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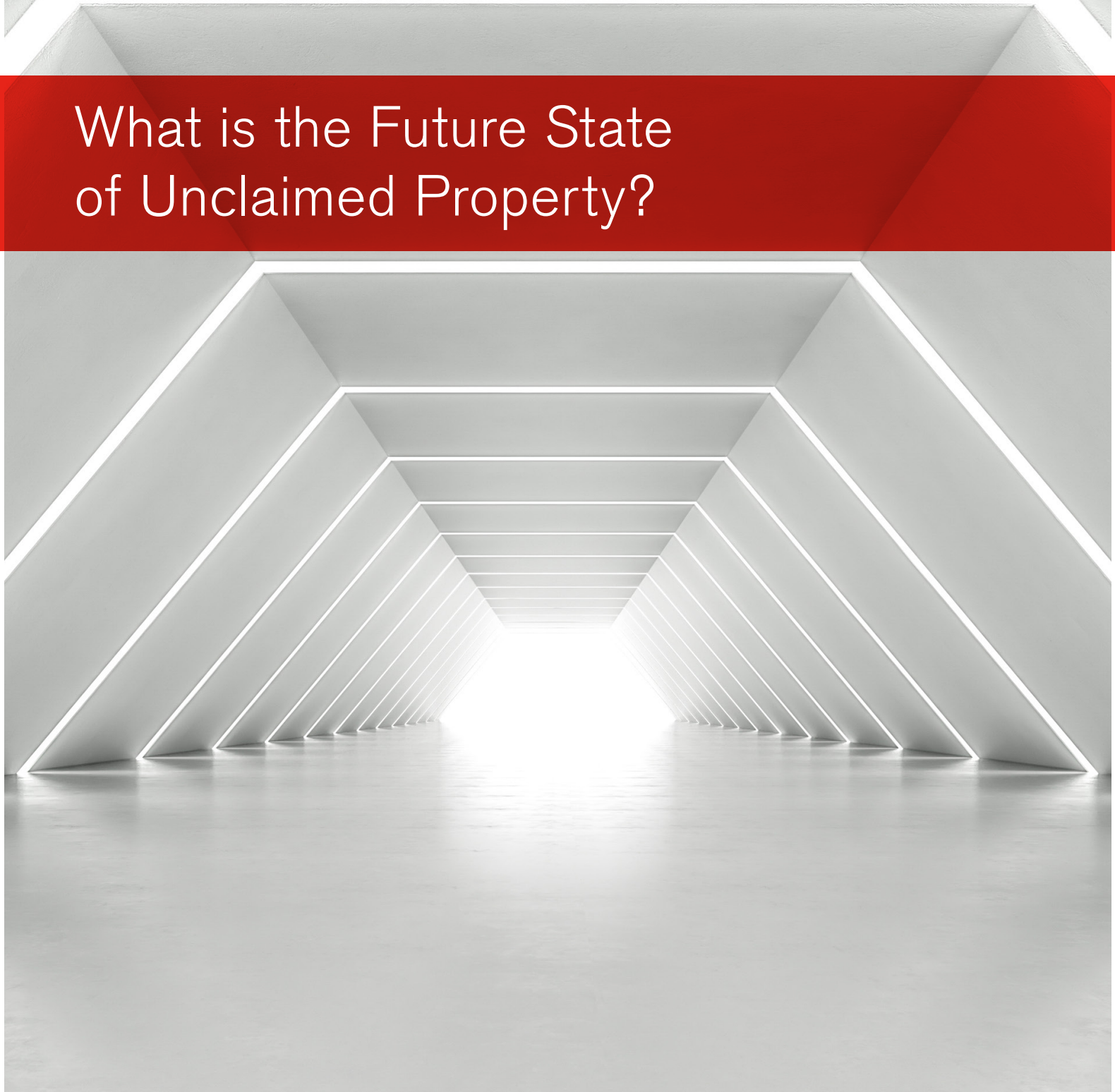
What is the Future State of Unclaimed Property?



Introduction

Over the past two years, a series of sea-change developments in the unclaimed property compliance arena have impacted corporations in the United States.

From the 2016 Court decision in *Temple-Inland v. Cook*[1] and subsequent settlement leading to the expansion of Delaware's Voluntary Disclosure Program, to the finalization of the Uniform Law Commissions' Revised Uniform Unclaimed Property Act (RUUPA) and the movement toward adoption by several states, the landscape has changed more rapidly than many imagined could have been possible.

At Duff & Phelps, we like to ask ourselves, "what's next?". What changes will impact our clients and the Holder community in general? The insatiable demand for enhanced revenue streams from the states, along with technological advances in payments and currency appears to set the stage for even more rapid changes in the years to come.

So, we asked, "what is the future state of unclaimed property"? In addition to gathering and presenting in this forum the ideas of our own team of advisors, we sought the opinions of leading attorneys and government officials. The articles that follow reveal a wide range of possible trends and outcomes that we trust our readers will find enlightening. Not surprisingly, there is a similar stream of consciousness in the opinions of those that serve as business advocates, and a very different perspective from those representing the states' interests.

One constituency not represented is the holder community. Despite our best efforts, we were not able to entice any corporate representative to comment about their experiences in dealing with unclaimed property regulators, or to opine on future trends. In our opinion, the reluctance of this group speaks to the current state of unclaimed property compliance.

1. 192 F.Supp. 3d 527 (D. Del. 2016).

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"States will attempt to increase amounts collected, accelerate collections, and strive to make greater amounts that are escheated the permanent and nonrefundable property of the state."

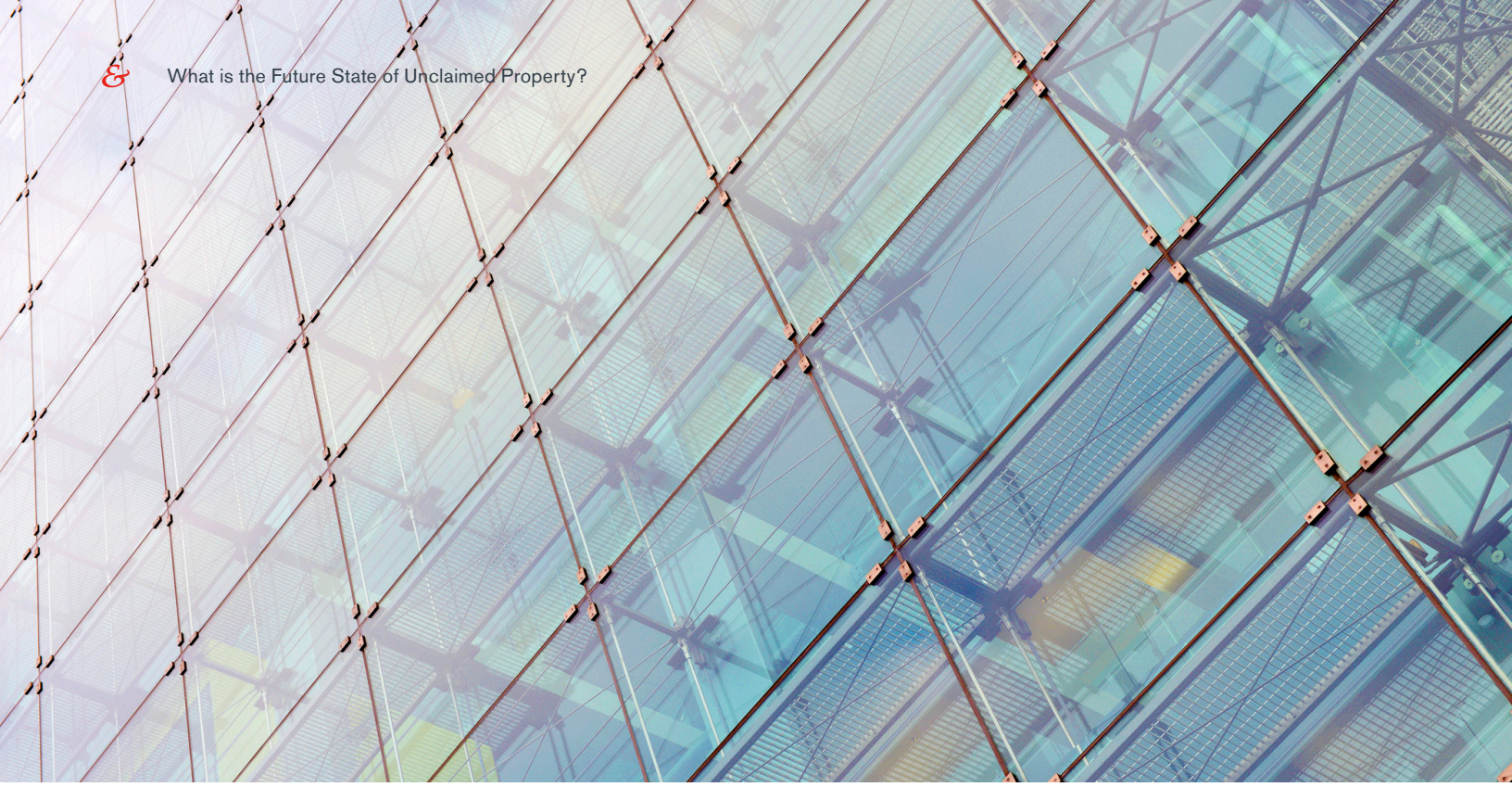
The Erosion of the Derivative Rights Doctrine and the Business to Business Exemption

As we review recent developments and consider the obvious reality of the states' financial situations, we can draw only one conclusion: the states will continue to increase amounts collected, will attempt to accelerate collections, and will strive to make ever greater amounts that are escheated the permanent and nonrefundable property of the state.

One key indicator of this potential trend is the erosion of the "Derivative Rights Doctrine." The Derivative Rights Doctrine is the bedrock of unclaimed property law and dictates that when a state takes possession of property, it is doing so as a custodian only and has identical, but no greater, rights than the owner. The taking is not permanent.

RUUPA failed to codify the Derivative Rights Doctrine when passed in 2016. Not surprisingly, legislators in three states – Hawaii, Arizona and Louisiana – proposed bills in 2018 to extinguish an owner's rights after a time period or below certain dollar thresholds, allowing those states to become the owners of the property. We expect more state legislatures to follow suit. The National Association of Unclaimed Property Administrators (NAUPA) has stated that they are opposed to permanent taking by the states, setting up a potential future conflict with lawmakers. Their interest in RUUPA's omission of the Derivate Rights Doctrine appears to be focused on preventing corporations from using contractual arrangements between parties to extinguish property rights, and thus by extension extinguishing a state's rights, a concept they refer to as private escheat.

A cornerstone concept of unclaimed property is consumer protection. Many states recognize that corporations have sophisticated accounting systems and don't need the same protection as individuals, and thus exempt transactions between businesses. Twelve key states have statutes or



regulations allowing Business to Business (B2B) exemptions, which have been utilized extensively by corporations to prevent dollars from escheating that should be reconciled with other businesses.

RUUPA failed to address B2B. Right on cue, Illinois enacted a new unclaimed property statute in 2018 based on RUUPA that eliminated their long standing B2B exemption and appears to make the application retroactive. We believe that B2B exemptions will become extinct soon, a victim of the states' desires to increase collections.

Chipping Away at "Buy and Hold"

The erosion of the B2B exemption is a clear indicator that states collectively intend to extract more unclaimed property from owners that are corporations. Will they do the same of owners who are individuals? Assets in retirement accounts are one of the most tempting sources for states to tap for unclaimed property collections. Most states ignore IRAs until the owner reaches the required minimum distribution (RMD) age of 70.5 years old, and then impose a three-year dormancy period if distributions have not been taken.

In 2016, Pennsylvania enacted HB 1605 that allowed for the escheatment of IRA accounts before the RMD if two pieces of mail from the investment company have been returned to the post office (RPO) as undeliverable. This action seemed to be an attack on the "buy and hold" investment philosophy upon which the investment industry has been based. This law may expose owners to potentially severe tax consequences.

Pennsylvania's action is especially troubling considering IRS Revenue Rule 2018-17 published in May. The IRS declared that escheated proceeds from an IRA constitute a designated distribution and must be recorded on a form 1099-R. While troubling for owners in all states, IRA owners in Pennsylvania may face additional taxes for early withdrawal. Collectively, these actions appear to be a trial balloon to push the limits of increasing unclaimed property collections onto the backs of individual investors.

The reaction to this law has been universally negative, with Pennsylvania legislators feeling pressure to take corrective action. Thus, HB 2167 and SB 1058 were introduced in 2018 to ease the burden a bit for private investors, proposing to

adopt standards that IRA accounts should have been coded as RPO and have had no activity for a three-year period before being subject to escheat. While better than an RPO standard only, such a corrective action will not return the standard of protection previously enjoyed by Pennsylvania citizens – that their account should not he considered for escheatment until they have reached the age of RMD.

In our view, states will further test the boundaries of their ability to escheat the assets of individual investors in the future.

Virtual Wallets, the Cloud and Cryptocurrency: New Frontiers for the States

Advancements in payment systems technology and the rise of digital currencies has been noticed by the states and their legislatures as potential sources of unclaimed property collection. Financial Technology, or "FinTech," companies have proliferated to offer new types of financial services. Many online transactions now take place with the use of virtual wallets. In lieu of a traditional payments, online retailers and marketplaces routinely place funds as a credit in a virtual wallet for individuals. These credits are often available to purchase goods or to be withdrawn by consumers in a variety of methods. The states noticed that funds available in virtual wallets are often small dollar amounts that frequently go unused by the owner. We believe as more and more companies, and the marketplace in general, migrate from paper checks to electronic payments, companies using virtual wallets will face continued and expanded scrutiny in the very near term.

Complicating matters is record retention. Any organization that has undergone an unclaimed property examination understands that access to detailed historical vendor, customer and employee payroll records is critical to overcoming the "presumption of abandonment" by the states and their contingent fee auditors. As organizations increasingly "offshore" or "outsource" their accounting functions to third-parties or park such records in the Cloud, the likelihood of retaining the necessary records diminishes over time. It is not a matter that the records cannot be retained, but rather that financial pressures and perpetual system upgrades make doing so cost-prohibitive. As such, we anticipate the use of estimation techniques, not only by the state of incorporation, but imposed as a penalty for failure to comply by the states, will increase in frequency. This is one of the components included in RUUPA. To date, Kentucky, Utah, Tennessee and Illinois have enacted legislation based on RUUPA, with several more states expected to follow suit in 2019.

We also anticipate continued focus by the states on loyalty, rewards and promotion programs. While currently exempt under RUUPA, few states have yet to embrace the RUUPA definition and we expect continued narrowing of those programs which will remain exempt from the definition of unclaimed property. Holders need to be especially careful in crafting such programs so as to avoid inadvertently causing their reward programs to give rise to unclaimed property.

The rise of crypto or virtual currency has been dramatic and covered extensively in the press. RUUPA included virtual currency and several states have adopted RUUPA-based laws calling for the escheat of virtual currency. One major problem is: no one can truly define who is the holder, is it the exchange? If a bank or financial institution offers virtual wallets for virtual currency, is it the holder? One of the most vexing questions is: who can transmit the virtual currency to the states and what would they do with it once they receive it? Virtual currency relies on a "crypto-key" for transmission. How can a holder transmit escheat when the owner holds the key? If the owner holds the key, can the owner truly be considered to have abandoned the property?

Finally, will states liquidate virtual currency if they receive it? And, if they do, will they expose themselves to jeopardy based on the wild valuation swings in that marketplace? We've seen lawsuits over the states' ill-timed liquidation of escheated securities. We are certain that the states will be looking for ways to escheat virtual currency in the very near future.

Howard J. Swibel
Partner, Saul Ewing Arnstein & Lehr LLP
Illinios Uniform Law Commissioner

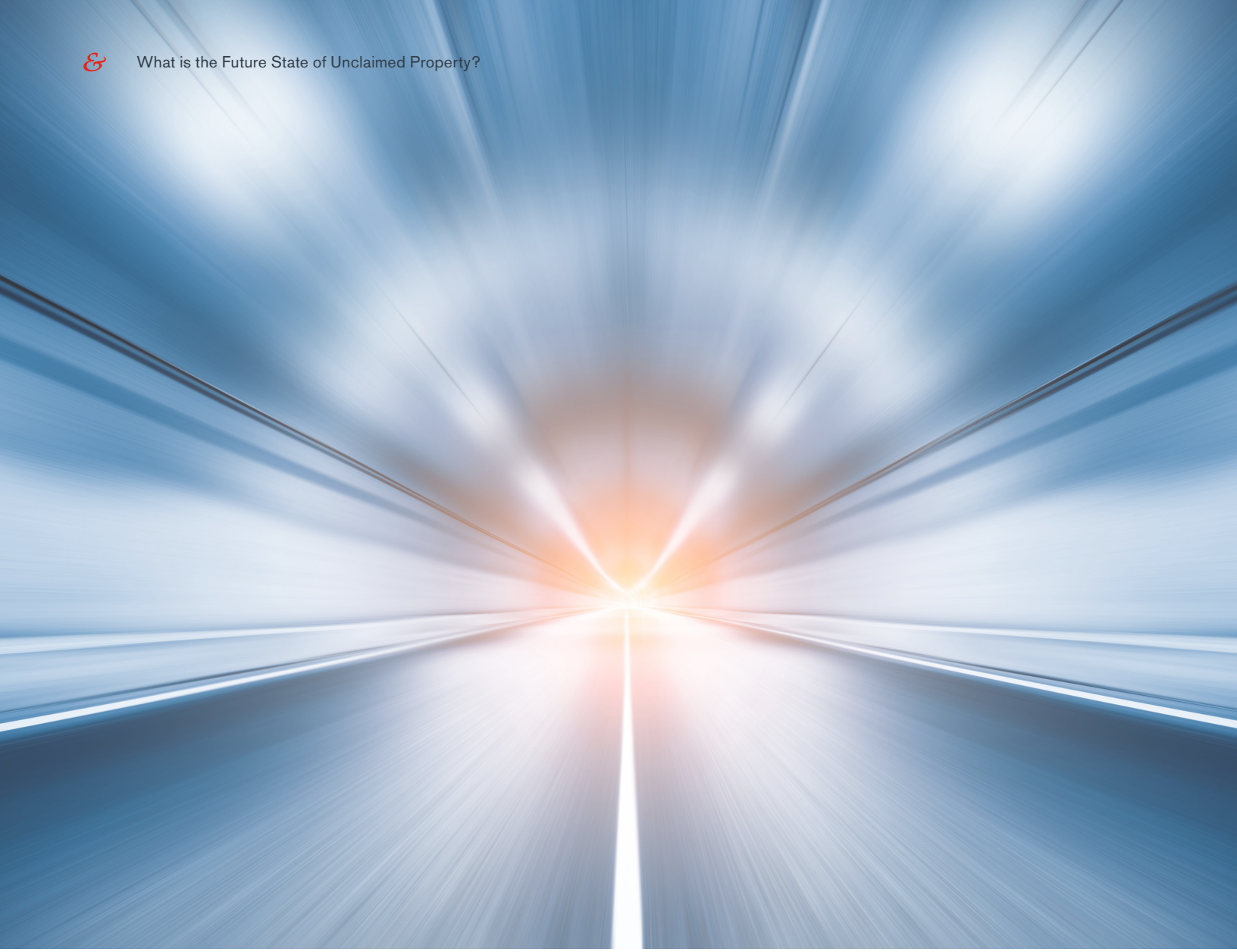
"Sixty-four years of unclaimed property legislation and accompanying administrative enforcement have not been accepted by some marginal, but well-financed, opponents, who continue to advocate for upending the unclaimed property regime."

Having participated in drafting two separate versions of the Uniform Unclaimed Property Act, fully 35 years apart, I see several facts and trends that deserve to be discussed. Ironically, these facts and trends have moved in opposite directions. What follows are my personal points of view that do not represent official pronouncements by the Uniform Law Commission, where I have served as an Illinois Commissioner for over 40 years.

States Have Increased Use of Technology

First, many state governments have developed impressive and sophisticated strategies to collect and distribute unclaimed property. Advancements in data collection and tabulation have taken hold, along with increased training and recruitment of the personnel who administer the state programs. State officials have acquired detailed working knowledge of a wide range of industries and business practices. That knowledge has enabled them to create the infrastructure and systems needed to assemble and digest large volumes of transactional data submitted to the states by business entities. At the same time, officials in many states have increasingly focused energy and resources to expand public access to the information needed for filing claims. As state officials have employed internet websites and other modern tools to aid citizens' efforts to retrieve their property, state officials have, in many cases, intensified their efforts to achieve ever greater return rates of property to rightful owners, measured both in sheer numbers of citizens served, as well as total dollar amount of property returned.

Of course, state practices do vary and the responsibility for administration of unclaimed property activities reside in different governmental hands. In some states, such as Illinois, the job has been transferred from one of the Governor's Cabinet-level departments to the State Treasurer, who is a directly-elected office holder. The Illinois unclaimed property duties now receive heightened attention and the elected State Treasurer has truly taken ownership of the function.



The public has benefitted handsomely, both through beefed-up enforcement and strengthened efforts to arm the public with information. Furthermore, specially trained investigators make extraordinary efforts to track down persons who are entitled to property held by the state. In case after case, the delivery of funds to rightful owners has resulted in meaningful quality of life enhancement. I expect the states to make ever greater strides in this regard.

Holders Advocate to Upend Unclaimed Property Regime

Sixty-four years of unclaimed property legislation and accompanying administrative enforcement have not been accepted by some marginal, but well-financed, opponents, who continue to advocate for upending the unclaimed property regime through a combination of attempted legislative reform and judicial dismantling. They attack unclaimed property enforcement as if it is a product of the New Deal social welfare protections or an unprincipled, if not unconstitutional, burden on free-wheeling business enterprise. Those opponents assert that unclaimed property is nothing more than a business tax in disguise, and accuse state officials of heavy-handed, abusive tactics designed to bolster state government finances on a stealth basis.

Alas, the opponents will fail in their efforts to turn back the clock to the days when big business could profit from organized efforts to play "finders keepers." When the spotlight of public opinion shines on such practices as life insurance companies holding on to death benefits long after their insureds have died, big business ultimately yields to fundamental notions of fundamental fairness. The truth is that unjust enrichment is not an American value and ethical conduct by business organizations should be promoted and required.

The 2016 revision to the Uniform Unclaimed Property Act takes steps to address legitimate concerns expressed by the business community. While outsourcing audit and examination functions to expert third-parties is a well-accepted good government practice, safeguards should be in place to deter overly aggressive tactics. Transparency in relation to those third-party arrangements and meaningful opportunity to process complaints about allegedly unreasonable audit procedures are among the statutory reforms we promulgated.

B2B Exemptions Being Challenged

As with many Uniform Law Commission projects, the most recent effort to revise the Unclaimed Property Act faced the practical reality that state legislatures previously staked out positions on important issues. For example, the question arises as to whether property that is the subject of a transaction or relationship between two "business" entities should be subject to unclaimed property reporting. In other words, should unclaimed property duties be limited to situations in which an individual consumer is the purchaser of goods and services? Arguments have been advanced to the effect that large, well-advised business organizations should be free to negotiate their own business terms and should be able to immunize themselves from unclaimed property compliance with respect to their privately negotiated business arrangements.

The problem is where to draw the line. The fact is that many individual consumers own their own small businesses. Indeed, many operate as sole proprietors, without the benefit of trained personnel to assist in navigating all of the consequences of relocation, business name changes, etc. As a result, millions of individual citizens who don the hat of a small businessperson end up losing track of millions of dollars of unclaimed property. If those small business owners live in the fifteen states which exclude "business to business" transactions from unclaimed property coverage, then they are left to fend for themselves and frequently miss out on collecting monies rightfully owed to them. While we at the Uniform Law Commission did not endorse that legislative technique, we respect the fact that some states may not choose to change their position on this and other issues, especially where special interest carve-outs are embedded in legislation. Perhaps future discussion and debate will reduce the incidence of outliers, so that the predictability which stems from uniformity can be achieved.

On an encouraging note, most businesses recognize the importance of setting up a compliance apparatus with respect to unclaimed property. The benefits to the public are real and meaningful. Especially in a society with maximum mobility, where our fellow Americans change their addresses multiple times and sometimes fail to make sure that the businesses which serve them know about those address changes, the unclaimed property legal structure makes perfect sense. I expect the adoption of compliance programs to proliferate as awareness continues to grow.

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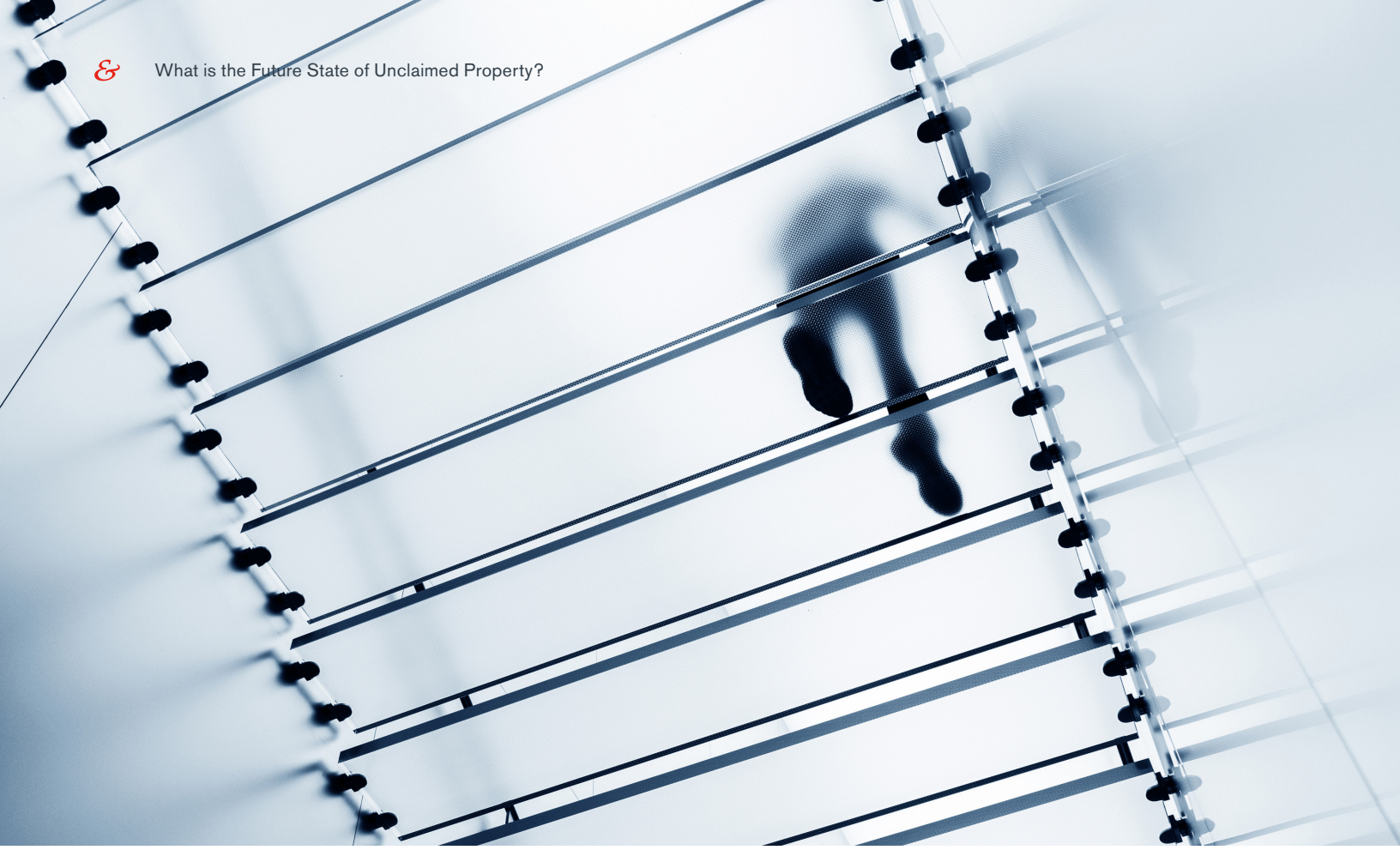
"I do not believe the voluntary disclosure agreement programs will significantly reduce the number of audits commenced."

The current landscape in state unclaimed property enforcement leads me to believe that an increase in litigation arising from audits, with the potential for another Supreme Court case, is likely. Additionally, I do not believe the voluntary disclosure agreement ("VDA") programs will significantly reduce the number of audits commenced.

More Litigation Is Likely

There are significant due process and federal preemption concerns that have not been corrected by recent legislation or in RUUPA and, in some instances, have actually created new issues or exacerbated existing ones. Prior to the decision in *Temple-Inland Inc. v. Cook*[1], few companies were willing to litigate audit assessments, even though the assessments were unreasonable and appeared to conflict with the federal priority rules affirmed in *Delaware v. New York*[2]. But, the opinion in *Temple-Inland* holding that Delaware administrators' audit conduct "shocked the conscience," coupled with the ruling in *Marathon Petroleum Corporation v. Sec'y of Finance*[3], that private parties have standing to enforce the federal common law in a dispute with a state, has changed the landscape. It also appears to have interested the Supreme Court. In *Taylor v. Yee*[4], Justice Alito, with Justice Thomas joining, concurred in denying *certiorari*, but seemed to invite the right case for addressing the "important due process concerns" created by shortened dormancy periods and insufficient pre-escheatment notice. Although virtually all states now require some form of mailed pre-escheatment notice, that does little to reach owners that moved and does nothing to minimize the due process concerns raised by claiming estimates of liability from companies that do not represent property abandoned by anyone (and raise significant federal preemption questions). The fact that in *Temple-Inland*, the state could not cite a single instance during a period of almost 30 years in which it returned property to an owner where the property was taken from a holder based on an estimate speaks volumes.[5]

1. 192 F.Supp. 3d 527 (D. Del. 2016).
2. 507 U.S. 490 (1993).
3. Fd.3, No. 16-4011, 2016 WL 5986000 (Dec. 4, 2017).
4. 136 S.Ct. 929 (Mem) (2016).



Notwithstanding statutory provisions authorizing estimation, virtually no company realizes how that estimate will be calculated and is quite shocked when they learn. So, I think there will be more law suits challenging assessments.

Voluntary Disclosure Programs Will Not Reduce Audits

The existence of voluntary disclosure programs indicates a desire by the states to avoid audits (and potential litigation) while enabling the states to collect and use the funds in perpetuity. But, there is relatively little effective outreach and education about those programs. Indeed, states provide limited information about the fact that companies are obliged to escheat more than just uncashed checks in the first place. Delaware's Secretary of State disseminates letters notifying companies of the VDA program, but the fact that so many new audits have commenced, even after those letters are sent, indicates that companies do not understand the implications of the letters. I have heard companies say that because they did not think they owed anything to Delaware, they ignored the letter, only to receive an audit notice letter later. The fact that so little of the unclaimed property is returned to owners means that states know this is free money, especially where assessments are based on estimates. Most companies have no idea that an estimated liability will be assessed if they do not retain records for far longer than standard document retention policies provide, and virtually none know how such an estimate will be calculated. So, companies receiving an invitation to voluntarily disclose do not fully understand what they may be facing in a multi-state audit if they ignore the VDA program. The result is that they must submit to a lengthy, burdensome audit.

5. See *Temple-Inland*, 192 F.Supp.3d at 549.

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Chief of Staff
Illinois State Treasurer Michael W. Frerichs

"States will continue to make great improvements in returning property to the rightful owners and processing claims promptly and efficiently."

RUUPA

The Revised Uniform Unclaimed Property Act (RUUPA), which the Uniform Law Commission (ULC) promulgated in 2016 will likely be the basis for most major legislative changes to state unclaimed property statutes. RUUPA, or significant portions of RUUPA, have become law in Tennessee, Kentucky, Utah, Illinois, and even Delaware.[1] Some form of RUUPA has been introduced in Colorado, the District of Columbia, Maine, Minnesota, Nebraska, Vermont and Washington with additional introductions expected in 2019.

Several states, including some of the largest, have gone on the record to say that they will not support an introduction of RUUPA. Among states supporting the introduction of RUUPA, it is reasonable to expect the introduced version will include some of the language adopted in Illinois' modified version.

Some holder advocates are expected to seek introduction of either amendments to existing unclaimed property laws or wholesale revisions to include items that were rejected in the ULC's drafting process, including a broad business to business (B2B) exemption and a "derivative rights" provision that would allow holders to use contractual provisions to avoid unclaimed property liabilities. The ULC and state unclaimed property administrators will vigorously oppose such proposals.

Third-Party Auditors

The ULC and NAUPA rejected the proposal from some holder advocates to prohibit the use of third-party auditors to perform unclaimed property examinations on a contingent fee basis.

While a small number of holder advocates are bringing court challenges to the use of third-party contingent fee auditors, no court has found the arrangement to be unconstitutional.[2]

1. With apologies to Field Marshall Von Moltke, no uniform act survives contact with the various state legislatures. In the sausage-making process of passing legislation uniform acts, including unclaimed property acts, are subjected to amendment.
2. See Fidelity & Guaranty Life Insurance Co. v. Frerichs, No. 3:17-CV-03050, 2017 U.S. Dist. LEXIS 181396, at *14 (C.D. Ill. Oct. 31, 2017) ("In Count 4, Fidelity alleges a violation of procedural due process resulting from the Treasurer's contingent-fee arrangement with Kelmar, which gives Kelmar a financial interest in the audit proceedings… Fidelity argues that Kelmar's role is analogous to a tax assessor, which courts have found are engaged in judicial or quasijudicial decision-making. The Court disagrees… Because Fidelity has not plausibly alleged that Kelmar is acting in a judicial or quasi-judicial capacity, the Court finds that Count 4 fails to state a claim.")

In response to complaints by holder advocates about the compensation for these auditors, NAUPA points out "the holder effectively receives a far more substantial sum when unclaimed funds are retained and taken into income."[3] If a holder can avoid reporting and remitting unclaimed property it takes 100% as compared to the 10-15% paid as a contingency fee for the auditors. Further, the auditors do not receive a percentage of all unclaimed property identified in an examination. Auditors receive no fee for unclaimed property identified in the examination that the holder returns to the rightful owner in the remediation and due diligence process. Auditors only receive their percentage on property which is reported and remitted to the state administrator at the end of the examination where the holder has not been able to return the property to its rightful owner. Holders are expected to address compliance issues identified by an examination report and remit accurately and completely all unclaimed property going forward; auditors receive no compensation for future compliance.

As NAUPA's whitepaper surmises, the organized objection to third-party contingent fee auditors arose after such auditors identified unclaimed life insurance benefits being held by life insurance companies utilizing the Social Security Administration Death Master File (DMF). By early 2016 the 22 largest life insurers had paid out over $7.4 billion "either directly to beneficiaries, or to state unclaimed-property departments" as a result of unclaimed property examinations according to the *Wall Street Journal*.[4]

Further, state administrators must make the final decision about legal issues raised in an examination–including approving the final amount to be reported and remitted to their state. Holders under examination can–and often do–make their arguments directly to state administrators when they disagree with the recommendations and findings made by auditors.

Estimation

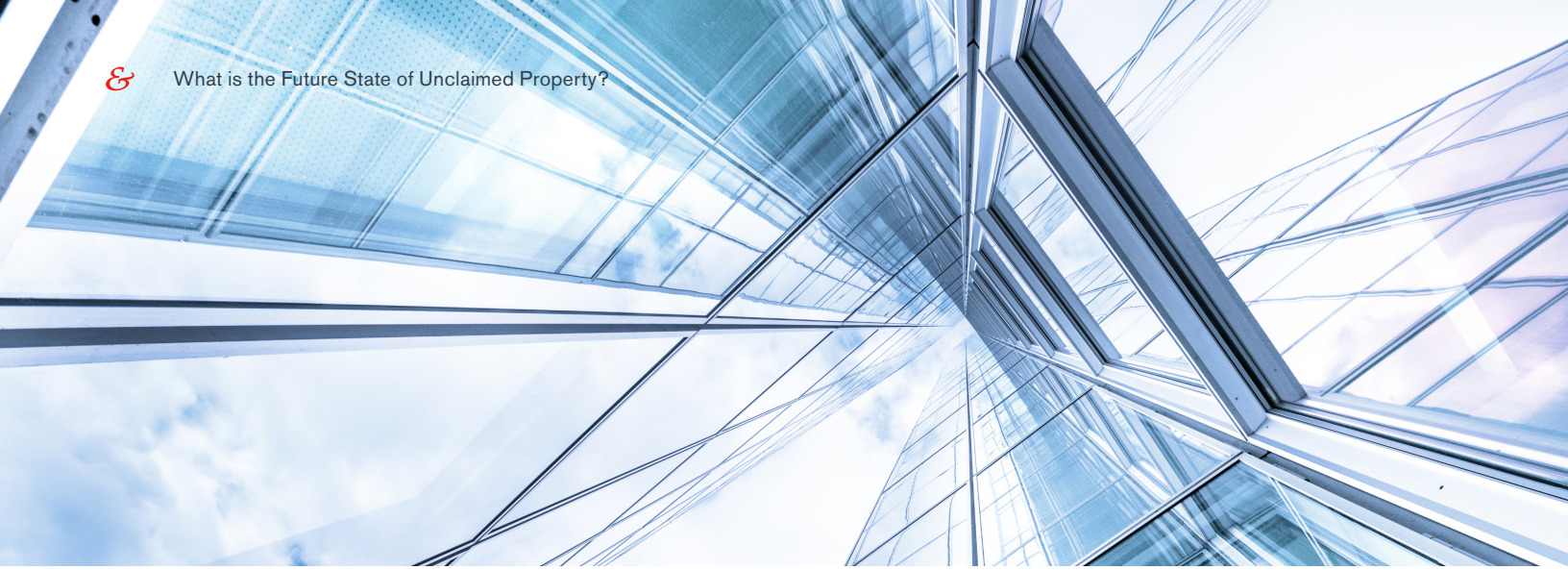
RUUPA authorizes the use of estimation either when the holder consents in writing or when the holder fails to retain records required by the Act. The ability of an unclaimed property administrator to use estimation is necessary as a deterrent to the intentional or negligent destruction of records needed in an examination. The official comments to the ULC's 1995 Uniform Act specifically note that estimation can be "viewed as a penalty for failure to maintain records of names and last known address" and not the imposition of multiple liability.[5] RUUPA has a similar, but more nuanced, comment referring to "adverse consequences, which might be characterized as 'penalties,' resulting from failure to maintain records…"[6] Even the *Temple-Inland* court upheld the use of estimation.[7]

For the vast majority of states, however, estimation in an unclaimed property examination is rare. It is typically used when a holder requests the use of estimation to quickly end an examination. Most state unclaimed property administrators prefer that property be reported and remitted with the name and address of the rightful owner. Estimation is disfavored and used as a last resort when a holder has destroyed records.

Future of Enforcement

As the official comments to the 1995 Uniform Act note, unclaimed property laws are "based on a theory of truthful self-reporting" by holders.[8] Unclaimed property administrators are acutely aware, however, that compliance with unclaimed property laws is not universal. States are expected to expand

3. "NAUPA States Effective Utilization of Private Auditors Whitepaper" http://www.uniformlaws.org/shared/docs/UnclaimedProperty/Comments-NAUPA.zip
4. Scism, Leslie. "Life Insurers Fight States" Wall Street Journal, Feb. 26, 2016 Comment to Section 20(f) of the 1995 Uniform Unclaimed Property Act. http://www.uniformlaws.org/shared/docs/unclaimedproperty/uupa95.pdf
5. Comment to Section 20(f) of the 1995 Uniform Unclaimed Property Act. http://www.uniformlaws.org/shared/docs/unclaimedproperty/uupa95.pdf
6. Comment to Section 1006 of RUUPA. http://www.uniformlaws.org/shared/docs/UnclaimedProperty/RUUPA_FinalAct_2016.pdf
7. "Courts have routinely upheld the government's use of statistical sampling as a valid audit tool, provided it was properly performed." Temple-Inland, Inc. v. Cook, 192 F. Supp. 3d 527, 548 (D. Del. 2016) citing Chaves Cty. Home Health Serv., Inc. v. Sullivan, 931 F.2d 914, 919, 289 U.S. App. D.C. 276 (D.C. Cir. 1991); Balko & Assocs., Inc. v. Sec'y of Health & Human Servs., 555 F. App'x 188, 194 (3d Cir. 2014); and United States v. Ukwu, 546 F. App'x 305, 308, 310 (4th Cir. 2013)
8. Comment to Section 19 of the 1995 Uniform Unclaimed Property Act. http://www.uniformlaws.org/shared/docs/unclaimedproperty/uupa95.pdf



their efforts to encourage holder compliance. These efforts are likely to include holder education, voluntary disclosure agreement (VDA) programs, and auditor or contractor assisted self-audits. But, multi-state examinations by third-party contingency fee auditors will continue to be used because, quite simply, they are effective and cost-efficient for the states.

Claims Processing Will Continue to Improve Rapidly

States will continue to make great improvements in returning property to the rightful owners and processing claims promptly and efficiently. More and more states use direct mail to notify owners. Some states are beginning to use targeted digital and social media advertising – targeting rightful owners and directing online searches to official state websites. Many states even use telethons where local TV stations devote airtime to promoting unclaimed property programs – leading to ratings increases for the station and spikes in claims from the viewing public.

Many states now use online identity verification to fast track claims for smaller amounts of single owner property. This is usually done by having a claimant provide their social security number, name, and address online. This information is both compared to information associated with the property and verified using a proprietary database provided by Lexis, Thompson Reuters, or similar vendors. If there is a sufficiently good match, then payment of a smaller property will be quickly approved. After Illinois adopted a fast track process for single-owner properties of less than $500, the number of completed claims doubled from roughly 58,000 in FY 2017 to over 116,000 in FY 2018.[9]

The next trend for state claims will be auto-payments based on data matching with state-level tax returns. Wisconsin[10] and Rhode Island[11] already returned millions of dollars in unclaimed property by simply mailing checks to owners when the owner of the unclaimed property can be matched to a recent state tax return. Illinois is now the third state and has now returned over 60,000 unclaimed properties without a claim ever having to be filed.

9. See "Treasurer Frerichs' I-Cash Program Returns Record-Breaking $180 Million to Individuals, Employers and non-Profits" http://illinoistreasurer.gov/TWOCMS/media/doc/July2018_ICash2018Returns.pdf
10. See "New Matching Program for Returning Unclaimed Property to its Owner" https://www.revenue.wi.gov/Pages/TaxPro/2015/news-2015-150609.aspx; and, "Unclaimed Property Matching Program Celebrates One Year Anniversary" https://www.revenue.wi.gov/Pages/News/2016/Unclaimed_Property_Matching_Program_Celebrates_OneYearAnniversary_20160620.pdf
11. See "Treasurer Magazine's YOUR MONEY Initiative Wins National Recognition" https://www.ri.gov/press/view/32845; "8,000 Rhode Islanders with To Be Reunited With $1.3 Million Under Treasurer Magazine's YOUR MONEY Program" https://www.ri.gov/press/view/33202; and, "1,700 more Rhode Islanders find unclaimed property after Treasurer's Office announces latest round of YOUR MONEY checks are in the mail" https://www.ri.gov/press/view/33245.

Kendall L. Houghton
Partner
Alston & Bird LLP

"Investment assets will continue to generate audit disputes and litigation – the states' reliance on inactivity as the fulcrum for escheatment and post-escheat liquidation of such assets throws buy-and-hold investors' plans into disarray and may impose adverse tax consequences."

As I consider the current unclaimed property landscape and try to predict the future, a number of issues and concerns vie for attention.

States Are Torn Between Consumer Protection and Revenue Generation

State enforcement will be shaped by competing forces of consumer protection and revenue generation. Consumer protection is an unquestionable priority for state administrators, and holders that proactively maintain active relationships with their customers, shareholders, employees and other property owners will be far better-positioned than those that hire an army of advisors for audit defense. On the other hand, the states' mass outsourcing of examinations to contract audit firms that are compensated on a contingent fee basis underscores the competing revenue generation motivation. Indeed, the 2016 Revised Uniform Unclaimed Property Act (RUUPA) blesses this arrangement, and numerous states have considered adoption of RUUPA (and I predict that RUUPA, or at least its updated and unique provisions, will become the most broadly adopted of the Uniform Laws Commission's uniform unclaimed property acts within a 5-year period).

The holder-domicile states' use of estimation will continue to attract challenges, to the extent that such methodologies apply presumptions designed to boost unclaimed property liabilities (e.g., 31+ day presumption of impropriety for voided checks) without regard to a specific holder's practices and filing history, and given that the use of estimation serves as a disguised tax by virtue of the fact that none of those dollars will ever be returned to actual owners/state residents.

New Property Interests Raise Potential Concerns

Business to Consumer (B2C) and Business to Business (B2B) will create property interests that defy easy classifications. In this regard, I am contemplating promotional/loyalty/rewards instruments, instruments for which no direct consideration is provided by the recipient, contingent/conditional/forfeitable property rights and non-custodied instruments (e.g., blockchain virtual currency platforms). Holders must consider the unclaimed property implications of these programs, transactions and business models in real time, or they risk producing the "next wave" of audit assessments. To be clear, the states are already studying these property interests and their starting point generally seems to be: "If it was issued or recorded as an obligation on your books, it is [potentially] escheatable."

Investment assets will continue to generate audit disputes and litigation. Foreign investors are the most significant victims of these escheat regimes, given their complete lack of awareness of U.S. escheat laws – much less their understanding that Delaware or another state with which the foreign resident has zero connection is holding their property – but the current regime should bear a universal "caveat investor" label. We are now seeing certain states grapple with an increase in U.S. resident owner claims to shares and to accounts – both retirement and non-retirement – shortly after escheatment, where the owners claim that "they were not lost" or "they were in contact with the custodians." Unwinding the escheat, much less the liquidation of assets, is burdensome and mistake-prone for both states and holders.

The risks to holders of post-liquidation claims to the "market" differential value of such assets (states will only return the liquidation values to claimants) has become clear. When audit firms and/or state administrators assert that a state's securities-specific dormancy standard – which is generally premised upon undeliverable mail triggers to run the dormancy period – does not apply to securities housed within an account, the potential for future litigation among states, holders and owners is amplified.

Conflicts Likely to Continue Between Holders and Third-Party Auditors

Suspicions and adversity will continue to flavor interactions between the holder community and state administrators and their contract audit firms. I have been shocked to hear state administrators and auditors assert that holders only want to retain property in order to impose fees on the owners, or because the holder presumes the right to a windfall from unclaimed property, in scenarios where the holders are merely asserting that the state's law does not apply (e.g., where a statutory exemption from escheat applies, or in settings where federal preemption of the state's unclaimed property laws is patent). Holders will need to engage in more education and outreach if such misperceptions and suspicions are to be allayed.

Areas that are ripe for cooperation between holders and states in 2018 and beyond include a review and expansion of National Association of Unclaimed Property Administrators (NAUPA) property codes, as well as the drafting of model audit and reporting/compliance regulations. Another prospective focus should be the development and implementation of uniform voluntary disclosure/compliance programs, which can be accompanied by educational programs that reach the mid-size and smaller businesses that seem to be much less aware of these laws and their associated compliance requirements.

The Honorable Jeffrey W. Bullock
Secretary of State
State of Delaware

"In three years, we went from a state that relied primarily on audits to get holders into compliance, to a state that was going to rely on voluntary compliance."

Over the past six years, the unclaimed property compliance landscape has changed dramatically in Delaware, and as a result of those changes, the future state of unclaimed property in Delaware is strong. In June 2012, legislation was passed by the Delaware General Assembly and signed by Governor Jack Markell to create a new voluntary disclosure agreement ("VDA") program that would be administered out of my office, the Department of State. In the prior decade or so, the primary vehicle to ensure company compliance with their unclaimed property reporting obligations was through an unclaimed property audit. Relying primarily, if not solely, on audits to get companies into compliance is not a good way to incent compliance, especially for a state that prides itself on being a corporate-friendly jurisdiction. Audits by their very nature can be contentious, take a lot of time and often do not lead to future robust and regular annual filings.

VDA Program Overview

We set out in 2012 to build an option for companies to voluntarily step forward to report their past-due unclaimed property through a rigorous, yet fair process that would not only give companies a level of certainty with a full release and waiver of future audit for the period covered by the VDA, but also directly incent future compliance by making three years of future annual compliance filings a condition of said release and audit waiver.

To administer a program that will be efficient and ultimately fair, it was critical we establish expectations up front. We published implementing guidelines outlining what process companies should follow after enrollment, what testing we expected to be done and what we wanted the final submission to look like. We also needed to convince companies that the new VDA program was a more business friendly, efficient and fair process for companies to come into compliance. In the first eight months after we started, we saw enrollment go from 19 companies in January 2013, to more than 400 by June 2013, and over 1,000 today.

More importantly, in late 2013 and 2014 we began settling VDAs, and companies could see we were living up to the

expectations we had set. The first several years of success led to even more sweeping changes in Delaware law in 2015. These changes include, but are not limited to, changes in the look back period, extending the VDA program indefinitely, and I think most significantly, not allowing a company to receive a new audit notice in Delaware without first having an opportunity to enter the VDA program. In three years, we went from a state that relied primarily on audits to get holders into compliance, to a state that was going to rely on voluntary compliance.

Impact of *Temple-Inland* Decision

Nothing was more indicative of how the compliance landscape had changed in Delaware then what happened after the *Temple-Inland* decision was issued in June 2016. Without question, the decision was critical of several specific executive actions taken by the state during that audit that in combination the Court deemed to be procedurally unfair. However, the facts and circumstances in the *Temple-Inland* audit bear little, if any, resemblance to our administration of the VDA Program. The impact of the *Temple-Inland* decision on the VDA program was virtually non-existent, as we settled VDAs days after the decision was rendered and continued settling VDAs in the months and years immediately after.

From my perspective, there are several reasons why the *Temple-Inland* decision had such a minimal impact on the VDA program. The first is that the way Delaware, and every other state, has historically estimated unclaimed property liability creates a bright line between what is owed to the state of formation of a company and every other jurisdiction, ensuring that a company does not pay twice for the same unclaimed property. More importantly, the VDA program's approach to estimation is the best business practice for all involved. Having such a bright line rule benefits holders as compared to the alternative of performing potentially 50 separate estimations based off of 50 different state standards, and then entering into 50 different VDAs or audits to come into legal compliance. Finally, the reality is an unclaimed property compliance gap exists in corporate America, and the VDA program provides companies with a compliance option that brings certainty in terms of a release of liability and waiver of audit and does so through a process that is efficient and fair.

Enhanced Compliance

Make no mistake, the name of the game is compliance. Annual compliance rates in Delaware are very low, and I would imagine other states would say the same. The VDA program itself is a testament to that fact, as nearly 600 companies, including thousands of their subsidiaries, of all sizes and virtually all industries have stepped forward with a significant amount of unclaimed property to report. Let me also be clear that to really drive meaningful, robust and full compliance, the state needs to have a strong audit program to examine companies that do not wish to voluntarily step forward.

There will always be disagreements, and in turn there may be additional litigation in Delaware and other jurisdictions. However, by establishing expectations up front, offering companies a meaningful voluntary compliance option and maintaining a strong audit program, I believe Delaware has cemented a strong foundation to carry the state's unclaimed property compliance programs well into the future.

Concluding Thoughts

We'd like to thank our esteemed colleagues in the unclaimed property industry for contributing their thoughts for this publication.

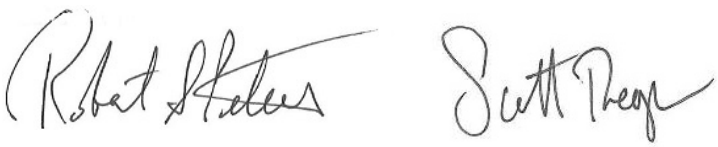
This forum presented a wide range of views and possible outcomes regarding the future state of unclaimed property.

We have read spirited defenses of the states and their consumer protectionist tendencies as well as warnings that the states are placing burdens on corporations that may be overreaching and perhaps unjust in the name of revenue enhancement. The retirement industry and new technologies in payments and currency have both been examined. The so-called B2B exemption has been reviewed from both sides, as well as the use of third-party audit firms and estimation techniques.

Enhancements in owner claims processing has been touted along with the possible erosion of the derivative rights doctrine. The future of RUUPA adoption received much attention. More litigation, and perhaps a Supreme Court challenge, have been predicted.

It would seem the future state of unclaimed property will be dynamic and influenced by competing forces.

The Unclaimed Property team at Duff & Phelps will monitor these changes for our clients and continually ask: what's next?



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Mr. Peters is a Managing Director at Duff & Phelps and practice leader of the firm's Unclaimed Property and Tax Risk Advisory team. He has over 35 years of experience providing unclaimed property as well as state and local and federal tax services to corporate clients. He assists companies in audit representation, voluntary disclosures, implementation of best practices and co/outsourcing of unclaimed property and sales tax compliance. He has been on the forefront of helping companies to effectively plan in the growing area of issuing stored value, gift card and consumer rebate programs, including working with states and industry leaders in addressing the unclaimed property issues resulting from such programs.

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Mr. Regan is a Director at Duff & Phelps on the firm's Unclaimed Property and Tax Risk Advisory team. He has 12 years of experience advising public and private companies. During his career, he has helped hundreds of companies address their unclaimed property compliance obligations by building custom programs that include risk assessments, remediation strategies, voluntary disclosure programs, asset recovery and outsourced annual compliance and reporting. He is particularly experienced in providing guidance with regards to single and multi-state unclaimed property audit and voluntary disclosure programs.

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Mr. Swibel is a Senior Partner at Saul Ewing Arnstein & Lehr LLP. He is a member of the federal trial bar and has represented clients in a wide range of matters, both litigation and transactional, including in connection with state unclaimed property examinations. He has served as a Uniform Law Commissioner since 1976 and held the office of national President of the Uniform Law Commission ("ULC") from 2005 to 2007. He was a member of the ULC's drafting committees that produced the 1981 and 2016 versions of the Uniform Unclaimed Property Act.

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Ms. Green-Kelly is a partner in the Global Regulatory group at Reed Smith LLP. She has successfully represented numerous Fortune 500 companies in unclaimed property audits and litigation for almost fifteen years. Her lawsuits challenging state audit practices and assessments have triggered legislative and administrative changes.

G. Allen Mayer
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Mr. Mayer is Chief of Staff to Illinois State Treasurer Michael Frerichs. The State Treasurer's Office is charged with providing treasury, cash management, and investment support to Illinois state government, providing the necessary liquidity to meet the State's daily obligations while investing the remaining funds. Mr. Mayer presently serves as the Chair of the National Association of Unclaimed Property Administrators (NAUPA) Legal Committee and as a member of the NAUPA Executive, Strategic Planning, and Program committees. He served as Treasurer Frerichs' official observer to the Uniform Law Commission's Committee to Revise the Uniform Unclaimed Property Act (RUUPA). Mr. Mayer was the recipient of the NAUPA 2017 Presidential Distinguished Service Award for his work on the RUUPA.

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Ms. Houghton is a nationally recognized expert whose practice focuses on state and local tax planning, tax controversies and unclaimed property/escheat matters. She leads the Alston & Bird State Tax and Unclaimed Property practice, where she advises clients with respect to unclaimed property/escheat compliance, voluntary disclosure initiatives, planning opportunities, single- and multi-state audit defense, and litigation of state unclaimed property assessments. Ms. Houghton is co-author of Bloomberg BNA's Multistate Tax Management portfolio entitled "Unclaimed Property." She lectures on unclaimed property and state tax issues as professor at Georgetown University School of Law and is a featured speaker at national state tax conferences and schools hosted by COST, TEI, IPT, and the Unclaimed Property Professionals Organization, Georgetown University School of Law and the New York University School of Law.

The Honorable Jeffrey W. Bullock
Delaware Secretary of State
Wilmington, DE

Mr. Bullock was sworn in as Delaware's 80th Secretary of State on January 21, 2009 and re-confirmed by the Delaware Senate on January 18, 2017. As Secretary of the most diverse department in state government, he oversees nearly twenty different agencies including Corporations, Historical and Cultural Affairs, Arts, Libraries, Veterans Affairs, Professional Regulation, and Human Relations. In addition, Secretary Bullock has a number of constitutional responsibilities, including serving on the Board of Pardons. He is also the chairman of the Diamond State Port Corporation, which owns and operates the Port of Wilmington.

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About Duff & Phelps

Duff & Phelps is the global advisor that protects, restores and maximizes value for clients in the areas of valuation, corporate finance, investigations, disputes, cyber security, compliance and regulatory matters, and other governance-related issues. We work with clients across diverse sectors, mitigating risk to assets, operations and people. With Kroll, a division of Duff & Phelps since 2018, our firm has nearly 3,500 professionals in 28 countries around the world. For more information, visit www.duffandphelps.com.