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Unclaimed Property ADVISORY ■

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Bracing for the Next Wave of Delaware Unclaimed Property Reform: Review of SB 103 and SB 104

Two unclaimed property bills were introduced in the Delaware State Senate on April 14, 2021. The first, SB 103, would "expressly" include virtual currency as escheatable property and, as currently proposed, would become effective on August 1, 2021. The second, SB 104, purportedly "clarifies various aspects of the State's procedures,""confirm[s] current examination practice" and "address[es] recent court decisions," and provides for an effective date of August 1, 2021 for certain—but not all—of the provisions; several of the provisions purport to apply retroactively to pending claims, examinations, and litigation. This potpourri bill is likely to have something to [dis]please everyone.

SB 103

The bill proposes to adopt an "express reporting requirement for virtual currency" by expanding the definition of "property" to include virtual currency and adopting a five-year dormancy period for such property, which is triggered upon the owner's last indication of interest in the property. The bill would also require liquidation of virtual currency within 90 days before the filing of the report and provides that owners would not have recourse against holders that liquidate the virtual currency as required. A definition of "virtual currency" modeled after the Revised Uniform Unclaimed Property Act (RUUPA) definition in Section 102(32) would also be added, which is "a digital representation of value, including cryptocurrency, used as a medium of exchange, a unit of account, or a store of value that does not have legal tender status recognized by the United States." This definition explicitly excludes "game-related digital content," "a loyalty card," and "software or protocols governing the transfer of the digital representation of value." "Game-related digital content" is a newly defined term also modeled after the RUUPA definition. "Loyalty card" is already a defined term under existing law and explicitly exempt from escheat.

Some observations

This is not the first time the Delaware General Assembly has attempted to include virtual currency as property. The original bill that overhauled Delaware's Escheats Law in 2017 would have subjected virtual currency to escheat, but that provision was removed. While legislation effectuating a change to include virtual currency should be prospective, the use of the word "expressly" in the legislative synopsis leaves open the possibility that Delaware would assert that virtual currency was already reportable property under existing law. That is unfortunate and troubling. Holders

should never be subject to escheat reporting responsibilities retroactively; holders' obligations should be clear and unquestionable. The bill's effective date of August 1, 2021 should, however, eliminate any claim by the state that virtual currency was escheatable property before that date.

If enacted, Delaware would join several states in subjecting virtual currency to escheat as a statutory matter, including Colorado, Illinois, Kentucky, Nevada, Tennessee, Utah, and Vermont, jurisdictions that have either enacted some or all of RUUPA. Only one of these states, however, has a statutory requirement for the pre-escheat liquidation of virtual currency (Kentucky), and this requirement is novel and controversial, not to mention potentially damaging to owners. That said, the concept appears to be gaining steam, as a number of pending bills in other states would similarly require pre-escheat liquidation. Moving forward, it is possible that states will obtain platforms to facilitate acceptance of virtual currency; some states, including Ohio, already accept tax payments via virtual currency. Thus, it is not out of the question that escheatment of cryptocurrency becomes analogous to the in-kind escheatment of securities.

Finally, while the hold-harmless provision for holders liquidating the virtual currency may be a welcome provision to holders, the impact to owners of liquidation would be a mixed bag due to the wide fluctuation in valuation. The legislature's synopsis recognizes the "volatility inherent in this property type's value" and suggests that the liquidation provision would benefit owners. However, fluctuation has both upside and downside potential and while "winners" are not likely to balk, there would likely be unhappy "losers," and those losers are apt to seek redress in the courts. Indeed, the prospect of there being more losers than winners is readily apparent by simply referencing the historical increase in value of bitcoin, for example. It is also highly questionable whether this type of provision would pass muster under the Takings Clause, Due Process Clause, or similar constitutional theories.

SB 104

This bill addresses a wide range of issues and revises numerous provisions in Delaware's Escheats Law. The bill is in part a response to various ongoing litigation matters involving the state and holders, as well as ongoing disputes in audits and voluntary disclosure agreements. We understand that the bill is on a fast track and is expected to be signed into law. If (or rather, when) it is enacted, the bill would make many changes.

Reduce the dormancy period for bonds from five to three years. [Section 2 of the bill]

While the bill's synopsis states that this provision "clarifies" the "current practice" of treating bonds "similar to securities-related property," suggesting that the state might try to assert a retroactive application, the bill itself provides that this change would not be retroactive – it is effective August 1, 2021 "for the next annual reporting period."

Would revise the dormancy standard for deceased-owner IRAs to be one year following the date of required distribution that results from the owner's death; under the SECURE Act, this date is generally December 31 of the tenth year following the year the owner dies. [2]

Currently the law provides that such an IRA is escheatable three years after the date of the owner's death, provided that the death has been confirmed by the holder. Thus, application of this new standard could result in an IRA becoming escheatable long before the beneficiary was required to take distribution under the SECURE Act. The three-year dormancy period for IRAs for which the holder has no knowledge of death remains unchanged.

Would provide that the statutory indemnity for holders would not include penalties and interest imposed by another state. [6]

Holder indemnification is a critical element of states' unclaimed property laws and protects holders that deliver unclaimed property to a state in good faith from claims by owners or another governmental agency. Penalties and

interest do not exist in a vacuum; they are inextricably related to the underlying reporting liability, and excluding them from the scope of the indemnity is contrary to the purpose of indemnification.

Would provide that the delivery to a holder of a voluntary disclosure agreement (VDA) notice from the secretary of state and a holder's written election to enter into a VDA would now toll the 10-year period of limitation for the state's commencement of an action to enforce the law. [7]

Existing law provides that the 10-year limitation period is tolled only by the state escheator's delivery of an examination notice; there is no tolling provision associated with the VDA program. Since the secretary of state's VDA notice is required to precede the issuance of a notice of examination and must provide holders with a 60-day window to request a VDA (which the bill proposes to increase to 90 days), the tolling of the statute of limitations will now occur at least 60 days earlier (or 90 days earlier under the bill) for such holders. Further, any holder filing a written election to enroll in the VDA program will also have the statutory 10-year period of limitations tolled; this provision likely does not impact current VDAs (because there is no existing tolling provision in Delaware law) and would only be applied prospectively.

Would revise the provisions applicable to the recovery of securities by owners. [8, 9]

The state escheator's office is required to sell securities delivered to it after the notice requirements to the owner have been satisfied and "as soon the State Escheator deems practicable after the delivery." Under existing law, if the state escheator no longer has the security, an owner claiming a security within 18 months would either be entitled to receive a replacement security or its fair market value. The bill changes the 18-month period to 558 days (18 months times 31 days per month) and would now provide that the period runs from the date of an owner's first documented contact if a claim is made within 60 days of that contact. The bill also "clarifies" that claims within the 558-day window would also receive dividends and interest (as would likely be constitutionally required).

States' rush to sell securities has often worked to the disadvantage of owners because securities are often purchased with the intention of being held to secure long-term appreciation and the stock market has reliably reflected appreciation over time. This bill offers modest changes to allow owners to fall within the 558-day window but does not address the underlying issue of states' race to liquidate property.

Would allow the state to review records that include information to verify the completeness or accuracy of the records provided, even if such records may not identify property reportable to the state. [13]

The legislative synopsis states that "recent court decisions" motivated the proposed provision. One such decision is *Delaware v. AT&T*, where the Delaware Chancery Court voided a subpoena because it was "so expansive that enforcement would constitute an abuse [of the court's process]." AT&T had challenged the subpoena on many bases, including that it requested records related to transactions with last-known addresses outside the state. The Chancery Court noted that including in a subpoena requests for information regarding property "at the outer limit of [Delaware's] auditing authority" and concluded that "a broad request for information concerning property that does not fall into any escheatable category makes it more likely that enforcing a subpoena would be an abuse of … process." The inclusion of this provision in the bill should not change that result.

Would allow the state to direct a person to send a due diligence letter to an owner (or the state can send such a letter directly). [13]

The legislature's synopsis notes that it "confirm[s] current practice that [due diligence] letters may be sent at any time during an examination at the holder's initiative or at the direction of the State Escheator." In addition, this section

"expressly allows the State to mail owner notification letters during an examination." The intent and motivation behind this provision are unclear. At a high level, the state cannot force a holder to send a due diligence letter to property that has not been determined to be presumed abandoned. And it would seem inappropriate for the state to send a holder a due diligence letter on its own accord, particularly for property that is not clearly escheatable.

Would adopt a permanent expedited audit program. [14]

As proposed, holders under an examination initiated after February 2, 2017 and before August 1, 2021, as well as holders subject to examinations initiated after August 1, 2021, would be allowed to elect to expedite their examinations. In addition, the bill would permit a holder that receives a VDA notice from the secretary of state to request an expedited audit as an alternative to the VDA. As provided by the bill, the benefit of an expedited audit, at least for audits after August 1, 2021, includes a reduction in interest (interest would be capped at 1% of the assessment) and no penalties. Holders that completed the prior expedited audit program were able to avoid all interest. Audits initiated between February 2, 2017 and August 1, 2021 are eligible for a complete interest waiver based on current Delaware law.

To convert an ongoing audit to an expedited audit, within 60 days of the effective date of the law, the holder would be required to submit a form to the state escheator, with any outstanding information requested and a workplan for completing the examination. For audits commenced after August 1, 2021, a holder presumably can make the request at any time (there is no time limit for doing so specified in the bill); however, a holder would be required to provide any outstanding information requested and a workplan for completing the examination. The state escheator would have 60 days to determine whether to grant the holder's request and could revise the holder's proposed workplan, and such determination would be "within the complete discretion of the State Escheator and subject only to the review of the Secretary of Finance." A holder that receives a VDA notice would have 90 days from the secretary of state's request that the holder enter into a VDA to request an expedited examination; the state escheator is required to mail a notice of examination within 30 days of receipt of the request.

As currently administered, the expedited audit program's disclosure and notice of intent to expedite completion of the unclaimed property examination pursuant to 12 Del. C. § 1172(c) was available to holders under audit when the 2017 Act became effective and provided full waiver of penalty and interest contingent on completion of the audit within two years of the date the holder notified the state of its intention to have its standard audit converted to an expedited audit. Under the current expedited audit program, all information and document requests are also required to be issued within 18 months. The bill does not propose to change these timeframes, but the two-year period to complete the expedited audit would run from the date of the state escheator's acceptance.

The bill also provides "full and final payment" requirements for holders permitted to have their audits expedited to the earlier of 90 days after the issuance of the statement of findings and request for payment or three years from acceptance of the request for an expedited audit. A single 180-day discretionary extension may be granted. Failure to pay could result in a conversion to a standard audit with the concomitant interest and penalties being assertable.

However, completing expedited audits within the two-year timeframe has proven elusive for many, particularly large holders and holders with numerous affiliates. The statute currently provides that the right to terminate an expedited audit "shall be within the complete discretion of the State Escheator and subject only to the review of the Secretary of Finance." Several companies have challenged the state escheator's actions in terminating expedited audits, and the federal district court ruled that the benefits of an expedited audit are not protected entitlements procedural due process applies to and that the companies in those cases did not sufficiently state a Fourth Amendment search and seizure violation.

Since the bill does not change the right of the state escheator to terminate an expedited audit, holders electing to undergo an expedited audit must be prepared to dedicate sufficient resources to comply with the short timeframe to ensure that they will be able to reap the benefits of the interest and penalty relief.

Would revise the time to request to elect to participate in the VDA program (or to request an expedited audit in lieu of the VDA) to 90 days from the date of delivery of the VDA request from the secretary of state. [16]

This proposed extension to 90 days would be a welcome change. Businesses are often unsure of whom to direct the secretary of state notices, which may be directed to persons having no familiarity with unclaimed property administration, and substantial time passes before the notice makes its way into the right hands. A 90-day period also affords holders an opportunity to review and evaluate their unclaimed property situations and determine whether to elect the VDA program or expedited audit and at least begin to get their ducks in a row to prepare for entry into the VDA program or the start of an audit.

Would revise the audit lookback period to be 10 years after the duty arose from the earlier of the date on which the state delivers written notice of such examination or the secretary of state delivers a notice that the person may enter into a VDA, except if the state reasonably concludes that the holder has filed a report containing a fraudulent or willful misrepresentation. [14]

Current law provides that the audit period is 10 years before property is presumed abandoned (vs. when the "duty arose") from the calendar year the state escheator provided the audit notice. There is no reference to a VDA invitation in the current audit lookback provision. In addition, the new law would provide for a similar 10-year lookback period for holders that withdrew (or are removed) from the VDA program based on the date the holder provided notice of intent to enter into the VDA program.

Would authorize the state to commence an audit for any reason and provide that the state is under no obligation to provide any other more specific or detailed reason or justification other than to determine compliance with law. [15]

This provision is in stark contrast to the laws of many states that require the state to have a "reason to believe" that the holder is in possession of past-due unclaimed property and may be subject to challenge on constitutional grounds, particularly by national banks and other regulated entities.

Would bar records obtained in audit or VDA from being used in a joint exam with another state unless the holder consents in writing. [17]

For examinations commenced after August 1, 2021, the bill would preclude holder records from being used in another state audit unless the holder agrees. Presumably, this provision in the bill was motivated by the Delaware Chancery Court's concern in *Delaware v. Univar*, which recognized confidentiality issues arising from multistate audits and resulted in Delaware "walling off" Kelmar auditors working on the Delaware audit from Kelmar auditors working on audits for other states.

Would require contract auditors to be paid hourly, except for examinations of customer accounts or policies for securities accounts and life insurance policies. [19]

Holders and their representatives have long railed against the practice of many states to use contingency fee auditors in unclaimed property examinations. The use of contingency fee auditors is the likely impetus for many of the egregious positions and assessments made in Delaware audits over the years (e.g., *Temple-Inland v. Cook*) and raises due process and other concerns. Delaware's Chancery Court recognized in *Delaware v. AT&T* that the contingency fee arrangement that the state had with Kelmar "potentially creates a pernicious incentive for Kelmar

to serve broad information requests and engage in expansive audits that impose substantial burdens on companies, thereby inducing settlements that generate income for Kelmar." It is unclear why *all* audits were not included within the requirement that hourly auditors be used and what is motivating the exclusion for customer account, securities, and life insurance audits.

Would require interest to be no less than 20% "per incident" (i.e., total past-due liability) for any holder that receives an audit notice after August 1, 2021; interest is capped at 1% per incident for any holder that receives a notice of examination after August 1, 2021 and completes and remits payment pursuant to an expedited audit. [21, 22]

Although interest will continue to be waivable for holders under the state's VDA program, the bill would remove the provision waiving interest for holders in the expedited examination program. Instead, holders involved in an expedited audit (at least, for audits commenced after August 1, 2021) would be subjected to a mandatory nonwaivable 1% interest assessment. For nonexpedited audits initiated after August 1, 2021, the bill would mandate a minimum nonwaivable 20% interest assessment. This would substantially increase the costs on holders, even if they took reasonable positions in reporting property to the state, and even if the resulting assessment would not have accrued interest at 20% or more. Further, mandating a minimum amount of interest is essentially an additional penalty, rather than true interest that is imposed for the use of (or inability to use) money. The legislature seems to be giving short shrift to the purpose of unclaimed property laws, which is to reunite property with its owners, not to raise revenue.

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