Unclaimed Property & Escheat Litigation | Alert

April 2016

Unclaimed Property Litigation Update: Victories on the Horizon for the Holder Community?

In recent years, states have become more and more aggressive in pursuing unclaimed property as a means of increasing revenue without increasing taxes. States have enacted and modified unclaimed property legislation expanding the scope of what constitutes escheatable property, shortening applicable holding periods and intensifying audit efforts. Heightened attention on unclaimed property has resulted in litigation among various states, holders, and owners of unclaimed property, all seeking to determine their respective rights and obligations under various states' unclaimed property laws. This *GT Alert* highlights recent developments in unclaimed property litigation.

Unclaimed Property Overview

Unclaimed property consists of a wide range of both tangible and intangible property held by a business. Once the business has held the property for a statutorily mandated holding period without communication with the true owner, the property is deemed unclaimed or abandoned, and becomes subject to escheat. Businesses holding such property are generally required to notify the true owners that their property is being turned over to the state as unclaimed property. Unclaimed property may include uncashed money orders and travelers checks, uncashed rebate checks and customer credits, unclaimed royalty payments, unused gift certificates and gift cards, uncashed employee payroll checks, uncashed vendor checks, uncashed dividend checks, amounts due and payable under insurance policies or annuities, amounts distributable from employee benefit plans, and certain pre-payments, deposits, and layaway items.

Supreme Court Questions the Constitutionality of State Procedures for Notifying Owners Prior to Escheat

The Supreme Court recently denied a petition for writ of certiorari in *Taylor v. Yee*, a case brought against the California State Controller challenging the notice procedures under California's Unclaimed Property Law. The petitioners, a group of property owners in California, alleged that California's Unclaimed Property Law fails to provide owners with constitutionally sufficient notice before escheating their financial assets to the State. In denying certiorari (because the "convoluted history of this case makes it a poor vehicle for reviewing the important question it presents"), the Supreme Court noted that many states, in recent years, have shortened applicable holding periods, and some states "still rely on decidedly old-fashioned [notice] methods that are unlikely to be effective." 577 U.S. ___ (2016) (citing Delaware's unclaimed property laws as relying only on blanket newspaper publication as a means of notifying property owners prior to escheat). The Court explained this recent trend of combining shortened holding periods with minimal notification procedures "raises important due process concerns," concluding the "constitutionality of current state escheat laws is a question that may merit review in a future case." Although not binding, this decision puts legislators and policymakers on notice that unclaimed property laws may become increasingly subject to heightened scrutiny and judicial review.

Bed Bath & Beyond's Recent Recovery of Mistakenly Escheated Property in California

The California Superior Court recently determined, in *Bed Bath & Beyond Inc. v. Chiang*, that merchandise return credits (MRCs) constitute gift certificates and are therefore not subject to California's Unclaimed Property Law. Between 2004 and 2012, Bed Bath & Beyond escheated nearly $2 million to the State of California, reflecting the full unredeemed balances of the MRCs that were issued to California customers who had returned merchandise to Bed Bath & Beyond without a receipt, and which had remained unredeemed for at least three years. In its action against the California State Controller's Office, Bed Bath & Beyond claimed it had mistakenly remitted the funds to the State, and it was entitled to a refund from the State for the full value of the MRCs.

The State Controller's Office argued the property was properly escheated because it constituted "intangible personal property" subject to escheat. However, the court found that only intangible personal property "owing" to its true owner is escheatable, and the MRCs do not constitute property "owing" to their owners because the MRCs are not redeemable for cash. By their own express terms, the MRCs are redeemable only for merchandise at Bed Bath & Beyond and its affiliate stores, and not for cash. Further, the MRCs do not expire and can be redeemed by customers against a future purchase of merchandise at any time.

Perhaps most notably, the court found that the MRCs qualified as gift certificates under California's Unclaimed Property Law, which expressly exempts gift certificates from escheat. The court noted the MRCs bear the same characteristics as a more traditional gift certificate or gift card, and other areas of the law recognize gift certificates as including certificates issued for purposes other than giving a gift (*e.g.*, certificates issued pursuant to an awards, loyalty, or promotional program).

This case may have a significant impact on holders who have historically escheated merchandise credits as unclaimed property to the State of California, although it is quite possible the California Controller's Office will file an appeal seeking further review of this decision. The decision currently provides support for any holder's position that merchandise return credits are not subject to escheat in California. It may also provide holders in similar situations with an opportunity to obtain a refund from the State of California for property which was mistakenly escheated in the past.

Pennsylvania Sues Delaware in Action Regarding Classification of Official Checks

The Pennsylvania Treasury Department and the Treasurer of Pennsylvania recently filed a complaint against the Delaware State Escheator and MoneyGram Payment Systems, Inc. (MoneyGram) to recover over $10 million escheated by MoneyGram to the State of Delaware reflecting abandoned "official checks" issued in the State of Pennsylvania. From 2000 to 2009, MoneyGram allegedly issued official checks totaling $10,293,869.50 at MoneyGram participating locations in Pennsylvania, which went uncashed for at least three years, and for which MoneyGram claims to not have the last known address of the owners. MoneyGram subsequently escheated the property to Delaware, its state of incorporation. The plaintiffs claim MoneyGram improperly escheated the property to Delaware when it should have escheated the property to Pennsylvania. Specifically, the plaintiffs claim the official checks constitute money orders, to which Pennsylvania is exclusively entitled under applicable Federal and Pennsylvania law.

Under the general priority rules set forth in *Texas v. New Jersey*, 379 U.S. 674 (1965), a holder of unclaimed property should first escheat the property to the state of the apparent owner's last known address, as shown on the company's books and records. If the apparent owner's address is unknown, or the apparent owner's last known address is in a foreign country, or the apparent owner's address is in a state which does not provide for escheat of the property in question, the holder should escheat the unclaimed property to the state of the holder's incorporation.

In this case, the plaintiffs claim the property should have been escheated to Pennsylvania, not Delaware, pursuant to 12 U.S.C. § 2503 and 72 Pa. Stat. § 1301.2(a)(2), which provide that the state in which a money order, traveler's check, or similar written instrument (other than a third party bank check) on which the issuer is directly liable was purchased is exclusively entitled to escheat of the amount payable on such instrument. On the other hand, the Delaware State Escheator has argued the official checks are "third party bank checks" subject to the general priority rules set forth in *Texas v. New Jersey*. Although the case has not yet been decided, the action highlights the increase in unclaimed property litigation seen in recent years.

Next Steps – How to Proactively Address Potential Unclaimed Property Issues

Businesses can take proactive steps to determine their rights and minimize their liabilities with respect to unclaimed property. In order to do so, it is important to understand your company's potential unclaimed property exposure. Opportunities may exist to recover funds your company previously remitted as unclaimed property if such funds were mistakenly remitted, akin to the position taken by Bed Bath & Beyond described herein. If you believe you may have mistakenly escheated property to a particular state and are entitled to a refund, or if you are considering whether certain types of property (such as store credits issued in exchange for returned merchandise) are escheatable under a particular state's laws, counsel can assist in determining your respective rights and potential liabilities.

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