taxnotes® state

Volume 98, Number 5 ■ November 2, 2020

Estimation and Unclaimed Property

by Ethan D. Millar

Reprinted from *Tax Notes State*, November 2, 2020, p. 475

Estimation and Unclaimed Property

by Ethan D. Millar

Ethan D. Millar

Ethan D. Millar is a partner at Alston & Bird LLP and co-leader of the firm's unclaimed property team.

In this installment of UP Ahead, Millar reviews legal and policy issues surrounding states' use of estimation in the unclaimed property context and argues that the justifications raised by Delaware and contract audit firms for supporting the domicile-takes-all approach are invalid and should be rejected by courts, holders, and other states.

There is perhaps no issue in the unclaimed property context that is more misunderstood than the issue of estimation. In unclaimed property audits, auditors almost universally assert that if the holder has incomplete records for prior periods, only one state — the holder's state of domicile — has the right to estimate the amount of unclaimed property that should have been reported for that period. Under this method, the estimate is calculated based on unclaimed property that the holder owed to *all jurisdictions* in years that are researchable by the holder. The state of domicile thus receives a windfall under this approach, whereas the states that *would have received the property* if the holder had properly reported it in the first place get nothing. Making matters worse, the state of domicile in the unclaimed property context means the holder's state of incorporation, and thus Delaware — as the chosen state of incorporation for most of corporate America[1] — reaps a hugely disproportionate share of these benefits even though only a tiny fraction of owners of unclaimed property are located in the state.

This estimation method is bad public policy and is also flawed as a matter of law. It is premised on the idea that under federal common law rules created by the U.S. Supreme Court in the 1960s, only the state of domicile has the right and jurisdiction to escheat unclaimed property when the address of the property owner is unknown, and therefore since there are no *actual* owners of *estimated* unclaimed property, the state of domicile must have the sole right to escheat all estimated property. The Supreme Court punched a gaping hole in that logic, however, in its 1993 decision in *Delaware v. New York*,[2] when it made clear that unclaimed property represents *actual* debts that are owed to *actual* owners, and left no room for an *estimated* debt owed to a *hypothetical* owner. Indeed, the concept of a hypothetical owner is anathema to state unclaimed property laws, the purpose of which is to return unclaimed property to the rightful owner. If the owner is merely hypothetical, then by definition this purpose cannot be fulfilled.

This does not mean that estimation has no place in the unclaimed property context. To the contrary, in order to encourage compliance with their unclaimed property laws, states must be permitted to penalize holders that do not properly report unclaimed property. And estimations of property that should have been but was not reported may be useful in calculating such penalties, to ensure that the

[1] Government of Delaware, Delaware Division of Corporations, "2019 Annual Report Statistics" (Delaware continues "to be the domicile of choice for members of the *Fortune* 500 and newly public companies, with approximately 89% of all U.S. initial public offerings last year").

[2] 507 U.S. 490 (1993).

penalty bears a close relationship to the level of noncompliance. The Uniform Law Commission recognized this as far back as 1995, when it amended the Uniform Unclaimed Property Act post-*Delaware v. New York* and clarified that an estimate of unclaimed property liability should be "viewed as a penalty for failure to maintain records" by the holder. There is nothing in the Supreme Court's jurisprudence that suggests that only the state of domicile of the holder can impose such penalties. Just the opposite is true: A holder that does not maintain required records of a debt owed to an owner potentially violates the record retention requirements of the state in which the owner is located. It does not violate the unclaimed property laws of its state of domicile. As a result, there is no justification for the state of domicile to impose a penalty under these circumstances.

Although the use of estimation as a penalty for failing to maintain required records, and the corollary that each state may impose a penalty based on an estimation of what should have been but was not reported to that state, seems obvious as a matter of policy, law, and logic, unclaimed property auditors have not yet embraced this approach. Instead, they have clung to the "domicile-takes-all" approach pioneered by Delaware. Historically, the reason for this was clear: In most audits, the auditors are third-party firms that are compensated on a contingency basis. These firms thus have a financial interest in the domicile-takes-all approach because it imposes a much greater liability on holders. Furthermore, although almost all states would be better off using the state-by-state approach than the domicile-takes-all approach,[3] few states have the in-house expertise to truly understand these complex issues and as a result have deferred heavily to the audit firms regarding how to conduct the audit and determine liability, including through the use of estimation. This may be changing, though, as Delaware recently amended its contract with its largest audit firm to eliminate the contingency fee arrangement for general ledger audits. These auditors — which still have contingency fee arrangements with other states — thus may now find it more lucrative to pursue the state-by-state approach. Also, many holders — which in the past may not have fully understood their rights — are becoming more educated and more willing to fight aggressive state unclaimed property practices, including Delaware's estimation method. Indeed, there are now several pending cases challenging the domicile-takes-all approach. On the other hand, Delaware still has a massive incentive of its own — to the tune of hundreds of millions of dollars per year in revenue — to keep pushing the domicile-takes-all approach, and the state has employed a massive misinformation campaign seeking to convince holders that they will pay the same or even more under the state-by-state approach. Holders should not be deceived: Applying a state-by-state approach would in almost all cases result in lower liability.

This article focuses on the legal and policy issues surrounding the use of estimation by states in the unclaimed property context and argues that the justifications raised by Delaware and contract audit firms for supporting the domicile-takes-all approach are invalid and should be rejected by courts, holders, and states.

I. General Purpose and Structure of State Unclaimed Property Laws

State unclaimed property laws have a history that dates back to feudal times. These laws have evolved over the centuries, originally focusing on real property and tangible personal property, and moving toward almost a singular focus on intangible personal property in the modern era.[4] Unclaimed property laws began as "pure escheat" laws, such that after a set period of time, if the owner did not claim his property, title to the property would revert to the government. Beginning in the 1950s, states

[3] Somewhat confusingly, Delaware refers to its domicile-takes-all method as the "gross" method of estimation and the state-by-state method as the "net" method of estimation.

[4] *See, e.g.*, Uniform Unclaimed Property Act of 2016, section 102(24) (defining "property" subject to the act to include "a fixed and certain interest in intangible property held, issued, or owed in the course of a holder's business or by a government, governmental subdivision, agency, or instrumentality").

began to adopt "custodial escheat" laws, in which "the state takes custody [of the property] and remains the custodian in perpetuity."[5] The Uniform Law Commission adopted the first Uniform Unclaimed Property Act in 1954, noting that under this custodial escheat law, "the owner retains his right of presenting his claim at any time no matter how remote."[6] Such laws thereby "serve to protect the interests of [the] owner, to relieve the holders from annoyance, expense and liability, to preclude multiple liability, and to give the adopting state the use of some considerable sums of money that otherwise would, in effect, become a windfall to the holders thereof."[7]

The Uniform Law Commission revised the Uniform Unclaimed Property Act several times, in 1966, 1981, 1995, and most recently in 2016. Most states have adopted unclaimed property laws that are based at least in part on one of the uniform acts. And all states have now adopted custodial rather than pure escheat laws. All states' laws also follow a similar overarching structure that is designed so "that property owners be reunited with their property."[8] Courts construing state unclaimed property laws have uniformly held that such laws are intended "to protect unknown owners by locating them and restoring their property to them and to give the state rather than the holders of unclaimed property the benefit of the use of it, most of which experience shows will never be claimed."[9]

To fulfill their purpose in reuniting the owner with his property, state unclaimed property laws require holders of unclaimed property to first conduct "due diligence" to attempt to locate the owner of the property and return the property to him or her (this generally involves sending a letter to the owner's last known address); and second, if the due diligence is unsuccessful, report and remit the property to the state.[10] After the holder reports and remits the property (colloquially known as escheating the property) to the state, "the state [then] holds the property as a custodian until the property's rightful owner can claim the property."[11] Such laws are imperfectly designed, though, as typically the state is not required to take significant action (or in some cases, any action at all) to reunite the owner with the property post-escheat, though more recent unclaimed property laws do impose a due diligence requirement on the state as well.[12] And some states (Florida being a notable example) do make considerable efforts to reunite owners with their property, even without mandatory statutory requirements to do so.

II. Federal Common Law Rules Limiting State Jurisdiction to Escheat

Despite their similar structures and relationships to the uniform acts, state unclaimed property laws are anything but uniform. This has led to competing claims by states to escheat the same intangible property. For tangible property, "it has always been the unquestioned rule in all jurisdictions that only the State in which the property is located may escheat."[13] But no similar rule existed for intangible property. In *Western Union Telegraph Co. v. Pennsylvania*, the U.S. Supreme Court held that subjecting a holder to potential conflicting claims by two or more states seeking to escheat the same intangible property would violate the due process clause.[14] Four years later, in *Texas v. New Jersey*, the Court "adopt[ed] a rule which will settle the question of which State will be allowed to escheat [] intangible property."[15]

In *Texas*, the Court began by recognizing that unclaimed intangible property is the "debt" that is owed by the debtor to the creditor.[16] Reasoning

[5] Prefatory Note to the Uniform Unclaimed Property Act of 1954.

[6] *Id.*

[7] *Id.*

[8] Cal. Civ. Proc. Code section 1501.5(c).

[9] *Azure Ltd. v. I-Flow Corp.*, 46 Cal. 4th 1323, 1328 (2009). *See also, e.g., N.J. Retail Merchants Ass'n*, 669 F.3d at 383; *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).

[10] *See, e.g.*, Uniform Unclaimed Property Act of 2016, sections 401, 501, and 603.

[11] *Fong v. Westly*, 117 Cal. App. 4th 841, 844 (2004).

[12] *See, e.g.*, Uniform Unclaimed Property Act of 2016, section 503.

[13] *Texas v. New Jersey*, 379 U.S. 674, 677 (1965).

[14] *Western Union Telegraph Co. v. Pennsylvania*, 368 U.S. 71, 75 (1961).

[15] *Texas*, 379 U.S. at 677.

[16] *Id.* at 680.

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."[17] The Court then established a "secondary rule" to apply if the debtor has no record of the creditor's last known address.[18] In that event, the debtor's state of incorporation has the right to escheat the debt.[19] 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."[20]

The Court revisited these rules nearly 30 years later in *Delaware v. New York*. In that case, 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*."[21] 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."[22] 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.[23]

In *Delaware*, the Court thus 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."[24] The Court 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.'"[25] For example, "charters, bylaws, and contracts of deposit do not give a bank the right to retain abandoned deposits, and a law requiring the delivery of such deposits to the State affects no property interest belonging to the bank. Thus, 'deposits are *debtor obligations* of the bank,' and a State may 'protect the interests of depositors' as creditors by assuming custody over accounts 'inactive so long as to be presumptively abandoned.' Such 'disposition of abandoned property is a function of the state,' a sovereign 'exercise of a regulatory power' over property and the private legal obligations inherent in property."[26] In summary, the Court held 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.[27]

Some 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

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

[18] *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 should apply only when the address of the creditor is unknown.

[19] *Id.*

[20] *Id.* at 683. The Court reaffirmed these rules in *Pennsylvania v. New York*, 407 U.S. 206 (1972), in which 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.'" *Id.* at 215.

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

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

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

[24] *Id.* at 501.

[25] *Id.* at 502.

[26] *Id.* (emphasis in original; internal citations omitted).

[27] *Id.* at 503.

unclaimed property. Thus, in these states' view, these rules can be ignored if they produce inconvenient results. However, the Supreme Court's decision in *Delaware v. New York* forecloses this result. The Court unequivocally 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."[28] Thus, even though the rules were created as the result of an interstate dispute, no state can adopt different rules regardless of the context. Furthermore, to the extent there was any lingering ambiguity on this issue, the Third Circuit's decision in *Marathon Petroleum Corp. v. Secretary of Finance for Delaware*[29] erased it. 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*,[30] 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."[31] The Third Circuit also made clear that an interstate dispute was unnecessary and that private parties (that is, putative holders of unclaimed property) may "invoke federal common law to challenge a state's authority to escheat property."[32] 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."[33] 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."[34] 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."[35] The court also noted that "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."[36] 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."[37]

The importance of the Supreme Court's holding in *Delaware v. New York* thus cannot be overstated. In plain terms, the Court's decision stands for the proposition that a state can only escheat actual debts that are owed by a debtor to a creditor. Indeed, by defining intangible property that may be escheated as the debt, the Court makes clear that the states' regulatory escheat powers are limited to that property. This makes sense. If no debt is owed, the state cannot create one out of whole cloth and then require the purported holder to escheat it. After all, "the right of escheat is a right of succession, rather [than] an independent claim to the property escheated."[38] If the state were to escheat property that is not owed, it would be taking assets that belong to the holder and converting them to an asset for the

[28] *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 Ass'n v. Sidamon-Eristoff*, 669 F.3d 374, 391-93 (3d Cir. 2012).

[29] 876 F.3d 481 (3d Cir. 2017).

[30] *Id.* at 491.

[31] *Id.* at 484.

[32] *Id.* at 484.

[33] *Id.* at 494.

[34] *Id.*

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

[36] *Id.* at 495.

[37] *Id.See also, e.g.*, *American Petrofina Co. of Texas v. Nance*, 697 F. Supp. 1183, 1190 (W.D. Okla. 1986), *aff'd*, 859 F.2d 840 (10th Cir. 1988); *N.J. Retail Merchants Ass'n v. Sidamon-Eristoff*, 669 F.3d 374, 391-93 (3d Cir. 2012); *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). Against this overwhelming authority, a single federal district court judge in 2019 struggled to justify the opposite result in *State of Texas v. ClubCorp Holdings Inc.*, Cause No. 1:19-CV-171-LY (W.D. Tex. Jan. 14, 2020).

[38] *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). *See also Hamilton v. Brown*, 161 U.S. 256 (1896) (holding that escheat is an aspect of state sovereignty allowing the regulation of succession to property); and *Cunnius v. Reading School District*, 198 U.S. 458 (1905).

benefit of a nonexistent creditor. Such action would have nothing to do with escheat.

The principle that a state's escheat powers apply only to actual debts forecloses the ability of states to escheat intangible property on an estimated basis. By definition, estimated debts are not actual "debtor obligations," and thus there is no property over which states have a right of succession. Indeed, in *Delaware v. New York*, the Court specifically rejected the use of "statistical surrogates" and "approximations" to support a state's right to escheat.[39] In that case, New York sought to use statistical sampling to show that the owners' addresses were located in New York to support its claim under the primary rule. The Court pointed out that in *Pennsylvania v. New York*,[40] it had similarly rejected a rule that would provide "a reasonable approximation" for the state in which the owner is located.[41] If states cannot use statistical sampling or other estimation methods to determine the owner's location for purposes of applying the primary rule, it follows that states cannot use estimation to determine the existence or amount of unclaimed property that a state may escheat. After all, as the Court held, the primary and secondary rules "cannot be severed from the law that creates the underlying creditor-debtor relationships."[42]

Indeed, in *Allstate Insurance Co. v. Eagerton*,[43] a court rejected the use of an estimation method to prove the existence of unclaimed property. In that case, Alabama used a formula to estimate the amounts of unpresented checks issued by Allstate as a result of its operations in Alabama during a period for which Allstate no longer retained claim files. The estimated amount was calculated by multiplying (a) Allstate's total loss amount in Alabama for such period by (b) a ratio, the numerator of which was equal to the total value of canceled checks for the period for which Allstate had records, and the denominator of which was equal to Allstate's total loss amount for the period for which Allstate had records. The court disallowed the formula, holding that "there is a lack of sufficient evidence to substantiate the existence of said amount" and that Alabama is not legally entitled to prove the existence of the amount "'held or owing' by Allstate through the application of a formula."[44]

None of this should be surprising. Again, if a state estimates unclaimed property that may have been owed in past periods, and then seizes that property under its unclaimed property laws, such action cannot accurately be described as an "escheat" of property, as there is no actual creditor who has abandoned his property. "A state's power to escheat is derived from the principle of sovereignty."[45] Thus, if there is no creditor, then there is no property over which the state has the power to escheat. Rather, any property taken by a state would belong to the putative holder. A state is therefore not only barred from escheating estimated unclaimed property by the federal common law rules, but also by the takings clause of the U.S. Constitution.[46]

---

[39] *Delaware*, 507 U.S. at 509.

[40] 407 U.S. 206 (1972).

[41] *Delaware*, 507 U.S. at 509 (*quoting Pennsylvania*, 407 U.S. at 221).

[42] *Id.* at 503 (emphasis added). If estimation could be used to establish the existence of a debt, the next step would be to determine which state could escheat this "debt" under the primary and secondary rules. This would necessitate either estimating where the owner's address is located, which the Court held could not be done, or presuming that the estimated debts have no owner address, which raises the same jurisdictional issue and thus is similarly problematic. The Court's prohibition of the use of estimation should thus apply equally whether the estimation is used in the first step of the escheat analysis (determining the "precise scope of the debtor-creditor relationship") or the second step of that analysis (applying the primary or secondary rules).

[43] No. CV-79-468-P (Ala. Cir. Ct. (Montgomery County)), *rev'd*, 403 So. 2d 172 (Ala. 1981).

[44] The trial court also held that the unpresented checks for which Allstate did maintain records constituted unclaimed property subject to escheat, but that holding was reversed on appeal. *See Allstate Insurance Co. v. Eagerton*, 403 So. 2d 172, 173 (Ala. 1981).

[45] *N.J. Retail Merchants Ass'n v. Sidamon-Eristoff*, 669 F.3d at 395 (*citing Texas*, 379 U.S. at 675; and *Delaware*, 507 U.S. at 504).

[46] Indeed, in *N.J. Retail Merchants Ass'n v. Sidamon-Eristoff*, 669 F.3d at 383, the Third Circuit recognized that the escheatment of gift cards could violate the takings clause by depriving the holder of its anticipated profits in the unredeemed cards. *American Express Travel Related Services Co. v. Sidamon-Eristoff*, 755 F. Supp.2d 556, 612 (D.N.J. 2010) (noting that "the issuer is deprived of its contractual right to earn profits in connection with the gift card sale and redemption," and, as such, may effect a taking of the card issuer's profits), *aff'd*, 669 F.3d 359 (3d Cir. 2012), and *aff'd*, 669 F.3d 374 (3d Cir. 2012). The court in *Service Merchandise Co. v. Adams*, No. 97-2782-III, 2001 WL 34384462 (Tenn. Ch. Ct. June 29, 2001), was more definitive, holding that requiring a holder "to pay to the State cash in the face amount of the gift certificates . . . violate[s] the Takings Clause." *Id.* at *6. An escheat of estimated property raises even greater concerns, as it is not merely taking the holder's profits interest, but the holder's entire interest in the property escheated.

III. Estimation as a Penalty and the Excessive Fines Clause

As suggested above, the fact that federal common law (and the takings clause) precludes estimation of unclaimed property does not mean that states are barred from using estimation in the unclaimed property context. To the contrary, there is nothing to prevent a state from adopting laws permitting it to use estimation as a *penalty* for failure to maintain records.[47] As noted, this was the conclusion reached by the Uniform Law Commission. In the commentary to the Uniform Unclaimed Property Act of 1995, the commission stated that the uniform act's estimation provision was to be "viewed as a penalty for failure to maintain records of names and last known addresses" of the property owners.[48] Importantly, though, the state whose record retention laws are violated will normally be the state where the creditor is located, *not* the state of domicile of the holder. This is because the creditor's state is where the property would have been escheated under the primary rule if the record retention law had been followed, and that state's record retention law would (or could) have required the holder to maintain records regarding the creditor's property. The use of estimation as a penalty thus has the effect of putting the holder and the state in approximately the same position that they would have been in had the holder either (a) escheated the property in the first place, as required by that state's laws, or (b) retained sufficient records to determine the amount of property the holder should have escheated to the state.

The federal common law rules would not be relevant to calculating the amount of the penalty because those rules are only applicable to determine what actual property states may escheat, which state may escheat it, and from whom.[49] This raises the question: Can Delaware dodge the federal common law rules and impose the domicile-takes-all method simply by couching it as a penalty for failure to maintain records? The answer is clearly no. Under the excessive fines clause of the Eighth Amendment,[50] any penalty cannot be grossly disproportionate to the gravity of the offense.[51] The domicile-takes-all approach would be grossly disproportionate to a holder's violation of Delaware's record retention laws because those laws require the holder only to maintain records regarding property that would have been reportable to Delaware under federal common law and the Delaware unclaimed property law, whereas the domicile-takes-all approach would impose a "penalty" equal to the amount of unclaimed property that should have been reported to all states. Put differently, if the domicile-takes-all approach is imposed by Delaware as a penalty for failing to maintain records, Delaware is effectively penalizing the holder for failing to maintain records in *all* states, not just Delaware.

A simple example illustrates the point. Suppose a holder with locations all over the country had total unclaimed payroll of $100,000 for periods when records are available (that is, the base period used for estimation), but only $300 owed to a single employee in Delaware.[52] Assuming Delaware had an applicable records retention requirement that the holder violated for the earlier years,[53] then a reasonable penalty (based on the state-by-state approach) would be to extrapolate the $300 to the period when the holder failed to maintain records. This penalty would be proportionate to the holder's failure to maintain records of Delaware unclaimed property in the prior years because it would

[47] As discussed below, not all states have adopted such estimation statutes, nor have any states adopted comprehensive record retention requirements.

[48] *See* Comments to Uniform Unclaimed Property Act section 17(f) (Uniform Law Commission 1995).

[49] *See* Ethan D. Millar, "Federal Common Law Preemption of State Unclaimed Property Laws," *Tax Notes State*, July 8, 2019, p. 89.

[50] U.S. Const. Amend. XIII.

[51] *See, e.g.*, *United States v. Bajakajian*, 524 U.S. 321 (1998); and *Timbs v. Indiana*, 139 S. Ct. 682 (2019) (applying the excessive fines clause to states).

[52] This example is based on the relative size of Delaware's total population (approximately 1 million) compared with the total population of the United States (approximately 330 million).

[53] As will be discussed below, Delaware did not adopt such a law until 2017, and the 2017 law requires retention of limited records relating to unclaimed property.

estimate what the holder would have been required to report to Delaware had it complied with Delaware's escheat laws or its record retention laws in the first place. In theory, Delaware could also probably get away with tacking an additional penalty on top of this amount (say, 10 to 25 percent) to further encourage holders to maintain their records (and even higher penalties, say 50 to 100 percent, to address willful noncompliance or fraud). But Delaware cannot get away with calculating the penalty by extrapolating the full $100,000 back to the prior periods and characterizing it as a penalty for failing to comply with Delaware's record retention law. That would be grossly disproportionate to the harm caused to Delaware by the holder's failure to comply with such law. Again, Delaware would, in effect, be penalizing the holder for failing to comply with *every* state's record retention laws.[54]

IV. Due Process and *Temple-Inland v. Cook*

The domicile-takes-all method of estimation has also been held invalid as a violation of substantive due process. In *Temple-Inland Inc. v. Cook*,[55] the putative holder also argued that Delaware's estimation method in an unclaimed property audit violated federal common law, the takings clause, and the ex post facto clause.[56] However, the district court initially granted Delaware's motion to dismiss regarding the federal common law claim, finding that the federal common law rules did not apply to disputes between private parties and states. Although the court later acknowledged in its decision on summary judgment that this finding was incorrect and that these rules do apply to disputes between a holder and a single state,[57] the court's decision did not address the merits of the federal preemption argument but instead focused on the more difficult substantive due process standard. In doing so, the court also did not reach the holder's takings and ex post facto claims.

The due process clause provides that no state shall "deprive any person of life, liberty, or property, without due process of law."[58] As the *Temple-Inland* court recognized, the "core concept" of due process is protection against "arbitrary" government action.[59] The court held that executive action — here, Delaware's unclaimed property audit and assessment — violates substantive due process "only when it shocks the conscience."[60] The court acknowledged that "there appears to be no precedent in this or any other court addressing whether a state's executive action with respect to unclaimed property shocks the conscience" but that "despite the lack of clear precedent," the court found several aspects of Delaware's actions "troubling."[61] The court found that Delaware "waited 22 years to conduct an audit, avoided the otherwise applicable 6 year statute of limitations under dubious circumstances, gave holders no notice that they would need to retain unclaimed property records to defend against unmeritorious audits, applied [an estimation statute] for a prolonged retroactive period for no obvious purpose other than to raise revenue, and failed to follow the fundamental principle of estimation where the characteristics of the sample set are

---

[54] Of course, a penalty for failure to maintain records need not be calculated based on an estimate of unclaimed property due to the state for the periods when the required records were not maintained. For example, a penalty based on a fixed dollar amount may potentially survive scrutiny. However, a penalty based on a reasonable estimate is most likely to approximate the harm actually caused by the holder's failure to maintain records and therefore be both proportionate to the holder's offense and appropriately encouraging to the holder to maintain the required records. A fixed dollar penalty lacks the flexibility to address the vastly different situations in which the holder may have had relatively low or relatively high amounts of unclaimed property that should have been reported. As a result, fixed dollar fee penalties tend to either be too high or too low in any given situation.

[55] 192 F. Supp.3d 527 (D. Del. 2016).

[56] Temple-Inland had also originally alleged that Delaware's practices violated the full faith and credit clause and the commerce clause of the U.S. Constitution, but dropped these claims when it amended its complaint in 2015. Both claims have merit, though, and may be pursued in future cases. A detailed discussion is beyond the scope of this article, but the domicile-takes-all approach would appear to be invalid under the commerce clause either on the basis that it discriminates against interstate commerce or that it imposes an undue burden on interstate commerce. Delaware's estimation method also fails to give full faith and credit to the escheat laws of other states by seeking to escheat (through estimation) property that would not have been escheatable under other states' laws — for example because of a business-to-business or other exemption.

[57] *Temple-Inland Inc.*, 192 F. Supp.3d at 532, n.1.

[58] U.S. Const. Amend. XIV, section 1.

[59] *Sacramento v. Lewis*, 523 U.S. 833, 845 (1998).

[60] *Temple-Inland Inc.*, 192 F. Supp.3d at 541.

[61] *Id.*

extrapolated across the whole, which also puts plaintiff at risk of multiple liability."[62] The court concluded that in combination, Delaware's executive actions shocked the conscience and therefore violated substantive due process.

The court offered no remedy, though, stating that it "is given some pause when contemplating appropriate remedies for defendants' violation of due process. It is defendants who are best able to know which remedy will be the most palatable in its anticipated efforts to normalize the enforcement of its unclaimed property laws. Thus, the court will defer its decision on the subject of an appropriate remedy until another day."[63] Delaware took the hint and quickly settled with Temple-Inland, dropping its proposed assessment and paying Temple-Inland's costs and attorney fees. Delaware also revised its unclaimed property statute to limit its lookback period for audits and voluntary disclosures to 10 report years (plus the five-year dormancy period), so that it would "only" seek to review records up to 15 years old (rather than 22 years).[64] At the same time, Delaware also added a "tolling" provision stating that "the period of limitation established by this subsection is tolled by the State Escheator's delivery of a notice of an examination to a holder under this chapter, or if the State Escheator reasonably concludes that the holder has filed a report containing a fraudulent or wilful misrepresentation."[65] Delaware unclaimed property audits routinely last five years or longer. Thus, as a practical matter, Delaware's "shortening" of its lookback period is not a significant concession. As discussed above, Delaware also adopted a record retention requirement for property required to be reported to Delaware.[66]

Yet Delaware did not address the most glaring defect identified by the court — its estimation method. While the court's holding that Delaware's audit practices violated substantive due process was based on a number of factors, the court rejected the domicile-takes-all approach in no uncertain terms. The court first held that "an estimation is properly performed when it is based on the principle that the unclaimed property in the reach-back years has 'all the same qualities and characteristics' as unclaimed property in the base-years."[67] The court then explained that the domicile-takes-all approach does not meet this test:

> *[Delaware's] logic is contrary to the fundamental principle of estimation.* [Delaware is] using the existence of unclaimed property in base years to infer the existence of unclaimed property in the reach back years. But [Delaware is] not extrapolating the characteristics of the property that would reduce the liability owed to Delaware. *If the property in base years shows an address in another state, then the characteristic of that property has to be extrapolated into the reach back years. [Delaware] simply did not do that. Because [Delaware] employed estimation in a manner where the characteristics and qualities of the property within the sample were not replicated across the whole, it created significantly misleading results.*[68]

The court also rejected Delaware's theory that it does "not need to extrapolate the characteristics

[62] *Id.*

[63] *Id.* at 550-551.

[64] 12 Del. Code section 1156(b) ("The State Escheator may not commence an action or proceeding to enforce this chapter with respect to the reporting, payment, or delivery of property more than 10 years after the duty arose.").

[65] Note that in audits and voluntary disclosures, Delaware maintains that the statute of limitations was tolled even before this tolling provision was adopted. This position is clearly wrong and is a ripe topic for another day. *State of Delaware, Department of Finance v. AT&T Inc.*, C.A. No. 2019-0985-JTL, at 42-47 (Del. Ch. July 10, 2020) (rejecting Delaware's argument that the 2017 statute of limitations, which includes the new tolling provision, applies retroactively).

[66] 12 Del. Code section 1145 ("A holder required to file a report under section 1142 of this title shall retain records for 10 years after the date the report was filed, unless a shorter period is provided by the State Escheator by rule or regulation. A holder may satisfy the requirement to retain records under this section through an agent. The records retained must contain all of the following: (1) The verifiable information required to be included in the report. (2) The date, place, and nature of the circumstances that gave rise to the property right. (3) The amount or value of the property. (4) The last address of the owner, if known to the holder. (5) If the holder sells, issues, or provides to others for sale or issue in this State traveler's checks or money orders, a record of the instruments while they remain outstanding indicating the state and date of issue.").

[67] *Temple-Inland*, 192 F. Supp.3d at 548-549 (*citing United States v. Mehta*, 594 F.3d 277, 283 (4th Cir. 2010)).

[68] *Id.* at 549 (emphasis added).

of the property on which the estimation is based, because, if records do not exist, then the address is unknown" and therefore the state of domicile may claim the entire estimated amount under the secondary rule.[69] As discussed above, that argument is based on a misreading of *Delaware v. New York*. The *Temple-Inland* court explained that when the Supreme Court established the federal common law rules, "it was addressing the escheatment of intangible personal property . . . where the property clearly existed but the owner's address could not be ascertained from the four corners of that property or related records" and that Delaware's argument "stretches the definition of address unknown property to troubling lengths."[70] The court's succinct explanation is notably consistent with the point emphasized above that no state may escheat estimated property, because in that case there is no property that "clearly exist[s]." To the contrary, as discussed above, estimation can be used only to calculate a penalty for failure to maintain records.

The *Temple-Inland* court also rejected the domicile-takes-all estimation method because it created the potential for multiple liability. As noted above, the U.S. Supreme Court had previously held in *Western Union Telegraph Co.* that a holder "is deprived of due process of law if he is compelled to relinquish [property] without assurance that he will not be held liable again in another jurisdiction or in a suit brought by a claimant who is not bound by the first judgment."[71] The Supreme Court reiterated that principle in *Texas v. New Jersey* and its progeny.[72] The *Temple-Inland* court reasoned that "if two states use the same property in the base years to infer the existence of unclaimed property in the reach back years, then a holder is being compelled to escheat the same estimated property to two states, in violation of the principles articulated in the *Texas* cases."[73] The court then pointed out that this is exactly what happened to Temple-Inland, as another state (Texas) had used the state-by-state approach to estimate Temple-Inland's unclaimed property liability to Texas for prior years. Delaware responded that Texas's use of estimation was improper, as only Delaware was entitled to escheat under the domicile-takes-all approach. The court rejected this circular reasoning, stating that the domicile-takes-all approach "is neither the law nor the custom. Indeed, none of the states that have adopted statutes permitting the use of estimation, including Delaware, have expressly limited the use of estimation to the secondary rule, and Texas' audit of plaintiff is clear evidence that, in practice, states use estimation when calculating liability under the primary rule."[74]

Delaware then argued that there was no risk of multiple liability because Delaware is statutorily obligated to indemnify the holder against any claims from another person or state that claims the property. Delaware's indemnification statute provides: "If a holder pays or delivers property to the State Escheator in good faith and thereafter another person claims the property from the holder or another state claims the money or property under its laws relating to escheat or abandoned or unclaimed property, the State Escheator, acting on behalf of the State, upon written notice of the claim, shall defend the holder against the claim and indemnify the holder against any liability on the claim."[75] The court rejected this argument as well, holding that "indemnification is not . . . adequate protection [because] [t]here is no identifiable property in an estimation to which another state could prove it had a priority claim under the primary rule."[76] In other words, the Delaware statute only clearly requires indemnification if the *same property* is escheated by both states, but if there is no actual property, then there is no "assurance" (in the words of the *Western Union* Court) that the indemnity would apply and the holder would be saved from multiple liability. A similar concern would be raised if the other state's estimation statute uses estimation as a penalty for failure to maintain records, as most states do,

[69] *Id.*

[70] *Id.*

[71] *Western Union Telegraph Co.*, 368 U.S. at 75.

[72] *Texas*, 379 U.S. at 678-79.

[73] *Temple-Inland*, 192 F. Supp.3d at 549-550.

[74] *Id.* at 550.

[75] 12 Del. Code section 1153(c).

[76] *Id.*

rather than as a mechanism for supposedly escheating property to the state. In that case, the other state is not "claim[ing] the money or property under its laws relating to escheat or abandoned or unclaimed property." Rather, it is not claiming property at all, but rather imposing a penalty. Therefore, it would appear that the Delaware indemnity provision would be inapplicable.

The court thus explained why the domicile-takes-all approach fails in general, and not merely as applied to the holder in that case. The amendments to the Delaware Escheats Law in 2017 do not address the court's criticisms of this method. Hence, it is highly unlikely that these relatively modest amendments cured the substantive due process problem. But even if they did, that does not mean the domicile-takes-all approach is valid. To the contrary, the domicile-takes-all approach still fails the "fundamental principle of estimation" because it fails to extrapolate the "qualities and characteristics" of property in the base years to the extrapolation period. Also, as discussed above, the domicile-takes-all method violates federal common law, the takings clause, and the excessive fines clause. The method may also be invalid under state law, as discussed below.

V. Statutory Limits on Use of Estimation

In addition to the constitutional restrictions on the use of estimation in the unclaimed property context, there are also state statutory restrictions. Under current law, these restrictions are significant. Most states have adopted estimation provisions that generally track one of the Uniform Unclaimed Property Acts.

Although the uniform act was originally created in 1954, it was not until the 1981 version that a record retention requirement and estimation provision were included. The 1981 act provides that "every holder required to file a report under Section 17, as to any property for which it has obtained the last known address of the owner, shall maintain a record of the name and last known address of the owner for 10 years after the property becomes reportable, except to the extent that a shorter time is provided in subsection (b) [addressing travelers checks, money orders and similar written instruments] or by rule of the administrator."[77] The act also provides that "if a holder fails after the effective date of this Act to maintain the records required by Section 31 and the records of the holder available for the periods subject to this Act are insufficient to permit the preparation of a report, the administrator may require the holder to report and pay such amounts as may reasonably be estimated from any available records."[78] As a result, under the 1981 act, a holder is only required to maintain the name and address of the owner for 10 years after the property becomes reportable. In most states and for most property types, property will become reportable (if at all), one to five years after it became due and payable to the owner. As a result, holders may be required to maintain the owner's name and address for up to 15 years, or potentially face an estimated liability, but are required to maintain no other documents. In particular, the holder is not required to maintain records of any information that may evidence whether the property at issue is actually due, including bank statements, bank reconciliations, checklists, due diligence mailings or responses, or other similar evidence. A state's ability to require a holder to use estimation under the 1981 act is therefore quite limited.

The 1995 and 2016 versions of the uniform act contain similarly narrow record retention provisions. The 1995 act provides that the holder must "maintain the records containing the information required to be included in the report for 10 years after the holder files the report, unless a shorter period is provided by rule of the administrator," and that estimation can be used only if the holder fails to maintain such records.[79] The 1995 act is thus broader than the 1981 act by requiring the holder to maintain all information included in the report, as opposed to just the owner names and addresses, but like the 1981 act, a holder can easily satisfy this requirement by keeping a copy of the report itself and nothing else. A state could argue that by requiring holders to maintain "the records containing the information required to be included in the

[77] 1981 Act, section 31(a).

[78] *Id.* section 30(e).

[79] 1995 Act, sections 21(a) and 20(f).

report," the record retention law also obligates the holder to maintain records of property that should have been, but was not, included in the report. This may be a reasonable interpretation, but it creates a gaping practical problem, which is that there is no way to enforce it. In particular, if a holder maintained records concerning only the property that was included in the report, the holder may contend that was the property required to be included in the report and therefore the holder had complied with the record retention law. The state could argue that there may be other properties that should have been included, for which the holder should thus have maintained records, but without those records, the state would have no way of proving its theory.

The 2016 act is nearly identical, providing that the holder must retain the following records for 10 years: "(1) the information required to be included in the report; (2) the date, place, and nature of the circumstances that gave rise to the property right; (3) the amount or value of the property; (4) the last address of the apparent owner, if known to the holder; and (5) if the holder sells, issues, or provides to others for sale or issue in this state traveler's checks, money orders, or similar instruments, other than third-party bank checks, on which the holder is directly liable a record of the instruments while they remain outstanding indicating the state and date of issue."[80] Like the earlier versions of the uniform act, the 2016 act provides that no estimation may be used if the holder files reports and retains the required records.[81] Of the records required to be retained, items (1), (3), (4), and (5) would be satisfied if the holder simply kept a copy of the filed report. Item (2) — requiring the holder to keep a record of "the date, place, and nature of the circumstances that gave rise to the property right" — is also likely satisfied by retaining a copy of the report. Granted, it is not entirely clear what the "nature of the circumstances that gave rise to the property right" means, but presumably including a property type code that generally describes the property, which is required in all unclaimed property reports, would be sufficient.

In sum, those states — including Delaware, which has adopted record retention and estimation provisions identical to those in the 2016 act[82] — that have adopted provisions similar to those in the 1981, 1995, or 2016 versions of the uniform acts will have very limited ability to use estimation. Essentially, no estimation will be permitted if a holder has filed a report and retained a copy of that report. Instead, estimation appears to be available in these states only when holders have not filed a report at all.[83] While that may have been the intent of the legislatures at the time these provisions were enacted, having such limited record retention requirements vastly limits the ability of states to enforce compliance with their unclaimed property laws. After all, a holder that files a report and keeps a record of the report is thereby immune to estimation. This could encourage holders to keep only minimal records — just a copy of the report. If holders do that, states will apparently have no remedy for underreporting by a holder, as the states will be unable to satisfy their burden of proving the existence of property if a holder has maintained only copies of the reports themselves.

In unclaimed property audits, states (or at least their third-party audit firms) often assert that the *holder* has the burden of proof, at least if a check was issued or a credit posted — but that position is contrary to law.[84] Indeed, the Delaware

[80] 2016 Act, section 404.

[81] 2016 Act, section 1003(c)(2).

[82] *See* 12 Del. Code sections 1145, 1172(f)(2), and 1176(a).

[83] Notably, some states that have not adopted the 1981, 1995, or 2016 uniform act provisions may not permit the use of estimation at all, even if the holder has not filed reports. Other states have adopted record retention laws that are similar to those in the uniform acts.

[84] *See, e.g.*, *Kane v. Insurance Co. of North America*, 38 Pa. Commw. 42, 50-51 (1978) (holding that Pennsylvania could not escheat uncashed checks because the state could not demonstrate the persons to whom the checks were payable "were unqualifiedly entitled to same"). *See also, e.g.*, *Aetna Casualty and Surety Insurance Co. v. State*, 414 So. 2d 455 (Ala. 1982) (state could not escheat voided checks because the state did not establish that the checks were unqualifiedly due); *Mason and Dixon Lines Inc. v. Eagerton*, 555 F. Supp. 434, 446 (M.D. Ala. 1982) (holding that the state unclaimed property act "requires proof [from the state] that the [owner] is unqualifiedly entitled to the property which [the state] contends is unclaimed"); *State of California ex rel. McCann v. Bank of America N.A.*, 120 Cal. Rptr. 3d 204, 215-216 (2011) (credits must be liquidated obligations in order to be subject to escheat); *Employers Insurance of Wausau v. Smith*, 154 Wis. 2d 199 (1990) (holding that the state must prove that the holder had a duty to make payment to the owner and that there must be a degree of certainty inherent in the holder's obligation to the owner); and *Revenue Cabinet v. Blue Cross and Blue Shield*, 702 S.W.2d 433 (Ky. 1986) (holding that the issue of whether uncashed checks were escheatable turned on "whether the amounts in question should be classified as a claim liquidated or unliquidated in amount"). A detailed discussion of this issue is beyond the scope of this article.

Chancery Court itself recently acknowledged that "the State Escheator has the burden to show that a check was improperly voided because it was unclaimed. Only by doing so can the State Escheator carry its 'burden of proof as to the existence and amount of the [unclaimed] property and its abandonment . . . by showing evidence of the unpaid debt or undischarged obligation and passage of the requisite period of abandonment.'"[85] Furthermore, states can hardly complain that a holder benefits from inadequate recordkeeping when the states did not require the holder to retain the records in the first place. That would amount to a game of "gotcha" similar to the one that was held by the *Temple-Inland* court to have violated due process.[86] The states have an easy remedy, though, which is to adopt more comprehensive record retention requirements. The American Bar Association's Draft Model Unclaimed Property Act, promulgated in 2018, sought to address this very issue by requiring holders to retain, among other records, "information sufficient to establish the amount of unclaimed property required to be shown by the holder on the report including, if applicable, quarterly bank reconciliations and annual accounts receivable credit aging reports (or, if the holder does not keep such aging reports in the ordinary course of business, then the holder shall retain transactional level detail regarding such credits)."[87] The fact that such a model act provision exists — one which could significantly aid the states in properly enforcing their unclaimed property laws — and almost no state has yet adopted it[88] speaks volumes.

Delaware's estimation statute — which, again, is based on the 2016 act provision — is also limited in scope by its own terms. It provides that "if a person subject to examination under section 1171 of this title does not retain the records required by section 1145 of this title, the State Escheator may determine the amount of property due using a reasonable method of estimation."[89] The prior version of the estimation statute was even more explicit, saying that "where the records of the holder available for the periods subject to this chapter are insufficient to permit the preparation of a report, the State Escheator may require the holder to report and pay to the State *the amount of abandoned or unclaimed property that should have been but was not reported that the State Escheator reasonably estimates* to be due and owing on the basis of any available records of the holder or by any other reasonable method of estimation."[90] Even putting aside the constitutional issues discussed above, the most reasonable (one may contend, the *only* reasonable) construction of the estimation statute is that it permits a "reasonable" estimate of the amount of property "that should have been but was not reported" to Delaware in the prior period. Of course, the amount that should have been but was not reported to Delaware in the prior period was Delaware-address property and not property where the address of the owner was located in another jurisdiction.

To justify the domicile-takes-all approach, a court would have to engage in statutory gymnastics by somehow construing the statute to mean that if a holder has failed to file a report of Delaware-address property in a prior year (of which there may have been none, particularly given Delaware's small size), or filed a report of Delaware-address property but somehow failed to keep a record of that report, Delaware can now estimate and escheat the amount of property due *to all states*, even though the holder may have filed reports in other states and maintained records required in those states. Again, a simple example highlights the absurdity of such a construction. Suppose a holder reported $100 of Delaware-address property to Delaware for a year but mistakenly omitted one item of Delaware-address property worth $30 and failed to keep a copy of the report. Delaware then sought to use estimation. But instead of estimating what the holder should have reported to Delaware in the

[85] *State of Delaware, Department of Finance v. AT&T Inc.*, C.A. No. 2019-0985-JTL, at 42-47 (Del. Ch. July 10, 2020).

[86] *Temple-Inland*, 192 F. Supp.3d at 550.

[87] ABA Draft Unclaimed Property Model Act, section 404.

[88] Illinois is the rare exception and has included in its record retention statute a requirement similar to the Model Act that the holder must retain "sufficient records of items which were not reported as unclaimed, to allow examination to determine whether the holder has complied with the Act." 765 Ill. Comp. Stat. 1026/15-404(5).

[89] 12 Del. Code section 1176(a).

[90] 12 Del. Code section 1155(a) (before Feb. 2, 2017).

prior year ($130), Delaware estimates what the holder should have reported to all states (let's assume that is $50,000), even though (a) Delaware's record retention laws apply only to the property that was due to Delaware and (b) Delaware's own estimation law permits it to estimate only what should have been reported to Delaware. Any statutory construction that permits such a result, which profits Delaware at the expense of other states (and the holder), defies even the broadest definition of a "reasonable" estimate under the circumstances.[91]

Finally, it is worth noting that Delaware did not even adopt an estimation statute until 2010 and did not adopt a record retention requirement until 2017. On top of that, in 2000 a bill introduced in the Delaware House of Representatives provided that "in conducting an examination under this chapter, extrapolation or any other commercially recognized method of statistical sampling may be used if employed in a neutral manner that may establish either the existence or non-existence or property subject to escheat and may otherwise be employed to the extent agreed upon by the Escheator and the holder."[92] The failure of the General Assembly to pass this legislation, if anything, indicates legislative intent *not* to adopt such estimation techniques. Yet in *Temple-Inland*, Delaware sought to apply the domicile-takes-all approach back to 1986. In determining whether this period of retroactivity violated due process, the court indicated that it "must consider whether the length of the retroactive period is appropriate given the reason why it is being applied retroactively."[93] The court unsurprisingly concluded that Delaware's reasons for applying the estimation statute retroactively "do not withstand scrutiny."[94]

The court first held that Delaware's estimation method "did not shift the benefits and burdens of economic life between different public constituencies" (which would have been presumptively valid). The court explained that Delaware "cannot show a . . . one-to-one shift between the burden on [the holder] and the benefit to owners of unclaimed property. [Delaware] may collect a greater amount of money through [its] application of [the estimation statute], but owners are not entitled to share in that increase. Instead, the amount of unclaimed property an owner can collect remains unchanged, because they are entitled to only the amount they abandoned."[95] The court also rejected Delaware's argument that the retroactive period was justified to support the state's unclaimed property program. The court pointed to U.S. Supreme Court cases holding that "burden-shifting" legislation can be upheld only if "the administrative programs were experiencing a financial shortfall that could have jeopardized the viability of the program." The court reasoned that "here, owners are not at risk of being unable to recover their unclaimed property, because Delaware's unclaimed property fund is not experiencing a financial shortfall. Indeed, Delaware has collected significantly more unclaimed property than it returns to owners."[96] Finally, the court noted that Delaware's use of estimation will not make it easier for owners to recover unclaimed property. By definition, estimated unclaimed property "does not identify the owner, the property, or the property's value" and therefore there is no way for a hypothetical "owner" of estimated property to recover that property.[97] The court was not moved by Delaware's argument that "if an owner cannot claim abandoned property because it is estimated, it is still better that the estimated property is used to serve the public good than to increase the profit margins of Delaware corporations," asserting that "unclaimed property laws were never intended to be a tax mechanism whereby states can raise revenue as needed for the general welfare." The court unequivocally concluded: "States violate substantive due process if the sole purpose of enacting an unclaimed property law is to raise

[91] Other states' estimation statutes also explicitly or implicitly include similar "reasonableness" requirements (such a reasonableness standard exists in the 1981, 1995, and 2016 uniform acts), and are likewise intended to estimate property that was required to be reported to that state but was not.

[92] *See* H.B. 617, 140th General Assembly.

[93] *Temple-Inland*, 192 F. Supp.3d at 547.

[94] *Id.*

[95] *Id.*

[96] *Id.*

[97] *Texas*, 379 U.S. at 681-682.

revenue."[98] That is unquestionably the purpose of the domicile-takes-all method.

VI. Public Policy Issues Related to Use of Estimation

The domicile-takes-all approach is not only legally infirm, but also fails as a matter of public policy and common sense. As detailed above, if a holder maintains sufficient (that is, complete and researchable) records to determine if there is unclaimed property, the state in which the owner's last known address is located, as shown by the holder's records, has sole claim to escheat that property.[99] Because the state of last known address has the sole right to escheat, that state undeniably also has the right to determine whether and under what circumstances the property should be escheatable (subject to constitutional limitations, of course), including whether to grant an exception (for example, for property owed to another business or for de minimis value property), the dormancy period for the property, etc. Similarly, the state in which the owner resides should also have the sole right to dictate whether holders must maintain records regarding the property, for how long, and the penalties for failure to maintain those records. Indeed, if the state has no power to penalize the holder for failing to maintain records regarding the property, then it would have no way to enforce its own laws requiring the holder to escheat the property in the first place.

Instead, it would be forced to rely on the state of domicile to adopt a record retention and estimation/penalty scheme that is sufficiently punitive to compel the holder to maintain the requisite records and escheat the property under the laws of the state of last known address. While Delaware's laws may serve this purpose, it could oddly encourage arbitrage in other states. For example, consider a holder that chooses to incorporate in a state that has adopted a business-to-business exemption so that any property owed by the holder to another business (for example, uncashed accounts payable checks or accounts receivable credit balances) are not subject to escheat. Under the domicile-takes-all approach, only the holder's domiciliary state could estimate, even if the holder has no operations whatsoever in that state. In our example, the domiciliary state does not require the escheat of B2B property, which often is the bulk of any unclaimed property that is due, and thus any estimated liability for those property types would be zero. This would further encourage the holder to not retain any records for those property types, since (under Delaware's theory) the states in which the holder has *actual* liability would be powerless to estimate a liability if the holder fails to maintain the requisite records (remember: only the state of domicile can estimate under this theory). Such arbitrage would be very easy for holders, given that the definition of domicile under federal law means the state of incorporation of the holder (or state of formation for a noncorporate entity). Any holder can easily change its state of incorporation at any time by filing the necessary paperwork with its current and future states of incorporation. By contrast, the state-by-state estimation method, by permitting each state to estimate liability based on violation of its own record retention laws, forecloses the possibility of this type of arbitrage.

Finally, owners of unclaimed property may also benefit from the state-by-state approach, as the states that are actually returning property to owners (rather than the state of domicile which, by definition, cannot because it lacks necessary information regarding the property owner) may increase their unclaimed property budgets through estimation penalties and thus would have more resources to try to track down actual owners and return their property to them.

VII. Practical Impact of Domicile-Takes-All vs. State-by-State Methods of Estimation

In the wake of *Temple-Inland* and other pending audits and cases challenging the domicile-takes-all estimation method, Delaware has tried to shift the conversation away from the legal and public policy arguments (which even Delaware almost concedes in its half-hearted defense of its estimation practices) and toward what Delaware refers to as "practical" considerations concerning estimation. Delaware posits that the total unclaimed property liability

[98] *Id.* at 548. *See also Memo Money Order Co. v. Sidamon-Eristoff*, 754 F. Supp.2d 661, 678 (D.N.J. 2010); *N.J. Retail Merchants Ass'n v. Sidamon-Eristoff*, 669 F.3d at 398.

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

through estimation will be essentially the same under both the domicile-takes-all approach and the state-by-state approach, and thus it is more a question of *where* to source the liability than the *amount* of the liability. And isn't it simpler for a holder to simply cut one check to Delaware than 50 checks to all the states? Worse, some advocates of Delaware's method have even gone so far as to suggest that the state-by-state approach is a plot by lawyers and consultants to generate more fees from their holder clients.

Putting aside the fact that this argument conveniently disregards the interests of all states other than Delaware, it is also wrong on the merits. This is apparent simply from the fact, discussed above, that some states do not even permit the use of estimation. Or that the requirements for using estimation may not be satisfied because the holder may have filed unclaimed property reports in other states and retained copies of those reports. After all, it is much more common for holders to actually have, and therefore report, unclaimed property owed to customers, vendors, and employees in states in which they do business than in Delaware, where they may have no customers, vendors, or employees. Under Delaware law, if a holder has no unclaimed property due to the state, the holder is not required to file a report (except for some financial institutions). Thus, the fact that a holder has filed reports in other states but not Delaware indicates that the holder did not actually have property to report to Delaware. But Delaware has used the failure to file a report as an excuse both to use estimation and to argue that the statute of limitations does not apply.[100] As the *Temple-Inland* court pointed out, Delaware has "not warned holders of these consequences."[101]

The domicile-takes-all approach will also result in a higher overall estimation for other reasons. Most obviously, about 15 states have adopted B2B exemptions.[102] Again, this tends to be the bulk of unclaimed property included in Delaware estimations, compared with other types of property (such as uncashed payroll checks). Under the state-by-state approach, states that have B2B exemptions would of course not include such property in their estimates. Yet under the domicile-takes-all approach, at least as applied by Delaware, the amount of unclaimed property calculated in the base period and extrapolated to the earlier periods includes all property, including property that is actually exempted from escheat by the state in which the owner is located. Delaware tries to justify this approach by saying that since the hypothetical owners in the extrapolation period are unknown, Delaware's unclaimed property laws apply and Delaware has not adopted a B2B exemption. But this rationalization forgets that the goal was to estimate the amount of unclaimed property that the holder *would have reported* in the extrapolation period if the holder had kept records for that period. Clearly, a holder would not have reported B2B property to a state that exempts B2B property if the holder had maintained the required records. Under Delaware's method, the holder is thus penalized for failing to maintain the records. Consider, for example, a holder for which 30 percent of its unclaimed property was owed to businesses in B2B states. The holder was not required to either report or remit that 30 percent in the prior period. Yet the holder's failure to report or remit that property is now used against it by Delaware to require the holder to remit that 30 percent to Delaware under the domicile-takes-all approach. This raises additional concerns under the full faith and credit clause of the U.S. Constitution by failing to give full faith and credit to the laws of the states that expressly exempt this property from escheat.[103]

[100]Under prior law, the statute of limitations began to run in Delaware upon the filing of a report. See former 12 Del. Code section 1158 (pre-2017).

[101]*Temple-Inland*, 192 F. Supp.3d at 543.

[102]States with B2B exemptions include Arizona, Indiana, Iowa, Kansas, Maryland, Massachusetts, Michigan, Missouri, Nevada, North Carolina, Ohio, Tennessee, and Texas.

[103]The full faith and credit clause provides that "full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state." U.S. Const. Art. IV, section 1. The purpose of this clause is to "preserve rights acquired or confirmed under the public acts and judicial proceedings of one state by requiring recognition of their validity in others." *Pink v. A.A.A. Highway Express Inc.*, 314 U.S. 201, 246 (1941). The full faith and credit clause also expresses "a unifying principle . . . looking toward *maximum enforcement* in each state of the obligations or rights created or recognized by the statutes of sister states." *Hughes v. Fetter*, 341 U.S. 609, 612 (1951) (emphasis added). It is well established that a state statute is a "public act" within the meaning of the full faith and credit clause. *See, e.g., Tennessee Coal, Iron and Railroad Co. v. George*, 233 U.S. 354 (1914).

Another way that the domicile-takes-all approach increases the liability of the holder compared with the state-by-state approach is regarding statutes of limitations. Under Delaware's current law, there is a 10-year statute of limitations (regardless of whether a report is filed) and a five-year dormancy period for the three primary property types for which estimation is used: unclaimed payroll, accounts payable, and accounts receivable credit balances.[104] As a result, Delaware's estimation calculates liability back 15 years. The Delaware statute of limitations also includes a tolling provision once the holder is notified of an audit.[105] Since Delaware audits often last many years, it is not uncommon for the state to be looking back over 20 transaction years by the time the audit is completed. By contrast, under the most recent version of the Uniform Unclaimed Property Act, the statute of limitations is 10 years if the holder does not file a report but is only five years if the holder files a report. And the dormancy period ranges from one year for payroll to three years for accounts payable and accounts receivable credit balances. The uniform act also does not include a tolling provision like Delaware. As a result, there are *at minimum* four fewer years of estimation for payroll than under Delaware's method, and potentially nine or more fewer years of estimation. For accounts payable and accounts receivable, there are between two and seven fewer years of estimation, or more once the tolling provision is factored into the analysis. Like the uniform act, most states have adopted one-year dormancy periods for payroll and three-year dormancy periods for accounts payable and accounts receivable (and only one or two states have tolling provisions like Delaware based on the issuance of an audit notice). Thus, most states, if they extrapolate at all, would be extrapolating over a significantly shorter period than Delaware under the domicile-takes-all approach.

But perhaps the most significant way in which the domicile-takes-all approach creates a greater liability for holders is the manner in which it is applied by Delaware. Delaware, unlike other states, relies heavily on unclaimed property as a source of revenue. Unclaimed property is Delaware's third largest source of revenue, making it a "vital element" in the state's operating budget.[106] As a consequence, Delaware has become more aggressive about how it calculates unclaimed property that is potentially due in the base period. For example, in audits, Delaware presumes that checks voided after 30 days are unclaimed property, even if the checks were voided in the ordinary course of business (that is, for business reasons) rather than because the checks were stale. Delaware thus improperly attempts to flip the burden of proof to the holder, though as noted briefly above, the burden actually rests with the state to prove the existence of unclaimed property.[107] Under the domicile-takes-all approach, Delaware is the sole state with authority to estimate, and thereby becomes the proverbial "800-pound gorilla," with leverage to extract concessions from holders to enforce such improper techniques. Even if some states were to adopt similar methods under a state-by-state approach, many would lack similar leverage against holders. And some states — particularly those not unduly influenced by contract audit firms that have a financial interest in convincing their client states that such techniques are valid — may not even attempt to enforce such aggressive techniques against holders, and may instead adopt methods that are more fairly designed to estimate actual amounts of unclaimed property that are due. For example, New York does not generally audit voided checks, presumably because such checks were voided for business reasons and are therefore presumptively not unclaimed property. Other states have taken a similar approach, at least when a contract audit firm is not involved in and controlling the examination.

One could counter that holders are better off dealing with one state as opposed to many, as the costs of appealing and litigating these issues across multiple states could be prohibitive. This is

[104] 12 Del. Code sections 1133, 1156.

[105] *Id.* section 1156(b).

[106] *Temple-Inland*, 192 F. Supp.3d at 543.

[107] *See supra* note 84.

a valid point. At the same time, given that unclaimed property decisions nationwide are few and far between, most holders and states apply unclaimed property decisions across borders. Thus, it seems probable that most states would stop applying a particular estimation method if the holder was successful in getting a court in one state to declare such a method invalid. This is particularly true if the court's decision did not hinge on a unique feature of the law of the state in question. Furthermore, whether correct or not, holders may feel like they may get a fairer shake in courts in states that do not depend so heavily as Delaware on unclaimed property as a source of revenue.[108]

Finally, unlike other states, Delaware has constructed an enforcement system that is designed to discourage appeal or even settlement of these issues. Delaware does this through its voluntary disclosure agreement (VDA) program. In general, Delaware may not conduct an unclaimed property examination of a putative holder "unless the person has first been notified in writing by the Secretary of State that the person may enter into an unclaimed property voluntary disclosure agreement."[109] Accordingly, when a holder is targeted for review, the secretary of state first sends the holder a notice saying that the holder has 60 days to enter the VDA program or the holder will be referred to the Delaware Department of Finance for audit. The VDA program was established in 2012 (though a prior version existed that was run by the Department of Finance rather than the secretary of state) and is touted as a more "business-friendly" program that is "faster" and "less expensive" than an audit.[110] And certainly in some ways, the VDA program is preferable to an audit. For example, the VDA program is run by administrators who have no direct financial stake in the outcome of the VDA, whereas at least historically, Delaware compensated its auditors on a contingent fee basis.[111] Also, a VDA involves only the state of Delaware, whereas other states will typically join an audit led by a third-party audit firm, which can add complexity and expense to the process. There are also substantive benefits to the VDA. For example, as noted above, in an audit, all checks voided after 30 days are presumed to be unclaimed property unless the holder can demonstrate otherwise. In the VDA program, only checks voided after 90 days are presumed to be unclaimed property, which can substantially reduce the number of checks to be researched and remediated (though, again, voided checks should not be presumed unclaimed property at all unless, perhaps, the holder has a practice of voiding them solely due to the passage of time).

On the other hand, unlike in an audit, a holder has no clear right to directly appeal the secretary of state's determination of liability in the VDA program.[112] Rather, the holder's only established recourse is to exit the VDA program (which, again, is technically voluntary), at which point the holder will be referred to the Department of Finance for audit. As a result, a holder can spend two or three years in the VDA program, only to reach an impasse, and then be forced to either accept the secretary's findings or start over in the audit program, which can last another three to seven years or even longer. The fact that the holder has already expended significant resources to get to that point in the VDA program and would likely incur substantial additional costs to start over in an audit provides an incentive to simply accept the secretary's findings. Furthermore, the fact that the holder has no clear, direct appeal rights in the VDA program likewise reduces the secretary's incentive to settle. As a result, while in audits the Department of Finance will settle disputed issues concerning the method of estimation, the secretary consistently refuses to

[108] Recent decisions in both federal and state courts in Delaware, however, suggest that judges are becoming more critical of Delaware's approach and less influenced by the politics involved.

[109] 12 Del. Code section 1172(a).

[110] Government of Delaware, "SOS Voluntary Disclosure Agreement Program FAQs."

[111] As noted above, Delaware recently amended its contract with one of its largest unclaimed property audit firms to provide that the auditor will be paid at fixed hourly rates for general ledger work.

[112] If a holder were to file an action for declaratory relief based on the position taken by the secretary on a particular issue in the VDA program, the secretary may contend that the action is unripe given the voluntary nature of the program. Of course, the holder may rightfully argue that it was compelled to join the program under threat of audit and that if it leaves the program, it will be audited and the Department of Finance will presumably take the same position as the secretary. However, no holder has yet filed such an action, so there is no clear authority at this point whether such an action is ripe for judicial review.

do so in the VDA program. Similarly, although the Delaware Escheats Law provides an express tolling provision for audits, there is no similar tolling provision for VDAs.[113] This has not stopped the secretary of state from asserting that such a tolling provision exists. Without a direct right of appeal, it is unclear how holders can stop this practice. If the holder exits the VDA program, the issue becomes moot unless, in a subsequent audit, the state escheator asserts that the tolling began when the holder entered the VDA program rather than when the audit notice was issued. But if the state escheator declines to pursue such an aggressive argument — which runs directly counter to the Delaware statute — the secretary's position in the VDA remains effectively unchallenged. Holders in the program may file for declaratory relief, but as noted above, it is unclear whether such an action would be ripe.[114]

Holders need to weigh these disadvantages of the VDA program against the benefits of the program when deciding whether to accept the secretary's invitation to join the VDA program or instead proceed with an audit.

VIII. Conclusion

The domicile-takes-all method of estimating unclaimed property conflicts with federal common law and defies the very purpose of estimation, which is to put the parties in approximately the same position that they would have been in had sufficient records been available to determine the actual amount of unclaimed property that was due to each state. This method also violates the excessive fines clause, the takings clause, substantive due process, and the states' own estimation statutes. Furthermore, no public policy justifies the use of the domicile-takes-all method. To the contrary, this method creates a windfall for the state of domicile — typically, Delaware — at the expense of both holders and the very states whose record retention laws were actually violated.

Fortunately, there is a simple alternative that contradicts no law and in fact is expressly contemplated by the uniform acts and most state unclaimed property laws: the state-by-state estimation method. Most importantly, this method appropriately compensates each state whose record retention law was violated, does not encourage arbitrage by holders, and serves the ultimate goal of estimation by approximating the amount that the holder should have reported to each state had it retained the required records. It has been over four years since a federal court declared the domicile-takes-all method unconstitutional. It is therefore high time that both holders and states push for universal adoption of the state-by-state method. The only thing standing in the way is Delaware and its audit firms, which continue to ignore the law and grow rich from the domicile-takes-all — perhaps more accurately called the "Delaware-takes-all" — method. ■

[113] 12 Del. Code section 1156(b).

[114] *See supra* note 112.