

Unclaimed Property Task Force

Wednesday, September 10, 2014
3:00p.m. – 5:00p.m.
Buck Library, Buena Vista, New Castle, DE

Meeting Attendance

Task Force Members:

Present:

Senator Bryan Townsend	Bryan.Townsend@state.de.us	302-744-4165
Representative Bryon Short	Bryon.Short@state.de.us	302-744-4297
Senator Greg Lavelle	Greg.Lavelle@state.de.us	302-744-4197
Representative Jeff Spiegelman	Jeff.Spiegelman@state.de.us	302-744-4179
Secretary Jeffrey Bullock	Jeff.Bullock@state.de.us	302-739-4111
Secretary Thomas Cook	Tom.Cook@state.de.us	302-577-8984
Thomas Collins	Tom.Collins@debankers.com	302-678-8600
Michael Houghton	mhoughton@mnat.com	302-351-9215
Edward Ratledge	ratledge@udel.edu	302-831-1684
Jordon Rosen	jrosen@belfint.com	302-225-0600
Stan Stevenson, Esq.	sstevenson@rlf.com	302-651-7707
Leonard Togman	ltogman@potteranderson.com	302-984-6005
Robert Tuinstra, Jr.	Robert.J.Tuinstra@usa.dupont.com	302-774-0485

E-mail:

Phone:

Absent:

Controller General Michael Morton Office of the Governor	Michael.Morton@state.de.us N/A	302-744-4211
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Staff:

Michelle Zdeb	Michelle.Zdeb@state.de.us	302-744-4059
Kiki Evinger	Kathryn.Evinger@state.de.us	302-744-4297

Attendees:

Jamie Johnstone	DOF	302-577-8965
David Gregor	DOF	302-577-8684
Michelle Whitaker	DOF	
Caroline Cross	DOJ representing DOF	302-577-8814
Courtney Stewart	CGO	302-744-4200
Bob Byrd	Byrd Group, LLC.	302-757-8300
James Hartley	Verus Financial	203-597-6314
Charles Hellman	Verus Financial	
Sara Lima	UPPO	215-851-8872
Ferdinand Hogroian	COST	202-484-5228
Doug Lindholm	COST	202-454-5212
Alison Iavana	DOS	

Organization:

Phone:

Mark McQuillen	Kelmar
David Kennedy	Kelmar
Deb Zumoff	Keane
Freda Pepper	Keane
James Dechene	DSCC

The Task Force Meeting was brought to order at 3:04 p.m.

CONSIDERATION OF MEETING MINUTES

Senator Bryan Townsend, co-chair, thanked the members of the Task Force and the public for attending the meeting. He addressed the first item on the agenda, consideration of the meeting minutes from August 12th.

Michelle Zdeb, Legislative Assistant to Senator Townsend, read in a memo describing the proposed changes recommended by Mr. Tuinstra, Jr. The recommendation made by Mr. Tuinstra Jr. related to making a name change on the last paragraph of page 7, where it stated his name instead of Mr. Rosen.

Senator Townsend asked if there were any objections to the changes. There were none.

Robert Tuinstra, Jr., Delaware Business Roundtable (DBR), motioned to approve the minutes.

Representative Jeff Spiegelman seconded the motion.

The Meeting Minutes of August 12, 2014 were approved, with all members in favor.

PRESENTATION BY COUNCIL ON STATE TAXATION (COST)

Bob Byrd, Byrd Group, LLC., said that he has represented COST for several years. COST is made up of approximately 600 member companies. COST has significant experience in the area of unclaimed property. The presenters are speaking on behalf of many national companies that have an interest in how Delaware handles this issue. COST and Mr. Byrd spent the last six weeks trying to convince representatives from member companies to attend the meeting and present, but they were unsuccessful. Mr. Byrd believes this is indicative of the tensions between businesses and the State. He then introduced the presenters from COST.

Doug Lindholm, President & Executive Director of COST, thanked the Task Force for inviting COST to present. COST became involved in the unclaimed property field in 2002. Delaware has historically been a great friend to Corporate America due to its business-friendly laws. COST is a strong supporter of unclaimed property laws and of consumer protection laws. There are some aspects of unclaimed property, such as life insurance proceeds and payroll checks, which all parties agree should be returned to the rightful owner. He plans to focus on the “gray areas” of unclaimed property, mainly business-to-business transactions, in this presentation.

Mr. Lindholm began the presentation, titled ‘Corporate Experiences with the Delaware Unclaimed Property Program,’ by stating that many of the members of COST describe the Delaware Unclaimed Property Program as “frustrating.” Delaware holds a unique position as a state of domicile for Corporate America, but there are some aspects of the program that “frustrate” holders. Audits by contingent-fee auditors have been described by some holders as “aggressive.” Mr. Lindholm understands that the auditors are working within the statutory framework allowed by the law, but believes that the law allows for an unreasonable statute of limitations and does not have workable definitions of “unclaimed property.” The estimation techniques used by auditors create fictional unclaimed property and owners. Businesses do not need the “protection” of unclaimed property statutes.

Mr. Lindholm would like to see Delaware recognize that business-to-business transactions should not be subject to escheat. Credits in vendor accounts could arise for many reasons, including a duplicate check or an early payment discount. Estimation performed on those credit balances of all of the subsidiaries in a company often results in a multi-million dollar assessment. He does not believe there is any pretense of the property being returned to the rightful owner. The market does a good job of removing poorly performing companies. If a company has a significant amount of debt, then perhaps they should not be in business in the first place.

In 2012, the Department of Finance (DOF) put the 1981 look-back in writing for the first time and temporarily limited the look-back to 1986 (16 DE Reg. 530). Businesses need certainty in statutes. The fact that it took so long for this to be officially written in the statute does not provide that certainty. This lengthy look-back is also not in line with what other states are doing. The Uniform Unclaimed Property Act (1995) recommends a ten-year statute of limitations. The American Bar Association (ABA) recommended a three-year statute of limitations to the Uniform Law Commission. Standard corporate recordkeeping practices for businesses require keeping seven years of records. Delaware’s statute of limitations is far longer, requiring businesses to keep 28 years of records.

Approximately 15 states employ a business-to-business property exemption, which ABA and Unclaimed Property Professionals Organization (UPPO) have endorsed in filings with ULC. Several other states are considering legislation which would allow this exemption. Businesses are in the best position to enforce their rights. Additionally, 44 states have adopted some version of the ULC Model Uniform Unclaimed Property Act (UUPA), which provides uniformity, definitions and best practices. Delaware has not adopted a version.

Mr. Lindholm introduced his colleague, Ferdinand Hogroian, to continue the presentation.

Ferdinand Hogroian, Tax & Legislative Counsel at COST, said that one of the main concerns that companies have is estimation. The majority of the companies that make up the COST Unclaimed Property Task Force have filed every year and they are still audited and subjected to estimation. Delaware first enacted the statutory authority for estimation in 2010. The *Select Medical Corporation v. Cook* (2014) and *Temple-Inland Inc. v. Cook et al* (2014) cases in federal court both focus on whether Delaware can retroactively apply estimation and whether estimation actually results in an appropriate approximation of escheatable property.

Mr. Hogroian said the concerns expressed in the *Select Medical* case mirror the concerns COST companies have about the Delaware Unclaimed Property Program.

Senator Townsend asked for clarification about where the quotes Mr. Hogroian was using in his PowerPoint presentation came from, specifically whether they were from the plaintiff's complaint or were a judicial finding.

Mr. Hogroian said that the quotes he was using in the presentation were from the complaint in the case. However, these sentiments were not limited to the complaint in the case; the concerns are echoed by COST member companies.

The estimation includes property escheatable to another state. The estimation methodology takes errors from the current period where there are records and extrapolates that error rate to other periods. Even though this is not Delaware property, it is considered escheatable to Delaware. The property may be escheatable to another state but not remittable, such as if the state has a business-to-business exemption. There is property included in the assessments that appears to have been returned to owners before it became dormant. Sometimes a check has been canceled and then reissued. This is not unclaimed property yet is being included in the estimation in error. Additionally, the use of estimation methodology for one year applied to entire periods makes the assumption that there is a constant level of unclaimed property from year to year even when the data does not support that. In that circumstance, the estimation methodology is suspect. This process of estimation creates property to be escheated to Delaware that is not necessarily Delaware property.

Mr. Hogroian presented a list of recommendations to reform the escheat process. He said that estimation should never be used when a holder's records are substantially complete. Estimation should be based on property reportable to Delaware and not to another state, regardless of whether that state requires escheat of the property. The statutes should describe all property that is subject to escheat; if the holder is not on notice then they cannot report the property. COST also recommends applying a reasonable statute of limitations period for current and future audits that is more consistent with reasonable recordkeeping requirements. The statute of limitations should run from the time a report is filed in good faith and should apply to all property. In order to reform the audit process, Mr. Hogroian recommended specifying standards for audits, adopting transparency measures, enacting penalty reform, and ending contingent fees.

Mr. Lindholm concluded COST's presentation by reminding the Task Force that Delaware is the domicile of many companies. The United States Supreme Court's (SCOTUS) ruling that unclaimed property without any address is escheatable to the state of domicile is extremely beneficial to Delaware. However, this ruling – when combined with the contingency fee auditors receive (causing them to maximize amounts), estimation, and the long look-back period – makes this business climate unpalatable for Corporate America. The fact that penalties are used as a negotiating tool by the State and that there is no independent tribunal for review of cases does not make the business climate welcoming. Other states sense this and would likely be pleased to have some of the businesses currently incorporated in Delaware incorporate in their state. Other states are modifying their corporate and unclaimed property statutes in order to compete for these

businesses. Mr. Lindholm hopes to work with Delaware officials to amend statutes to ensure a friendlier environment for Corporate America in Delaware.

Representative Spiegelman asked if a list of suggested changes to the Delaware statute, submitted by all groups that have presented to the Task Force, would be compiled so that he would know what possible recommendations could be made to the General Assembly.

Senator Townsend said that could be done.

PRESENTATION BY VERUS FINANCIAL

James Hartley, Esq., CEO of Verus Financial, stated that Verus is an unclaimed property auditing firm that conducts unclaimed property audits on behalf, and at the direction, of Delaware and Verus' other 45 client-states. Verus was founded on the principle of addressing the issue that life insurance policy holders across the country were dying with no beneficiaries named and the funds, after a dormancy period, were being declared as unclaimed property. These audits have had a profound impact on the life insurance industry and on countless lives. It is because of states like Delaware who support Verus that they are able to do this work.

Verus has reached a resolution in approximately 70% of life insurance cases. It is a complex process. Verus conducts complex multi-state audits, requiring a high degree of specialization as well as the use of sophisticated computing and data processing algorithms and systems. It would not be practicable for Delaware to conduct these audits on its own without the assistance of third-party auditors, such as Verus. By performing these audits on a multi-state basis, Verus makes it possible for Delaware to ensure compliance with its unclaimed property laws in an efficient manner that minimizes the burden on the companies being examined.

Mr. Hartley explained the process of investigating an unclaimed life insurance policy payment. Verus meets with life insurance companies and enters into non-disclosure agreements with them. Verus asks the companies to provide them with their policies and procedures so that they know if the company has procedures in place to allow them to identify property that should be reported to the State. While analyzing data that they have received from the company, which is a long and involved process, Verus engages in dialogue with the company to agree upon an audit template. This increases transparency and can provide for a mediation solution in case of conflict, although Mr. Hartley noted that there has only ever been one dispute and it was satisfactorily resolved. Verus has this type of agreement with 17 major life insurance companies.

As a result, Verus has uncovered about \$2 million in unclaimed death benefits across the country. Verus works with the company to verify that the names they uncover match their records (name commonality is an issue) and what, if any, benefits are owed. Following the identification of unclaimed property during the audit, Verus works with the holder to reconcile any issues the holder may have with items contained on the report. After it is agreed that

unclaimed property identified during the audit is subject to remittance, Verus works with the holder to ensure that appropriate due diligence is performed to try and locate and pay the owner prior to the property being reported to the State. As part of the examination process, Verus informs the holder of their continuing statutory obligation to report unclaimed property of the type identified during the examination and to follow any required due diligence when reporting that property in order to ensure compliance going forward and minimize the need for future audits. Companies are usually pleased with the service that companies like Verus supply because they do not have the technology to keep up with unclaimed policies, since some beneficiaries do not know that the policyholders had a life insurance policy and do not file to claim it.

Mr. Hartley discussed Verus' compensation. Verus is compensated on a contingency-fee basis only for unclaimed property that is actually delivered to its client-states after reconciliation with the holder and due diligence is performed to try and locate and pay the owner. Verus is not compensated at all for unclaimed property that it identifies during the audit if the owner is able to be located and paid before the property is delivered to the State. In audits Verus has conducted, a significant amount of the unclaimed property that it has identified has been able to be reunited with the owner through the due diligence process.

Charles Hellman, Esq., Vice President & Managing Director of Verus Financial, stated that the results of Verus' audits provide concrete benefits to Delaware citizens by reuniting them with their property. He then gave examples of two audits where death benefits were paid directly to Delaware beneficiaries. Verus did not receive any compensation for these audits, since the beneficiaries were found before the money went to the State.

Mr. Hellman showed a video that was produced for other state-clients and that showed clips of interviews of beneficiaries who had received a life insurance policy payment due to Verus' investigation into the unclaimed benefit. Mr. Hellman stated that there were thousands more stories like the ones in the video. Having a longer look-back period is helpful because it allows Verus to reunite more owners with their property.

Mr. Hartley stated that the average payment on a policy is \$2,000 and the policyholder on average has been deceased for thirteen years.

Senator Greg Lavelle said that he is glad that the insurance companies are increasing their due diligence. He asked about how many policies Verus reconnects with beneficiaries.

Mr. Hartley said that it depends on the type of the policy. If the policy is one of the older ones that used to be sold door-to-door then it is unlikely that they will be able to find beneficiaries due to poor recordkeeping. On other policies he estimates that there is a 30-40% success rate reuniting beneficiaries with payments.

Senator Lavelle asked if Mr. Hartley knew how much property had been reunited with Delawareans.

Mr. Hartley said that there have been 2,600 policy holders with \$4.7 million in unclaimed property sent to DOF.

Senator Lavelle said that this seems like a perverse incentive, since Verus gets paid only when money is escheated to the State.

Mr. Hartley said that there are due diligence process steps that must be followed before the property can be escheated to the State. There are a variety of methods which the holder can use to try to find the beneficiary. There is legislation pending in many states that requires life insurance companies to check the Death Master File (DMF) to see if the insured is deceased.

Senator Lavelle asked how much the State of Delaware has paid Verus in the past couple of years.

Mr. Hartley said that they received about 10.5% of the \$4.7 million that was escheated to the State.

Stan Stevenson, Esq, Delaware State Bar Association (DSBA), asked if Verus only audits the insurance industry. He also asked if Verus only audits payments of policy benefits or if they audit other aspects of the companies as well. Additionally, does Verus use estimation?

Mr. Hartley said that Verus has only audited the insurance industry in Delaware. Verus does not use estimation.

Robert Tuinstra, Jr., Delaware Business Roundtable (DBR), asked if Verus requests a significant amount of information from insurance companies or if it would be a simple request to accommodate.

Mr. Hartley said that Verus specifically requests the company's life insurance data. That data is then normalized and analyzed by Verus. It's an involved process.

Mr. Tuinstra, Jr. clarified that Verus is asking companies for its list of people insured.

Mr. Hartley said that is correct. Non-disclosure agreements prevent Verus from using that information for any other purpose.

Mr. Hellman said that Verus looks at death benefits as well as matured annuities and retained benefit asset accounts. They look at policyholders who are alive as well. There is also a settlement option.

Mr. Stevenson asked if Verus audits companies for their business-line profits as well.

Mr. Hellman said yes.

Mr. Tuinstra, Jr. asked if the majority of Verus audits were of owner-known property.

Mr. Hartley said yes. If the beneficiary's address is unknown, it is presumed that it is the same as the insured. It is very rare to have owner-unknown property.

PRESENTATION BY KELMAR

Mark McQuillen, JD, President of Kelmar, thanked the Task Force for inviting him to present. He hopes that his presentation will provide some clarity into what Kelmar does and will help the members when they formulate their final report.

Mr. McQuillen described the unclaimed property case of *Texas v. New Jersey* (1965). This was a case that involved the issue of jurisdictional priority that was disputed by four states. Sun Oil Company drilled for oil in Texas, was incorporated in New Jersey, had headquarters in Pennsylvania, and had a last known address in Florida. This is a debt that is owed, not an asset of a holder. When deciding this case where jurisdictional priority is in question, the court considered: which state was in the best position to return the money to the rightful owner, how to minimize conflict between the states, the ease of administration and clarity, and how to avoid unjust enrichment of the holder. This court case recognized that all of the states had a claim to the priority, but that some claims were stronger than others. They ranked the claims from strongest to weakest as follows: name and address on books and records of the holder, the state of incorporation, state of allocation, and then the state with any nexus.

The nature of businesses is that small businesses send goods and services up to big businesses while big businesses send money down to small businesses. Abandoned property is big businesses sending the property to the small businesses. According to the Small Business Association (SBA), 80% of businesses are sole proprietorships, 98% have fewer than twenty employees, 99.7% are considered small businesses by SBA, and on average small businesses employ 1.95 people. A business-to-business exemption would affect all businesses, not just the larger ones. Small businesses do buy from big businesses, but these are not part of a bilateral economic relationship. These sales are done on the retail side of big businesses where there is a disproportionate economic relationship.

Mr. McQuillen said that there are many reasons to have a business-to-business exemption. Small businesses do not have many employees; they cannot afford the "red tape" of compliance. Small businesses are almost always the creditor, not the debtor. Bigger companies do not need statutory help to protect themselves against other businesses. Businesses also do not operate bilaterally; it is a multilateral system. Business-to-business exemptions can end up hurting companies in the state. For example, Ohio (OH) has a business-to-business exemption. If an OH Company owes the State of California money, they are required to pay that debt. However, if a New York (NY) company owes an OH company, the NY company is not required to pay the State of OH for the debt it owes the OH company because OH has a business-to-business exemption. OH businesses

then lose out on monies owed. Business-to-business exemptions actually hurt in-state citizens and help out-of-state companies.

Exempting unclaimed property does not violate federal due process. An exemption is not converting the debt of a holder into the asset of a holder. Rather, it is simply stating that the State Escheator will not become the custodian of the property for consumer protection purposes. Holders often presume that an exemption enacted by the state legislature is a lawful conversion of a holder's debt to a holder's asset, but it is not. The holders cannot "keep" the funds. The state legislature can choose to not pursue finding the rightful owner but it is unconstitutional to allow that property that is owed to someone else be kept by the holder.

Senator Townsend asked if Mr. McQuillen thought it would be beyond the power of the State to regulate the definition of unclaimed property.

Mr. McQuillen said yes. He believes that a debt on the books of a company is a debt. There is a distinction between what is a debt and if the State is willing to step in to enforce that debt being repaid. Whether or not that debt is defined as unclaimed property is a different issue, for example a \$5 gift card would not be considered unclaimed property. The holder should not keep the property.

If the state of address does not want the money or does not have supporting documentation to show that it should be sent to them, then estimation is often used.

Mr. Tuinstra, Jr. said that he agreed with Mr. McQuillen's statement that if a debt is on the books of a company it should be paid. He asked how that logic fit with estimation.

Mr. McQuillen said that estimation is used when books and records do not exist. Estimation and projection are used by Kelmar and most other public accounting firms. It is just math. The state legislature has to decide what the appropriate amount of time to look at is for estimation; the period of estimation varies between states.

Mr. Tuinstra, Jr. asked if Mr. McQuillen would agree that the result of estimation is that it creates property which can never be reunited with a real owner.

Mr. McQuillen said that was true. Unless records show up later, estimation produces a product that can never be returned. However, if the property is in the holder's bank account it can also never be returned. Most of the money Delaware receives has names and addresses on it; only 8% is received as a result of estimation.

Mr. Tuinstra, Jr. asked if the 8% Mr. McQuillen mentioned referred to Kelmar or all of the revenue the State of Delaware receives in unclaimed property.

Mr. McQuillen said that it referred to the State of Delaware.

Mr. Tuinstra, Jr. asked if that meant that 92% of the property Delaware receives is owner known and has an address.

Mr. McQuillen said yes. Some of that property is foreign, and approximately \$600-700 million in foreign property was returned last year. Billions of dollars are returned nationwide before the company is audited because the owner is known. Billions of dollars are returned prior to assessment.

Deputy Secretary David Gregor, Department of Finance (DOF), said that property with a foreign address is returned.

Senator Townsend asked Mr. McQuillen to clarify what he meant when he said that ‘billions of dollars are returned prior to assessment.’ He asked if the property was returned as a result of the current system being in place and functioning correctly.

Mr. McQuillen agreed with Senator Townsend and said that was what he meant.

Michael Houghton, Esq., Uniform Law Commission, said that the Task Force understands that businesses are upset to find that if they are incorporated in Delaware, but have no other form of operations in the State, that Delaware has a claim on their unclaimed property. He also understands that businesses are suspect of the auditing firms, like Kelmar, because they get paid such large contingency fees.

Mr. McQuillen said that he understands the concerns that Mr. Houghton described, but said that it is important to question whether it is better to have this sort of system or to let the funds enrich the holder. Mr. McQuillen presented at a previous Unclaimed Property Task Force (2006) in Delaware when similar concerns were raised about the auditing process. The Task Force then feared that the auditing process would cause companies to become incorporated in other states, leading to a loss of revenue for Delaware. This has not happened, and Mr. McQuillen does not think it will. The benefits that companies receive by being incorporated in Delaware vastly outweigh any hardships caused by the auditing program.

Senator Lavelle suggested making the escheat environment more competitive so that the State does not have to pay auditors so much.

Mr. McQuillen agreed that increasing competition would be one way to make the unclaimed property business less lucrative for his company. However, he said that Kelmar is currently unmatched by other companies in terms of the resources, expertise, and services they can provide.

Edward Ratledge, public, University of Delaware Director of the Center for Applied Demography & Survey Research (CADSR), requested that some information about the sampling techniques these companies use and their accuracy be presented to the Task Force.

Senator Townsend said that topic would be discussed later in the meeting.

PRESENTATION BY UNCLAIMED PROPERTY PROFESSIONALS ORGANIZATION (UPPO)

Sara Lima, Esq., Reed Smith representing UPPO, said that UPPO is a non-profit trade organization similar to COST. They have hundreds of member companies. UPPO members identified some concerns that would be of interest to this Task Force.

Ms. Lima referred to the handout provided by UPPO titled “Unclaimed Property Professionals Organization Requests for Task Force” and to the letter dated September 8, 2014 that Toni J. Nuernberg, Executive Director of UPPO, wrote to the Task Force. One of the biggest requests that the holder community has is to define and clarify what constitutes owner “contact” sufficient to toll the dormancy period. This is especially difficult when it comes to dealing with long-term investment property. When a company escheats shares of stocks to the State of Delaware, the State is entitled to sell those shares and does not have a waiting period for selling them. If an owner is later found for the shares, they receive the value of the shares from when the State sold them. This is frustrating because the value of the shares may have increased (or decreased) by that time, and frustrated owners may bring litigation against the holder. UPPO recommends limiting the post-escheat sale of securities in order to protect shareholders from loss and holders from litigation.

Ms. Lima stated that UPPO does not believe that estimation should be eliminated completely. However, UPPO does recommend limiting estimation to “reasonable” methods and that it should be used only as a penalty when holders have failed to meet defined record retention requirements. There are some ambiguities in the audit process that have caused disputes. There is also a perception that because auditors are paid a contingency fee, that they inflate the amount of property that is required to be escheated to the State. Therefore, UPPO recommends increasing guidance to contract auditors and/or revising the incentive provisions to reduce any perception of impropriety.

Additionally, UPPO recommends refining Delaware’s administrative process to be more impartial and to allow holders the opportunity to interface with representatives of the State during an audit. UPPO would like a written acknowledgement that holders have the right to communicate directly with the State if there is a dispute. The holders would also like to have some say in who arbitrates disputes in order to make the process more impartial.

Deputy Secretary Gregor said that with respect to the sale of securities, there was an examination of the securities industry. It was discovered that due diligence was not being done to the extent DOF thought. Since it was found that due diligence was not being done appropriately by holders, now when the State receives escheated shares they do another round of due diligence before

selling the shares. Last year DOF returned approximately \$60 million in securities. Due diligence for securities might have been a problem before but Deputy Secretary Gregor does not believe that it is anymore. DOF also states in its engagement letter that they welcome the opportunity to interface with holders. However, advocates for holders often advise against this.

Michelle Whitaker, DOF Audit Manager, said that she communicates in writing and verbally that she is the final arbitrator in any dispute. DOF is doing everything possible to communicate with holders and to make the audit process clear.

OPEN DISCUSSION BY TASK FORCE

Mr. Ratledge said that he has done a lot of work with complex sampling design and believes that almost anything can be measured. He asked what the sampling method was that Kelmar used in audits and if they checked their accuracy in estimation against the records of the company.

Mr. McQuillen said that they do check their accuracy. In one case they used estimation and then additional records became available going back to 1971. Kelmar's estimation mirrored those records and was well within the margin of error. Kelmar's statisticians seek to have a 90% confidence rate. Many states use the same estimation/projection calculations as Delaware and have similar results. He said the Task Force should focus on what the role of estimation should be rather than the math of the equations used to estimate.

Mr. Ratledge asked if someone monitors the quality of the sampling.

Mr. McQuillen said yes. The state-client vets the process as well. In terms of Delaware, Kelmar auditors meet with Delaware DOF members, such as Michelle Whitaker, every month and go over every single audit that is in process and DOF makes all of the decisions. The contingency fee Kelmar receives is decided by the State.

Secretary Thomas Cook, DOF, wanted to clarify that the estimation process is not conducted solely by the State. The holder is also involved in the decision-making process of the methodology and estimation.

Mr. McQuillen said he agreed with Secretary Cook. He said that there is a healthy tension between the State, the holder, and the advocate about what records should be included.

Ms. Whitaker confirmed that the State is in contact with both the auditors and the holders. If a holder believes that a decision is not fair and can provide support that it is unfair, Ms. Whitaker is open to reconsidering a decision.

Mr. Stevenson said he was surprised to learn that estimation is only used in 8% of unclaimed property cases; he had thought that percentage would have been much larger.

Senator Townsend asked if any State official disputed that estimation is only used in approximately 8% of unclaimed property cases.

Deputy Secretary Gregor said that 8% is probably an accurate number, but that they would want to check in order to be certain.

Mr. Houghton said that he would like to see a historical view of that number, such as what the rate was over the past ten years.

Senator Townsend said that he and Representative Bryon Short would be in touch with DOF before the next Task Force meeting in order to make sure that the Task Force is supplied with the data they have requested.

Mr. Tuinstra, Jr. said that if estimation is used in such a small percentage of unclaimed property cases, then the impact of eliminating estimation would seem to be minimal. He asked if this was correct. He then asked what percentage of Kelmar's audits utilize estimation.

Senator Townsend said the first question Mr. Tuinstra, Jr. asked would be a matter of policy.

Mr. McQuillen said that in terms of the audits that Kelmar does for Delaware, approximately 50% of the audits use estimation. There are a lot of subcategories that may or may not use estimation.

Jordon Rosen, Delaware State Chamber of Commerce (DSCC), asked if 50% of the audits for Delaware involve estimation. He had heard earlier in the meeting that the total revenue received from using estimation was only 8%.

Deputy Secretary Gregor said that the 8% refers to all the revenue that is collected, whether it is through a VDA or annual filing. The 50% refers to the estimations Kelmar does.

Senator Townsend asked for clarification. He asked if the 50% meant that half of all audits involve estimation, or that half of all revenues collected come via estimation.

Mr. McQuillen said that in an examination there are two services that Kelmar provides. One service is in securities. Most of that area has names and addresses, so virtually none of those audits would use estimation. In contrast, general ledger audits almost always involve projection and estimation. Whether or not estimation is used depends on the type of audit being done, the nature of the business involved, and what sorts of records are available. If Delaware decided to completely eliminate estimation, half of the audits Kelmar does would go away. A lot of Delaware's annual filings would also go away because audits play an important role in ensuring compliance.

Senator Townsend asked if Mr. McQuillen was saying that the estimation part of that 50% constitutes less than 10% of all revenues from Delaware's unclaimed property program.

Mr. McQuillen said yes.

Deputy Secretary Gregor said that it is important to understand that if estimation is not available as an alternative, DOF will not receive the records they need to do an examination. The 10% is not a static number.

Senator Townsend said he looks forward to seeing concrete data from DOF to support the figures that were being discussed. Given the complaints that the Task Force has heard about the lengthy time period that companies are required to keep books and records, he asked how often estimation is used to audit companies that have chosen never to file.

Ms. Whitaker said that when an examination is being done, the company's filing history is taken into account. Companies may be upset about estimation, but if they would maintain their records it would not have to be utilized.

Senator Townsend asked if companies are being told to keep records for 15-20 years, or if they chose not to file then the consequence is estimation will be used. He asked if anyone had a problem with the latter.

Mr. Stevenson said that is what companies are told. The way the statute currently reads is companies only have to file if they have property to report. A company that is incorporated in Delaware but that operates entirely in California would never have any occasion to file a Delaware unclaimed property return because they would never owe anything to Delaware.

Ms. Whitaker corrected Mr. Stevenson's statement by stating that the company would have to report if it had any unknown items.

Mr. Stevenson agreed with Ms. Whitaker. If the company gets audited thirty years later, they would be unable to defend themselves against estimation even though they were not required to file in Delaware.

Senator Townsend asked how many of those types of companies are the ones expressing concern and are subject to being audited.

Ms. Whitaker said that if a holder can produce their filing history to DOF, those years are not subject to estimation. They get credit for filing.

Mr. Houghton said that would assume that the holder has kept their filing history for 30 years. Many companies believe that is too much, particularly since the State of Delaware would not be able to produce their records from thirty years ago.

Senator Townsend said that was tremendously ironic.

Mr. Tuinstra, Jr. asked what level of records auditors would be looking for and for what period of time.

Mr. McQuillen said they would usually ask for 3-4 years of records or whatever is agreed upon with the holder within the statute of limitations.

Mr. Tuinstra, Jr. asked if on average the auditors would be looking to find transactional-level records and how far back they would be looking for those records to be kept.

Mr. McQuillen said that they would be looking for transactional level data. North Carolina requires that level of records be kept for fifteen years. Kelmar used to ask for at least five years of records, but they received complaints that the auditors were not really trying to reunite property, that they were just looking for an excuse to use estimation. Then they started asking for all records going back to when the company was started and they were called “aggressive.” Now, Kelmar asks for as many records as the company has and goes from there. There is no definitiveness and the process depends on many factors, such as the size of the company and mergers/acquisitions. Most records they receive are electronic. Kelmar takes direction from their client-states on how many years of records to ask for.

Mr. Rosen asked if there were any restrictions on what documents an outside contractor can request from the holder.

Ms. Whitaker said no. The statute allows for all records to be requested.

Mr. McQuillen said that Kelmar signs confidentiality agreements with all holders to ensure confidentiality of any records they receive.

Ms. Whitaker said she knew of one case when a holder reported an unknown item through the VDA program. Within a year and a half, the claimant came forward with documentation that was provided to them by the holder that substantiated the claim that that particular item should have never been reported to Delaware. The State of Delaware is very concerned about making sure that no property comes to Delaware that it is not entitled to.

Secretary Cook asked the representatives from COST if they agreed that if there is no filing history that DOF should be using estimation.

Mr. Lindholm said that he wanted to point out that not all companies are obligated to file. He hears information from companies that have gone through audits. In terms of Mr. McQuillen referring to unclaimed property as a “debt,” Mr. Lindholm said that it may not be a debt but may be a credit balance or bookkeeping error. The basis of estimation is larger than unclaimed property. Holders are not unjustly enriched by keeping unclaimed property.

Senator Townsend referenced the language from the *Select Medical* complaint COST used in their presentation. He said it is not a judicial finding, but an opinion from the claimant. He asked if Mr. Lindholm was saying that Kelmar and other auditing companies are not making adjustments for those situations. He wants to make sure everyone’s intentions are clear and that the Task Force is discussing what is actually in the system.

Mr. Lindholm said that in the complaint in *Select Medical*, they were willing to argue everything mentioned. The case was settled by the State of Delaware for \$0; they were not assessed anything at all. He recommends taking a look at that complaint. He does not believe that case involved unclaimed property at all.

Secretary Cook said that in the *Select Medical* case, the State of Delaware asked for records numerous times and was denied. The assessment of \$0 was made once the State was given access to the company's records.

Mr. Lindholm said he did not know the specifics of the case, but it seemed to include items that were not unclaimed property being included in estimation.

Secretary Cook said that the point was that companies are not filing and not submitting records to the State. The VDA program that was created by Secretary of State Jeffrey Bullock and the outreach that department does specifically targets companies that have never filed.

Mr. Hogroian said that many of the member companies that COST works with are not eligible for the VDA program.

Secretary Cook said that those audits must have been started prior to the last two years. That is where the audits are coming from

Mr. Hogroian said that there are some ongoing audits and some have settled recently. Their complaints about the audit process and estimation are current.

Senator Townsend said that was a fair point to note, but that it was also important to acknowledge the changes that have been made in the last couple of years to improve the audit process. He then asked if estimation was being used to "explode" the error rate in company's filings or the underreporting rate in order to justify overcoming the statute of limitations.

Mr. McQuillen said that he only does the math. Other people determine whether or not the error rate "explodes." He said that he does his job extremely well and does not think that he makes any judgment calls that benefit his company. He does not believe that is happening at all.

Mr. Hogroian said that according to the numbers he has, property that has an address outside of Delaware is extrapolated backwards and then taken as Delaware property. If the holder keeps the property, it can still be claimed by the owner at a later date. It does not have to be given to the State of Delaware. He does not think it is right that property with an address in another state be given to the state of incorporation.

Mr. Houghton said that what is right or wrong can be argued about this issue, but he believed Kelmar would say that incidents of unreported property (even if it is owed to another state on an address basis) constitutes a more recent experience of unclaimed property. When this is extrapolated backwards over time, this does create a number but it is one that cannot be directed

to other states based on addresses. COST is saying that the only type of extrapolation that should be done is take a Delaware corporation, identify the items of unclaimed payroll and accounts payable/receivable in Delaware (which will be small) and then estimate back based on those figures. That is not the rule Kelmar uses. Many of other auditors use the same methods as Kelmar.

Senator Townsend asked if people were disputing the amount of unclaimed property or which state it was assigned.

Mr. Hogroian said that it depends on the statutes that other states have.

Mr. Houghton said that proving which state the property should go to is difficult if there are no records proving that it should go to one state over another.

Mr. Hogroian said regardless of whether the other state requires the escheatment or it is put outside the statute, it should not be reported to Delaware.

Mr. McQuillen said that SCOTUS decided that if the property is not claimed by the addressed state it goes to the state of incorporation. The holder should not keep it. The juxtaposition of COST's position is that they say that people have complied with filing and now their records are gone and they cannot prove their compliance, but there are also people who have not complied. Those people want the property to only go to one or two people in Delaware and have the majority of the property go to another state. The property would either go nowhere or go to another state.

Senator Townsend said that the issue of whether the money does not go anywhere or is sent to another state is important to discuss.

Ms. Whitaker said that anything that is estimated under their agreement they are indemnified for. If proof can be shown that the property belongs to another state, DOF will pay that claim to the claimant.

Mr. Houghton said that the problem was that there would be no claim because no records exist to prove the claim. However, he agreed with Mr. McQuillen that this was a SCOTUS decision. The Delaware legislature can decide the extent it is to be applied, but this was the decision reached by SCOTUS.

Mr. Lindholm agreed that the SCOTUS decision said that unknown property should go to the state of incorporation, however he questions how that property is identified. COST alleges that the audit process is very aggressive, factors in errors to other states, and assumes that the amount of unclaimed property will be the same from year to year.

Senator Townsend asked if COST is alleging that the statistical models that Kelmar and other auditing companies use do not allow for those variables. He asked Mr. McQuillen if the models

that Kelmar uses assume that there will be the same rate of unclaimed property every year or if they have found that Corporate America tends to have complied at different rates over different time periods. He asked to see concrete examples from Corporate America about what is going on.

Mr. Hogroian said that in the case of *Select Medical*, the matter was resolved by the courts and it was found that Delaware was not entitled to the property.

Mr. McQuillen said it was his opinion that neither his company nor the State is behaving aggressively in audits. The Task Force has heard a lot of anecdotes, but no one has come forward to testify or give specific examples of their experiences.

Ms. Lima said that in the letter from UPPO they do detail specific areas of dispute in the estimation process.

Mr. McQuillen said that is different than calling the auditing process “aggressive.” The issues described in the UPPO letter are ones that there can be dialogue around and changes made.

Senator Townsend said that how “aggressive” behavior is defined is in the eye of the beholder.

Mr. Rosen said that he thinks that “fairness” should be substituted for “aggressiveness.” That is really what the holder community is looking for. Corporate America likes certainty, and the statutes should be very clear about what is expected of them. This Task Force is supposed to ensure that the audit process is fair for both the State and the holder.

Senator Townsend reiterated that he would like examples of specific aspects of the audit process that are unfair identified. He would like examples of specific companies who have always filed but who have been subject to estimation techniques that have eliminated the statute of limitations.

Ms. Lima asked if Senator Townsend was referring to holders that have filed or ones that can prove they have filed.

Senator Townsend said he was referring to those that have filed.

Ms. Whitaker said that just because a holder has filed does not mean that they have filed accurately or reasonably.

Senator Townsend said that he understood that. However, the system is structured so that once a holder files the statute of limitations kicks in.

Mr. Rosen said that in tax the statute of limitations is three years. If the government does not audit by then, and there is no instance of fraud, then the statute of limitations has tolled and no further audits of that time period can be done. He does not think Corporate America feels the

same way. If the State audits them twenty years later, they will most likely be vulnerable since they do not keep records that long.

Senator Townsend asked how many instances are there of companies that have filed being audited and subject to estimation because they no longer have their records, as opposed to companies that have never filed.

Mr. Tuinstra, Jr. asked Mr. McQuillen what portion of the audits they perform for Delaware where they do a look-back to 1986 are of companies that have not filed versus those that have a substantial underpay.

Mr. McQuillen said that he is not directly involved in the auditing process so he can only speak anecdotally. He said that most of Corporate America does not file, or if they do they file very small amounts or very specific and discrete amounts. It is theoretically possible that a company could be in very good compliance and then not be able to prove that in an audit, but that is not the experience that Mr. McQuillen has had. In his experience, companies are either in no compliance or marginal compliance.

Mr. Tuinstra, Jr. asked in the marginal compliance scenario how long of a period of time is there to audit.

Mr. McQuillen said that was a policy question he could not answer.

Senator Townsend said that the Delaware Code lays out the statute of limitations.

Mr. Tuinstra, Jr. asked if in the audits that determine whether a company has underreported, conducted during the appropriate statute of limitations, if the look-back period goes back to 1986.

Mr. McQuillen said that they accumulate the books and records for an initial review and then the audit team meets with Ms. Whitaker to determine what the records mean and their relevance. The determination about how far back the audit goes is determined by Ms. Whitaker on a case-by-case basis.

Mr. Tuinstra, Jr. asked if that system applies to both filers and non-filers.

Mr. McQuillen said that it applied to both.

Mr. Houghton said that from 1981-2001 there was no statute of limitations in Delaware.

Secretary Cook said that he wanted to clarify what was said about the credits companies get for filing and being used for estimation. Those are only looked at as credits if they are taken as income.

Mr. McQuillen said that they look at credits that are currently on the books and records that have reached the dormancy period and have not been resolved. The vast majority of the items they examine have been taken off the books. Kelmar works very closely with the holder and the advocate to figure out which are accounting errors and which are not. It's a complicated process, but it has rules and if the company is not happy with the end result they can appeal to Ms. Whitaker.

Mr. Lindholm said that companies are in the position that they have to prove that the property is not unclaimed property, which is difficult to do since they may not keep records that extend that far back. There are many other reasons that a credit could appear in a company's accounts.

Senator Townsend asked if Mr. Lindholm was saying that auditing companies do not take those factors into account in their calculations.

Mr. Lindholm said that was correct. There is no way to verify accuracy with estimation.

Senator Townsend said that some of the comments made to the Task Force made it seem like the estimation calculations that companies like Kelmar are doing are very rudimentary and inaccurate. The concerns that are being expressed are valid, but Senator Townsend wanted to make sure that the auditors are using advanced techniques to adjust for variables.

Mr. Lindholm said that he gets his information second-hand from COST's member clients. The concerns have also been expressed through litigation.

David Kennedy, JD, Kelmar General Counsel and Principal Member, said that Kelmar goes through the audit and the holder gets the opportunity to prove that the credit balance or duplicate entry was resolved in another way. Those adjustments are made in every audit. Those items that the holder cannot prove were resolved in another way have to be left in the audit. Holders who do not think that is appropriate seek mediation with Ms. Whitaker.

Senator Townsend said that he understands that there is a disagreement about whether that is fair. He wanted to know how many companies have been subjected to this process and have filed versus those who have not filed.

Mr. Lindholm said that companies would be much more comfortable being incorporated in Delaware and having their businesses in the state if the look-back period is significantly shortened.

Senator Lavelle suggested that if companies are afraid to testify to the Task Force about their experiences that perhaps they can speak in private and have that testimony shared. He asked if the contracts that Kelmar has with other states are similar to the one they have with Delaware, particularly the length of the contract and the contractual obligations. He also asked if Kelmar entered into simultaneous contracts with other states.

Mr. McQuillen said that Delaware does have one of the longest contracts with Kelmar compared to the contracts Kelmar has with other states. However, this time length is not unique when compared to the time length of contracts that the State of Delaware has with other auditors. Kelmar has represented other states as long as they have represented Delaware.

Senator Lavelle said that he does not know of many other vendors that the State would enter into such a long contract with.

Secretary Cook mentioned that the State had similarly long agreements with video lottery machine groups. The purpose of having such a long agreement was revenue sharing and to try to keep the cost down.

Senator Lavelle said that this contractual agreement has been in place since 2001. In the years since then, he would have expected there to be competitors in the field developing. He believes that this competition should allow the State to find a better price for these audits.

Secretary Cook said there was analysis done of what the major accounting firms charge for this type of service and that amount has been used as a benchmark. The rates have gone up over the past several years, but the long contract the State has with Kelmar has helped keep the costs lower.

Mr. Ratledge said that he thought that if Kelmar was not using proper accounting procedures that a holder would have sued them by now. He asked how Kelmar accounts for changes in a company, such as IBM, in an estimation looking back when they are working with forward-looking data.

Mr. McQuillen said that they start by looking at revenue and then make adjustments for companies that have been acquired or have spun off. They then look at the nature of the companies acquired, such as where they are located; since Kelmar has no contract with Alaska those records might be excluded while records pertaining to California and Delaware would be included. It is a regressive view of the economic history of the company. In some circumstances, such as payroll review, it is possible to review the 10K's and get the historic payroll records. The criteria that Kelmar is instructed to use to decide which data to use is that it has to be historic, determinable, and as close as possible to the economic stream that they are trying to measure. The statisticians try to do aggressive curves rather than a flat line backwards, since that would give a more accurate historical picture of the company.

Ms. Whitaker said that if the holders have a problem with the way the auditor is doing the audit they can contact her. If they have an alternate way to suggest for doing the audit her office is open to considering that.

Mr. Ratledge said that there is an assumption that company recordkeeping is improving and that the unclaimed property field is consistently increasing. A lot of businesses that go out of business

are small businesses that are probably being run on the proprietor's credit card. It is important that they get their money back.

Senator Townsend said that he would be interested in hearing from groups that represent small businesses in order to hear the small business perspective on this issue.

Ms. Whitaker said that companies that are concerned about the long look-back system have the option of joining the VDA program.

Mr. Lindholm said that companies that are already undergoing audits do not have that option.

PUBLIC COMMENT

There was no comment from the public.

Senator Townsend thanked the Task Force members for attending and for their comments. He then informed the members and the public of the next Task Force meeting, which will be held on Thursday, October 2, 2014 from 1:30 p.m. – 3:30 p.m. at Buena Vista. The Senator also informed them that there would be an additional meeting on Tuesday, October 28, 2014 at Legislative Hall in Dover at a time to be determined.

The meeting was adjourned at 5:40 p.m.