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In this inaugural installment of UP Ahead, Millar discusses federal common law preemption in the context of state unclaimed property laws.

When most companies or state authorities think of federal preemption of state unclaimed property laws, they think of federal statutes that supersede these laws. And to be sure, there are many federal statutes that preempt state unclaimed property laws, including ERISA, the Bankruptcy Code, the Airline Deregulation Act, the Motor Carrier Act, and the National Bank Act.[1] However, federal common law preempts state laws to the same extent as federal statutes.[2] And in the context of unclaimed property, preemption by federal common law is much broader than preemption by federal statute since it applies across industries and property types and vastly limits state powers to escheat unclaimed property.[3]

This article provides an overview of federal common law preemption in this area and explains why preemption should apply to render invalid state laws requiring escheatment of foreign-address property, escheatment of estimated property, escheatment from non-debtor entities, escheatment of money when there are obligations merely to provide goods or services, and escheatment of property that is not (or is no longer) owed to the owner.

I. The Origins of Federal Common Law in the Unclaimed Property Context

In *Texas v. New Jersey*,[4] the U.S. Supreme Court first considered the question of when a state has the right and jurisdiction to escheat unclaimed intangible property. Because this question was raised in the context of an interstate dispute, the Court exercised its original jurisdiction to hear the case under Article III, section 2 of the U.S. Constitution.[5] Importantly, the Court recognized that unclaimed property is the "debt" that is owed

[1] *See, e.g.*, 29 U.S.C.A. section 1144(a); 11 U.S.C. section 1141(d); 49 U.S.C.A. section 41713(b); 49 U.S.C. section 14501(c)(1); 12 U.S.C. sections 21 et seq.; and 12 C.F.R. section 7.4009(b).

[2] *Wilburn Boat Co. v. Fireman's Fund Insurance Co.*, 348 U.S. 310, 314 (1955).

[3] As a technical matter, state unclaimed property laws are not "true escheat" laws, which refer to laws in which the states take title to the property. Rather, all state unclaimed property laws are now "custodial escheat" laws, in which the states take custody of property for the owner of the property, who can reclaim it at any time. However, the term "escheat" has endured and will be used herein to refer to the taking of property by a state as custodian for the owner.

[4] 379 U.S. 674, 677 (1965).

[5] This section permits the Court to hear, as a matter of first (and last) impression, all "Controversies between two or more States" and "all cases . . . in which a State shall be a Party." *See also* 28 U.S.C. section 1251(a) (1958 ed.).

by the debtor to the creditor.[6] Reasoning that a debt is the property of the creditor and not the debtor, the Court established a "primary rule" that "the right and power to escheat the debt should be accorded to the State of the creditor's last known address as shown by the debtor's books and records."[7] The Court chose this primary rule because it "involves a factual issue simple and easy to resolve, and leaves no legal issue to be decided."[8]

The Court then established a "secondary rule" to apply if the debtor has no record of the creditor's last known address.[9] In that event, the debtor's state of incorporation has the right to escheat the debt.[10] The Court noted that its holding "is fundamentally a question of ease of administration and of equity. We believe that the rule we adopt is the fairest, is easy to apply, and in the long run, will be the most generally acceptable to all the States."[11]

The Court reaffirmed these primary and secondary rules in *Pennsylvania v. New York*[12] and *Delaware v. New York*.[13] In *Pennsylvania*, the Commonwealth of Pennsylvania sought to escheat money orders based on where the money orders were sold rather than where the debtor was incorporated. The Court rejected Pennsylvania's claim, stating that "to vary the application of the *Texas* rule . . . would require this Court to do precisely what we 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.'"[14]

Next, in *Delaware*, the Court was asked to determine which state had the right to escheat unclaimed dividends and other securities distributions. In analyzing this question, the Court clarified that the jurisdictional escheat rules set forth in *Texas v. New Jersey* "*cannot be severed from the law that creates the underlying creditor-debtor relationships*."[15] Thus, "in framing a State's power of escheat, we must first look to the law that creates property and binds persons to honor property rights."[16] The Court therefore held that the resolution of the issue was to be conducted in three steps:

> *First, we must determine the precise debtor-creditor relationship as defined by the law that creates the property at issue.* Second, because the property interest in any debt belongs to the creditor rather than the debtor, the primary rule gives the first opportunity to escheat to the State of "the creditor's last known address as shown on the debtor's books and records." Finally, if the primary rule fails because the debtor's records disclose no address for a creditor or because the creditor's last known address is in a State whose laws do not provide for escheat, the secondary rule awards the right to escheat to the State in which the debtor is incorporated.[17]

In *Delaware*, the Supreme Court reaffirmed its holding in *Texas v. New Jersey* and clarified that the legal relationship between the creditor and debtor, and the nature of any obligation owed, is grounded "in the positive law that gives rise to the property at issue."[18] The Court emphasized that its "examination of the holder's legal obligations not only defined the escheatable property at issue but also carefully identified the relevant 'debtors' and 'creditors'" for purposes of determining which state, if any, has the right to escheat.[19] Therefore, under *Delaware*, both the identity of the debtor and the nature of the debt are essential to determining a state's right to escheat.

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[6] *Texas*, 379 U.S. at 680.

[7] *Id.* at 680-81.

[8] *Id.* at 681.

[9] *Id.* at 682. The Court also held that the secondary rule may apply if the last known address of the owner is in a state that does not "provide for escheat" of unclaimed intangible property. However, all states have now adopted rules providing for the escheat of such property. Thus, as a practical matter, the secondary rule applies only when the address of the creditor is unknown.

[10] *Id.*

[11] *Id.* at 683.

[12] 407 U.S. 206 (1972).

[13] 507 U.S. 490 (1993).

[14] *Pennsylvania*, 407 U.S. at 215.

[15] *Delaware*, 507 U.S. at 503 (emphasis added).

[16] *Id.* at 501-02.

[17] *Id.* at 499-500 (emphasis added; internal citations omitted).

[18] *Id.* at 501.

[19] *Id.* at 503.

II. State Laws That Conflict With Federal Common Law Are Preempted

The rules set forth by the Supreme Court in *Texas v. New Jersey*, *Pennsylvania v. New York*, and *Delaware v. New York* constitute federal common law, which cannot be changed or countermanded by any state law. Indeed, in *Delaware*, the Court expressly stated: "These rules arise from our 'authority and duty to determine for [ourselves] all questions that pertain' to a controversy between States, and no State may supersede them."[20]

Nonetheless, states have argued that, since the federal common law rules were originally created in the context of an interstate dispute, they do not apply to disputes between a single state and a holder of unclaimed property. The only federal appellate courts to have considered this issue have soundly rejected such arguments. For example, in *American Petrofina Co. of Texas v. Nance*,[21] a suit by private litigants against the Oklahoma Tax Commission, the court declared an Oklahoma statute to be "invalid and unenforceable pursuant to the supremacy clause of the United States Constitution, because it is inconsistent with the federal common law set forth in *Texas v. New Jersey*."[22] "State laws are preempted to the extent they conflict with federal common law," the court noted, and thus "the Supreme Court's decision in *Texas v. New Jersey*, may be relied upon to prevent state officials from enforcing a state law in conflict with the *Texas v. New Jersey* scheme for escheat or custodial taking of unclaimed property."[23] On appeal, the Tenth Circuit affirmed, stating that "the district court's reasoning is in accord with our views."[24]

Similarly, in *New Jersey Retail Merchants Association v. Sidamon-Eristoff*,[25] the Third Circuit upheld a preliminary injunction of a New Jersey escheat law on the basis that it was inconsistent with these federal common law rules. In that case, the New Jersey statute at issue would have permitted the state in which gift cards were sold, rather than the state where the debtor was incorporated, to escheat the cards.[26]

Most recently, in *Marathon Petroleum Corp. v. Secretary of Finance for Delaware*,[27] the Third Circuit expressly held that states may escheat property only in accordance with the federal common law rules set forth in *Texas*, *Pennsylvania*, and *Delaware*,[28] and that any state that attempts to escheat property in a manner conflicting with those rules "is preempted by federal common law from escheating the property."[29]

Like the Tenth Circuit in *American Petrofina*, the Third Circuit also expressly held that private parties (that is, holders of unclaimed property) may "invoke federal common law to challenge a state's authority to escheat property."[30] The court analyzed the issue in detail, explaining that "the reasoning of the *Texas* cases is directly applicable to disputes between a private individual and a state" because the federal common law rules "were created not merely to reduce conflicts between states, but also to protect individuals."[31] The court stated that "without a private cause of action, the *Texas* trilogy's protections of property against escheatment would, in many instances, become a dead letter."[32] The court explained that "denying a private right of action would leave property holders largely at the mercy of state governments for the vindication of their rights" and "would make it easier for states outside of the line of priority to escheat property and would require the Supreme Court to exercise or delegate its original jurisdiction in a greater number of cases, undermining one of the chief benefits of the rules of priority."[33] The court also noted that

[20] *Id.* at 500 (citation omitted). *See also Illinois v. City of Milwaukee, Wisconsin*, 406 U.S. 91, 105-06 (1972); and *New Jersey Retail Merchants Association v. Sidamon-Eristoff*, 669 F.3d 374, 391-93 (3d Cir. 2012).

[21] 697 F. Supp. 1183, 1190 (W.D. Okla. 1986), *aff'd*, 859 F.2d 840 (10th Cir. 1988).

[22] 697 F. Supp. at 1190.

[23] *Id.* at 1187.

[24] 859 F.2d at 842.

[25] 669 F.3d 374, 391-96 (2012).

[26] Also, in *Nellius v. Tampax Inc.*, 394 A.2d 233, 237 (Del. Ch. 1978), the Delaware Court of Chancery held that "the Delaware State Escheator has no present standing to claim the property under the Delaware escheat statutes" from a holder when Delaware was attempting to do so in a manner inconsistent with the federal common law rules.

[27] 876 F.3d 481 (3d Cir. 2017).

[28] *Id.* at 491.

[29] *Id.* at 484.

[30] *Id.* at 484.

[31] *Id.* at 494.

[32] *Id.*

[33] *Id.* at 494-95 and n.15.

"making private rights contingent on state action would likewise undermine the Supreme Court's goal of national uniformity, because whether an individual is protected would depend on whether a state brings suit to contest escheatment of the property."[34] The court concluded that "the Supreme Court's desire for a uniform and consistent approach to escheatment disputes indicates that a private right of action is fully appropriate."[35]

III. The Extent of Federal Common Law Preemption of State Unclaimed Property Laws

The federal common law rules set forth in the *Texas* trilogy of cases apply broadly to limit state power to escheat unclaimed intangible property in three primary contexts: (1) determining which state has the right to escheat unclaimed property, (2) determining the identity of the person with the obligation to escheat the property, and (3) determining the property that the state has the right to escheat. Each of these scenarios is discussed below.

A. Determining Which State Has the Right to Escheat

The primary and secondary rules determine which state, if any, has the right and jurisdiction to escheat unclaimed property in any particular case. In *Texas*, the Court designed rules that would "unambiguously and definitively resolve disputes among states regarding the right to escheat abandoned property."[36] In other words, the Court intended the primary and secondary rules to be the sole bases under which states may take custody of unclaimed property. States have nonetheless attempted to expand their jurisdiction to escheat from the *Texas* rules in several ways. For example, over 30 states have adopted a "tertiary rule" that would permit the state in which the transaction giving rise to the property occurred to escheat the property, if no state escheats the property under the primary or secondary rule.[37] However, in *Marathon Petroleum Corp.*, the Third Circuit unequivocally held that "the two states allowed to escheat under the priority rules of the *Texas* cases are the *only* states that can do so."[38] This opinion followed *American Express Travel Related Services Co. v. Sidamon-Eristoff*, in which the district court similarly held that under federal common law, "there is no room for a third priority position. If the secondary-rule state does not escheat, the buck stops there."[39] The Third Circuit also held in that case that state laws presuming the address of the owner to be located in the state where the transaction took place were likewise preempted.[40] As a result, no states appear to be attempting to enforce these types of "transaction-based" custody rules, although they have not yet been formally repealed.

A much more significant issue, as a practical matter, is the escheatment of property when the owner is in a foreign country. The Supreme Court has not held that *any* state has the right to escheat property belonging to an owner residing in a foreign country.[41] Yet, almost all states have adopted statutes permitting the state of domicile of the holder to escheat such property. These state laws were based on provisions in the Uniform Unclaimed Property acts.[42] In designing these provisions, the Uniform Law Commission (ULC) acknowledged that "this issue was not dealt with by the Supreme Court in *Texas v. New Jersey*," but

[34] *Id.* at 495.

[35] *Id. See also, e.g.*, *Temple-Inland Inc. v. Cook*, 192 F. Supp.3d 527 (D. Del. 2016); *State ex rel. French v. Card Compliant LLC*, No. N13C-06-289 FSS [CCLD], 2015 Del. Super. LEXIS 1069 (Del. Super. Ct. Nov. 23, 2015); and *State ex rel. Higgins v. SourceGas* LLC, No. N11C-07-193 MMJ CCLD, 2012 WL 1721783 (Del. Super. Ct. May 15, 2012).

[36] *New Jersey Retail Merchants Association*, 669 F.3d at 394. The Supreme Court stated that it wanted to "settle the question" of which state will be entitled to escheat unclaimed property in any given circumstance. *Texas*, 379 U.S. at 677.

[37] Unif. Unclaimed Prop. Act section 3(6) (Unif. Law Comm'n 1981); Unif. Unclaimed Prop. Act section 4(6) (Unif. Law Comm'n 1995); and Unif. Unclaimed Prop. Act section 305 (Unif. Law Comm'n 2016). The 2016 version of the act narrowed the scope of this rule by making clear that it does not apply if the holder's state of domicile "specifically exempts" the property from escheat. However, while that change limits the practical impact of the tertiary rule, it does not cure the constitutional infirmity.

[38] *Marathon Petroleum Corp.*, 876 F.3d at 491 (emphasis added).

[39] 755 F. Supp.2d 556, 606 (D.N.J. 2010).

[40] *New Jersey Retail Merchants Association*, 669 F.3d at 394.

[41] To the contrary, the Court expressly stated in *Texas v. New Jersey* that the state of domicile of the holder has the right to escheat only if the last known address of the owner of the property is unknown or "is in a *State* which does not provide for escheat of the property." *Texas*, 379 U.S. at 682 (emphasis added); *see also Delaware*, 507 U.S. at 498 (*quoting Texas*, 379 U.S. at 682).

[42] Unif. Unclaimed Prop. Act section 3(6) (Unif. Law Comm'n 1981); Unif. Unclaimed Prop. Act section 4(6) (Unif. Law Comm'n 1995); and Unif. Unclaimed Prop. Act section 304 (Unif. Law Comm'n 2016).

argued that the escheat of foreign-address property is "a rational extension of that ruling."[43] But *Marathon* found that there are no "rational extensions" of the *Texas* rules; rather, any state laws that go beyond the two-rule scheme laid out by the Supreme Court in *Texas* are preempted. As the Third Circuit held:

> Constructed as federal common law, that order of priority gives first place to the state where the property owner was last known to reside. If that residence cannot be identified or if that state has disclaimed its interest in escheating the property, second in line for the opportunity to escheat is the state where the holder of the abandoned property is incorporated. *Any other state is preempted by federal common law from escheating the property.*[44]

The foreign country where the owner is located also has a greater interest in regulating unclaimed property belonging to its citizens than the U.S. state in which the holder of the property is domiciled. This is consistent with the *Texas* rules, which reflect the traditional view of escheat as an exercise of sovereignty over persons and their property and the common law doctrine of *mobilia sequuntur personam*, which recognizes that the law governing an owner's personal property is the law of the jurisdiction where the owner resides.[45]

Many states have also adopted statutes that permit the state to escheat property if the holder of the property does not have a record of the owner's address or identity, but the administrator has "determined" by other means that the last known address of the owner is in the state.[46] It is not clear exactly what the states (or the ULC, which originally created such rules) were contemplating here, but in *Texas*, the Court held that under the primary rule, "each item of property . . . is subject to escheat only by the State of the last known address of the creditor, *as shown by the debtor's books and records*."[47] Accordingly, the Court's decision in *Texas* does not support the use by a state of extrinsic evidence of the owner's address to establish an obligation of the holder under the primary rule. To the contrary, as discussed above, one of the key objectives of the Court in creating the federal common law rules was to establish rules that are simple and easy to administer.[48] These goals would be served by applying the primary rule based solely on the holder's records. Indeed, the Court expressly stated that "since our inquiry here is not concerned with the technical domicile of the creditor, and since ease of administration is important where many small sums of money are involved, *the address on the records of the debtor*, which in most cases will be the only one available, *should be the only relevant last-known address*."[49]

Many states also attempt to define the scope of the *Texas* rules through their statutes. For example, some states attempt to define the term "last known address" in the primary rule either narrowly (that is, the full mailing address of the owner) or broadly (that is, a ZIP code or other information that merely identifies the state where the owner is located).[50] Other states attempt to define the holder's "domicile" for purposes of the secondary rule.[51] These laws miss the point. States simply have no power to construe federal common law, and therefore these laws are meaningless to the extent that they would expand

[43] *See* Cmts. to Unif. Unclaimed Prop. Act section 3(5) (Unif. Law Comm'n 1981).

[44] *Marathon Petroleum Corp.*, 876 F.3d at 484 (emphasis added).

[45] *Delaware*, 507 U.S. at 503. Although beyond the scope of this article, the escheat of foreign-owned property is also almost surely unconstitutional under the foreign affairs doctrine and the commerce clause of the U.S. Constitution. *See, e.g.*, *Zschernig v. Miller*, 389 U.S. 429 (1968); and *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434, 448, 449, 454 (1979).

[46] Unif. Unclaimed Prop. Act section 3(3) (Unif. Law Comm'n 1981); Unif. Unclaimed Prop. Act section 4(3) (Unif. Law Comm'n 1995); and Unif. Unclaimed Prop. Act section 302(2) (Unif. Law Comm'n 2016).

[47] *Texas*, 379 U.S. at 681-82 (emphasis added).

[48] *Id.* at 683.

[49] *Id.* at 681 n.11 (emphasis added).

[50] While the Supreme Court did not expressly explain what it meant by "last known address" in the *Texas* cases, it is likely that the Court intended the ordinary meaning of the term to apply. The ordinary meaning of the term "address" is a mailing address. *See, e.g.*, *In re Application of County Collector*, 826 N.E.2d 951, 956-57 (Ill. App. Ct. 2005); *Bank of America NA v. Bridgewater Condos LLC*, No. 299441, 2011 WL 5866932, at *7 (Mich. Ct. App. Nov. 22, 2011); and *State v. Knudson*, 174 P.3d 469, 472 (Mont. 2007).

[51] The Supreme Court held that the domicile of a corporation is its state of incorporation. The Court also rejected the right of the holder's principal place of business to escheat the property in both *Texas v. New Jersey* and *Pennsylvania v. New York* because it may give rise to factual issues and thus would not fulfill the Court's goal of creating a bright-line test. It appears that the Court would similarly consider the state of domicile of a noncorporate entity to be its state of formation.

the scope of the state's jurisdiction to escheat, as intended by the Supreme Court. On the other hand, there is no bar on a state *limiting* its jurisdiction to escheat. A state may adopt a jurisdictional rule that is narrower than what the *Texas* rules permit. Many states have done this, albeit perhaps unintentionally.[52]

B. Determining the Identity of the Person With the Obligation to Escheat

The Supreme Court held in *Delaware v. New York* that the federal common law rules also establish that only the legal "debtor" has the obligation to escheat the property. *Delaware* involved the question of which state had the right to escheat unclaimed dividends and other securities distributions. As discussed above, the Court explained that the primary and secondary rules set forth in *Texas* "*cannot be severed from the law that creates the underlying creditor-debtor relationships*"[53] and that therefore the first step in analyzing any unclaimed property issue is to "determine the precise debtor-creditor relationship as defined by the law that creates the property at issue."[54] Once the debtor is identified, the debtor's records must be reviewed to determine if the primary rule applies. If the primary rule does not apply, the debtor's domicile identifies which state can escheat under the secondary rule.

The Court left no doubt that "we have not relied on legal definitions of 'creditor' and 'debtor' merely for descriptive convenience. Rather, we have grounded the concepts of 'creditor' and 'debtor' in the positive law that gives rise to the property at issue."[55] Thus, the Court concluded that "the holder's legal obligations not only defined the escheatable property at issue but also carefully identified the relevant 'debtors' and 'creditors.'"[56] In *Pennsylvania v. New York*, therefore, Western Union was a debtor "insofar as it owed contractual duties" to pay money to creditors.[57] The Court explained that by "recognizing that 'a debt is property of the creditor,' the primary rule permits the escheating State to protect the interest of a creditor last known to have resided there."[58] Similarly, if the creditor's address is unknown, "the secondary rule protects the interests of the debtor's State as sovereign over the remaining party to the underlying transaction."[59] The Court was concerned that if the terms "creditor" and "debtor" are *not* based on the underlying debtor-creditor relationship, that could "permit intangible property rights to be cut off or adversely affected by state action . . . in a forum having no continuing relationship to any of the parties to the proceedings."[60] Such a rule could also result in a person other than the actual legal obligor being required to escheat property, which would be directly contrary to the very purpose of state unclaimed property laws.

Many states have deviated from the straightforward rules set forth by the Supreme Court in *Delaware v. New York* by defining the term "holder" to include a person "in possession of property belonging to another."[61] However, as the Third Circuit succinctly stated in *Marathon*, the U.S. Supreme Court "rejected any efforts to loosen or change the priority rules by broadening the concept of a property-holding 'debtor.'"[62] These state-law definitions also ignore the basic principle in *Texas v. New Jersey* that "debts owed by" a holder of unclaimed property "are not

[52]For example, if a state defines the domicile of a holder to be its principal place of business, then the state can escheat under its own statute only if the holder's principal place of business is in the state (and the address of the owner is unknown). But if federal common law defines the domicile to mean the state of formation, then the state is of course bound by that rule as well. By putting its finger on the scale of when the state has jurisdiction, the state has effectively limited its right to escheat under the secondary rule to situations only when *both* (1) the holder is formed in the state *and* (2) the holder has its principal place of business in the state.

[53]*Delaware*, 507 U.S. at 503 (emphasis added).

[54]*Id.* at 499-500.

[55]*Id.* at 502.

[56]*Id.*

[57]*Id.*

[58]*Id.*

[59]*Id.* at 504.

[60]*Id.* (*quoting Pennsylvania*, 407 U.S. at 213.).

[61]These definitions are based on the Uniform Unclaimed Property Act of 1981. *See* Unif. Unclaimed Prop. Act section 1(8) (Unif. Law Comm'n 1981).

[62]*Marathon Petroleum Corp.*, 876 F.3d at 490.

property to it, but rather a liability."[63] Once it is understood that unclaimed property is not an asset but a liability, it makes no sense to define the "holder" of unclaimed property based on who is in "possession" of the property. After all, what does it even mean to be in possession of a liability? In any event, *Delaware*'s holding is unambiguous: To the extent that a state law definition of holder would impose escheat liability on any person other than the debtor, that definition is preempted by federal common law.

C. Determining the Property That the State Has the Right to Escheat

Just as the federal common law rules mandate that only the debtor has the obligation to escheat, such rules also prohibit states from escheating property other than the "debt" itself. As the *Delaware* Court expressly stated, "the holder's legal obligations . . . defined the escheatable property at issue."[64] Indeed, the Court further explained that "funds held by a debtor become subject to escheat *because the debtor has no interest in the funds* — precisely the opposite of having 'a claim to the funds as an asset.'"[65] Conversely, if the purported debtor *does* have an interest in the property at issue, no state may require escheat of the property. Put simply, the state cannot escheat what is not owed.

This basic principle (which has become known as the "derivative rights doctrine") is, of course, entirely consistent with the fundamental purpose underlying state unclaimed property laws, which is to return property to the rightful owner.[66] After all, "the right of escheat is a right of succession, rather [than] an independent claim to the property escheated."[67] There is a long line of cases, dating back to the 1950s, in which courts have recognized that a state's rights to escheat property is "purely derivative" from those of the owner and that the state "takes only the interest of the unknown or absentee owner."[68]

As these cases illustrate, the principle that a state's rights are based on and limited by those of the owner has long preceded *Delaware v. New York* and even *Texas v. New Jersey*. Most of these cases frame the issue as one of state law. But the U.S. Supreme Court's decision in *Delaware* clarified that this principle is also embedded in federal common law, to which states are bound. The concept would appear uncontroversial. After all, it makes little sense for states to escheat property that is not owed to give it to someone to whom it does not belong. Yet states surprisingly attempt to do this frequently. The following examples demonstrate that the problem is significant and widespread:

- *Escheat of Money When There Is an Obligation to Provide Goods or Services.* One area in which states commonly deviate from the derivative rights doctrine is when the debtor's obligation is to provide goods or services rather than pay money — for example, gift cards, movie or concert tickets, prepaid spa sessions, and the like. Instead of attempting to escheat the gift card or other item itself, the state will often attempt to escheat the money that the customer paid for the card.[69] However, unless the gift card is redeemable for money, the amount paid by the customer is property that belongs to the retailer that issued the card. It does not constitute a debt that is owed to the customer. In some cases, it may be presumed that the states only intended for their statutes to cover gift cards (or similar property) that were redeemable for money. After all, that was apparently the Third Circuit's presumption in *Marathon* when it considered the question of which

[63] *Texas*, 379 U.S. at 680.

[64] *Id.* at 503.

[65] *Id.* at 503.

[66] *See, e.g.*, *New Jersey Retail Merchants Association*, 669 F.3d at 383; *Azure Ltd. v. I-Flow Corp.*, 46 Cal.4th 1323, 1328 (2009); *State Department of Financial Services v. O'Connor*, 155 So.3d 479, 482 (Fla. App. 2015); and *GSC Enterprises v. Rylander*, 85 S.W.3d 469, 472 (Tex. App. 2002).

[67] *Barker v. Leggett*, 102 F. Supp. 642, 644-45 (W.D. Mo. 1951), *appeal dismissed*, 342 U.S. 900 (1952), *reh'g denied*, 342 U.S. 931 (1952) (internal citations omitted).

[68] *State v. Standard Oil Co.* ("The State's right is purely derivative: it takes only the interest of the unknown or absentee owner."). 74 A.2d 565, 573 (1950), *aff'd*, 341 U.S. 428 (1951). *See also, e.g.*, *State v. Texas Osage Royalty Pool Inc.*, 394 S.W.2d 241 (Tex. Civ. App. 1965) (adopting "the elementary rule that the State cannot acquire by escheat property or rights which were not possessed at the time of the escheat by the unknown or absent owners of such property or rights").

[69] *See, e.g.*, Ga. Code section 44-12-205.

entity was the debtor of a gift card.[70] In these cases, the state statute, if properly construed, would not run afoul of federal law.[71] Other states, however, cannot be given the benefit of the doubt because their unclaimed property laws expressly state that money must be escheated even if the gift card is redeemable only for goods or services.[72] In these states, there is no way to construe the statute in a manner consistent with federal common law. These statutes should be preempted.[73]

- *Escheat of Debts That Are No Longer Owed.* Over two-thirds of the states have also adopted provisions in their unclaimed property laws that provide that the expiration of the owner's right to recover the property, whether by contract, statute, or court order, does not prevent the property from being escheatable to the state.[74] These statutes (commonly referred to as "anti-limitations provisions") are perhaps the most blatant violators of the federal common law because they expressly purport to override contractual restrictions on an owner's right to claim property — *even if those restrictions are valid and enforceable under applicable laws governing the debtor-creditor relationship*. Rather than deferring to the underlying debtor-creditor relationship, as commanded by the Supreme Court in *Delaware v. New York*, these provisions purport to change it. These provisions are also directly contrary to the express purpose of unclaimed property laws: Rather than returning property to the rightful owner, these provisions take property that now belongs to the former debtor for the purpose of giving it to someone who no longer has any rights to, or interest in, such property.[75] The anti-limitations provisions would wreak havoc in a multitude of different contexts, from statutes of limitations (or repose) that have run on the owner's claim, to court-approved settlements in class actions that expire class members' rights to receive payments if they do not respond within the period allotted. Contract provisions that expire a party's ability to file claims against the other party are also common, particularly in the health insurance context. The anti-limitations provisions would disregard entire bodies of law that define the debtor-creditor relationships in these various situations, and therefore should be preempted.
- *Escheat of Property Based on an Estimate.* Delaware and other states have long maintained that they can use estimation to escheat property for periods when the holder no longer has complete and researchable records. These states argue that any such estimated property is escheatable to the holder's state of domicile under the secondary rule because there is no actual creditor and therefore all the estimated property is address-unknown. But if there is no actual creditor and no actual debt, then there is no property to escheat. Indeed, as the

[70] *See Marathon Petroleum Corp.*, 876 F.3d at 490 n.12.

[71] For example, in *Bed Bath & Beyond Inc. v. Chiang*, No. 37-2014-00012491-CU-MC-CTL (Cal. Super. Ct., San Diego Cty. Mar. 4, 2016), the court construed California's unclaimed property law to not require the escheat of store credits because they "are not redeemable for cash," and therefore the retailer "does not 'ow[e]' money to the owner" of a store credit. Likewise, in *Bed Bath & Beyond Inc. v. Treasurer, State of New Jersey*, Docket No. A-4880-14T3 (N.J. App. Div. 2017), the New Jersey Appellate Division concluded that the store credits were not escheatable under New Jersey's catchall provision "because they are not claims for the payment of money." The federal common law preemption issue thus became moot.

[72] *See, e.g.*, N.Y. Abandoned Property Law section 1315.

[73] Some states have attempted to cure the legal deficiencies in these laws by requiring the escheat of only 60 percent of the remaining balance on the gift card (or for Delaware, by escheating the "maximum cost" of the goods or services for which the card can be redeemed). However, such "accommodations" to holders, while arguably reducing the risk of a takings clause violation, cannot survive scrutiny under the federal common law analysis. There, the question is simply what is the debt that is owed to the owner of the card. If no money is owed to the owner of the card, then the state lacks power to escheat any money from the card issuer.

[74] Unif. Unclaimed Prop. Act section 29(a) (Unif. Law Comm'n 1981); Unif. Unclaimed Prop. Act section 19(a) (Unif. Law Comm'n 1995); and Unif. Unclaimed Prop. Act section 610(a) (Unif. Law Comm'n 2016).

[75] States have argued that the U.S. Supreme Court's 1948 decision in *Connecticut Mutual Life Insurance Co. v. Moore*, 333 U.S. 541 (1948), somehow overrides *Delaware* (decided 45 years later) and permits states to ignore contractual conditions that may prevent the property from being owed. However, *Connecticut Mutual* involved the narrow issue of whether New York's escheat statute applicable to life insurance proceeds violated the contract clause of the U.S. Constitution. It did not address the federal common law rules, which were not even created until the Court's 1965 decision in *Texas v. New Jersey*.

Supreme Court held in *Delaware v. New York*, under federal common law, the state can escheat only the actual debt owed, and an estimation is — by definition — not an actual debt.[76] In case there were any doubts on this issue, the Court also specifically rejected the use of "statistical surrogates" and "approximations" to support a state's right to escheat.[77] The *Delaware* Court rejected the use of statistical sampling to show that the creditors' addresses were located in New York to support a claim by New York under the primary rule. The same reasoning applies to prohibit use of sampling and other methods of estimation to determine the existence or amount of unclaimed property that a state may escheat. After all, since the primary and secondary rules "cannot be severed from the law that creates the underlying creditor-debtor relationships,"[78] it makes no sense to prohibit sampling to determine the location of the creditor but permit sampling to "create" the underlying debtor-creditor relationship. But that does not mean states are totally barred from using statistical sampling in the escheat context. To the contrary, there is nothing to prevent a state from using estimation as a *penalty* for failure to maintain records.[79] In fact, this was the conclusion reached by the ULC: In the commentary to the Uniform Unclaimed Property Act of 1995, the ULC stated that the estimation provision was to be "viewed as a penalty for failure to maintain records of names and last known addresses" of the property owners.[80] Thus, the state whose record retention laws were violated could impose a penalty. This will normally be the state where the creditor was located (because that is where the property would have been escheated if the record-retention law had been followed), not the state of domicile of the holder. This has the effect of putting the holder and the state in approximately the same position that they would have been in had the holder retained its records and escheated the property as required by that state's laws.[81]

The escheat of property that is not actually owed to the creditor also raises serious concerns under other constitutional provisions, including the takings clause and the due process clause of the U.S. Constitution. However, these issues are beyond the scope of this article.

IV. Conclusion

Most states do not appreciate the scope of the federal common law rules set forth in *Texas v. New Jersey*, *Pennsylvania v. New York*, and *Delaware v. New York*. However, these rules greatly restrict states' rights and jurisdiction to escheat unclaimed property. First, they permit states to escheat property only if the last known address of the creditor or owner is in the state or if the address is unknown and the holder is domiciled in the state. As a result, state laws permitting the escheat of foreign-address property or property based on where the transaction occurred are preempted and invalid. Second, the federal common law rules require only the legal debtor to escheat the property; state laws imposing liability on any other person are likewise void. Finally, but perhaps most importantly, federal common law

[76] *Delaware*, 507 U.S. at 499-500.

[77] *Id.* at 509.

[78] *Id.* at 503 (emphasis added).

[79] This assumes that the state in fact has adopted a record-retention requirement. Interestingly, Delaware (the primary exploiter of estimation methods) did not adopt a record-retention law until February 2017, and therefore should have no right to impose penalties on holders for failing to maintain records before such date.

[80] *See* Cmts. to Unif. Unclaimed Prop. Act section 17(f) (Unif. Law Comm'n 1995).

[81] A federal district court reached this same conclusion in *Temple-Inland Inc. v. Cook*, 192 F. Supp. 3d 527 (D. Del. 2016), albeit under a substantive due process theory. Delaware's method was invalid because it "created significantly misleading results" by not replicating the "characteristics and qualities of the property within the sample . . . across the whole."

provides that states can escheat only the actual debt that is owed. State laws that require escheat of money when there are obligations merely to provide goods or service, or escheat of debts that are no longer owed, or escheat based on estimation are therefore also preempted. Yet despite these federal common law rules, states continue to assert that their laws are valid and enforceable in unclaimed property examinations. Holders of unclaimed property should understand their legal rights in this complex area and resist the states' *ultra vires* positions. Indeed, as the Third Circuit held in *Marathon*, if a state acts in a manner contrary to federal common law, "it would defy logic to hold that the process itself [i.e., the audit] cannot be preempted."[82] ■

[82] *Marathon Petroleum Corp.*, 876 F.3d at 501 (*quoting NE Hub Partners LP v. CNG Transmission Corp.*, 239 F.3d 333, 348 (3d Cir. 2001)).