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Unclaimed Property ADVISORY ■

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Delaware Moves to Revamp Its Unclaimed Property Law

On January 12, 2017, the Delaware Senate introduced legislation that represents a complete rewrite of the state's Escheats Law, currently codified at 12 Del. Code Ann. § 1130 *et seq*. The bill – **SB 13** – is essentially the state's reaction to recent unclaimed property developments in Delaware, including primarily the 2016 *Temple-Inland* decision. (Alston & Bird's prior coverage of *Temple-Inland* can be found **here**, **here** and **here**.) We do not intend to provide an exhaustive discussion of the legislation given that it is subject to change. Rather, the purpose of this advisory is to summarize select provisions that may have an impact on currently pending audits and the state's Voluntary Disclosure Agreement (VDA) program.

Structural Changes to the Escheats Law

Structurally, SB 13 repeals the current subchapters II, III and IV of the Escheats Law and enacts a completely new set of statutes as subchapter II of Title 12 beginning with section 1130. The bill includes a new set of definitions, along with a new set of dormancy standards similar to section 201 of the Uniform Unclaimed Property Act (UUPA), which was revised in 2016. Although many of these definitions and dormancy standards are derived from the UUPA, in other cases (such as the definition of "holder") the definitions remain consistent with the Escheats Law as currently drafted. Certain new concepts and features include the following:

- There is a new statutory dormancy standard for "property in an individual retirement account that is qualified for tax deferral under the income tax laws of the United States." The Escheats Law does not currently address IRAs and other retirement accounts. Such property would be presumed abandoned upon one of the following:
  - Three years after the date of the required distribution, specified in U.S. income tax laws by which distribution of the property must begin in order to avoid a tax penalty.
  - Three years after knowledge of death of the owner, either before or after reaching the age of required distribution and the beneficiary has not contacted the business association within three years after the date of death.
- Loyalty cards would be expressly exempt from escheat. For this purpose, "loyalty card" is defined as "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."

- "Money or credits owed to a customer as a result of a retail business transaction" would be escheatable five years after the obligation arose.

- Virtual currency would be escheatable, which is consistent with the UUPA's treatment of this emerging property type. This term is defined as "a digital representation of value used as a medium of exchange, unit of account, or store of value, which does not have legal tender status recognized by the United States," not including loyalty cards.

- Gift cards and stored value cards would be escheatable. Current law requires the escheat only of gift certificates.

The state would continue to exempt "uninvoiced payables," though the language of such exemption continues to make clear that there is no general business-to-business exemption. In addition, layaway deposits would continue to be exempt.

SB 13 also addresses what is considered to be an "indication of an owner's interest in property" for purposes of applying the dormancy standards, which are also based in part on the UUPA. An indication of an owner's interest would include, among other things, oral communication by the owner to the holder regarding the property, as well as activity directed by an owner in the account (including accessing the account). Notably, automatically recurring transactions are not included, in contrast to the UUPA. The concept of owner activity is currently defined in the Escheats Law in a much more limited manner. In addition, the bill codifies guidance issued in 2012 by former State Escheator Mark Udinski pertaining to ACH accounts and dividend reinvestment plan accounts related to the non-return of an IRS Form 1099.

Audits, Voluntary Disclosures and "Compliance Reviews"

SB 13 provides a number of provisions that would revamp Delaware's current audit and voluntary disclosure programs. There are a number of options for holders who have not yet been contacted for audit by Delaware, as well as holders with pending unclaimed property audits. Most notably:

- The bill continues the requirement enacted by the Delaware General Assembly in 2015 and effective July 1, 2015, that all holders be given the opportunity to enter into the Secretary of State's VDA program before being subject to audit by the Department of Finance. The bill does provide an exception to this requirement for (1) holders who have failed to comply with a requirement imposed under the VDA program, (2) information received under Delaware's False Claims and Reporting Act and (3) a joint examination initiated by another state.

- For holders currently under audit, the bill offers two options:

  – **Conversion to a VDA.** For pending audits authorized on or before July 22, 2015 (except securities examinations in which estimation is not required), the bill offers holders the opportunity to convert the audit into a VDA. Penalties and interest would generally be waived under the VDA program. Holders desiring to take advantage of this option must notify the State Escheator and Secretary of State in writing by July 1, 2017.

  – **Expedited audit review.** For pending audits authorized before the bill's effective date, holders would have the opportunity to request an expedited review. Under the process, the State Escheator would complete the examination and provide a report within two years from the date of the request. Penalties and interest would generally be waived under an expedited audit review. Requests to participate in the process must be received by July 1, 2017.

SB 13 also establishes a new so-called compliance review process that allows the Department of Finance to conduct a review of a report filed by a holder, along with all supporting documents related to the report, in instances in which the state believes a holder has filed an inaccurate, incomplete or false report. The state is required to notify the holder of any deficiencies discovered during the review within one year from the date the review was authorized. Holders will have 90 days to pay the deficiency; otherwise, the state may proceed to either enforce the assessment or refer the holder to the VDA program. It is important to note that holders selected for a compliance review do not need to first be given notice of the opportunity to participate in the VDA program, though a holder undergoing a compliance review is not precluded from participating in the VDA program.

The bill also provides a host of additional provisions that will impact the construct of future audits and VDAs, including the following:

- **State Escheator must adopt regulations.** The bill requires the State Escheator to adopt regulations governing the procedures and standards for compliance reviews and examinations, including rules for estimation, extrapolation and statistical sampling in conducting an examination.

- **Verified reports for holders electing not to file negative reports.** Holders that do not file a report may be required to file a verified report indicating whether the person is holding reportable property and, if so, describing the property not previously reported and its value.

- **Reduced look-back periods.** The look-back period would be reduced for all VDAs and audits to a maximum of 10 report years. Currently, audits have a maximum rolling 22-year look-back period, and VDAs have a maximum statutory 19-year look-back period, which was administratively reduced to 10 years following the *Temple-Inland* decision.

- **10-year statute of limitations.** There would be a 10-year statute of limitations for the state to seek payment of unclaimed property. This is greater than the current statute of limitations, which is three years from the date the report was filed (six years for reports with an omission of unclaimed property of more than 25 percent of the amount disclosed in the report). However, the new statute of limitations applies in instances in which a holder did not file a report, whereas currently there is no statute of limitations for years in which a report was not filed. Under the bill, the new statute of limitations is tolled if a holder is contacted for audit or if the State Escheator reasonably concludes that the holder filed a report containing a fraudulent or willful misrepresentation.

- **(Mostly) mandatory interest.** The bill increases the maximum amount of statutory interest that may be assessed on late-reported property from 25 percent to 50 percent of the amount of property due. While the bill gives the Secretary of State and the Department of Finance the authority to waive interest under the VDA and expedited audit programs, respectively, outside of these programs, the State Escheator is only permitted to waive up to 50 percent of the interest assessment and only for good cause.

- **Added unclaimed property evasion civil penalties.** In addition to the penalties currently provided by statute – that is, penalties for the failure to file a timely report, failure to pay unclaimed property and fraud – the bill establishes an additional penalty for any holder that enters into a contract or other arrangement for the purpose of evading unclaimed property obligations or that otherwise willfully fails to perform any other duty. The penalty is $1,000 for each day the obligation is evaded or the duty is not performed, up to a cumulative maximum of $25,000, plus 25 percent of the amount or value of any property that should have been but was

not reported, paid or delivered as a result of the evasion or failure to perform. Under the bill, the State Escheator may waive this penalty, in whole or in part, for good cause.

Record Retention

In *Temple-Inland*, the federal district court sharply criticized Delaware for employing estimation after failing to specify how long holders should retain records. In response to this decision, SB 13 proposes to substantially adopt the record-retention requirements of the UUPA. Specifically, the bill requires holders to retain records for 10 years after a report is due and provides specific data elements that these records must contain. Notably, the Delaware bill does not require issuers of instruments "similar" to money orders to retain the state and date of issue of the instrument, in contrast to the UUPA. This omission presumably was intentional and made to reflect Delaware's position in its case before the U.S. Supreme Court (*Arkansas v. Delaware*) that the priority rules for instruments similar to money orders are not governed by federal statute. In addition, the State Escheator would be required to retain records of holder reports for at least 10 years after the report was filed.

Estimation

Since 2010, the Escheats Law has given the State Escheator the power to estimate holder liability during an audit. SB 13 continues this authority but limits it to cases where the holder (1) has not retained records for the 10-year period required by the bill or (2) has not filed unclaimed property reports during the look-back period. These limitations were included in direct response to the *Temple-Inland* decision in which the court held that Delaware's historical estimation practices were unconstitutional for various reasons, including that the state lacked a record-retention requirement and improperly disregarded the statute of limitations. The bill also would require the Secretary of Finance and Secretary of State to coordinate on promulgating a regulation laying out the method of estimation the state will use. This regulation will guide estimation both in audits and VDAs.

Jurisdictional Rules for Taking Custody of Unclaimed Property

Unlike the laws of most other states, the Escheats Law currently does not contain an articulation of the federal common law rules established by the U.S. Supreme Court for determining when a state has the right and jurisdiction to take custody of unclaimed property, presumably on the basis that such rules constitute federal law and cannot be altered by any state. However, SB 13 changes that by including provisions that are apparently intended to either codify, clarify or unlawfully expand these federal rules.

In particular, SB 13 would provide that Delaware has the right to take custody of property if the last-known address of the owner, as shown on the records of the holder, is in Delaware. In addition, under SB 13, Delaware also has the right take custody of property if the holder is "domiciled" in Delaware and any of the following apply:

1. The holder does not have a last-known address for the property owner;
2. The owner's last-known address is in a state that does not provide for custodial taking of unclaimed property; or
3. The last-known address of the owner is in a foreign country.

While the federal rules generally permit the state of domicile of the holder to escheat property if the address of the owner is unknown (or if the address is in a state that has not adopted laws applicable to unclaimed intangible property), the federal rules do not permit the state of domicile to escheat foreign-owned property.

Notably, SB 13 would also define "domicile" to mean the state of formation or organization (if such formation/organization requires a state filing) for a business association other than a corporation. This definition (which is consistent with the UUPA definition) codifies Delaware's administrative position regarding LLCs and LLPs. The U.S. Supreme Court has never addressed which state is the domicile of an LLC or LLP.

Liquidation of Securities

Delaware's practices associated with the liquidation of securities have come under fire in recent years. SB 13 would change those practices by imposing the following requirements:

- The State Escheator must send written notice to an owner prior to liquidating a security, with certain exceptions. Currently, the state is only required to publish notice of unclaimed property in a daily newspaper.

- The owner of a security has the ability to recover from the state the replacement of the security or the market value of the security at the time the claim is filed (at the State Escheator's option), provided that the claim is made within 18 months from the date notice was mailed. To the extent the security is still in the custody of the State Escheator at the time of the claim, the owner is entitled to receive it back along with dividends/interest that have accrued.

However, securities would remain subject to an "inactivity" dormancy standard – a security is presumed abandoned "3 years after the last indication of interest in the property." Though, as noted above, the non-return of a Form 1099 is considered to be an indication of interest in certain circumstances.

Judicial Review

Currently under the Escheats Law, a holder that wishes to protest an unclaimed property assessment must first appeal to the Audit Manager, then directly to the Secretary of Finance, who will appoint an independent reviewer to hear the case and issue a written report. The secretary then issues an acceptance or rejection of the independent reviewer's report, which the holder may appeal to the Court of Chancery. SB 13 does away with this two-step administrative process. Under the bill, a holder would appeal an assessment directly to the Court of Chancery, either before or after remitting the amount assessed. In the resulting suit, the Court of Chancery must give deference to the State Escheator's findings of fact but will review issues of law de novo. The court is specifically empowered to hear federal constitutional challenges to assessments.

Due Diligence Requirements

SB 13 requires holders to provide written due diligence notices to owners before transferring property to the state, aligning Delaware with every other jurisdiction. Delaware mandates first-class mail and does not allow for email notice (unlike the UUPA). Otherwise, the due diligence requirements are essentially identical to the UUPA's. In particular, a holder must (1) inform the owner that property will be turned over to the state, after which the owner must file a claim with the state to recover the property, (2) identify the nature and value of the property, (3) state that property is not legal tender of the United States and may be sold by the state and (4) provide instructions that the owner must follow to prevent the holder from reporting and paying or delivering the property to the state. The notice must also contain a heading that reads "Notice. The State of Delaware requires us to notify you that your property will be transferred to the custody of the State Escheator if you do not contact us before [insert date that is 30 days after the date of this notice.]"

Overall, SB 13 represents a sea change in Delaware unclaimed property law. We will continue to monitor this legislation and provide additional detailed updates as the bill progresses through the Delaware General Assembly.

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