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Delaware's New Voluntary Disclosure Program Aims at Improving its Image with Holders

Guest contribution for the March 2013 newsletter by Mover & Osibodu (www.MoverOsibodu.com)

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In its effort to stem the backlash from Fortune 500 companies that have long been the targets of Delaware's aggressive unclaimed property audits of businesses incorporated in Delaware, this past July the state enacted a sweeping new Voluntary Disclosure program.¹ The terms of the new program - at least at face value - are substantially more generous to Holders than the terms Delaware demands in its contract audits of noncompliant Holders. For Holders that meet the new VDA requirements, Delaware will reduce the Holder's liability look-back period by 15 years, from 1981 to 1996, and waive 100% of interest and penalties. This could reduce a typical noncompliant Holder's liability dramatically.

Delaware has long been aggressive in unclaimed property audits of Delaware incorporated entities. As the domiciliary state of choice for 50 percent of all publicly traded companies and 63 percent of the Fortune 500, it has had a huge inventory of targets to choose from. The financial benefit to Delaware has been astounding with \$484 million in unclaimed property (its third-largest source of annual revenue) remittances forecast for its FY2013 alone.

Delaware's New Approach to the Holder Community

Delaware's reliance on private contract auditors that it pays a percentage of what they recover for Delaware has led to many instances of perceived overreaching and abuses by the auditors over the years (e.g., reopening "closed" audits to mine for missed unclaimed property). In recent years, several well-known Holders incorporated in Delaware who had experienced the contract audits first hand shared their aggravations with the Delaware Governor, with some even threatening to leave the state to reincorporate elsewhere.

¹ See "Unclaimed? Delaware Gets It", Wall Street Journal, January 29, 2013 at B7.

Delaware responded to its Holder critics in July, 2012 by creating a new Voluntary Disclosure program for unclaimed property. See Senate Bill 258 (2012). Additional modifications were made to the program by House Bill 2 signed into law by Governor Markel on January 30. At least on paper, and in the right circumstances, the new program has the potential to reduce substantially the typical noncompliant Holder’s liability compared to the liability that would be exacted from the Holder in a contract audit. Key differences between traditional Delaware audits and the new VDA terms include:

Terms	Traditional Audit	New Program
Look-Back Period:	Required review of books and records dating back to 1981.	Review dating back to 1996 (increased to 1993 if the Holder executes VDA-1 after June 30, 2013)
Review Period:	Audits can take up to 5 years to complete and many last longer than that.	The new VDA program is designed to be completed as quickly as 9 months after the kick-off meeting.
Interest and Penalties:	Substantial penalties and interest on past-due unclaimed property, subject to possible waiver at the discretion of Delaware Department of Finance/ State Escheator.	No interest and penalties asserted unless the Holder fails to reasonably adhere to the VDA work plan, in which case the Secretary of State has the discretion to assess interest.
Administering Delaware Official:	Department of Finance’s Unclaimed Property Director/ State Escheator	Delaware Secretary of State

Delaware’s New VDA Program Has Very Tight Deadlines and Sunsets Altogether in 2015

While the VDA terms are certainly generous compared to those of an audit, the VDA timeline that Holders must adhere to are very abbreviated compared to the pace of contract audits.

June 30, 2013: Holders must enroll by June 30, 2013, to get the benefit of the look-back period limited to only 1996 forward. That look-back period expands by another three years to 1993 forward for Holders not enrolled until after June 30, 2013 and no new Holders at all may enroll in the program after June 30, 2014.

June 30, 2015: By this date all Holders enrolled in the program regardless of when they enrolled must enter into a settlement agreement with Delaware and remit all past-due unclaimed property by this date. Thus, “early adopter” Holders who enrolled, say by 2012 year end, now have as long as two and a half years to conclude the VDA process. On the other hand, Holders who wait until the last possible date to enroll, June 30, 2014, will not only have a 3 year *longer* look-back period, but will have only one year to complete the process. Such tight deadlines to report and remit (2.5 years at best and 1 year at worst) are in stark contrast to the leisurely pace of traditional Delaware audits with a usual time to conclusion of 3 to 5

years. This brisk pace of play will require that a Holder be more efficient to meet the VDA's time constraints and may require that additional staff resources be deployed to keep up with the workload.

The original 2012 legislation gave Holders who enrolled by June 30, 2013 only until June 30, 2014 to report and remit, but HB 2 enacted in January extended that another year to June 30, 2015, a tacit acknowledgement by the state of the difficulty in wrapping up a settlement of this complexity within such tight deadlines.

June 30, 2015: The VDA program sunsets. All Holders who entered the program must have entered into an executed settlement agreement and remitted all past-due unclaimed property by this date.

Delaware Secretary of State, Not the State Escheator, Put in Charge of the new VDA Program

Delaware's decision to place the new VDA program under the jurisdiction of its Secretary of State, Jeffrey Bullock, is a subtle but clear indication that Delaware is using its new VDA program to project a "kinder, gentler" image to its Holder community. It is unprecedented because the Secretary of State has not until now had any authority for unclaimed property compliance. That responsibility had been the sole province of the Department of Finance and the State Escheator. The prior, less generous VDA program was administered by the State Escheator within the Department of Finance and the Escheator will continue to conduct the contract audit program.

Holders Under Delaware Audit Barred from VDA Enrollment

Holders currently under audit by Delaware or who received notice of audit before enrolling in the VDA program are barred from participating in the new VDA program. In 2012 the Delaware Department of Finance held off issuing new audit notices to Holders while the VDA program was being rolled out. That hiatus ended abruptly in early February 2013 with dozens of new audit notices issued to Holders by the State Escheator. State officials have indicated that Delaware will maintain its typical level of contract audit activity, so its private auditors are now incentivized to seek the issuance of audit notices in order to keep their inventory of audits at current levels. Obviously, interested Holders need enroll quickly in the VDA program before they receive notice of audit. Early indications are that more than 70 Holders are currently enrolled but Delaware expects as many as 500 Holders to apply before the application cutoff in 2014.

The original 2012 VDA legislation also barred Holders that had entered into VDA settlement with the State Escheator prior to June 12, 2012 from enrolling in the new VDA program. HB 2 sensibly modified this bar to permit such Holders to enroll in the new program as to any related parties of the Holder not included in the prior VDA or with respect to any property types and/or periods not covered in the prior VDA.

Conclusion

Delaware's new VDA program for qualifying Holders is unprecedented with automatic 100 percent waiver of penalties and interest and shortening the look-back period by 15 years, from 1981 to 1996.

However, it remains to be seen whether this new VDA program is in fact a legitimate path for fully and finally resolving outstanding unclaimed property obligations, or is instead a mechanism by which Delaware secures information to be used in a future audit – a criticism that has often been levied at Delaware’s prior VDA process. Also, Delaware has clearly adopted a “carrot and stick” policy towards noncompliant Holders by leaving its aggressive and grueling contract audit program intact and fully operational.

With Holders barred from the new VDA program if they first come under audit, Holders uncertain of their exposure should not delay assessing their situation and devise the best strategy for remediating any exposure, whether through participation in the new VDA process or through vigorous defense of any audit that may be on the horizon. Those Holders that do choose the VDA process need to commit sufficient resources and focus to cope with the program’s tight timelines.