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Unclaimed Property ADVISORY ■

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Predicting the Possible "Perfect Storm" of Unclaimed Property Trends in 2018

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The upcoming year promises to be action-packed and potentially unsettling for unclaimed property professionals – we will need to monitor, advocate, analyze and apply a slew of new rules and standards in order to effectively manage risk and optimize outcomes for our clients and employers.

In fact, 2018 is shaping up to be a "perfect storm" of holder- and state-initiated litigation, multistate and federal legislative initiatives, the onset of a new round of Delaware VDAs, and of course the continuing saga of more contract audit firms performing more compliance examinations for more states on more holders. ***Did we mention there would be "more"?***

We provide the following summary of what is already on the radar for holders and their advisors in 2018.

Litigation – What Happened, and What's Next

Not to be outdone by 2016 and *Temple-Inland*, 2017 was a banner year for courts to issue substantive decisions involving unclaimed property issues. Several of these decisions will likely reverberate into 2018 and beyond. From our perspective, the most significant decisions in 2017 that are likely to be felt in 2018 were the Third Circuit's decisions in *Plains All American Pipeline* and *Marathon Petroleum Corp.*, as well as the state court decision in the ongoing Delaware qui tam litigation and the New Jersey *Bed Bath & Beyond* case. We will briefly summarize these decisions and provide a view as to the next steps in each litigation, if any.

Plains All American Pipeline L.P. v. Cook, 866 F.3d 534 (3rd Cir. 2017)

What happened? In 2015, Plains All American Pipeline brought suit against Delaware in federal court seeking declaratory judgment that an audit proposed by the state and outsourced to Kelmar Associates was unconstitutional. Plains alleged that the proposed audit and components of the Delaware Escheats Law violated various provisions of the U.S. Constitution. The district court granted the state's motion to dismiss in 2016, holding that the case was not yet ripe because the state had not conducted its audit yet, and thus there were no actual injuries suffered by Plains.

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On August 9, 2017, the Third Circuit reversed the dismissal of Plains' as-applied procedural due process claim (while affirming the district court's dismissal in all other respects). The Third Circuit found that such procedural due process claim was ripe for judicial review, holding that the claim satisfies the ripeness test based on the fact that Kelmar—a self-interested party—has been vested with responsibility for conducting the audit and had demanded documents. The court also held that a ruling on the merits "would be 'useful to the parties and other who could be affected' given Delaware's widespread use of private auditors." Accordingly, the court remanded to the district court for consideration of Plains' procedural due process claim on the merits.

What's next? Subsequent to the Third Circuit's remand, Plains notified the district court that it had elected to convert its audit into a Delaware VDA (more on this below). Thus, the parties stipulated to dismissal of the lawsuit. This means that the district court will not have an opportunity to decide the procedural due process claim on the merits, and holders are left with merely encouraging language by the Third Circuit regarding contingency fee auditors but no decision on which to rely. Nonetheless, given the window opened by the Third Circuit, it is possible that another holder will bring a procedural due process claim in the early stages of a Delaware audit being conducted by a contingency fee auditor.

Marathon Petroleum Corp. et al. v. Cook, **876 F.3d 481 (3rd Cir. 2017)**

What happened? Through Kelmar, Delaware initiated an audit of Marathon Petroleum Corporation and Speedway LLC. As part of the audit, Kelmar requested "extensive detailed information" about Marathon and Speedway's affiliated entities, Marathon PrePaid Card LLC (MPC) and Speedway Prepaid Card LLC (SPC), which are Ohio domiciled. In response, Marathon and Speedway produced documents demonstrating that MPC and SPC were not Delaware-domiciled entities to show "that Delaware lacks standing to claim any unredeemed gift cards, even if any exist."

Kelmar responded in a letter stating that failing 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." Marathon and Speedway, along with their affiliated entities, filed a complaint in federal district court seeking a declaratory judgment and injunctive relief on federal preemption and Fourth Amendment grounds. The district court granted Delaware's motion to dismiss, holding that although the plaintiffs' claims were ripe, the federal common law rules established in Texas v. New Jersey do not apply to disputes between a state and a private party.

On December 4, 2017 the Third Circuit reversed and held that the federal common law rules established by the Supreme Court did in fact create a private right of action to challenge a state's unclaimed property audit and escheatment of unclaimed property. However, the court also held that Delaware "plainly" had the authority to conduct an unclaimed property audit of Marathon, Speedway, and MPC/SPC and "dig for information about who, a parent or a subsidiary, is the true holder of escheatable funds." The court also found that the Texas trilogy does not restrict the state to only looking within the four corners of the contracts in question in making this determination. Rather, the state may engage in an "alter ego" analysis, which involves a "fact-based inquiry into whether the formalities of corporate separates have been observed, not just in theory but in practice." However, the court made clear that an audit could be preempted where "a state's demands for information may become so obviously pretextual or insatiable" as to lead to conflict

preemption. The Third Circuit concluded that such a preemption challenge was not yet ripe in this case, as Delaware had not formally demanded that the companies comply with the audit or risk facing penalties. Accordingly, the court vacated and remanded the district court's decision so that the district court could clarify that the plaintiffs' preemption claim was dismissed without prejudice.

What's next? On January 5, 2018, the district court acted on the Third Circuit's mandate and vacated its prior decision with respect to plaintiffs' federal preemption claim. The district court dismissed such claim without prejudice so that it could be "revived at a later date, if appropriate." Despite the dismissal, the Third Circuit's opinion is likely to play a crucial role in future audits by Delaware of gift card programs, as it establishes the contours of the state's authority to conduct an alter ego inquiry into parent-subsidiary relationships, including language that would support a preemption claim if the process turns from investigative to abusive. In addition, the Third Circuit appears to have settled with finality the debate regarding whether the federal common law rules apply in disputes between a private holder and a state.

Delaware qui tam *(State ex rel. French v. Card Compliant, LLC,* No. N13C-06-289 (Del. Super. Ct. April 21, 2017)

What happened? The ongoing Delaware qui tam litigation has been well covered over the last few years. Essentially, in early 2014, Delaware intervened in a false claims act case claiming that the use of a non-Delaware third party gift card entity to issue gift cards and assume the liabilities for preexisting cards effectively constituted fraud subject to treble damages and other penalties under the Delaware False Claims and Reporting Act (the "DFCRA").[1] On April 21, 2017, the Delaware superior court dismissed three of the defendants from the lawsuit based on the DCFRA's Administrative Proceedings Bar. The court found that the allegations in the qui tam were "substantially based upon allegations or transactions which are the subject of the State's previous or current audits or inquiries" of the defendants. In particular, two of the defendants had been under audit since before the qui tam suit was filed, and another defendant had enrolled in the state's VDA program prior to that date. The court subsequently refused to certify the relator's interlocutory appeal regarding the dismissal of the defendant that had participated in a prior Delaware VDA rather than an audit.

What's next? The case proceeds to trial in 2018, if the court does not rule in defendants' favor on its motion for summary judgment, which was argued in late 2017. In the interim, the Department of Finance continues to audit gift card and loyalty and rewards programs regardless of whether those instruments are issued by related-party entities or by third-parties such as Card Compliant.

***BBB Value Services, Inc. / Bed Bath & Beyond Inc. v. Treasurer, State of New Jersey et al.,* No. A-2973-14T3/A-4880-14T3 (N.J. App. Div. Sept. 21, 2017)**

What happened? Bed Bath & Beyond and its subsidiary, BBB Value Services, sued the state of New Jersey for a refund of merchandise return certificates that were reported to the state as unclaimed property between 2004 and 2012 after a three-year period of dormancy. BB&B contended among other things that the certificates were not escheatable prior to the July 2010 change in New Jersey's unclaimed property law to require the escheat of "stored value cards." In addition, for items issued in July 2010 forward, only 60% of the value of stored value cards was escheatable (and the dormancy period was five years rather than three

[1] Alston & Bird is representing several retailers that were named as defendants in this action.

years). The New Jersey Superior Court, Appellate Division, agreed with BB&B and ordered the Unclaimed Property Administration to provide BB&B with its refund. With respect to the pre-July 1, 2010 certificates, the court held that such certificates were not "property" under the New Jersey unclaimed property act, because they were not claims for the payment of money, consistent with the court's prior decision in *Matter of Nov. 8 1996, Determination of State* case (309 N.J. Super. 272 (1997)). With respect to the certificates issued on and after July 1, 2010, the court agreed that these items were stored value cards under the statute and thus were remitted early and at an incorrect amount (100% rather than 60%).

What's next? The New Jersey Unclaimed Property Administration has recently promulgated proposed regulations that would essentially formalize the court's decision. In particular, the proposed regulations provide that credits issued for merchandise returned without a receipt are "stored value cards," and that any such stored value cards that redeemable only for merchandise or services that were issued after July 1, 2010 are escheatable 5 years after last activity at 60% of unused balance. Stored value cards redeemable only for merchandise/services (including those issued for returned merchandise) issued prior to July 2010 are not escheatable.[2]

In addition, this coming year is sure to have its own set of momentous decisions. While it is somewhat difficult to predict, we would not be surprised if a case challenging the constitutionality of Delaware's estimation methodology found itself back in federal court in light of Temple-Inland. 2018 should also see resolution of the ongoing Delaware qui tam litigation – at least at the trial court level – as well as continuation of litigation pending in the Delaware Court of Chancery challenging Delaware's right under federal law to escheat foreign-owned property. See JLI Invest S.A. v. Cook, No. 112740-VCN (Del. Ch. filed July 9, 2015).

Additional States Will Likely Adopt the Revised Uniform Unclaimed Property Act

In 2017, three states—Illinois, Tennessee, and Utah—enacted a version of the Revised Uniform Unclaimed Property Act ("RUUPA"), which was finalized by the Uniform Law Commission in 2016. Overall, while there are some controversial and less holder-friendly aspects of RUUPA (as discussed below), the act represents an improvement over the previous 1995 Uniform Unclaimed Property Act in many ways, including section 610, which provides a statute of repose thus imparting greater certainty to holders that have been filing unclaimed property reports, and section 208, which provides dormancy standards for investment assets that trigger the running of a dormancy period on mail being returned as undeliverable to the owner, versus mere inactivity by the owner, who may have a buy-and-hold approach.

Although the RUUPA is billed as a uniform act, each state's enactment differed in some respects from the standard RUUPA provisions, and Illinois' enactment in particular represented the most drastic departure. This is in some ways attributable to the fact that there are several optional provisions included in RUUPA, such as the treatment of gift cards and merchandise return credits – it is entirely up to the discretion of the state whether to exempt or escheat these items.

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2 See N.J.A.C. 17:18-3.1 (proposed amendment) and 17:18-3.3 (proposed new rule). We will note that several aspects of the proposed regulations are problematic, including deviations from the statutory definitions of "holder" and "issuer of a stored value card," as well as language regarding promotional cards that is completely inconsistent with the statutory provision that cards for which no "direct monetary consideration" was paid are exempt.

However, even with respect to the non-optional provisions, states have found a way to depart from the uniformity and chart their own path. One notable example relates to Illinois' new statutory provision applicable to securities. Rather than adopt the RUUPA's relatively straightforward standard based on the receipt of returned mail, Illinois has concocted a complex, three-part standard that applies one of three potential dormancy periods. In particular, a security is presumed abandoned upon the earlier of (a) three years after receipt of returned mail, (b) five years after the last owner-generated activity, or (c) two years after the owner's confirmed death.

Illinois' adoption of RUUPA has also illustrated that not all aspects of the uniform law are an improvement over current state laws, as Illinois no longer recognizes a business-to-business ("B2B") exemption and has adopted a contractual anti-limitations provision, consistent with the standard RUUPA.3 Other controversial aspects of RUUPA include its continued adherence to the third jurisdictional priority rule, express provision for the escheatment of foreign-owned property, recognition of the state's ability to use contingency fee auditors, and no restriction on the use of estimation, among other things.

We expect that an increasing number of states will adopt a version of RUUPA in 2018 to join Illinois, Tennessee, and Utah. Indeed, already in 2018 RUUPA legislation has been introduced or is pending in the District of Columbia (B22-0654), Maine (LD821, carried over from 2017), Minnesota (SF1035, introduced in 2017), Nebraska (LB141, carried over from 2017), Vermont (H311, introduced in 2017), and Washington (HB2486).

The ABA's Model Unclaimed Property Act Will Continue to Move Forward

At the same time that various states are moving forward with the adoption and enactment of RUUPA bills, the American Bar Association has completed several drafts of its own Unclaimed Property Model Act. The ABA's impetus for urging states to consider adoption of its Model Act as opposed to the RUUPA was to address several perceived infirmities with RUUPA and other state unclaimed property laws. According to the ABA's Unclaimed Property Subcommittee, these infirmities include, among other things:

- Provisions that violate or likely violate the U.S. Constitution
- Provisions that are inconsistent with the federal common law rules established the U.S. Supreme Court for determining when states have the right to escheat unclaimed property
- Provisions that are inconsistent with the primary purpose of unclaimed property laws, which is to return missing property to its rightful owner
- Provisions that do not adequately protect the rights of owners or holders of unclaimed property
- Provisions that are needlessly complex or that are vague or ambiguous

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[3] Unlike exemptions for gift cards and merchandise return credits, RUUPA does not include an option for states to provide for a B2B exemption. Rather, a comment to RUUPA indicates that any state "that wants to continue to exempt this type of property will need to include in this section its definition of a business-to-business relationship and specifically state in the definition of 'property' in paragraph 102(24)(C) that it does not include property arising from a business-to-business relationship." Tennessee is one state that has continued its B2B exemption in its new RUUPA-based law.

- Provisions that raise significant public policy concerns[4]
- It is anticipated that a final version of the Model Act will be available sometime in 2018. Whether any state moves to adopt it in place of the RUUPA provisions remains to be seen, however.

Delaware VDA Program

As this article went to print, we learned that more than 150 holders had converted their Delaware audits into VDAs, pursuant to the statutory election that 2017's S.B. 13 created. These holders opted to convert their audits into VDAs in order to secure the VDA waiver of interest and penalties, as well to de-couple from contract audit firm methodologies and the challenges associated with defending many Delaware contract audits. This said, the Secretary of State and his VDA administration firms (Drinker, Biddle & Reath and the newly retained TL2Q LLC (an acronym for "To Look, To Question")) expect the standard VDA process to be followed – including the estimation of liability for Delaware-domiciled entities – and the holders' VDA submissions must be completed within a two-year timeline. In addition, holders that migrated the Delaware portion of their audits to the VDA program will still have to continue the audit process with regard to other audit-participating states.

We expect issues to arise in the VDA context associated with scoping (the audit firm's scoping determinations are controlling for VDA purposes, but not every scoping issue will be clearly delineated), the question whether an audit firm's decision to cease review of a property type is sufficient grounds to conclude that no liability exists for VDA purposes, and other "translational" questions. Given the fact that estimation is still being employed by both State agencies (Finance and State), we predict that some of these holders may eventually withdraw from the VDA in order to be in position to litigate the constitutional validity of the estimation method – if a holder completes the VDA program, it forfeits any right to challenge the VDA liability.

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[4] See https://apps.americanbar.org/dch/committee.cfm?com=CL690014. Ethan Millar, a partner with Alston & Bird, chairs the Unclaimed Property Subcommittee.

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