UNCLAIMED PROPERTY: A Delicate Balance for Delaware

Enforcing the law in the face of ongoing legal challenges and economic uncertainty

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UNCLAIMED PROPERTY is an arcane concept, a modern outgrowth of ancient legal principles. These principles, as recognized in a series of U.S. Supreme Court opinions, provide the State the right to take custody of abandoned property – uncashed checks, unclaimed bank accounts, stock certificates and much more – in the possession of a person or company (i.e., "holders"), which has not been claimed by the owner for a defined period of time ("dormancy period") pursuant to certain "priority rules." Under these rules, once property is in the State's possession, it may (1) hold it indefinitely for the benefit of the owner who may come forward to claim it in the future or (2) take property for which there is no known owner or which is never claimed by an identifiable owner and use that property for "the common good" (e.g., fund government operations). As case law and commentators have noted, "in these situations the policy is that it is better that the states and its citizens enjoy the benefit of the windfall rather than the holder."[1]

For Delaware, the legal home to thousands of "holders," collection of, and fiscal reliance on, unclaimed property has always been tricky. Delaware markets itself to American business as the "corporate capital of the world" with a world-class judiciary, a balanced corporate tax structure and responsive state government. But it is a dicey proposition to also then pursue these same companies for often millions of dollars in unclaimed property, some of which is "estimated," much of which is used by Delaware to fund State operations. Though enabled by law to collect these monies from its companies, the State must balance what it can do with what it should do. Trying to strike this delicate balance has involved legislative changes, creation of programs encouraging voluntary compliance and – most recently – litigating with companies. And it is all further complicated by the economic stress that both the State faces from the disruptions of coronavirus, or COVID-19 (and the need for every dollar available to address that disruption), and that companies also face with operations closed and revenues in decline.

As the state of formation for well over a million business entities, including a majority of the Fortune 500 companies, unclaimed property has become an important – though volatile – source of revenue for Delaware. According to the March 2020 update of Delaware's Economic and Financial Advisory Council (DEFAC), unclaimed property continues to be the State's third-largest source of revenue. Total gross unclaimed property for fiscal year 2020 is anticipated to be at least $540 million – at least prior to the impact of the COVID-19 crisis. But it is an unpredictable revenue source, subject to significant decline if courts invalidate or limit Delaware's program or rights to collect or use this property. Delaware's increased dependence on unclaimed property revenue in troubling economic times – post-9/11 and after the 2008/2009 economic crisis – has always been risky.

Every state has unclaimed property laws.[2] Some states, home for thousands of entities formed under their laws, similarly benefit from these federal rules and collect millions annually (e.g., California, New York). Given the number of Delaware incorporated companies, and the consequent significant amounts that could be owed to the State, Delaware has had a strong economic incentive in enforcing its escheat laws and has developed a robust audit and voluntary disclosure program in order to do so. But where is the line between the legitimate enforcement of Delaware's right to audit and collect unclaimed property and pursuing policies prompting legal challenge? For Delaware, finding this balance has resulted in an unprecedented number of challenges being filed against the State in the last several years.

In a 2016 case, the U.S. District Court for the District of Delaware held that Delaware's estimation methodology when applied to an audit whose scope included a look-back period of 22 years violated the company's substantive due process rights.[3] In the *Temple-Inland* decision, the Court stated that the State's behavior was "troubling" and that the State had engaged in a game of "gotcha" that "shocks the conscience." This case was settled before it was finally resolved by the courts, but it was a tough criticism of the State's administration of its unclaimed property audit program prior to 2016.

In part in response to the *Temple-Inland* decision, Senate Bill 13, signed into law on February 2, 2017, was a major overhaul of Delaware's unclaimed property statute. The new legislation adopted significant portions of the 2016 Revised Uniform Unclaimed Property Act (RUUPA) developed by the Uniform Law Commission and addressed potential constitutional infirmities discussed in the *Temple-Inland* decision. However, notwithstanding this legislative attempt to defuse legal challenges, because Delaware has continued to employ estimation to quantify liability for periods where company records do not exist, it appears challenges will continue. This, the use of contract auditors, and other practices have prompted some companies to use Delaware's Federal Courts as a venue to attempt to stop audits and to shut down the Delaware process. The ramification of these suits – now being vigorously defended by Delaware – is significant for both holders,

seeking relief from practices that have riled some companies – and for Delaware, facing its third biggest source of revenue being at risk.

And there have been more recent challenges to the Delaware program with the State and Federal Court suits including *Univar*[4] attacking the State's unclaimed property program on constitutional grounds (e.g., unreasonable search and seizure; violation of substantive and procedural due process; violation of the ex post facto clause; violation of the takings clause; and violation of equal protection of the laws) and reviving a set of claims that had previously been raised in other lawsuits filed post *Temple-Inland* but before Delaware had revised its unclaimed property statute.[5]

A second wave of litigation was initiated in December 2019 when AT&T, Eaton Corporation, Siemens and Fruit of the Loom each filed complaints in the U.S. District Court raising a series of constitutional challenges to Delaware's conduct of its unclaimed property audits in the context of "expedited audits," a limited class of reviews involving a short list of companies. Many of the claims in these suits track those raised by *Univar*.[6]

This new litigation is keeping the State busy. The timing of decisions by the courts is unclear. What is clear is that it has not had a chilling effect on Delaware pressing for compliance with the State's unclaimed property laws. Separate from audits, the State bolstered its voluntary disclosure compliance (VDA) program in the past decade to allow self-reviews and managed assessments overseen by the State. The VDA program is designed to be a kinder, gentler off-ramp to litigation—a less contentious vehicle for corporate compliance. For several years now, Delaware has "invited" companies that may have compliance deficiencies to enter its VDA program – but if a company does not, the State has made clear, it will be audited. "Invitations" to about a hundred companies are mailed almost quarterly. If a company enters into the VDA program, it is not a target for audit – and it will not be assessed interest and penalties on its liability.

Are VDAs working to tamp down litigation? Perhaps. The recent wave of lawsuits involves only audits – not VDAs – and about 50% of companies invited into the VDA program now enter it and virtually all, to date, negotiate settlements with the State. Regardless of pending litigation, on February 20, 2020 the State sent out invitations to enter into Delaware's VDA program to more than 100 companies identified as ones likely out of compliance with Delaware's unclaimed property laws. Delaware appears to remain committed to maintaining a robust compliance and enforcement program. As many state administrators noted during the development of RUUPA, voluntary compliance relies on the threat of audit and holders can choose which route to follow – voluntary compliance or audit. Delaware's litigation with holders may force the courts to provide useful guidance to holders and the State on the rules for unclaimed property in Delaware. All would benefit from that – and perhaps Delaware can adjust the balance between being the "corporate capital of the world" and relying on unclaimed property for a troublingly high percentage of its revenue, something as concerning to current Delaware policymakers as it is to the holder community. ■

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1 *2016 Revised Uniform Unclaimed Property Act, Prefatory Note, pp 1-4.*

2 *A version of the Uniform Unclaimed Property Act is the basis for these laws in over forty states. Delaware's new unclaimed property legislation borrows heavily from the 2016 Revised Uniform Unclaimed Property Act (RUUPA). Michael Houghton is Co-Chair of the ULC RUUPA Drafting Committee.*

3 *See Temple-Inland, Inc. v. Cook, 192 F. Supp.3d 527 at 541 (Del. D. June 2016).*

4 *See Univar, Inc. v. Geisenberger, C.A. No. 18-1909 (MN) (Del. D. Dec. 3, 2018).*

5 *See State of Delaware, Department of Finance v. Univar, Inc., C.A. No. 2018-0884-JRS. (Del. Ch. Dec 7, 2018); Univar, Inc. v. Geisenberger, C.A. No. 18-1909 (MN) (Del. D. Dec. 3, 2018).*

6 *Several of these new complaints also challenge the State's position that foreign addressed property should be escheated to the state of incorporation.*