



## Unclaimed Property ADVISORY ■

**MARCH 12, 2015**

### Temple-Inland District Court Denies Delaware's Motion to Dismiss — Looks Good for Temple-Inland and Holders

On March 11, 2015, the U.S. District Court for the District of Delaware issued an important decision in *Temple-Inland, Inc. v. Cook*, No. 1:14-cv-00654-SLR (D. Del. March 11, 2015). While the district court did not grant Temple-Inland summary judgment at this point in the litigation, the court's decision should be considered a significant victory for Temple-Inland, which appears likely to prevail under its four remaining constitutional claims. The decision may also have a meaningful impact on other holders that are domiciled in Delaware and are currently under audit or participating in a voluntary disclosure program with the state. Unfortunately, however, the court also held that the *Texas Cases*<sup>1</sup> priority rules do not apply in disputes between private parties and states.

#### **Facts**

On May 21, 2014, Temple-Inland, Inc., a Delaware incorporated entity, filed a complaint in the U.S. District Court for the District of Delaware against the Delaware Secretary of Finance, State Escheator and Audit Manager (collectively, "defendants"), challenging the use of a statistical model by the State of Delaware to estimate Temple-Inland's liability under the Delaware Escheats Law, specifically, Section 1155. In its complaint, Temple-Inland alleged various constitutional violations as a consequence of the estimation of liability and assignment of 100% of that liability to Delaware.<sup>2</sup>

The defendants moved to dismiss for lack of subject matter jurisdiction and failure to state a claim. Temple-Inland moved for summary judgment on its various claims. The court granted in part and denied in part the defendants' motion to dismiss and denied Temple-Inland's motion for summary judgment.

<sup>1</sup> *Texas v. New Jersey*, 379 U.S. 674 (1965); *Pennsylvania v. New York*, 407 U.S. 206 (1972); and *Delaware v. New York*, 507 U.S. 490 (1993).

<sup>2</sup> For additional background and facts, see [Alston & Bird Unclaimed Property Advisory: Delaware's First Published Administrative Appeals Decisions Addresses Validity of Estimation Techniques](#) (June 16, 2014).

## The District Court's Decision

### Jurisdiction

The district court denied the defendants' motion to dismiss for lack of subject matter jurisdiction. The court held that it "has federal question jurisdiction pursuant to 28 U.S.C. § 1331," since Temple-Inland asserted "five counts for federal preemption and violations of the United States Constitution."

### Federal common law and preemption

The district court rejected Temple-Inland's argument that Section 1155 violates federal common law (i.e., the priority rules set forth in the *Texas Cases*) because Delaware does not first identify the property interest at issue or the precise debtor-creditor relationship. On this issue, Temple-Inland relied on a decision from the U.S. District Court for the District of New Jersey in *American Express Travel Related Services, Inc. v. Sidamon-Eristoff*, 755 F. Supp. 2d 556, 608 (D.N.J. 2010), where the court held that "[i]t is true that the Supreme Court's original jurisdiction [in the *Texas Cases*] was premised on the dispute between state parties, but to say that the Court's substantive decision is limited to state parties confuses jurisdiction with merits."<sup>3</sup> Remarkably, however, the Delaware district court appeared to limit the priority rules to "disputes among states," and determined they do not apply to "disputes between private parties and States."<sup>4</sup> In a footnote, the court attempted to distinguish this case from the ruling in *American Express*, stating:

In *American Express*, the [New Jersey] district court applied the *Texas Cases* to determine whether the State of New Jersey could escheat assets over which it had neither first nor second priority under the priority scheme outlined in *Delaware [v. New York]*. Unlike *American Express*, the present dispute concerns the propriety of estimates, not whether the State of Delaware has authority to escheat under the *Delaware [v. New York]* priority scheme.

The court granted the defendants' motion to dismiss Temple-Inland's claim for violation of and preemption by federal common law and, accordingly, denied Temple-Inland's motion for summary judgment that federal common law preempts the Escheats Law and prohibits the estimation of abandoned property liability.

### Substantive due process

Temple-Inland essentially argued that its substantive due process rights were violated because the use of estimation to calculate the debt results in two or more states claiming the same property, as expressly prohibited by the *Texas Cases*. The district court rejected the defendants' use of the rational basis test, which applies in cases challenging the validity of a legislative act, to determine whether a substantive due process violation occurred. The court stated:

[P]laintiff does not challenge the constitutionality of the Escheat Act, but instead alleges a deprivation of property. . . . Specifically, plaintiff alleges a deprivation of property in the form of the money claimed by the State under authority of the Escheat Act, arguing that the use of estimates to calculate the debt results in two or more States claiming the same property as expressly prohibited by the *Texas Cases*.

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<sup>3</sup> This holding was ultimately affirmed by the Third Circuit in *New Jersey Retail Merchants Ass'n v. Sidamon-Eristoff*, 669 F.3d 374 (3rd Cir. 2012). Note that Delaware is one of the states within the Third Circuit and is directly subject to its jurisprudence/precedents.

<sup>4</sup> The Delaware district court's ruling is also contrary to the Tenth Circuit's decision in *American Petrofina Co. v. Nance*, 859 F.2d 840 (10th Cir. 1988), which similarly held that the federal common law rules established in the *Texas Cases* apply to a dispute between a holder and a single state. It appears that Temple-Inland may not have brought this case to the court's attention, though.

While the court did not answer whether an estimation of liability, in and of itself, violates substantive due process, it strongly suggested that the methodology employed by Delaware would violate due process. The court noted specifically that Delaware's methodology for calculating an estimated liability—which in this case was allegedly based on (1) uncashed checks escheated to other states under the primary rule, (2) checks that were voided, reissued and cashed by the payees, and (3) checks payable to payees with addresses in other states, some of which expressly exempt the property from escheat—would likely violate substantive due process. The court stated, "If the allegations as claimed are true, the disputed money may indeed violate the Supreme Court's prohibition against 'more than one State . . . escheating a given item of property.'"<sup>5</sup> Accordingly, the court denied the defendants' motion to dismiss Temple-Inland's claim for violation of substantive due process. Interestingly, the court acknowledged, however, that the estimates cannot be attributed to a particular owner, but that nevertheless, "the unclaimed money on which the estimate is based may be traced to identifiable creditors." Although the court did not grant Temple-Inland's summary judgment on this issue, all holders, specifically those under audit and in the Delaware VDA program, should take note of this ruling and consider its impact, especially given that uncashed checks escheated to other states under the primary rule and checks payable to payees with addresses in other states are routinely utilized in Delaware's estimation of liability.

### **Ex Post Facto Clause**

Temple-Inland asserted that Section 1115 of the Escheats Law violates the Ex Post Facto Clause of the U.S. Constitution by imposing a retroactive penalty for a holder's lack of recordkeeping. The district court determined that additional facts were needed to determine whether the Delaware General Assembly in adopting Section 1155 "merely codified a pre-existing practice" such that an Ex Post Facto review would be unnecessary. It did, however, raise doubts that Section 1155 could be viewed as a penalty. In its discussion of whether Section 1155 was punitive in nature, the court constructed a "heads I win/tails you lose" analytical dichotomy that tellingly suggests that Temple-Inland may ultimately prevail in this litigation. The court stated:

The Delaware General Assembly . . . eliminated the document retention requirement and avoided characterizing § 1155 as a penalty. In so doing, the General Assembly set the stage for a violation of substantive due process. In other words, defendants are faced with a dilemma: If § 1155 is not a penalty provision, it likely violated plaintiff's rights to substantive due process. If, on the other hand, § 1155 is a penalty provision, its retroactive application likely violated the Ex Post Facto Clause. The court is unprepared, at this juncture, to determine which scenario is most likely.

Accordingly, the court denied the defendants' motion to dismiss Temple-Inland's unlawful Ex Post Facto law claim.

### **Takings Clause**

The district court found that Temple-Inland pled sufficient facts to support the position that it has a legitimate property interest in the estimated liability, given that the estimate may not be traceable to bona fide creditors. The court therefore denied the defendants' motion to dismiss Temple-Inland's takings claim, stating that "if Delaware does not have the authority to escheat the property in question, then the seizure of such property without just compensation would be a violation of the Takings clause."

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<sup>5</sup> Citing *Texas*, 379 U.S. at 676.

## Commerce Clause and Full Faith and Credit Clause

On Temple-Inland's Commerce Clause and Full Faith and Credit Clause claims, the district court stated:

Given the brevity of the parties' briefing, the court is unprepared, at this stage, to determine whether the Supreme Court intended secondary priority to attach if the laws of the creditor's State are silent on the question of escheat or if, as defendants allege, secondary priority attaches if the laws of the creditor's State actively exempt certain property from escheat.

The court acknowledged, however, that if estimates were based on "cashed checks" or "property actually escheated to other States," the estimates are "in tension with the Supreme Court's prohibition against double escheat as a violation of the Full Faith and Credit Clause." As pled, the court noted that "the Full Faith and Credit Clause violation is inexorably intertwined with the alleged violation of the Commerce Clause." Accordingly, the court denied the defendants' motion to dismiss Temple-Inland's "potentially meritorious Commerce Clause claim" and its Full Faith and Credit Clause claim.

## Alston & Bird Observations

The district court's decision may benefit holders in several important respects. First, the federal court retained the case on the grounds that numerous constitutional claims had been presented for review; this underscores the availability of the Delaware district court as an alternative to the Delaware state courts, which the state legislature has designated as the sole forum for litigation of unclaimed property disputes. Second, the court acknowledged the meritorious nature of most of the plaintiff's constitutional claims; holders have long articulated these concerns to the State of Delaware and its contract audit firms, and we anticipate that even this preliminary ruling in *Temple-Inland* is going to shift the landscape in pending audits and VDAs.

While the plaintiff did not prevail on a very important claim concerning the applicability and preemptive effect of federal common law, it seems clear that the distinction drawn by Judge Robinson between this case and the *American Express/NJRMA* Third Circuit case is faulty. Therefore, if *Temple-Inland* is appealed to that court, the Third Circuit would presumably review the preemption claim with great scrutiny.

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