summary judgment of custody of [the funds at issue].[51]

Despite this single 1989 New Jersey case, the enforceability of transaction-based state escheat claims appears, at the very least, subject to debate.

Franchise System Prepaid Cards

The application of the unclaimed property laws to a closed system prepaid card that is distributed, and redeemed, throughout a multistate franchise system gives rise to certain critical questions that, under the present state of the law, do not have widely accepted answers. Some of these questions relate to all closed system prepaid cards, while others relate to the unique structure of a franchise system comprised of the franchisor and independently owned and operated franchisees.

Are Prepaid Cards "Property"?

Neither the 1981 nor the 1995 Uniform Act expressly identifies prepaid or gift cards as either subject to or excluded from the definition of property subject to the act. The states are taking a variety of approaches to prepaid cards for unclaimed property purposes, including (i) making no express reference to prepaid cards in the unclaimed property statute, (ii) interpreting an unclaimed property statute that does not reference prepaid cards to nonetheless include prepaid cards,[52] (iii) expressly including prepaid cards as property subject to the unclaimed property statute,[53] (iv) expressly including "gift" cards within the definition of *gift certificates* used in the unclaimed property statute,[54] (v) expressly excluding gift cards from the unclaimed property statute,[55] and (vi) addressing the escheat of prepaid cards in statutes other than the unclaimed property statute.[56] Given this variety of approaches and the ongoing legislative activity relating to prepaid cards, it is essential that the applicable state's law be carefully reviewed in order to determine whether an unredeemed prepaid card will be subject to escheat.

Furthermore, many states, although not expressly referencing prepaid cards or gift cards, do reference gift certificates in their unclaimed property statutes.[57] More than thirty states have total or partial exemptions of gift certificates from their unclaimed property statutes.[58] The conditions under which gift certificates may be exempted from the unclaimed property statutes vary widely. For example, Delaware exempts from its unclaimed property statute gift certificates that are both valued at five dollars or less and issued by certain food service providers.[59] California, which generally prohibits expiration dates on gift certificates, makes such gift certificates subject to escheat if an expiration date is placed on the gift certificate.[60] Thus, for those states with unclaimed property statutes that do not expressly reference prepaid cards or that include prepaid cards within the definition of gift certificates, the gift certificate provisions of the applicable statute may, either by analogy or directly, provide a basis for determining that a prepaid card is exempted from the statute. In the absence of such an exemption, a franchisor is well advised to review the applicable state's intangible property catchall provision to determine whether prepaid card breakage may be subject to escheat.

What Entity Is the Holder of the Card's Value?

The typical nonfranchise retailer that uses closed system prepaid cards is the issuer of the cards, the seller of the cards, the holder of the funds received for the cards, and the entity that redeems the cards. Although the various states use different definitions to identify the holder of unclaimed property, there generally is little doubt that, assuming the unclaimed property statute applies to the cards, the issuing retailer is the holder that is obligated to report and pay the value of its prepaid card breakage to the state.

In contrast, identifying the holder of an unredeemed franchise system prepaid card is somewhat more uncertain and may depend upon the structure of the prepaid card program itself. In a common franchise system prepaid card program, the franchisor is the issuer of the prepaid cards, the franchisees sell the cards to consumers and remit the purchase prices to the franchisor, the franchisor holds or controls the funds represented by the unredeemed cards, the cards are redeemed by other franchisees in the system, and the franchisor then reimburses the redeeming franchisees. The franchisees generally are obligated by contract with the franchisor to honor a prepaid card regardless of whether they sold the specific prepaid card being presented for redemption.

The 1981 Uniform Act defines the holder as the person "who is (i) in possession of property belonging to another, . . . or (iii) indebted to another on an obligation."[61] The 1995

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Uniform Act defines the holder as "a person obligated to hold for the account of, or deliver or pay to, the owner property that is subject to this [act]."[62] Under each of these definitions, it is possible that either the franchisor or the franchisees in the typical prepaid card program described above could be deemed the holders of unredeemed prepaid cards.

The franchisees could be deemed the holders as the parties obligated to redeem the cards. For example, under the 1981 Uniform Act definition, the franchisees might be the parties who are "indebted to another [the card owner] on an obligation [to provide goods or services to redeem the card]." Likewise, the franchisees could be deemed the parties "obligated to . . . deliver or pay to[] the [card] owner the property" under the 1995 Uniform Act definition. This interpretation might be rejected, however, if the franchisor, as the issuer and administrator of the card program, holds all prepaid card revenue and is required to reimburse franchisees as card value is redeemed by consumers at franchised locations. Despite perhaps being technically "obligated" to the card owner by virtue of its contract to participate in the program, the franchisee may be considered a pass-through for the franchisor's obligation to the owner.

Identifying franchisees as the holders for unclaimed property purposes, moreover, would create a number of administrative difficulties. For example, the franchisees typically would not have the ability to determine which prepaid cards, including the prepaid cards they have sold, remained unredeemed. That information would be held by the franchisor as the issuer of the prepaid cards. Furthermore, the franchisees would not have control of the funds represented by the unredeemed cards because those funds would be held by the franchisor. The franchisees thus would be required to recover the value of the unredeemed cards from the franchisor in order to pay that value to the state. Finally, identifying the franchisees as the holders could result in state-by-state variations in the treatment of the prepaid card program for unclaimed property purposes.

The franchisor is more likely to be deemed the holder of the prepaid card breakage under either definition as the party that actually holds or controls the value represented by the unredeemed cards. The franchisor can be deemed the party "in possession of property [the card value] belonging to another [the card owner]" under the 1981 Uniform Act definition, or the party "obligated to hold for the account of . . . the [card] owner [the] property [the card value]" under the 1995 Uniform Act definition. Although identifying the franchisor as the holder for unclaimed property purposes places the reporting and payment obligations directly on the franchisor, it alleviates the administrative difficulties associated with requiring each individual franchisee to undertake those burdens and is likely to be simpler to implement on a systemwide basis. Moreover, as the party in possession of the actual breakage revenue, it is easier for the franchisor to arrange to report and pay the funds to a state, should that become necessary.

At present, the determination of whether the franchisor or the franchisees will be deemed the prepaid card holders for unclaimed property purposes remains unresolved. Attempting to resolve this issue conclusively for any specific franchise system prepaid card program will require a review of the applicable state definition of *holder* and may require an analysis of the relative distribution of program responsibilities between the franchisor and the franchisees.

Applying the Priority Rules

Assuming that (a) prepaid card breakage is property that is escheatable under state unclaimed property laws and (b) franchisors that administer systemwide prepaid card programs will be considered holders of that property, the next question becomes, How will the priority rules discussed above apply to franchise system prepaid card programs? To answer that question, let us consider the case of the following hypothetical franchisor.

PKK, Inc., is a retail restaurant franchisor specializing in organic food served fresh and fast—a healthy alternative to traditional fast food, yet with all the convenience of the fast-food concept. PKK's niche is franchisee-operated kiosks located at airports, but PKK also has franchised stores located in major malls. Currently, PKK has franchised stores in ten states but also plans to expand nationally.

The marketing department at PKK has determined that PKK must have a prepaid card that customers can use to purchase food at PKK's kiosks and restaurants. The marketing folks think that, in addition to consumers purchasing cards for self-use and as gifts, busy executives will buy prepaid cards to reduce the need for cash and to add convenience to their numerous business trips. Marketing also plans to approach major employers about buying the PKK cards for their traveling executives, both for convenience and as part of an overall corporate health and wellness initiative.

And so, the PKKard was born. The PKKard is a prepaid stored-value card, available for purchase at any PKK location. The PKKard is also reloadable, meaning that consumers may purchase and add value to existing PKKards at any PKK location. Capitalizing on its reputation as an environmentally conscious corporation, PKK actively promotes reuse of PKKards in its advertising to avoid creating plastic waste—both for the environment and to reduce the country's dependence on foreign petroleum. The PKKard program is in its infancy with the first cards sold in December 2005. Nonetheless, sales are robust, and approximately $1 million in cards was spent in calendar year 2006. Now PKK's accounting department has called with questions from their outside auditors. The auditors want to know how PKK plans to deal with the unredeemed breakage on the PKKards and what plans, if any, PKK has to report any such breakage to various states under the unclaimed property laws.

Although it may be too late for PKK to control how its historic breakage will be treated under state law, the company may still be in a position to customize its program and its practices in order to position itself to take advantage of the better arguments (based on the principles discussed in this article) to avoid or reduce liability and compliance costs, where possible, in the future.

Applying the Primary Rule

In assessing the application of state unclaimed property laws to its business, PKK will need to determine what state law to apply to its prepaid card breakage by analyzing the rules of priority discussed above. As with most prepaid cards, the last known address of a PKKard owner will usually be unknown because the personal information of PKKard purchasers is not recorded. Although pre-

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paid cards and the software that enables their use may record the date, time, and amount of transactions (and may even record the location of a transaction), prepaid cards themselves do not typically record the identity of the purchaser. Nor do retailers typically record the identity of the purchaser as a matter of practice, although we can certainly envision a situation where retailers would do so.[63] Thus, the primary rule will seldom apply.

This is doubly true if the card is then gifted to another individual and that person is considered to be the owner. PKK should nonetheless carefully consider whether and what information it and its franchisees are currently obtaining and recording regarding prepaid card purchasers and weigh the benefit of continuing to collect such information against the potential unclaimed property liability.[64] Contracts with franchisees governing the PKKard program (be they franchise agreements or separate program agreements) should likewise regulate the collection of information regarding PKKard purchasers.

In the case of the PKKard, moreover, there has been a specific effort to market the cards to large employers. Under these facts, we add a new layer of complexity: Is the owner the company that purchases the card or the employee to whom it has given the card? If it is the company, then there is arguably a basis for determining priority under the primary rule since its last known address is likely to have been recorded by PKK. If the owner is the employee, then PKK'*s* records are not likely to show the owner's last known address. PKK should attempt to structure its contracts with these employer accounts so as to ensure that the recipient employees will be considered the owners of the PKKards, unless, of course, PKK wishes to cede the breakage revenue to the employer customers. In any event, PKK should evaluate these issues in advance.

Applying the Secondary Rule

Assuming that a large percentage of PKKard owners' last known addresses are ultimately unknown, we must next consider the secondary rule of priority. Under the secondary rule, the unclaimed property law of the state of PKK's incorporation will likely prevail, provided that its statute includes prepaid cards in its definition of escheatable property. In that case, PKK would be obligated to report and pay breakage according to that law's particular requirements and abandonment period. PKK should analyze the specific unclaimed property statute in the state of its incorporation to determine what, if any, reporting obligation it will have in the near future with respect to emerging breakage, and to plan accordingly. Alternatively, PKK should consider establishing a subsidiary to run the PKKard program, one that is domiciled in a state with more favorable treatment of prepaid card breakage.

Applying the Tertiary Rule

What happens to prepaid card breakage if neither the primary nor secondary rule apply? Here, we must give some thought to the tertiary rule. As noted above, more than thirty states have total or partial exemptions of gift certificates from their unclaimed property statutes, and these exemptions could easily be applied by analogy to prepaid cards. Assuming PKK (or its applicable subsidiary) is domiciled in one of these states, then conceivably any of the ten states in which PKK has franchised locations may have a claim to breakage on PKKards sold in its state, provided that the state has enacted a provision for escheat based upon the occurrence of a transaction relating to the property.[65] An aggressive state unclaimed property office might audit PKK's records in an attempt to determine the amount of prepaid card breakage associated with cards sold in its state. PKK should consider carefully, therefore, what kinds of records it will keep.

The analysis is further complicated for both PKK (and for any state seeking to escheat PKKard breakage under the tertiary rule) inasmuch as the PKKard is reloadable, that is, users can add value to an existing PKKard from any PKK location. Which state's law will apply when the abandonment period runs on a PKKard that has had value added to it in multiple states at various times? Unfortunately for PKK's attorneys, these are questions that do not have easy answers grounded in binding legal authority. Nonetheless, the practical concerns surrounding state escheat claims based on the tertiary rule, as well the lack of judicial support for the tertiary rule, should factor into PKK's overall analysis of how to internally track and classify its PKKard breakage.

Conclusion

The intersection of prepaid cards and unclaimed property laws at present creates a plethora of questions that do not have well-established answers. As prepaid card programs mature, with their associated breakage arguably becoming subject to unclaimed property laws due to the passage of presumed abandonment time periods, it seems highly likely that the states' enforcement efforts, and the resultant litigation, will increase. Given the significant dollar amounts of breakage involved, franchisors must design their prepaid card programs to minimize the future potential liabilities to their program against a landscape of legal authority that is still developing and evolving.

Endnotes

1. For example, in June 2005, Home Depot, Inc., reported that it had taken approximately $43 million in previously unrecognized gift card breakage to income on its balance sheets. Lisa R. Schoolcraft, *Unused Gift Cards Deliver $43 Million to Home Depot*, ATLANTA BUS. CHRON., June 10, 2005.

2. *See, e.g.*, Young Am. Corp v. Ivey, No. 05-CV-2524 (D. Minn. 2005).

3. J. CHENIE & S. RHINE, PREPAID CARDS: AN IMPORTANT INNOVATION IN FINANCIAL SERVICES (Fed. Reserve Bank of Phila. July 2006).

4. *Id*. In addition to use in the retail industry, prepaid cards are increasingly being used for payroll, for health savings accounts, for loyalty programs, etc.

5. Various service providers have developed retail prepaid card programs to market to retailers. These programs, however, are not necessarily designed for the framework of a franchise system.

6. The legality of expiration dates and dormancy fees is a subject worthy of an article in itself. Generally, state law governs these issues, and that law is rapidly changing. The National Conference of State Legislatures tracks the changes on a state-by-state basis at a helpful website, www.ncsl.org/programs/banking/GiftCardsandCerts.htm.

7. Technically, the term *escheat* refers to a reversion of property to the state under intestacy statutes when no rightful heir exists. BLACK'S LAW DICTIONARY 584 (8th ed. 2004). The obligation of holders to report and pay to the state abandoned intangible property is more accurately described as a "custodial taking," as the state, in theory, holds property for

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rightful owners to later claim. Nonetheless, the term *escheat* is commonly used to describe custodial takings under state unclaimed property statutes, and we will follow this convention for the purposes of this article.

8. *See, e.g.*, UNIFORM UNCLAIMED PROPERTY ACT (1995), 8C U.L.A. 87–149 (West 2001) [herinafter 1995 Uniform Act].

9. *See* BNA CORPORATE PRACTICE SERIES NO. 74-2, UNCLAIMED PROPERTY § IV.A.3 (BNA 2007), for citations to the unclaimed property statutes of the fifty states and the District of Columbia.

10. 1995 Uniform Act; UNIFORM UNCLAIMED PROPERTY ACT (1981), 8C U.L.A. 151–279 (West 2001) [hereinafter 1981 Uniform Act]; UNIFORM DISPOSITION OF UNCLAIMED PROPERTY ACT (1966), 8A U.L.A. 229 (West 2001) (noting that this uniform act has been superseded); and UNIFORM DISPOSITION OF UNCLAIMED PROPERTY ACT (1954), 8A U.L.A. 231 (West 2001) (noting that this uniform act has been superseded).

11. The uniform act upon which a particular state's unclaimed property statute is based can be determined from the tables of enacting jurisdictions set forth at the beginning of each of the uniform acts as published in 8C and 8A U.L.A., with variations from the applicable uniform act noted in the section-by-section annotations. *See also* BNA UNCLAIMED PROPERTY, *supra* note 9, § IV.A.3. Delaware and New York are notable examples of states that have unclaimed property statutes that are not based on one of the uniform acts. *Id*. § IV.A.3.h, gg.

12. 1995 Uniform Act § 1(6); 1981 Uniform Act § 1(8).

13. 1995 Uniform Act § 1(11); 1981 Uniform Act § 1(12).

14. 1995 Uniform Act § 1(2); 1981 Uniform Act § 1(2).

15. 1995 Uniform Act §§ 2, 3; 1981 Uniform Act §§ 2, 4–16.

16. *See, e.g.*, 1995 Uniform Act §§ 1(13), 3; 1981 Uniform Act §§ (10), 16.

17. 1995 Uniform Act § 1, official comment, at 100; *see also* 1981 Uniform Act § 1, official comment, at 179 (same).

18. 1995 Uniform Act § 1, official comment, at 100.

19. 1981 Uniform Act §§ 4–16.

20. 1981 Uniform Act §§ 1(10), 2(a).

21. 1995 Uniform Act § 1(13).

22. 1981 Uniform Act §§ 2, 4–16.

23. 1995 Uniform Act § 2(a).

24. *See, e.g.*, 1995 Uniform Act §§ 2(a)(2) (money orders), (7) (gift certificates); 1981 Uniform Act § 5(a) (instruments payable on demand).

25. *See, e.g.*, 1995 Uniform Act §§ 2(a)(12) (wages), (13) (deposits and refunds); 1981 Uniform Act §§ 2(a) (general rule), 12(a) (property held by agents or fiduciaries), 14(a) (gift certificates or credit memos).

26. 1995 Uniform Act § 2(c). The 1981 Uniform Act uses a similar test for some types of property but for other types simply requires that the property have been "unclaimed" for the presumption period. *See, e.g.*, 1981 Uniform Act §§ 2(a), 7(a), 8, 9, 11, 13–15.

27. 1995 Uniform Act § 7(e); 1981 Uniform Act § 17(e).

28. BNA UNCLAIMED PROPERTY, *supra* note 9, § IX.A.3.

29. 1995 Uniform Act § 7(e)(3); 1981 Uniform Act § 17(e)(iii).

30. BNA UNCLAIMED PROPERTY, *supra* note 9, § IX.A.1.

31. *See* NATIONAL ASSOCIATION OF UNCLAIMED PROPERTY ADMINISTRATORS, www.unclaimed.org (links to relevant state websites).

32. BNA UNCLAIMED PROPERTY, *supra* note 9, § IX.A.2.

33. *Id.* § VI.A.3.

34. 379 U.S. 674 (1965)

35. *Id*. at 675–76.

36. *Id*. at 680–82.

37. *Id*.

38. *Id*.

39. *Id*.

40. *Id*. at 682.

41. *Id*.

42. 407 U.S. 206 (1972).

43. Pennsylvania involved a dispute over the state escheat of unclaimed Western Union money orders. For a number of unclaimed money orders, the records of the holder (Western Union) did not identify either the sender or the payee. *Id*. at 209. As a result, "strict application of the Texas v. New Jersey rule to this type of intangible property would result in the escheat of almost all the funds to the state of incorporation, here New York." *Id*. at 212. The State of Pennsylvania, however, argued that the state in which a given money order was purchased should be permitted to escheat the abandoned funds because that state "should be presumed to be the state of the sender's residence." *Id*. The Court wished to avoid deciding "'each escheat case on the basis of its particular facts.'" *Id*. at 215 (quoting *Texas*, 379 U.S. at 679). Strict application of *Texas* was upheld, and the state of Western Union's domicile, New York, was entitled to escheat all unclaimed money orders for which there was no last known address of the recipient. *Id*. at 216. If *Pennsylvania* were argued today, of course, the appeal would have never made it to the Supreme Court. The secondary rule of priority, which permits the state of the holder's domicile to escheat if the last known address of the owner is unknown, has long enjoyed the Supreme Court's stamp of approval and has been codified by both of the states with an arguable interest in the property (New York and Pennsylvania.) *See* N.Y. U.C.C. LAW ABP § 1309 (Consol. 2007); 72 PA. CONS. STAT. § 1301.2 (2007) However, the situation might be different if New York law did "not provide for the escheat or custodial taking of" unclaimed money orders. 1995 Uniform Act § 4(6). If that were true, Pennsylvania would have at least a colorable claim to the funds, provided that it has enacted some version of the tertiary rule. In fact, Pennsylvania has not enacted language akin to Section 6 calling for tertiary escheat based on the location of a transaction. *See* 72 PA. CONS. STAT. § 1301.2. A number of other states, however, have.

44. *Pennsylvania*, 407 U.S. at 214. The Supreme Court again reaffirmed strict adherence to the *Texas* rule in *Delaware v. New York*, 507 U.S. 490 (1993). Delaware involved unclaimed securities dividends in the possession of (and held in the name of) brokers or other intermediaries, *id*. at 495, a small percentage of which could not be traced to their rightful owners. *Id*. at 496. The State of New York claimed that a statistical analysis would show that the vast majority of owners of such dividends were, in fact, other securities brokers with addresses in New York, *id*. at 508, entitling New York to escheat under the primary rule, rather than Delaware under the secondary rule. The Court rejected the statistical analysis approach, ruling that New York could only avail itself of the primary rule if it could show owners' last known addresses within its borders for each transaction. *Id*. at 492.

45. State v. Chubb Corp., 570 A.2d 1313, 1315–16 (N.J. Super. 1989).

46. *Id*. at 1314.

47. *Id*. at 1315.

48. *Id*.

49. *Id*. at 1315–16.

50. *Id*. at 1317.

51. *Id*.

52. Op. Colo. Att'y Gen. 05-01, *available at* www.ago.state.co.us/agopinions/AGO_PDFs/AGO05–1.pdf ("stored value cards and gift cards" are property covered by the statute under the general definition of intangible property).

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53. TEX. PROP. CODE § 72.1016 (a "stored value card," which would likely include a gift card, is subject to the statute unless certain expiration date and dormancy fee conditions are met).

54. IOWA CODE § 556.9 ("electronic gift card" included within the definition of *gift certificate*).

55. ARIZ. REV. STAT. § 44-301(15) ("electronic gift cards" are excluded from property subject to the statute).

56. R.I. GEN. LAWS § 6-13-12 (Rhode Island Unfair Sales Practices Act, which prohibits expiration dates on gift certificates, including "electronic gift cards," also provides that gift certificates are not subject to escheat).

57. Both the 1995 and 1981 Uniform Acts likewise expressly include gift certificates as property subject to the acts. 1995 Uniform Act § 1(13)(ii); 1981 Uniform Act § 1(10)(ii).

58. BNA UNCLAIMED PROPERTY, *supra* note 9, § VIII.A.

59. 12 Del. Ch. § 1199(g).

60. CAL. CIV. PROC. CODE § 1520.5.

61. 1981 Uniform Act § 1(8).

62. 1995 Uniform Act § 1(6).

63. For instance, a retailer may desire to record (and to require franchisees to record) identifying information on purchasers of prepaid cards in order to later conduct marketing analysis and/or targeted marketing programs.

64. Note, however, that at least two states, Rhode Island (beginning in 1992) and Wyoming (beginning in 1993), require businesses issuing gift certificates to record either the name and address of purchasers of gift certificates or the state of purchase, presumably seeking to create records of owners' last known addresses or the state of transaction for purposes of the primary or tertiary rules. R.I. GEN. LAWS § 33-21.1-14(d) (2007); WYO. STAT. ANN. § 33-24-114(d).

65. That is, the "transaction out of which the property arose," in the case of 1981 and 1995 Uniform Acts.

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