

Unclaimed Property ADVISORY

July 2, 2012

Delaware's Unclaimed Property Saga Continues

Two significant unclaimed property developments have recently come out of Delaware: (1) the passage of Delaware Senate Bill No. 258 (S.258) and (2) the settlement of the *Staples* litigation. S.258 authorizes the Secretary of State (as opposed to the State Escheator) a limited three-year window to enter into voluntary disclosure agreements (VDAs) with holders. Such VDAs involve shortened look-back periods, which are also available to holders currently involved in a VDA with the State Escheator (in addition to those that have submitted a notice of intent to enter a VDA). In addition, Staples and the state recently settled Staples' lawsuit for declaratory and injunctive relief. In February 2012, the Delaware Chancery Court held that rebates were "property" within the meaning of section 1198(11) of the unclaimed property code; thus, the court concluded that rebates were not exempt from escheat by virtue of the U.C.C.'s statute of limitations. Before the court could address the other substantive issues (including issues associated with Delaware's use of estimation), the parties settled the dispute.

Delaware General Assembly Passes Unclaimed Property VDA Legislation

On June 28, 2012, S.258 was passed by the Delaware House of Representatives (41-0). Previously, on June 21, 2012, the bill passed the Delaware Senate (21-0) and the version passed by the House is the same bill. The bill is expected to be signed by Governor Markell and enacted into law.

The key provisions of S.258 are as follows:

- **Shortened Look-Back Periods.** Unlike the look-back period for current Delaware VDAs, which requires holders to report property dating back to 1991, holders who enter the new program with the Secretary of State and complete the VDA by June 30, 2014, will be eligible for a shortened look-back period to 1996. Holders who complete their VDA by June 30, 2015, would be eligible for a shortened look-back period to 1993.
- **Administration.** The new program will be administered by the Secretary of State, as opposed to the State Escheator of the Delaware Department of Finance, which will offer holders an alternative avenue to become compliant with their unclaimed property reporting obligations.
- **Authority to Audit.** S.258 requires both the Secretary of State and the State Escheator to waive their right to audit or seek payment after a holder has voluntarily come forward under the new program, unless there is evidence of fraud or willful misrepresentation.
- **Eligibility.** To be eligible for the new program, holders must indicate their intent to take part in the program in writing by either June 30, 2013 (for the 1996 look-back period), or June 30, 2014 (for the 1993 look-back period). The Secretary of State is not authorized to accept notices of intent to enter VDAs after June 30, 2014, or enter into a VDA with a holder after June 30, 2015, and the law sunsets on July 1, 2015.

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- **Holders Currently Involved in a Delaware VDA.** Holders that are currently participating in the State Escheator's VDA program or that have completed, executed and delivered a notice of intent to enter a VDA form by June 30, 2012, are entitled to the same shortened look-back periods if they make payments by either the June 30, 2014, or June 30, 2015, deadline.
- **No Substantive Changes to Review.** The legislation makes no mention of how the VDAs will be reviewed or the substantive methods that will be employed. However, the bill does allow the Secretary of State to make necessary rules and regulations. [The question has arisen about whether and how the Secretary of State's office will review submitted VDAs; while one possibility is for the Secretary of State to hire outside consultants for this purpose, we are not aware that a decision has yet been made in this regard. Regulations will presumably be drafted to address this and other questions concerning implementation of the new VDA program.]

The new program may provide holders with a valuable opportunity to address their historic unclaimed property compliance. Holders that are interested in the new program should confer with legal counsel to ensure that attorney-client privilege and other protections are established and maintained. Holders currently involved in a VDA with the State Escheator should also be aware of the potential benefits provided by the legislation and consider whether to make efforts to complete the VDA by the respective deadlines.

Delaware and Staples Settle Unclaimed Property Litigation

Background of Litigation

In 2005, Delaware (via Kelmar Associates LLC) initiated an unclaimed property audit of Staples, Inc. Following completion of the audit, Delaware demanded payment from Staples of approximately \$3.9 million, which the state asserted to be unclaimed property consisting of accounts payable and payroll. Staples filed a complaint on April 30, 2010, against Delaware in the Delaware Chancery Court, seeking declaratory and injunctive relief from the state's demand. Staples' complaint set forth numerous statutory and constitutional arguments in support of its claim that the \$3.9 million did not constitute unclaimed property, including that any demand for uncashed rebates (which were one category of A/P checks that remained uncashed) was barred by the U.C.C.'s four-year statute of limitations; Delaware's audit was untimely; numerous audit methodologies employed by Kelmar and Delaware were improper; Delaware's demand violated Staples' due process rights; and the demand constituted an unlawful taking without just compensation.

Cross-Motions for Partial Judgment

After a few months of procedural posturing, in which Delaware countersued for a declaration that the demand from Staples was proper and authorized by the unclaimed property code, as well as to obtain records regarding other property types (such as gift certificates), the parties filed cross-motions for partial judgment on the pleadings in August 2011. The cross-motions essentially addressed the issue of whether the U.C.C. trumps Delaware's right to demand payment of the uncashed rebates held by Staples. These uncashed rebates were issued by Staples in connection with the sale of inventory to certain of its business customers. Such customers entered into supply contracts with Staples, pursuant to which Staples agreed to give the customers a reduction in price (or rebate) if they purchased a minimum volume of inventory during a one-year period. The rebates took the form of either credits or checks.

Delaware contended that these rebates were subject to escheat as unclaimed property after they had remained uncashed for five years. On the other hand, Staples argued that the rebates were not escheatable pursuant to section 1198(11)(a) of the unclaimed property code. That section excludes from the definition of “property” “any property, except the items specifically enumerated above..., the right to recover which in a proceeding brought by the owner would be barred by any statute of limitations.” Staples argued that (a) the rebates were not specifically enumerated as “property” in section 1198(11) and (b) the four-year U.C.C. statute of limitations applied to the rebates since they involved the sale of inventory. Accordingly, Staples contended that the rebates fit within section 1198(11)’s exclusion and were thus not escheatable.

Court Grants Delaware Partial Judgment

The Chancery Court issued its opinion on February 2, 2012. The court found that the rebates were either “credits” or “bills of exchange” (i.e., checks) under the plain language of section 1198(11), and thus were “enumerated” by that section as being “property.” Because the rebates were enumerated property, the exclusion provided by 1198(11)(a) was inapplicable. The court also held that section 1198(11)(a)’s inapplicability rendered the U.C.C. statute of limitations irrelevant because of the Delaware anti-limitations provision. The court rejected Staples’ arguments that “a ‘rebate’ is not itself a check or a credit just because it might be paid with a check or issued as a credit, and that instead the court must look to the ‘underlying property’—the rebate.” The court stated that the “relevant inquiry is what the property is and whether it fits within one of the categories specifically enumerated in § 1198(11) of the Escheat Statute. The reason why the property was given is irrelevant.” Accordingly, the court granted Delaware’s motion for partial judgment and dismissed Count I of Staples’ complaint for a declaratory judgment that the rebates are not escheatable. However, the court’s opinion did not address the remaining eight counts of Staples’ complaint.

Settlement

Delaware and Staples issued a joint statement late in the week of June 18, 2012, announcing that the litigation had been settled. The specific terms of the parties’ settlement agreement are confidential.

Implications for Holders

The *Staples* litigation did not come to a full resolution in court and left unresolved several important issues, such as the propriety of Delaware’s estimation techniques and other auditing methodologies, not to mention the constitutional issues. Nonetheless, the court’s opinion still leaves holders with a potentially significant precedent regarding uncashed rebate checks. The Chancery Court unequivocally held that rebates constitute either “bills of exchange” or “credits” and thus are considered “property” under section 1198(11) of the Delaware unclaimed property code. While the court’s conclusion that uncashed rebate checks are subject to escheat under Delaware law is unsurprising, the court based its decision in part on its determination that the reason underlying the check—i.e., whether it was issued as a rebate versus whether it was issued to pay vendors—was ultimately irrelevant. This is a departure from the holdings of other courts, which have focused on the nature of the underlying obligation rather than the form of payment, and raises potential issues in other contexts.

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

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