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Why Conflict Is Brewing Over Del. Unclaimed Property Law

By **Matthew Wright and Matthew Rifino** (January 23, 2020, 5:27 PM EST)

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No one may be looking forward to new beginnings in 2020 more than the state of Delaware's Department of Finance. Its highly lucrative unclaimed property program has been the subject of substantial criticism for several years, beginning with the U.S. District Court for the District of Delaware's stinging rebuke of the state's aggressive escheat enforcement practices as "a game of 'gotcha' that shocks the conscience," in Temple–Inland Inc. v. Cook.[1]

In response, Delaware's General Assembly passed legislation in early 2017 to overhaul the Delaware Unclaimed Property Law. The amendments were meant to promote predictability, fairness and efficiency by, among other things, reducing the look back period for audits to 10 years, establishing record-retention requirements for businesses and clarifying annual reporting requirements.

But those legislative amendments have not stopped a growing parade of legal challenges, starting with a lawsuit filed in December 2018 by Univar Inc. and recently culminating in four new lawsuits filed last month alone.[2] Like Univar, these new lawsuits allege that unclaimed property audits initiated by the Delaware Department of Finance and conducted by its contingent-fee audit firms violate the companies' rights under the Fourth, Fifth and 14th Amendments of the U.S. Constitution.

Each of these lawsuits raise serious constitutional challenges to Delaware's unclaimed property laws and the collection practices of the state and its auditors. Although the latest lawsuits are only in the initial pleading stages, the detailed complaints and extensive attachments allow readers (and other unclaimed property holders) to peek behind the curtain and see how the state finds itself in this deepening legal quagmire.

The state's use of estimation to calculate a subject holder's unclaimed property liabilities for a period of time in which there are no available records is the primary focus of the plaintiffs' ire. The plaintiffs allege that the state's estimation methodology inflates unclaimed property liabilities, in which the state and its auditors purportedly exploit the difference in subjects' record retention policies and the statutory requirements to impose liabilities that can neither be established nor refuted. The recent 2017 amendments unfortunately add to, rather than resolve, much of the confusion around this issue.

For example, the subpoena power that Delaware relies upon in Univar to compel the production of documents only became effective in 2017. Those same amendments also created a 10-year record retention requirement for unclaimed property records. But prior to that legislative amendment, there was no record retention requirement under the DUPL.

Thus, Delaware is retroactively applying an estimation of liability over a period of years when the law did not have any affirmative obligation to maintain such records — estimation practices that the federal courts have already ruled are invalid and that violate substantive due process.

In one of the recently filed lawsuits, Eaton alleges that approximately 81% of the amount sought by the state is the product of estimation. Siemens AG and Fruit of the Loom Inc. contend that the auditor's estimation calculations account for more than 90% of the alleged liabilities. The state attempts to justify the use of estimation on public policy grounds, as it purportedly maintains unclaimed property as a custodian in an effort to reunite owners of uncashed checks, uncollected dividends or utility deposits with their true owners.

But the records attached to the Siemens and Fruit of the Loom complaints show that the state only returns a small fraction of unclaimed property recoveries to actual owners, while retaining the overwhelming majority of these funds for its own use and at the expense of audit subjects — but only after the state's contingent-fee auditors take home a significant percentage as a bounty for their efforts.

The state's retention of third-party auditing firms to conduct unclaimed property audits on a contingent fee basis is another common complaint across the various lawsuits. Delaware law permits the state to hire third-party agents to conduct unclaimed property audits. The lawsuits allege that the auditors' compensation depends on the size the state's recovery. The practice is extremely lucrative; the Siemens complaint alleges that one particular firm, Kelmar Associates LLC, received approximately $53.5 million from the state of Delaware in financial year 2013 alone.

Where the state delegates responsibility for conducting unclaimed property audits to these third-party firms, these plaintiffs alleges that the contingent-fee model causes the audit firms to target large companies, propound excessive requests for documents, exploit an estimation methodology for the auditor's own pecuniary gain and deny holders due process.

The district court recognized this apparent conflict in Temple–Inland, and more recently, in Univar. For example, AT&T Inc.'s complaint alleges that state authorities (acting through their designated audit agent, Kelmar) demanded production of records related to "approximately 60 million transactions reflecting almost $100 billion of spend," which AT&T declined to produce on the grounds that such requests violated the company's rights to due process and protections against unreasonable searches and seizures.

AT&T also objected to the state's requests to produce evidence of disbursements made to recipients with known addresses outside of the state of Delaware, based on the U.S. Supreme Court's seminal ruling in Texas v. New Jersey, which established binding federal common law priority rules to resolve conflicts between states over unclaimed intangible property and a process for applying those rules.

Under the recent amendments to the DUPL, the state is obliged to give holders the opportunity to enter into its voluntary disclosure agreement program before initiating a formal unclaimed property audit. The VDA program is designed to serve as a comprehensive self-review of a holder's books and records to determine whether the holder has past-due abandoned or unclaimed property reportable to Delaware.

Each of the lawsuits filed in December 2019 followed shortly on the heels of the state's decision to expel each plaintiff from this VDA process. AT&T alleges in its complaint that after the state escheator determined that AT&T did not comply with Kelmar's document demands in a timely manner or to its satisfaction, the VDA was terminated. This invited AT&T and similarly situated companies to seek protection through the courts.

The litigation surrounding Delaware's unclaimed property laws and enforcement practices is likely to continue for the foreseeable future. The similarity of the conduct alleged in these federal complaints suggests that other companies may also be subject to similar practices. Given the importance of unclaimed property revenue to the state's finances, neither the state nor its auditors are likely to reverse course unless the courts intervene decisively.

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[1] Temple–Inland, Inc. v. Cook, 192 F.Supp. 3d 527, 550 (D. Del. 2016).

[2] Univar, Inc. v. Geisenberger, et al., Case No. 1:18-cv-01909; AT&T Capital Services Inc., et al., v. Geisenberger, et al., Case No. 1:19-cv-02238; Eaton Corp., et al., v. Geisenberger, et al., Case No. 1:19-cv-02269; Fruit of the Loom, Inc., et al., v. Geisenberger, et al., Case No. 1:19-cv-2273; and Siemens USA Holdings, Inc., et al., v. Geisenberger, et al, Case No. 1:19-cv-02284. (All four new suits were filed in the United States District Court for the District of Delaware.)