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Abandoned/Unclaimed Property Liability: Legal Aspects and Planning Opportunities

Jack Gaggini
ABANDONED/UNCLAIMED PROPERTY LIABILITY

LEGAL ASPECTS
AND PLANNING OPPORTUNITIES

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I. Introduction.

A. States’ Incentive to Conduct Audits

1. Generally audits have indicated to state administrators that there is a level of noncompliance among holders.

2. Noncompliance by holders typically can be attributed to a broad range of property types covered by the various state Unclaimed Property Acts as well as to the complexities associated with conducting a nationwide business. If holders do comply, usually that compliance reports only commonly understood unclaimed property such as payroll and dividend checks; other types of property such as promotional/gift certificates, customer overpayments and unidentified remittances may not be reported.

3. Many states have turned to third-party contract auditors such as the National Abandoned Property Processing Corporation (“NAPPCO”), which then aggressively audit holders’ records for numerous states simultaneously.

B. Problems for Holders

1. Old records: Documentation may be difficult to obtain to demonstrate that property is not escheatable.
2. Administrative/clerical errors and poor documentation to support accounting practices usually create problems for holders, possibly erroneously suggesting an abandoned property issue when actually there is no unclaimed property involved. Examples and problem areas include:

a. Write-offs.

b. Unidentified remittances.

c. Customer overpayments.

d. Vendor overshipments.

e. Promotional programs including gift certificates, rebates and credits.

C. Thirty states are currently participating in an extended Voluntary Compliance Program encouraged by NAUPA (National Association of Unclaimed Property Administrators) to facilitate holders achieving compliance for past periods.

1. The thirty states are:

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2. These states have agreed to waive interest and penalties for holders that, prior to October 31, 2000, voluntarily file reports and remit abandoned property amounts for prior periods.

3. Nine other states have indicated informally that they will also waive interest and penalties for voluntary compliance, even though these states are not formally participating in the NAUPA Program: Colorado, Florida, Georgia, Illinois, Massachusetts, Montana, Nevada, New York, Oklahoma.
4. Currently pending in California is legislation that, if enacted, will offer amnesty benefits to holders filing delinquent abandoned property reports.

II. Legal Principles of Escheat of Abandoned Property

A. General Principles

1. States, as representatives of the sovereign power of the people, have historically exercised the power of escheat over abandoned property. States frequently administer their escheat laws through their Department of Financial Institutions, not the state taxing agency.

2. Generally, intangible personal property is presumed to be abandoned if:

   a. the intangible personal property is held or issued in the ordinary course of the holder's business; and

   b. the intangible personal property constitutes a debt or obligation running from the holder to its creditor or owner; and

   c. the intangible personal property has remained unclaimed by the owner for more than the statutory period of time (ranging generally from one year to seven years, depending upon the state and the type of property involved) after the intangible personal property becomes payable or distributable by the holder to the owner.

3. The statutes and laws of each state determine the procedural requirements and time periods under which intangible personal property is presumed to be abandoned and is to be turned over to the state.

4. Examples of unclaimed property include:

   a. Uncashed dividend and interest checks (under some states' laws, also the underlying stocks, bonds and other securities).

   b. Uncashed payroll checks.
c. Uncashed accounts payable checks.*

d. Customer overpayments, credit balances and outstanding credit memos.*

e. Security deposits or other deposits.

f. Uncashed refund checks.

g. Unidentified remittances.

h. Unredeemed gift certificates and other promotional awards.

i. Over the last few years, the abandoned property laws regarding unclaimed gift certificates have changed. Approximately 19 states currently exempt unclaimed certificates in their entirety or claim only a portion of the face value of unredeemed certificates.

i. See Exhibit A for other types of intangibles that may be presumed abandoned according to NAPPCO.

B. Model Unclaimed Property Laws

1. Several Uniform Acts have been proposed by the National Conference of Commissioners on Uniform Laws.

   a. The Uniform Acts were proposed to create a uniformity or symmetry among state law; to ease compliance for holders; to reduce the possibility of multiple liability for holders that conduct business in various jurisdictions; and to give the states rather than the holders of unclaimed property the benefit of retention of unclaimed property.

   b. All 50 states and the District of Columbia have adopted some type of abandoned property legislation; however, not all of these jurisdictions have adopted one of the Uniform Acts.


* Approximately eight states exempt unclaimed property payable to another business.

b. Seven additional states and the District of Columbia have enacted portions of the 1981 Uniform Act, but have not adopted that Act in its entirety. The seven states are: Colorado, Iowa, Massachusetts, Michigan, Missouri, Nevada and Oklahoma.


b. Five states have adopted the 1995 Uniform Act, an updated version of the 1981 Uniform Act. These five states include Indiana, Maine, Montana, New Mexico and West Virginia.

4. Other Acts.

a. Seven states and Puerto Rico have adopted their own escheat laws that do not conform to the 1954/1966 or 1981 Uniform Acts. These states include California, Delaware, Kentucky, New York, North Carolina, Ohio and Texas.

b. Five states have adopted the 1995 Uniform Act, an updated version of the 1981 Uniform Act. These five states include Indiana, Maine, Montana, New Mexico and West Virginia.

C. Priority of State Claims

1. Because more than one state may assert a claim to escheatable property, judicial decisions and state escheat laws establish priority rules for determining which state has the best claim to the property.

a. These priority rules were established in the United States Supreme Court's decision in Texas v. New Jersey, 379 U.S. 674 (1965) (unclaimed benefit payments on insurance policies escheated to state of last known address of the beneficiaries; if none, then to the state of corporate domicile).
b. The priority rules set forth in Texas v. New Jersey were then adopted in the 1981 Uniform Act.


2. Last Known Address.

a. The state of last known address of the apparent owner, the person whose name appears on the business records of the holder or as established as the person entitled to the property held, issued, or owing by the holder, has the first priority claim to the abandoned property.

i. In Texas v. New Jersey, the United States Supreme Court held that "for ease of administration," a holder may rely on the name of the owner appearing in the holder's records and is not required to confirm whether the abandoned property has passed to another owner.

ii. Under the 1981 Uniform Act, the state of last known address is an address sufficient for sending mail to the apparent owner.

iii. The 1995 Uniform Act modifies the rule to require only some indication in the holder's records (e.g., a computer code or E-mail address) that the apparent owner's last known address was located in a particular state.

3. State of Corporate Domicile

a. If the apparent owner's address is unknown or if the last known address of the apparent owner is in a foreign nation, or if the apparent owner's state of residency does not claim the abandoned property, the holder's state of corporate domicile (i.e., state of incorporation or place of principal business of an unincorporated holder) has the next claim to the abandoned property.

4. Transactional Rule

a. The 1981 Uniform Act and 1995 Uniform Act expand the Texas v. New Jersey rule and provide that the state where the
transaction giving rise to the escheatable property takes place (so-called "transactional state") may claim the property if the state of corporate domicile does not claim the property and the last known address of the owner is unknown or that state does not claim the property.

b. This "transactional" rule has not yet been tested in the courts. The United States Supreme Court's decision in Delaware v. New York, 113 S. Ct. 1550 (1993), makes it clear that states may not legislate alternative priority rules under their state laws.

III. Requirements of Escheat

A. Jurisdictional - Nexus Standards

1. What nexus standard determines whether a state may require a holder of abandoned property to file abandoned property reports?

   
   b. Quill/National Bellas Hess minimum contacts standard.
   
   c. "Long-arm" jurisdictional standard used for service of process under state civil procedure rules.
   
   d. Many states endorse a "Mere Debt"/Contract Right standard.

2. State Positions

   a. States frequently contend that a holder of abandoned property does not have to be "doing business" in a state or meet a tax jurisdiction standard in order to be subject to the state's unclaimed property laws.
   
   b. Under a "stepping into the owner's shoes" theory, states of last known address assert that they are entitled to require a holder to report escheatable property that belongs to an owner located in that state in the same manner that an administrator of a decedent's estate may compel a holder of the decedent's property to account for that property.
   
   c. States contend that the inability to assert their claims in their own courts does not limit their authority to act as a custodian to collect abandoned property.
B. Time Periods

1. Unclaimed property is presumed to be abandoned if the apparent owner has neither communicated in writing with the holder concerning the unclaimed property, nor otherwise indicated an interest in the unclaimed property, during the statutory dormancy period.

2. Each successive uniform act has further shortened the dormancy periods:
   a. The general dormancy period of the 1954 Uniform Act was seven years.
   b. The 1981 Uniform Act shortened the general dormancy period to five years.
   c. The 1995 Uniform Act again shortens the 1981 Uniform Act's periods of time after which certain intangibles will be presumed to be abandoned, as follows:
      i. Corporate stock: From 7 to 5 years.
      ii. Gift certificates: From 5 to 3 years.
      iii. Life insurance obligations: From 5 to 3 years.
      iv. Retirement plans and accounts: From 5 to 3 years.

C. Reporting Requirements

1. State escheat laws place the burden on the holder of escheatable property to file verified annual reports with the appropriate states, listing the property that has become abandoned during the reporting period.

2. Some states require holders to file negative reports.

3. Under the 1981 Uniform Act, the verified annual report must include:
   a. The names and last known addresses (if known) of the apparent owners of abandoned property with a value of $25 or more.
i. The 1995 Uniform Act raises the threshold value to $50 for separately identifying abandoned property.

ii. The 1995 Uniform Act also requires the reporting of taxpayer identification numbers of apparent owners.

b. The aggregated amount of abandoned property items valued under the $25 threshold amount (a $50 threshold is proposed under the 1995 Uniform Act).

c. Descriptions of the abandoned property and the date that the property became payable, demandable or returnable, and the date of the last transaction with the apparent owner with respect to the property.

d. If the holder is a successor to other persons who previously held the property for the apparent owner (or the holder has changed its name while holding the property), the name(s) of such predecessor holders of the property.

4. Not more than 120 days before filing the annual report, the holder is required to send written notice to the apparent owner of property presumed abandoned, informing the apparent owner that the holder is in possession of property that has become abandoned under the state statute.

5. The 1981 Uniform Act requires delivery of the abandoned property to the state within six months after the filing of the report (except for the abandoned property items worth less than $25, which must be turned over to the state at the time the holder files the annual report). Under the 1995 Uniform Act, the holder must pay or deliver all of the unclaimed property described in the report to the state administrator at the time it files the annual report.

6. The state administrator then publishes notices in newspapers regarding the abandoned property and, if the owner comes forward, delivers the property to the owner.

7. Upon delivering the unclaimed property to the state, the holder is no longer subject to a claim by the apparent owner of the property. If the holder makes payment of the property to the owner after reporting it to the state, the holder may claim reimbursement from the state. Note: State laws vary on: (i) indemnity to holders and (ii) the ability of holders to pay apparent owners and obtain a credit from the state for the payment. The specific law of the state involved should be reviewed.
D. Statute of Limitations

1. Generally, states are not limited in their right to audit holders unless the state has expressly adopted a statute of limitations.

   a. 25 states have adopted statutes of limitation with respect to abandoned property audits.
   c. Approximately 20 states have general statutory provisions that limit the time period in which the state may bring an action in the name of, or for the benefit of, the state.

2. Courts have held that statutes of limitation do not begin to run against a state until the holder files an abandoned property report or the state is notified of the existence of the abandoned property. See, e.g., Blue Cross of Northern California v. Cory, 120 Cal. App. 3d 743 (1981); Employers Insurance of Wausau v. Smith, 453 N.W.2d 856 (Wis. 1990); Sennet v. Insurance Company of North America, 247 A.2d 774 (Pa. 1968).

3. Does the doctrine of laches limit how far back a state may audit a holder’s records?

E. Interest and Penalties

1. The failure of a holder to report, pay or deliver unclaimed property within the prescribed time periods may result in the assessment of interest, penalties and administrative fees.

2. All four Uniform Acts (1954, 1966, 1981 and 1995), have some provision for fines, penalties or interest to be levied against holders who fail to pay unclaimed property to the state.

   a. The 1954 and 1966 Acts are very limited, providing for the possibility of fines in certain circumstances, while not providing for interest or penalties.
   b. The 1981 and 1995 Acts are more expansive and require interest and penalties from holders who fail to pay or deliver property to the state.

3. Many states now have enacted civil penalties under their unclaimed property laws.
a. The 1954 Uniform Act only provides for penalties under a criminal law standard (i.e., willfulness), not under a civil law standard (i.e., failure to comply without reasonable cause).

b. The 1981 Uniform Act provides for a penalty of 25% for the willful failure to pay or deliver abandoned property; the penalty for willful failure to file reports or perform other duties under the 1981 Uniform Act is $100 per day of such failure, up to $5,000.

c. The 1995 Uniform Act recommends civil penalties of:

   i. $200 per day, up to $5,000, for failure to file reports or pay over abandoned property to the state. This penalty is subject to waiver upon showing of reasonable cause.

   ii. $1,000 per day, up to $25,000, plus 25% of the value of any unreported property, for fraudulent reports or willful failures to file reports and/or pay over abandoned property.

   iii. Criminal penalties are eliminated by the 1995 Uniform Act since they were not effective and were rarely, if ever, pursued by states.

4. In many cases, however, interest or penalties may be waived by the administrator of the state’s unclaimed property law. For example, Section 24 of the 1995 Uniform Act specifically provides that “the administrator for good cause may waive, in whole or in part, interest under Subsection (a) and penalties under Subsections (b) and (c), and shall waive penalties if the holder acted in good faith and without negligence.”

5. Interest.

   a. The 1981 Uniform Act provides for the payment of interest at the rate of 18% or 10% above the annual discount rate of U.S. Treasury Bills on the value of property not reported.

   b. The 1995 Uniform Act decreases the interest rate to 12% or 2% above the annual discount rate of U.S. Treasury Bills on the value of property not reported.
IV. Specific Issues in Connection with Abandoned Property

A. ERISA’s Preemption Clause

1. Except as provided in Section 514(b) of ERISA, the provisions of Titles I and IV of ERISA preempt all state laws as they relate to employee benefit plans. There are eight exceptions to the general preemption provisions of ERISA. The most important exceptions are:

   a. Section 514(b)(2) - State laws regulating insurance, banking or securities. However, for purposes of this exception, an employee benefit plan is not considered to be an insurance company, bank or investment company. Because of this provision, states may indirectly regulate insured medical plans, but cannot regulate self-insured plans.

   b. Section 514(b)(4) - Generally applicable to state criminal laws.

   c. Section 514(b)(6) - State laws regulating the funding of insured multiple employer welfare arrangements ("MEWAs").

   d. Section 514(b)(7) - Qualified domestic relation orders ("QDROs") and Qualified Medical Child Support Orders ("QMCSOs").

2. U.S. Supreme Court Interpretations - The Struggle to Interpret the Preemption Clause.

   a. In its first major attempt to define the scope of the phrase "relate to," the U.S. Supreme Court decided in Shaw v. Delta Air Lines, 463 U.S. 85 (1983), that a state law "relates to" an employee benefit plan "if it has a connection with or reference to such a plan." While the "reference to" test is self-explanatory and has been relatively easy for the courts to apply, the "connection with" test provides very little guidance and has been very difficult for the courts to apply. As a result, ERISA’s preemption provision has become one of the most litigated provisions under federal law and has been the subject of over fifteen U.S. Supreme Court cases.

   b. In the late 1980s, the U.S. Supreme Court either interpreted the definition of "employee benefit plan" very strictly or applied the preemption clause in a very limited manner in
order to allow states to directly regulate employee benefit plans.

i. In Fort Halifax Packing Co. v. Covne, 482 U.S. 1 (1987), the Court allowed a state to require an employer to establish a severance pay plan.

ii. In Mackey v. Lanier Collection Agency & Serv., Inc., 486 U.S. 825 (1988), the Court allowed a state to enforce its garnishment procedure against an unfunded welfare plan.

iii. In Massachusetts v. Morash, 490 U.S. 107 (1989), the Court allowed a state to prosecute a corporate officer for nonpayment of vacation benefits under a state law which specifically referred to an employee benefit plan.

c. However, in the early 1990s, the U.S. Supreme Court interpreted the phrase "connection with or refers to" very strictly and prevented states from directly regulating employee benefit plans.

i. In FMC Corp. v. Holliday, 49 U.S. 52 (1990), the Court prevented enforcement of a state law prohibiting subrogation with respect to a self-insured welfare plan.

ii. In Ingersoll-Rand Co. v. McClenden, 49 U.S. 133 (1990), the Court prevented a discharged employee from using state law tort and contract actions to sue an employer where the principal allegations were that the termination was caused by a desire to avoid contributing to a pension plan.

iii. In District of Columbia v. Greater Washington Board of Trade, 113 S. Ct. 580 (1992), the Court prevented enforcement of a state law requiring an employer to provide the same health insurance to injured employees eligible for workers' compensation as was provided to existing employees.

d. In 1995 the Supreme Court addressed the general scope of the ERISA preemption provision and narrowed its scope in some respects. In N.Y. State Conference of Blue Cross and
Blue Shield Plans v. Travelers Insurance Company, 514 U.S. 645 (1995), the U.S. Supreme Court allowed New York to impose various surcharges on commercial insurance companies and HMOs. The Court viewed that these state surcharges imposed only an indirect impact on ERISA medical plans and indirect economic impact is not preempted by ERISA. According to the Court, the surcharges did not preclude uniform administration of claims or uniform interstate benefit packages.

i. The Court acknowledged that the "connection with" test in Shaw created a problem and, therefore, developed a partially new approach to ERISA preemption cases.

ii. The Court also found the text of Section 514(b) to be unhelpful, and stated that it must look at the objectives of ERISA as guidance for determining which state laws are preempted.

iii. The Court then ruled that state laws which have an indirect economic impact on employee benefit plans are not preempted.

iv. Since one of the major objectives in the enactment of ERISA is uniform nationwide administration of claims, and the imposition of various state surcharges is inconsistent with that objective, did the Court really follow its own guidance?

e. The Travelers decision did not significantly undercut the rationales for arguing that state unclaimed property laws are preempted by ERISA. Under Travelers, in determining whether state law is to be preempted by ERISA, it is important to determine whether state law thwarts one or more of the objectives for the enactment of ERISA.

f. The Court in Travelers did not indicate that the "reference to" test articulated in Shaw had changed.

3. ERISA Preemption of State Escheat Laws.

a. Under Travelers Insurance, state unclaimed property laws that have a direct impact on ERISA plans are preempted by federal law.

c. The Department of Labor also has informally indicated that it believes that ERISA preempts the application of state unclaimed property laws to welfare plans (i.e., funded VEBAs).

d. In Commonwealth Edison v. Vega, 174 F.3d 2794 (7th Cir.) cert. den. (1999), the Seventh Circuit Court of Appeals (Judge Posner) ruled that ERISA preempts application of the Illinois abandoned property laws to unclaimed benefit checks issued by an employee pension plan. In reaching its decision, the court observed that:

i. ERISA preempts any state regulation that "relates to" an ERISA plan. Although the Illinois Unclaimed Property Act does not explicitly refer to ERISA plans, it directly and substantially relates to ERISA plans.

ii. To allow Illinois to take custody of the unclaimed benefit checks would allow Illinois to become custodian of those assets in violation of ERISA provisions regarding plan administration and would deplete the amount of plan assets available for other participants in the plan.

iii. ERISA was enacted in order to avoid a patchwork of state laws affecting benefits paid by ERISA plans.

iv. Application of state abandoned property laws to ERISA plans would affect plan administration and override ERISA’s regulations affecting plan benefits.

e. In Manufacturers Life Ins. Co. v. East Bay Restaurant & Tavern Retirement Plan, 57 F. Supp. 2d 921 (N.D. Calif. 1999), a federal court in California recently adopted the "plan asset" analysis used in Commonwealth Edison. The court viewed the unclaimed amounts as "plan assets" and viewed the state's attempt to claim the amounts as an act interfering with the uniform administration of the plan and
an unwarranted use of plan assets which could be used for the benefit of other plan participants.

f. Note that other courts have determined that state unclaimed property laws are not preempted if they have only a tenuous, remote and peripheral impact on ERISA plans. See, e.g., Aetna Life Ins. Co. v. Borges, 869 F.2d 142 (2d Cir. 1989); Attorney General v. Blue Cross & Blue Shield of Michigan, 424 N.W.2d 54 (Mich. App. 1988), app. denied, No. 83788 (Mar. 31, 1989). The Commonwealth Edison court distinguished Aetna Life Ins. and Blue Cross on the grounds that in those two cases the unclaimed benefits were held by third-party insurance companies, not the ERISA plan.

g. Distinction Between Funded and Unfunded Plans.

h. Strategy.

B. Private Escheat Statutes

1. Can holders and contracting owners avoid the application of state unclaimed property laws?

2. Is a gift certificate deemed to be abandoned if it expires under its own terms before the end of the state escheat period?

   a. Were the terms of the expiration provision part of a written contract entered into between the holder and the purchaser at the time the gift certificate was purchased?

   b. Does the holder regularly enforce the expiration provision?


3. If a gift certificate is redeemable in merchandise only, the amount deemed abandoned under the 1995 Uniform Act is 60% of the gift certificate's face value. But see 1981 Uniform Act (the amount presumed abandoned is the price paid by the purchaser of the gift certificate).
4. States have adopted statutory provisions that disregard contractual time periods agreed to by the holder and the owner. See 1995 Uniform Act, § 19(a). Can these state "private escheat statutes" be viewed as an unconstitutional impairment of contract?

C. Dormancy Service Charges

1. Under state laws, a holder may deduct a charge from abandoned property by reason of the owner's failure to claim the abandoned property within the statutory dormancy period only if there is a valid and enforceable written contract between the holder and the owner pursuant to which the holder may impose the charge and the holder regularly imposes the charge, which is not regularly reversed or otherwise cancelled. 1981 Uniform Act; South Carolina Tax Commission v. Metropolitan Life Ins. Co., 221 S.E.2d 522 (S.C. 1975); Cory v. Golden State Bank, 95 Cal. App. 3d 360 (1979).

2. The amount of the holder's charge or deduction may not be unconscionable as between the holder and the owner.

D. Promotional Credits

1. Issues arise regarding whether promotional-type credits that are generated by the seller constitute unclaimed property.

2. These credits should not constitute escheatable customer overpayments; instead, the amounts may be likened to advertising discounts.

   a. Arguably, promotional credits which provide customers with a fully vested right to receive the value of a credit or cash may constitute unclaimed property.

   b. Promotional credits that limit the customer to a discount on the purchase should not constitute escheatable property.

E. Foreign Transactions/Foreign Based Holders

1. Can a state claim abandoned property in circumstances when the holder is a resident of or domiciled in a foreign country?

   a. What rules apply when a foreign holder has no business operations physically located in the state, but holds property attributable to an apparent owner located in that state?

   b. Section 36 of the 1981 Uniform Act provides that:
This Act does not apply to any property held, due and owing in a foreign country and arising out of a foreign transaction.

c. The Commentary to Section 36 states that the provision is designed to exclude from the coverage of the Act wholly foreign transactions. Some state administrators and commentators (writing on behalf of the states) suggest that if the foreign transaction is connected in any way to the United States, the unclaimed property would be subject to state escheat laws.

d. Does the state have jurisdiction over the foreign holder? Will jurisdiction over the parent of a foreign subsidiary be sufficient to enforce escheat laws?

V. The Unclaimed Property Audit Process

A. Introduction

1. In an unclaimed property audit, a state auditor's principal job is to determine the correctness of a holder’s unclaimed property report (or if no report was filed, the amount that should have been reported by the holder). Typically, an unclaimed property auditor will send a notice to a business that an unclaimed property audit has been scheduled. A listing of the type of records to be reviewed is normally included as part of the notice, or may be listed in a follow-up notice.

2. Unclaimed property audits may be performed either by a state auditor or a contract auditor (such as the Unclaimed Property Clearing House or The National Abandoned Property Processing Corporation). The state agency responsible for these audits and for the processing of unclaimed property payments normally is a state Treasurer's office, Department of Financial Institutions, or other similar state agency.

3. An unclaimed property audit may be conducted for one state, or, in many cases, on behalf of a number of states. Most states have interstate agreements with other states, allowing auditors from one state to calculate the amount of unclaimed property due for many states at once. Similarly, the Unclaimed Property Clearing House has agreements with a number of states allowing its auditors to conduct audits on behalf of these states.
4. After an audit is conducted, a report is given to the business laying out the amount of unclaimed property believed to be owed. A report may also contain a provision for interest and/or penalties due.

B. Reasonable Limits on the Scope of the Audit

1. Depending upon the state, an unclaimed property audit period may range anywhere from a few years to more than 20 years. Section 19 of the 1995 Uniform Act sets forth a ten-year statute of limitations for holders which “either specifically reported the property to the Administrator or gave express notice to the Administrator of a dispute regarding the property.” See also 1981 Uniform Act, § 29. The 1954 and 1966 Uniform Acts have no statute of limitations.

2. Do the Due Process Clauses of the U.S. and state constitutions limit the scope, and provide relief from unreasonably burdensome state abandoned property audits? Considering the holder’s past filing practices and business operations, some of these audits may not be reasonable in scope and may violate holders’ constitutional rights under Due Process to be protected from “fishing expeditions.”

3. Can holders be required to create schedules for auditors?

C. Record Retention

1. The 1981 Uniform Act requires holders to retain records of last known addresses for 10 years from the date the property was first reportable. There is no requirement that a holder initially obtain names and addresses; however, once obtained a holder is obligated to retain that information.

2. If records are not retained or are inadequate, states will attempt to use estimating techniques to determine liability.

3. Accounting and administrative errors should be identified and eliminated prior to or during the audit, in order to reduce erroneous abandoned property liability.

D. Who Bears the Cost of an Audit?

1. Some unclaimed property statutes provide that under certain circumstances a holder can be assessed the cost of an audit. See, for example, Section 30(d) of the 1981 Uniform Act.

2. Do holders have the right to be reimbursed for the costs of recordkeeping and reporting unclaimed property to the state?
E. Audit Extrapolation or Estimation

1. Introduction to audit estimations or extrapolations.
   a. “If, after the effective date of this [Act], a holder does not maintain the records required by Section 21 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 to the Administrator the amount the Administrator reasonably estimates, on the basis of any available records of the holder, or by any reasonable method of estimation, should have been but was not reported.” 1995 Uniform Act, § 20(f).
   b. It is common practice for auditors of unclaimed property to use some type of estimation or extrapolation technique to calculate the amount of unclaimed property due for the audit period. Because most businesses do not keep records for the lengthy period under audit by an unclaimed property auditor, records may be available only for the most recent years of this period.
   c. Because of the lack of records for an audit period, an auditor will normally try to apply some type of estimation technique in order to extrapolate the results of his audit of available records to the entire audit period.

2. Statutory authorizations for estimations or extrapolations.
   a. The 1981 Uniform Unclaimed Property Act specifically provides that when a holder fails to maintain/keep adequate records of its unclaimed property for the audit period, the state is allowed to "estimate" the amount of unclaimed property due from any available records of the holder. 1981 Uniform Act, § 30. As previously noted, a similar requirement is contained in the 1995 Uniform Act. The 1995 Act specifically allows unclaimed property administrators to use reasonable estimation techniques to calculate the amount of unclaimed property owed for periods in which the holder does not have adequate records. See, 1995 Uniform Act, § 20(f).
   b. Many states have adopted some type of provision to allow their auditors to estimate or extrapolate unclaimed property for a period where inadequate records were kept by the
holder. These estimation techniques allow auditors in some cases to project an unclaimed property amount for an entire audit period where available records are kept only for a portion of the period. In some cases, auditors may have to use records from outside an audit period to project unclaimed property owed for the audit period. In other cases, an auditor may even use “industry averages” to calculate a business’s unclaimed property liability. See, Commentary to 1995 Uniform Act, § 20(f), Comments Section.

c. Some states may be limited in their estimation techniques by the actual wording of the state’s statute. For instance, Illinois requires that any estimation technique must “conform to either generally accepted auditing standards or generally accepted accounting principles.” 765 ILCS 1025/11.5(a).

d. Moreover, in those states which do not provide any estimation technique in their law, it may be argued that estimation or extrapolation techniques cannot be used in their audits. These states may be limited to the actual documentation available. Generally, however, it may be difficult to argue that no projection or estimation is allowed when available records reveal an unclaimed property liability and no records for a portion of the audit period were kept.

3. Proper and improper estimation techniques.

a. While there is no general body of law stating what are proper and improper estimation techniques for unclaimed property audits, there is no doubt that any estimation technique used must at least be a “reasonable” and valid method for determining the amount of unclaimed property not reported for an audit period. Estimation techniques which are arbitrary or not calculated to provide a reasonable picture of the amount of unclaimed property not reported would in all likelihood be rejected by a court. See generally, Epstein v. New York State Tax Comm., 521 N.Y. Supp. 2d 880 (1987) (audit method must be reasonable); Vitale v. Illinois Department of Revenue, 118 Ill. App. 3d 210 (3d Dist. 1983) (audit conclusions must be based on “reasonable statistical assumptions”).

b. Moreover, under AU Section 342.09 of the AICPA’s Professional Standards, an auditor is required to consider the following factors in doing an estimate:
i. Significance to the accounting estimate.

ii. Sensitivity to variation.

iii. Deviations from historical patterns.

iv. Subjectivity and susceptibility to misstatement and bias.

While these are the factors used in financial statement audits, they demonstrate what the accounting profession believes are factors to use in reaching a reasonable estimate.

4. Remedies for improper estimations or extrapolations.

a. If in the course of an unclaimed property audit, a holder believes that the estimation technique is not reasonable, the holder has certain options available:

i. It can discuss the estimation technique with the auditor to suggest modifications to the technique that will more accurately determine the unclaimed property owed. This should be done before the estimation takes place, in order to avoid later arguments concerning the reasonableness of the estimation technique.

ii. If the auditor is unwilling to modify his estimation technique, the auditor's supervisor or the administrator in charge of the unclaimed property division of the state should be contacted concerning the problem. An alternative estimation technique should be provided, along with specific reasons and an analysis on why the estimation technique used was unreasonable.

iii. If an administrative review of the estimation technique is provided, a formal protest to the estimation technique used can be made administratively to the unclaimed property administrator of the state. This may result in an administrative hearing on the estimation technique. A later appeal of an unfavorable hearing decision can generally be made to the appropriate reviewing court.

iv. If estimation technique will not be revised administratively, and there is no administrative
protest or hearing system concerning the estimation
technique used, then the matter must be decided in
court. This can be done either through a declaratory
judgment action (if available) or otherwise in the
defense of a collection suit brought by the
administrator.

F. State Audit Agreements

1. Purpose and extent.

   a. Most states have entered into agreements with other states in
      order to enforce their unclaimed property laws. Both the
      1981 and 1995 Uniform Acts specifically provide for
      interstate agreement to enforce a state’s unclaimed property
      Clearly, one of the purposes of these provisions is to enhance
      the state’s ability to audit potential holders of unclaimed
      property. By authorizing another state to perform an audit
      on its behalf, the state increases the number of auditors
      available. This increases the number of holders it can audit.

2. Problems created for holders of unclaimed property.

   a. Joint audit agreements among states cause a number of
      problems for holders of potential unclaimed property. Not
      all state laws agree as to what property is considered
      unclaimed or as to dormancy periods. Consequently, these
      variations could greatly expand the time and complexity of
      any multi-state audit performed. Moreover, because some
      states have taken more aggressive positions than others as to
      what property is deemed unclaimed, it could result in
      property being collected for a state that would not otherwise
      be due.

   b. It is unclear whether one state can bind another state with
      respect to an audit performed on its behalf. Some interstate
      agreements merely allow one state to audit for the other, but
      do not restrict the non-auditing state’s ability to reaudit the
      holder at a later date for the same period.

   c. A holder of unclaimed property may not be willing to be
      audited by states in which it does not believe it has a liability
      for unclaimed property. This may result from a dispute over
      the interpretation of the state’s law or whether the state has
      jurisdiction to require the holder to file unclaimed property
reports. By allowing one state to audit on behalf of a number of other states, the holder may lose its ability to raise these issues.

G. Reciprocity and Exchange Agreements.

Several states have entered into reciprocity and exchange agreements. These agreements provide for the exchange of property between states where the last known address of the owner is in the other state.

1. Reciprocity agreements are intended to simplify holder reporting by filing unclaimed property for many states through one state agent.

2. Reciprocity reporting is voluntary, thus the holder is not required to report unclaimed property to the agent state for each of its reciprocal states.

3. Instead, a holder may elect to report directly to the reciprocal state.

4. If a state does not have a reciprocal agreement with another state, the holder should be aware that no agency agreement between the states have been established, and the protection provision of the unclaimed property act might not be available.

   a. The protective provision relieves the holder from any claim by the owner of the property once the property has been remitted to the state.

   b. This is especially important in the case of appreciated property such as stock certificates.

H. Issues Raised in Unclaimed Property Audits Conducted by Contract Auditors.

1. Ability of a State to Appoint NAPPCO and Other Commercial Entities to Conduct State Audits.

   a. Due Process - Do states have the authority to privatize a governmental activity by entering into audit contracts with NAPPCO or other commercial entities such as public accounting firms (e.g., Andreoli firm for Delaware; Grant, Thornton firm for D.C.)?

   b. What is the impact of U.S. Steel Corp. v. Multistate Tax Commission, 434 U.S. 452 (1978)?
2. What Limitations Can Be Imposed on NAPPCO and These Other Commercial Entities Hired by States to Conduct State Abandoned Property Audits?

a. Are these companies subject to the same constraints imposed upon state auditors?

b. Is the holder entitled to a copy of the contract between the state and these firms?

c. Is the holder entitled to a written schedule and outline of audit plan?

d. What substantive or procedural limitations may be imposed on these firms?


a. Is there a risk that these firms might disseminate, either directly or indirectly, confidential and proprietary information to third parties?

b. Can that risk be substantially avoided?

c. Is the absence of a satisfactory confidentiality provision sufficient cause for holders to preclude these firms from conducting an audit on behalf of a state?

d. Can these firms distribute audit information to states that have not joined the audit?

e. Can holders justify resort to state court and summons procedures to assure confidentiality?

4. Contingent Fee Contracts: NAPPCO and other firms have entered into contingent fee contracts with states to conduct abandoned property matters.

a. Does a contingent fee contract violate public policy?

b. Jurisdictions differ on public policy argument.

  Yes.
5. Multiple State Claims to the Same Abandoned Property.

a. The priority rules were designed to minimize or eliminate risks that holders might experience more than one state asserting a claim to the same unclaimed property.

b. Nevertheless, problems may still arise on audit if holders agree to estimation techniques to determine escheatable property.

c. If the estimation techniques assume that the holder’s records identify the owner’s last known address when in fact the holder’s records are not adequate, the state of the holder’s domicile has the rightful claim.

d. If the estimation techniques assume that the holder’s records do not identify the owner’s last known address when in fact that data is available, the state of last known address – not the holder’s domiciliary state – has rightful claim.

e. In such circumstances, holders may be required to pay over abandoned property a second time to the state with the rightful claim, unless the first payment was made in “good faith.”

f. To the extent that holders and the states (or the states’ representative third-party contract auditors) agree to utilize estimation techniques, the holders also need to be protected/indemnified from secondary claims by other states.
## Investment, Trading and Broker/Dealer Account

<table>
<thead>
<tr>
<th><strong>Insurance Proceeds and Property</strong></th>
<th><strong>General Ledger Items</strong></th>
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<td>Salaries, Commissions</td>
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<td>Fiduciary Checks</td>
<td>Amounts Owed by Sales and Insurance Finance Companies</td>
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<tr>
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<td>Credit Checks or Memos</td>
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<td>Securities Long in Customers' Trading, Investment, Trust Accounts</td>
<td>Mineral Proceeds</td>
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<tr>
<td>Securities held in vault or Storage Area of Bank</td>
<td>Royalties</td>
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<td>Securities found in a Safe Deposit Box</td>
<td>Utility Service</td>
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<td>Other Securities Owed</td>
<td>Advance Payments for Utility Service Not Furnished</td>
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<tr>
<td>Credit Balances in Trading and Trusts, Brokers, Investment Firms, etc.</td>
<td>Refunds due from Insurance Companies</td>
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### CLASSES OF PROPERTY SUBJECT TO ESCHATE

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<th>Account Balances</th>
<th>Negotiable Instruments</th>
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<tr>
<td>• Cash Dividend (ADR)</td>
<td>• Demand Deposits</td>
<td>• Warrants</td>
</tr>
<tr>
<td>• Stock Dividends (ADR)</td>
<td>• Savings Accounts</td>
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<tr>
<td>• Other Distributions resulting from Ownership of Interest or Debt Obligation</td>
<td>• Credit Balances Arising from Loans (Includes Secured Mortgages)</td>
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<td>• Bond Principal:</td>
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<tr>
<td>matured and called</td>
<td>• Credit Balances</td>
<td>• Foreign Exchange Drafts</td>
</tr>
<tr>
<td>• Mutual Fund Shares:</td>
<td>• Credit Balances or Cash Due Renters</td>
<td>• Warrants</td>
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