



## Unclaimed Property ADVISORY ■

**SEPTEMBER 30, 2016**

### Delaware District Court Sets Up Another Marathon Unclaimed Property Battle

On September 23, 2016, the Delaware federal district court granted the state's motion to dismiss in *Marathon Petroleum Corp., et al. v. Cook, et al.*, ending (for now) the plaintiffs' claims that Delaware's audit of the plaintiffs' gift card function overstepped constitutional bounds. *Marathon Petroleum* is the latest decision in an increasingly active litigation theater starring Delaware and holders regarding enforcement of Delaware's unclaimed property laws.

#### **Background**

Through its third-party auditor, Kelmar Associates, in 2007 Delaware initiated an unclaimed property audit of Marathon Petroleum Corporation and Speedway LLC, along with the companies' affiliated entities, Marathon PrePaid Card LLC (MPC) and Speedway Prepaid Card LLC (SPC), which are Ohio LLCs. According to the complaint, MPC issued Marathon-branded gift cards redeemable for fuel and/or merchandise at Marathon retail locations. Those cards were sold by Marathon Petroleum Company LP (a Marathon operating subsidiary) on MPC's behalf, as well as by certain third parties. Under a prepaid card agreement between Marathon and MPC, when Marathon sold an MPC-issued card, the funds were transferred to MPC, and when a card was subsequently redeemed by Marathon, MPC transferred the funds to Marathon. Further, Marathon agreed to accept the cards in exchange for fuel and/or merchandise. Likewise, SPC issued Speedway-branded cards redeemable for fuel and/or merchandise at Speedway and Rich Oil retail locations, and SPC and Speedway entered into a prepaid card agreement similar to the MPC-Marathon agreement.

In the course of the audit, Kelmar requested "extensive detailed information" relating to MPC's and SPC's gift card operations. In response, the plaintiffs produced documents demonstrating that MPC and SPC were not Delaware entities but rather were Ohio limited liability companies, for purposes of showing "that Delaware lacks standing to claim any unredeemed gift cards, even if any exist." Subsequently, Kelmar sent a letter stating that the plaintiffs' continued failure to comply with the request "will result in the Office [i.e., the State Escheator] referring the matter to the Attorney General's Office for consideration of enforcement action."

Shortly after receiving this letter from Kelmar, the plaintiffs filed their complaint in federal district court, seeking a declaratory judgment and injunctive relief on the basis that Delaware's actions were preempted by and in violation of federal law—i.e., federal common law rules established by the U.S. Supreme Court in *Texas v. New Jersey* for determining when a state has the right and power to escheat unclaimed property—and that the audit requests constituted an unreasonable search in violation of the Fourth Amendment.

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## Motion to Dismiss

Delaware filed a motion to dismiss, arguing that the court lacks subject-matter jurisdiction and that none of the claims state plausible grounds for relief. Essentially, Delaware's primary argument was that the dispute was not yet ripe because "[n]othing has happened" yet to the plaintiffs. In Delaware's view, there would only be a ripe dispute when the state issues and enforces a summons, which had not yet happened when the lawsuit was filed. Delaware contended that the plaintiffs' assertion that the state's audit of Delaware entities will result in the escheat of gift cards from Ohio entities, which Delaware is not entitled to claim under federal common law, is "entirely premature." According to the state, "Delaware has not proposed any escheatment of unclaimed gift cards, much less has Delaware proposed an escheatment that conflicts with the Supreme Court's guidance on this issue."

Delaware also argued that "[t]here are some scenarios in which wholly owned subsidiaries of Delaware corporations, like Marathon's single purpose gift card entities here, ... are structured to evade Delaware's escheat law. Therefore, we have to have the authority to review the records of that entity to assess whether there is an unclaimed property liability."

Following oral argument, District Court Judge Leonard Stark ordered the parties to file "supplemental letter briefs, addressing the impact, if any, of the recent decision from another Judge of this Court in *Plains All American Pipeline, L.P. v. Thomas Cook, et al*, C.A. No. 15-468-RGA D.I. 49, on the issues presented in the pending motion to dismiss."

## Meanwhile, in Delaware...

The *Marathon* litigation is one of a handful of recent cases challenging Delaware's unclaimed property enforcement practices. In June 2016, in *Temple-Inland Inc. v. Cook*, another judge in the district court (Judge Sleet) granted Temple-Inland's motion for summary judgment on its claim that Delaware's audit practices (including estimation methodology) violated the company's substantive due process rights, holding that such practices "shocked the conscience." The parties settled the litigation shortly after that decision. Judge Stark asked the parties during oral argument in *Marathon* to explain whether the *Temple-Inland* decision had any implications to this case. The state argued that that case had no implications ("the programs are extremely different"), whereas the plaintiffs explained that *Temple-Inland* is "color," "background" and "context" for this litigation.

In addition, a few weeks earlier, a different district court judge (Judge Andrews) granted Kelmar's and Delaware's motions to dismiss a holder's pre-audit claims in *Plains All American*. Essentially, Plains All American sought to prevent the audit from getting off the ground in an effort to avoid being subjected to Delaware's standard audit practices. The court held that Plains All American lacked standing to sue Kelmar, had not demonstrated ripeness of declaratory relief against Delaware for any of its claims, except equal protection, and failed to state a cause of action regarding its equal protection claim.

## District Court Grants Delaware's Motion

Judge Stark granted the state's motion to dismiss Marathon and Speedway's lawsuit. As an initial matter, Judge Stark held that the plaintiffs' claims were in fact ripe (contrasting this case to *Plains All American*, where neither the audit nor enforcement actions had begun). The judge found that the plaintiffs were "suffering real harms and their interests are adverse to those of Defendants" based on the "aggressive and persistent nature of Defendants' audit, in conjunction with Defendants' letter threatening referral to the Attorney General," which places the plaintiffs "in a difficult position." Judge Stark cited Judge Sleet's holding in *Temple-Inland* as a concrete example of how the parties

have adverse interests, and why “the disputes presented by Plaintiffs are real.” Thus, the judge found that Delaware’s arguments that there is no real threat to the plaintiffs “ignore the real and detrimental effects of the audit process, the uncertainty regarding Plaintiffs’ operating funds, and the harm caused by the ongoing, and possibly unconstitutional, audit process.”

However, Judge Stark also ruled that the audit process itself is not preempted by federal common law, because the *Texas v. New Jersey* trilogy of cases only apply to and govern disputes between states (citing to Delaware federal district court Judge Robinson’s earlier motion to dismiss opinion in *Temple-Inland*, which preceded Judge Sleet’s summary judgment opinion in that case). In this regard, Judge Stark distinguished the Third Circuit’s prior ruling that New Jersey’s “attempt to override aspects of the [*Texas*] priority scheme” was preempted by federal common law in the *N.J. Retail Merchants Association v. Sidamon-Eristoff* case from 2012, in part because Delaware has suggested in this litigation that the plaintiffs’ gift card structures may in fact be fraudulent, which was not an issue in the *N.J. Retail Merchants Association* case.

Judge Stark also ruled that the Fourth Amendment was not violated, holding that the audit and associated information requests did not constitute “searches.” Judge Stark found that Delaware lacks authority to compel compliance, and so the plaintiffs “could simply ignore Defendants’ demand for information.” Moreover, even if Delaware’s actions did constitute a search, Judge Stark noted that “judicial review of administrative searches is ‘strictly limited,’” citing Third Circuit and U.S. Supreme Court authority. Such review is limited to whether the request is within the authority of the requesting agency, not too indefinite and reasonably relevant to the inquiry, which the judge found was satisfied here.

## Implications of the Court’s Ruling

The immediate practical effect of Judge Stark’s grant of Delaware’s motion to dismiss Marathon and Speedway’s complaint is unclear. In theory, his finding that Kelmar’s extensive requests for MPC’s and SPC’s records regarding gift cards they issued does not violate the Fourth Amendment could result in efforts by Delaware to enforce compliance with those requests. However, that prospect is clouded by the fact that the very basis for Judge Stark’s finding that the requests did not constitute “searches” for purposes of Fourth Amendment analysis is that Delaware lacks enforcement authority. Judge Stark does note that Delaware disputes this finding, and contends that Delaware’s attorney general could enforce a summons issued by the state escheator for the information requested by Kelmar. However, if Delaware sought to enforce the information requests, we would expect the plaintiffs to go back to Judge Stark and request an order enjoining any such enforcement action pending the outcome of the plaintiffs’ anticipated appeal of his decision to the Third Circuit. As a result, it seems doubtful that Delaware would attempt to move forward immediately with any enforcement efforts, especially since it is anticipated that Delaware likely will seek legislation to clearly grant such enforcement authority in the next session of the Delaware legislature.

Perhaps the most significant and concerning aspect of Judge Stark’s ruling is the holding that the *Texas* federal common law rules do not apply to disputes between private parties and a single state. It is unclear how to square this ruling in light of the Third Circuit’s decision in *N.J. Retail Merchants Association*. The court in that case unequivocally applied *Texas v. New Jersey* in determining that New Jersey’s attempt to circumvent a rule permitting the state of domicile of the debtor to escheat unclaimed property when the address of the creditor is unknown was preempted by the Supremacy Clause of the U.S. Constitution. At issue in that case was a New Jersey law providing that, in instances when a holder does not have a record of the last known address of the owner of a stored value card, the address is presumed to be in the state where the stored value card was purchased or issued. In finding that this law was unconstitutional, the Third Circuit held:

[T]he place-of-purchase presumption ... allows New Jersey to infringe on the sovereign authority of other states. Even when states decide not to exercise custodial escheat with the intent of allowing the holders to maintain custody of the property, the place-of-purchase presumption gives New Jersey the right to make the holder ... turn over the property to the State. When fashioning the priority rules, the Supreme Court did not intend such a result, which would give states the right to override other states' sovereign decisions regarding the exercise of custodial escheat.

The court concluded:

[T]he potential of a windfall for the [stored value card issuers] that are incorporated in states that do not escheat abandoned property does not merit departing from the established priority rules. To depart from the *Texas* priority rules here would require us "to do precisely what [the Supreme Court] said should be avoided — that is, 'to decide each escheat case on the basis of its particular facts or to devise new rules of law to apply to ever-developing new categories of facts.'"

The Third Circuit clearly established in *N.J. Retail Merchants Association* that the *Texas* priority rules *do* apply to disputes between a state and a private party. For this reason alone, it seems that Marathon and Speedway may have compelling grounds for an appeal to the Third Circuit.

In a footnote, Judge Stark distinguished this case from *N.J. Retail Merchants Association* on the basis that the latter did not involve allegations of potential fraud (which the state raised in its motion to dismiss the Marathon and Speedway complaint). It is unclear why such allegations would serve to alter the fundamental federal common law rules applicable to a state's right and jurisdiction to escheat property. Perhaps the intended holding was *not* that the *Texas* rules do not apply to disputes between a single state and a holder, but rather that such rules do not necessarily preclude Delaware from discovering facts from non-Delaware companies that might lead to claims for escheat under a proper application of those rules to the facts of this case.

Otherwise, the import of Judge Stark's holding would be to allow Delaware to do exactly what the Third Circuit said it could not, which is to escheat property that is subject to the jurisdiction of another state. The Third Circuit found that doing so would violate the *Texas* rules even where the state of domicile of the debtor (i.e., the card issuer) affirmatively exempts the property from escheat. Here, the plaintiffs' gift cards are expressly exempt in such state (Ohio), yet the judge's holding would apparently allow Delaware to escheat those cards notwithstanding that exemption. Theoretically, Ohio could challenge Delaware's claim, thus setting up the kind of state-versus-state dispute the district court believes the federal common law rules were intended to apply to; however, the actual likelihood of Ohio pursuing a claim against Delaware regarding exempt property seems remote. For practical purposes, Delaware's claim to property exempted by other states would in many cases go unchecked.

It is likely that the next step in this ongoing saga will be an appeal of Judge Stark's ruling to the Third Circuit. Stay tuned for more.

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Please direct any questions to the following members of Alston & Bird’s Unclaimed Property Group:

John L. Coalson, Jr.  
john.coalson@alston.com  
404.881.7482

Kendall L. Houghton  
kendall.houghton@alston.com  
202.239.3673

Maryann H. Luongo  
maryann.luongo@alston.com  
202.239.3675

Michael M. Giovannini  
michael.giovannini@alston.com  
704.444.1189

Ethan D. Millar  
ethan.millar@alston.com  
213.293.7258

Samantha M. Bautista  
samantha.bautista@alston.com  
213.576.1052

Andrew W. Yates  
andy.yates@alston.com  
404.881.7677

Matthew P. Hedstrom  
matt.hedstrom@alston.com  
212.210.9533

Alexandra P.E. Sampson  
alexandra.sampson@alston.com  
202.239.3523

# ALSTON & BIRD

WWW.ALSTON.COM

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ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777  
 BEIJING: Hanwei Plaza West Wing ■ Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, 100004 CN ■ +86 10 8592 7500  
 BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719  
 CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111  
 DALLAS: 2828 North Harwood Street ■ 18th Floor ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899  
 LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100  
 NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444  
 RESEARCH TRIANGLE: 4721 Emperor Blvd. ■ Suite 400 ■ Durham, North Carolina, USA, 27703-85802 ■ 919.862.2200 ■ Fax: 919.862.2260  
 SILICON VALLEY: 1950 University Avenue ■ 5th Floor ■ East Palo Alto, California, USA, 94303-2282 ■ 650.838.2000 ■ Fax: 650.838.2001  
 WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333