

PROCEDURE

Delaware Overhauls the State's Unclaimed Property Law Engine

Delaware has significantly revised and updated its unclaimed property law.

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On February 2, 2017, Delaware enacted Senate Bill 13 ("S.B. 13" or the "Act") into law, thereby significantly revising and updating the Delaware unclaimed property law (UPL). The Act addresses some of the concerns arising out of the recent *Temple-Inland* court case and also updates the UPL by incorporating some provisions found in the 2016 Revised Uniform Unclaimed Property Act (RUUPA). For purposes of how holders are affected by the Act, the discussion in this article focuses on the following four areas: (i) addressing issues raised in the recent *Temple-Inland* case, (ii) holder elections afforded by the Act, (iii) provisions providing benefits or helpful guidance to the holder community, and (iv) provisions unfavorable to the holder community.¹

Addressing Issues Raised in the Recent *Temple-Inland* Case

A number of key issues raised in the recent *Temple-Inland* case were addressed in the Act. First, a reduced look-back period for both audits and Voluntary Disclosure Agreements (VDAs) of 10 years was enacted.²

Second, a 10-year record retention period was added; previously, there essentially had been no such period. Records are to be retained for 10 years after a report is filed, unless a shorter period of time is provided by rule of the State Escheator.³ In practice, records should be retained for 10 years plus the dormancy period, which is generally five years in Delaware. Note: Our experience has been that records pertinent to settlement of audits, VDAs, etc., should be retained for longer periods.

Third, the statute of limitations rules were changed to provide that the State Escheator may not commence an action to enforce the UPL more than 10 years after the duty to report and remit arose.⁴ However, the Act provides two exceptions to the general rule: (i) the period of limitations is tolled by the State Escheator's delivery of an examination notice, and (ii) the period is tolled if the State Escheator reasonably concludes the holder has filed a report containing a fraudulent or willful misrepresentation.

Fourth, in an effort to clarify the previously murky waters regarding lack of guidance with respect to estimation, the Act provides that if a holder has filed reports and retained records for the prescribed periods, estimation may not be used in an audit without the holder's consent.⁵ However, given that there will likely be situations where a holder has not retained the required records, the Secretary of Finance, in consultation with the Secretary of State, is directed to promulgate estimation regulations by July 1, 2017. These regulations are required by the Act to include "permissible base periods, items to be excluded from the estimation calculation, aging criteria for outstanding and voided checks, and the definition of what constitutes complete and researchable records."⁶ The regulations should hopefully assist in bringing clarity and transparency to a very gray area.

Holder Elections Afforded by the Act

Eligible holders (i.e., those who have been under audit on or before July 22, 2015) are afforded an ability to make two important alternative elections under the Act. First, the Act generally affords entities currently undergoing a Delaware unclaimed property audit that was authorized by the State Escheator on or before July 22, 2015, an opportunity to convert their current audit into a review under the Secretary of State's VDA program. This election is made by giving written notice to both the State Escheator and the Secretary of State within 60 days after the promulgation of the estimation regulations.⁷ However, securities audits in which estimation is not required are not eligible for this election.

The Act provides a special look-back period for such "converted VDAs" which is 10 years prior to when property is presumed abandoned under the UPL from the calendar year in which the State Escheator provided the original audit notice.⁸ A potential advantage to making the election to convert to a VDA is that penalties and interest generally are not assessed under the VDA program.⁹

Second, in the event a holder under audit does not elect to convert an eligible audit into a VDA under the Secretary of State's program, an entity under audit alternatively can request an expedited completion of the audit via written notification to the State Escheator. This election must be received by the State Escheator

within 60 days of the adoption of the estimation regulations.¹⁰ This election can be pursued for any examinations authorized by the State Escheator up to the effective date of the Act.

There are potential advantages to requesting an expedited audit. First, the Act provides that the State Escheator must conclude the expedited audit within two years of the date of receipt of the written request. Second, all penalties and interest assessments must be waived, provided auditees respond within the time and the manner established by the State Escheator to all requests for records, testimony, and information.¹¹

A potential disadvantage of the expedited audit program is the Act does not provide for any judicial or impartial review of whether a holder responded in a timely manner. Rather, the Act provides the criteria as being within the complete discretion of the State Escheator and subject only to the review of the Secretary of Finance. Another potential disadvantage of the expedited audit program is that it is not clear what happens if the fast-track audit is not completed within the two-year period. For example, does a holder then return to the "regular" audit program, with attendant mandatory interest?

It is noted that entities remaining under audit (who choose not to convert to a VDA or expedited audit) are subject to the new mandatory interest provisions of the Act, as discussed in more detail later in this article. In summary, the election to expedite an ongoing audit and the election to convert to a VDA are both very facts and circumstances driven and, as such, merit discussion with the holder's designated advocate.

Provisions Providing Benefits or Helpful Guidance to the Holder Community

The Act provides a number of provisions providing additional clarity to holders. First, a number of new definitions are added. The term "business association" has been added, as has "gift card," and "loyalty card."¹² The term "loyalty card" is defined to mean "a record given without direct monetary consideration under an award, reward, benefit, loyalty, incentive, rebate or promotional program that may be used or redeemed only to obtain goods or services or a discount on goods or services. The term does not include a record that may be redeemed for money or otherwise monetized by the issuer."¹³

Second, the Act exempts several categories of property by excluding them from the definition of "property," including uninvoiced payables, non-escheat capital credits, layaway accounts issued or maintained by any person in the business of selling tangible personal property at retail, and certain loyalty cards that cannot be redeemed for money or otherwise monetized by the issuer.¹⁴ In addition, holders who are issuers of gift cards are entitled under the Act to retain their maximum cost of merchandise, as well as their cost for goods and services, when reporting unredeemed gift cards.¹⁵ This is a particularly helpful provision for holders

who provide services or goods because the old law only provided an exemption for "maximum cost to issuer of merchandise represented by the card."

Third, the Act provides clarity and guidance on specific types of activities that indicate owner interest in the property, thus tolling or interrupting the running of the dormancy period. An owner's indication of interest in the property can include, for example, written communications, oral communications where the holder or agent contemporaneously makes a record of such communication, accessing account information, presentment of a check, etc.¹⁶

Fourth, the Act codifies the federal priority rules adopted by the U.S. Supreme Court, which determine which state has priority to claim the property.¹⁷

Fifth, a new due diligence/owner notification provision would require that holders send written notice by first-class mail to the apparent owner not more than 120 days, or less than 60 days, before the property is reported to the state as unclaimed property for amounts of \$50 or more.¹⁸ Previously, there was only a requirement to send notice on securities-related property.

Sixth, the Act provides that a holder may file a new type of direct appeal to the Delaware Court of Chancery, provided the appeal is made within 90 days after the State Escheator had mailed its statement of findings.¹⁹ The holder may seek a declaration from the court that the determination is unenforceable, in whole or in part. This is particularly helpful, as previous law provided for a cumbersome, multi-step administrative review process, which was not widely used. The Act provides that the Court of Chancery's review is limited to a determination of "whether the statement of findings and request for payment was the product of an orderly and logical deductive process rationally supported by substantial, competent evidence on the hearing record."²⁰ It is recommended that holder advocates properly document communications with the states and state auditors, key decisions made, etc. as the audit process unfolds such that, if an appeal to the Court of Chancery is made, the documentation can be presented in an orderly and logical manner to the court.

Finally, most holders believe it is helpful that the Act does not require holders to utilize the Social Security Administration's Death Master File (DMF). However, the Act does provide that "knowledge of death" can be identified through various sources, such as a copy of a death certificate, or certain DMF matches.²¹

Provisions Unfavorable to the Holder Community

The Act also provides several provisions that are not helpful to the holder community. As a starting point, the Act provides that for any late-filed unclaimed property that is reported and remitted on or after July 1, 2017, interest accrues at 0.5% per month on outstanding unpaid amounts, with the assessment commencing when the property was first due.²² However, interest cannot exceed 50% of the amount required to be paid.

There are several major exceptions to the general rule that interest will be mandatory on any late-filed unclaimed property. First, the Secretary of State is authorized to waive interest under its VDA program.²³ Second, the Act further provides interest shall be waived with respect to any holder who requests an expedited examination from the State Escheator on or before July 1, 2017, provided the holder acts in good faith to complete the audit.²⁴ The legislation also allows for the State Escheator to "waive up to 50% of the calculable interest" related to this provision.²⁵

Significant penalty provisions are also provided for in the Act.²⁶ Additionally, the Act provides that a holder may not assign or otherwise transfer its obligation to hold for, pay to, deliver property, or to comply with any duties under the UPL, other than to a parent, subsidiary, or affiliate of the holder.²⁷ A new penalty is associated with holders entering into contracts or other arrangements for the purpose of evading an obligation under the UPL or otherwise willfully failing to perform a duty imposed on the holder under the UPL. The penalty amount is \$1,000 per day, with a cumulative maximum of \$25,000, plus 25% of the amount or value of identified property that should have been reported and remitted "as a result of the evasion or failure to perform."²⁸

In addition, as amended by the Act, the UPL—for the first time—expressly gives Delaware the right to claim certain foreign property.²⁹ When the 2016 RUUPA was being considered, various professional groups, such as the American Bar Association and the Unclaimed Property Professionals Organization, presented arguments as to why it was unconstitutional for a state to assert a claim to foreign property.

Finally, prior to enactment of the Act, it was widely believed that Delaware used a definition of "last known address" to mean an address sufficient for the delivery of mail.³⁰ Many holders liked the clarity and simplicity the "delivery of mail" concept provided. It is recalled that in the leading case of *Texas v. New Jersey*, the U.S. Supreme Court noted that the "last known address" test, which is used to identify the first priority state entitled to receive unclaimed property, would be easy to apply because, the Court ruled, the address to be

used would be the address recorded in the books and records of the holder. The Court predicted that the "last known address" test would "distribute escheats among the states in proportion to the commercial activities of their residents."³¹

As amended by the Act, the UPL now provides that the Delaware definition of "last known address" generally means "a description, code or other indication of the location of the owner on the holder's books and records which identifies the last known address of the owner."³² It is possible the new definition of "last known address" will add administrative confusion and complexity to the question of determining what is a sufficient description or code such that a holder is satisfied it has a proper "last known address."

Summary

Overall, the Act provides a number of holder-friendly improvements over the current version of the Delaware UPL for the following reasons. First, it articulates helpful definitions of a number of terms, which were not previously addressed in the law. Second, it delineates several exemptions that were not previously discussed and provides additional helpful guidance on the parameters of the gift card "exclusion for cost" feature. Third, it provides helpful guidance on record retention and look-back periods. Fourth, it gives guidance on when estimation may be used by the state, and directs Delaware regulatory officials to provide specific guidance in the form of regulations. Finally, it provides for a helpful direct appeal mechanism to a Court of Chancery.

However, as previously noted, some of these provisions (such as the ones related to interest and penalties and the limitation on assignment of liabilities) are not as holder friendly. While there are undoubtedly a number of other provisions the holder and holder advocate community would like to see in the Act, overall the Act represents a step in the right direction for holders seeking more clarity and transparency.

¹ Due to the complexity and length of the Act, this article does not purport to summarize all aspects of the Act.

² See UPL §§ 1172(h) and 1173(c). The Act provides two general rules for look-back periods for Secretary of State VDA programs. First, with respect to any person who enters into a VDA and makes payment in full or who entered into a payment plan no later than June 30, 2016, the look-back period applies to transaction years beginning June 1, 1996. Second, with respect to any person who enters into a Secretary of State VDA and makes payment in full or enters into a payment plan on or after July 1, 2016, the look-back period shall start "the first of January for the prior 10 years from when the property is presumed abandoned starting from

the calendar year in which the person's intent to enter into a VDA was accepted by the Secretary of State." Note: The five-year dormancy period for most Delaware property types also should be taken into account. Certain narrow exceptions to the general rules are delineated in the Act.

³ See UPL § 1145.

⁴ See UPL § 1156(b).

⁵ See UPL § 1172(f).

⁶ See UPL § 1176(b).

⁷ See UPL § 1172(b). Note: A technical error in the bill drafting indicates that the election decision must be made by July 1, 2017, but that the decision must be made no later than 60 days after the adoption of the estimation regulations. Due to the lag time between preparation of this article and publication, it is hoped that this apparent error will be corrected via subsequent clarifying legislation.

⁸ See UPL § 1172(b).

⁹ See UPL §§ 1173(a)(1) and 1183(2).

¹⁰ See UPL § 1172(c).

¹¹ See UPL §§ 1172(c)(2) and 1183(a)(2).

¹² See UPL §§ 1130(3), 1130(8), and 1130(11).

¹³ See UPL § 1130(11).

¹⁴ See UPL § 1130(18).

¹⁵ See UPL § 1133(14), which provides that for a stored value card or gift card, "the amount unclaimed is the net card value minus an amount representing the maximum cost to the issuer of the merchandise, goods, or services represented by the card."

¹⁶ See UPL § 1136.

¹⁷ See UPL §§ 1140-1141. Sec. 1141(b) is particularly helpful, providing that "[p]roperty is not subject to custody of the State Escheator . . . if the property is specifically exempt from custodial taking under the law of this state or the state of the last known address of the owner."

¹⁸ See UPL § 1148.

¹⁹ See UPL § 1179(b).

²⁰ See UPL § 1179(d). It is noted that the Court of Chancery is to review errors of law *de novo*, and the Court's review is to include state or federal constitutional questions related to the examination.

²¹ See UPL § 1137.

²² See UPL § 1183(a).

²³ See UPL §§ 1183 and 1173.

²⁴ See UPL § 1183(a)(2).

²⁵ See UPL § 1185(b).

²⁶ See UPL §§ 1183 and 1184. Per § 1185(a), the State Escheator may also waive penalties for good cause.

²⁷ See UPL § 1147(a). It is noted that the Act provides that unless otherwise agreed to by the parties to a transaction, "the holder's successor by merger or consolidation, or any person or entity that acquires all or substantially all of the holder's capital stock or assets, shall be responsible for fulfilling the holder's obligation to hold for or pay or deliver property or to comply with the duties of this chapter regarding the transfer to it of property owed to and being held for an owner resulting from the merger, consolidation, or acquisition." See UPL § 1147(b).

²⁸ See UPL § 1184.

²⁹ See UPL § 1141. However, Delaware's administrative position for many years has been that it is entitled to receive foreign property, since the UPL had never provided an express exemption for such property.

³⁰ See, for example, Sec. 1(11) of the 1981 Uniform Unclaimed Property Act, which defines the term "last known address" to mean "a description of the location of the apparent owner sufficient for the purpose of the delivery of mail." RUUPA, however, changed this definition to generally mean "any description, code, or other indication of the location of the apparent owner which identifies the state, even if the description, code, or indication of location is not sufficient to direct the delivery of first-class United States mail to the apparent owner." See RUUPA § 301(1).

³¹ See *Texas v. New Jersey*, 379 U.S. 674, 680-681 (1965).

³² See UPL § 1139(a).