IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF DELAWARE

TEMPLE-INLAND INC., Plaintiff, v. THOMAS COOK, in his capacity as the Secretary of Finance for the State of Delaware; DAVID M. GREGOR, in his capacity as the State Escheator of the State of Delaware; MICHELLE M. WHITAKER, in her capacity as the Abandoned Property Audit Manager for the State of Delaware; and KELMAR ASSOCIATES, LLC, Defendants.	)	C.A. No. _____

OPENING BRIEF IN SUPPORT OF PLAINTIFF TEMPLE INLAND, INC.'S MOTION FOR PRELIMINARY INJUNCTION

Dated: May 21, 2014

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I. NATURE AND STAGE OF PROCEEDINGS

On May 22, 2014, Plaintiff Temple-Inland Inc. ("Plaintiff") filed its Verified Complaint For Equitable, Declaratory, Injunctive And Other Relief against Defendants Thomas Cook, in his capacity as Delaware's Secretary of Finance (the "Secretary"), David M. Gregor, in his capacity as Delaware's State Escheator (the "State Escheator"), Michelle M. Whitaker, in her capacity as Delaware's Abandoned Property Audit Manager (the "Audit Manager," together with the Secretary and State Escheator, the "State Defendants"), and Kelmar Associates, LLC ("Kelmar," together with the State Defendants, "Defendants"). Plaintiff brings this action pursuant to 42 U.S.C. § 1983 to enjoin Defendants from depriving Plaintiff's rights under federal law and the U.S. Constitution and pursuant to 28 U.S.C. §§ 2201 and 2202 to seek a declaratory judgment and injunctive relief. Plaintiff has filed concurrently herewith a motion seeking a preliminary injunction enjoining Defendants from (1) enforcing their assessment against Plaintiff of purported unreported unclaimed property in the amount of $1,388,573.97 (the "Demand") and assessing interest and/or penalties and engaging in enforcement actions because the Demand violates federal common law and the U.S. Constitution, and (2) continuing to audit Plaintiff for property which, under federal law, Delaware is not authorized to claim even if it turned out to be unclaimed property.

II. SUMMARY OF ARGUMENT

As discussed more fully below, Plaintiff is entitled to a preliminary injunction.

1. Plaintiff is likely to succeed on the merits of its claims for the following reasons. First, the Demand violates the federal common law established in *Texas v. New Jersey*, 379 U.S. 674 (1965) and its progeny, which expressly preempts state law, because Defendants demand that Plaintiff pay an ***estimate*** of purported unreported unclaimed property interests which in fact were paid to other states, resulting in multiple liability. Second, Defendants violate Article I,

Clause 1 of the U. S. Constitution, which bars ex post facto laws, by retroactively enforcing an amendment to 12 *Del. C.* § 1155, thereby penalizing Plaintiff for pre-amendment conduct that was legal at the time. Third, even if Defendants could estimate unreported unclaimed property interests (which Plaintiff refutes), the methodology used resulted in violations of federal common law, the Due Process Clause, the Commerce Clause, the Full Faith and Credit Clause and the Takings Clause because it creates multiple liability, ignores other states' laws and interferes with commerce in those states, and requires Plaintiff to turn over to Delaware Plaintiff's own property without just compensation.

2. Absent a preliminary injunction, Plaintiff will be irreparably harmed because it will face interest and state enforcement action and Plaintiff will have no recourse because the Eleventh Amendment to the U.S. Constitution bars claims for damages against a state.

3. The harm to Plaintiff if a preliminary injunction is not entered will far exceed the harm to Defendants if Plaintiff's requested relief is granted, because Defendants have no interest in enforcement of conduct that violates the federal common law and is unconstitutional.

4. Preliminary injunctive relief will be in the public interest because the public interest is not served by enforcement of unconstitutional and illegal conduct.

III. STATEMENT OF FACTS

Plaintiff is a Delaware corporation that manufactures and sells corrugated packaging. (Verified Complaint ("Cmpl.") ¶ 8). The State Defendants are authorized to enforce the Delaware Escheat Law, Chapter 11, Subchapter IV, Title 12 of the Delaware Code and related regulations (the "Delaware Escheat Law"). (*Id.* ¶¶ 9-11). Kelmar is a contract auditor that provides auditing services for the State Defendants. (*Id*. ¶ 12).

"Unclaimed property" is property that has not been claimed by the owner for a period of 5 continuous years. 12 *Del. C.* § 1198(1); *Id.* § 1198(9)a. A "holder" of unclaimed property is

any person having "possession, custody or control of the property of another person," and an "owner" of unclaimed property is "any person holding or possessing property ***by virtue of title or ownership***." *Id.* § 1198(7) (emphasis added). Holders must report and pay to Delaware by March 1 of each year (for public use until the true owner reclaims it), property that is unclaimed as of December 31 of the prior year. *Id.* § 1199. The State Escheator may "examine the records of any person" to determine compliance with the Delaware Escheat Law. *Id.* § 1155.

In a letter dated December 22, 2008, the then State Escheator gave notice to Plaintiff of an unclaimed property audit. (Cmpl. ¶ 47). He stated that the audit period would extend back to 1981, notwithstanding his recognition that "I'm sure all records are being retained under standard retention policies" (*id.* ¶ 49), which would clearly not go back as far as 1981. After reviewing numerous accounts, Kelmar audited two of Plaintiff's bank accounts (one for accounts payable disbursements and one for payroll). Kelmar also reviewed accounts receivable credits. (*Id.* ¶ 50). Kelmar requested voluminous detailed disbursement records (*id.* ¶ 51), and Plaintiff produced the records it had, which dated back to 2003 for accounts payable disbursements and 2004 for payroll disbursements (*id*. ¶ 55). Plaintiff also produced its unclaimed property reports showing $1,338,116.70 escheated during the audit period to numerous states, including Delaware ($434,613.28 of payroll for the period 1986-2009 and $903,503.42 of unclaimed accounts payable checks for the period 1986-2007). (*Id.* ¶ 52). Kelmar examined Plaintiff's accounts payable disbursement records for the 5-year period 2003 through 2007 and did not find any unreported unclaimed property escheatable to Delaware. (*Id.* ¶ 54). Yet, Defendants demand an ***estimated*** liability for purported unreported unclaimed property to Delaware in that account for the period 1986 through 2002 in the amount of $1,176,767.77. (*Id.* ¶ 80). Similarly, Kelmar examined Plaintiff's payroll disbursements records for the 6-year period 2004 through 2009 and

identified only one check for $147.30 that was unclaimed property payable to Delaware, which Plaintiff escheated on May 22, 2013. (*Id.* ¶ 55). Yet, Defendants ***estimated*** unreported unclaimed property in that account for the seven-year period 1986 through 2003 in the amount of $952,066.36. (*Id.* ¶ 85). Plaintiff exhausted administrative remedies to appeal the assessments. (*Id*. ¶ 103). Pursuant to Delaware administrative process, an appointed local attorney (whose website describes him as a bankruptcy attorney) reviewed the calculation, and the Secretary adopted his recommendation to reduce the demand to $1,388,573.97 (the "Demand"). (*Id.* ¶¶ 106, 107).

The Demand results from extrapolations of (1) property that is not subject to escheat to Delaware (*id.* ¶ 78a-g), (2) property Plaintiff already escheated to other states (*id.* ¶¶ 78d), (3) property exempted from escheatment under a business-to-business exemption by states with a priority claim to such property under federal law (*id.* ¶¶78a), and (4) property returned to owners or not owed so it is not unclaimed property as a matter of law (*id.* ¶¶ 78c, 78e, 78f).

IV. ARGUMENT

A. The Legal Standard For Preliminary Injunctive Relief

Plaintiff seeks a preliminary injunction pursuant to Fed. R. Civ. Proc. 65(a), enjoining Defendants from: (1) enforcing the Demand and assessing interest and penalties; and (2) continuing its audit of Plaintiff because Defendants continue to examine property that is not subject to escheat to Delaware under federal law. A court considers four factors when determining whether to grant a preliminary injunction: "'(1) whether the movant has shown a reasonable probability of success on the merits; (2) whether the movant will be irreparably injured by denial of the relief; (3) whether granting preliminary relief will result in even greater harm to the nonmoving party; and (4) whether granting the preliminary relief will be in the

public interest.'" *New Jersey Retail Merchants Assoc. v. Sidamon-Eristoff*, 669 F.3d 374, 385 (3d Cir. 2012) (quoting *Crissman v. Dover Downs Entm't Inc.*, 239 F.3d 357, 364 (3d Cir. 2001)). As demonstrated below, Plaintiff has satisfied each of these requirements.

B. Plaintiff Has A Reasonable Probability Of Success On The Merits

A party seeking a preliminary injunction must demonstrate a "reasonable probability of eventual success in the litigation." *New Jersey Retail Merchants Ass'n*, 669 F.3d at 385; *Bennington Foods LLC v. St. Croix Renaissance Group, LLP*, 528 F.3d 176, 179 (3d Cir. 2008). "It is not necessary that the moving party's right to a final decision after trial be wholly without doubt." *Oburn v. Shapp*, 521 F.2d 142, 148 (3d Cir. 1975). "Moreover, on an application for preliminary injunction, the plaintiff need only prove a *prima facie* case, not a certainty that he or she will win." *Highmark, Inc. v. UPMC Health Plan, Inc.*, 276 F.3d 160, 173 (3d Cir. 2001).

1. The Demand violates federal common law because it estimated purported unclaimed property interests, rather than identifying them

The Supremacy Clause provides that "the Laws of the United States ... shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2. "It is undisputed that state law can be preempted by federal common law as well as federal statutes." *New Jersey Retail Merchants Ass'n,* 669 F.3d at 392 (citing *Boyle v. United Techs Corp.*, 487 U.S. 500, 518 (1988)) (enjoining an amendment to New Jersey's escheat law because it violated and was preempted by federal common law). The Demand is in clear violation of the common law established in *Texas v. New Jersey* and affirmed in, *Pennsylvania v. New York*, 407 U.S. 206 (1972) and *Delaware v. New York*, 507 U.S. 490 (1993).

The right of states as sovereigns to take custody of abandoned personal property has been clearly established. *See Delaware*, 507 U.S. at 497 (citing *Christianson v. King County*, 239

U.S. 356 (1915)). When the abandoned property is tangible, the State in which the property is located may claim the property by escheat. *Id*. at 498. However, intangible property "is not physical matter which can be located on a map," thus potentially giving rise to conflicting claims by different states. *Id.* To prevent multiple liability being imposed on holders, the U.S. Supreme Court established a set of "priority" rules to settle "the question of which State will be allowed to escheat intangible property." *Id.* (citing *Texas*, 379 U.S. at 677).

The priority rules require a three-step process: "First, we must determine the ***precise*** debtor-creditor relationship as defined by the law that creates the property at issue." *Delaware*, 507 U.S. at 499 (emphasis added). This step ensures that an obligation will be identified and escheated only once to one state. "Second, because the property interest in any debt belongs to the creditor rather than the debtor, the primary rule gives the first opportunity to escheat to the State of 'the creditor's last known address as shown by the debtor's books and records." *Id.* "Finally, if the primary rule fails because the debtor's records disclose no address for a creditor …, the secondary rule awards the right to escheat to the State in which the debtor is incorporated." *Id.*

Thus, the threshold step in any application of the priority rules is to identify the "precise" legal obligation that creates the property on a transaction-by-transaction basis. *See Delaware*, 507 U.S. at 509. This first step is critical because, "[u]nlike taxation, where a state holds direct authority to collect, retain, and spend ...[to] fund[] government operations, a statute's authority to receive and retain unclaimed property is derived from the owner's rights in that property and exists for the purpose of protecting those rights." *See* Houghton, *et al.*, *Unclaimed Property*, 74-2nd C.P.S. (BNA) at A-43. An owner possesses such property because of title and ownership, which is created by state law.

In *Delaware v. New York*, the unclaimed property consisted of dividends and shares issued by a corporation. The question was whether the debtor was (1) the corporation that issued the unclaimed distributions or (2) intermediaries (*e.g.,* brokers) in whose names and addresses the securities were registered on the corporation's books. If the corporation was the debtor, the state of the intermediaries' addresses could claim the unclaimed distributions by escheat under the primary rule. The records of the intermediaries lacked addresses for the beneficial owners of the distributions, so if the intermediaries were the debtors, the intermediaries' states of incorporation could claim the unclaimed property under the secondary rule. *See* 507 U.S. at 505.

Performing the first step in the escheat analysis, the Court looked to Article 8 of the Uniform Commercial Code which governs investment securities and provides that "payment to a record owner discharges all of an issuer's obligations." *Id.* at 504 (citing § 8-207(1) of the Uniform Commercial Code). Because the corporation had made the distributions to the intermediaries, the corporation's obligations were discharged. The Court held that "an intermediary serving as the record owner of securities is the 'debtor' insofar as the intermediary has a contractual duty to transmit distributions to the beneficial owner" and the "creditors [owners] are the parties to whom the intermediaries are contractually obligated to deliver unclaimed securities distributions." *Id.* at 508. Because the intermediaries lacked addresses for the beneficial shareholders, Delaware, the intermediaries' state of incorporation, could claim the property under the secondary rule. *Id.* This prevented multiple liability (*i.e.*, the rule prevented both Delaware from claiming the distributions from the intermediaries under the secondary rule and New York from claiming the distributions from the issuing corporation under the primary rule, because the intermediaries had New York addresses).

The Court stressed the importance of the first step in the three-step process:

> We have not relied on legal definitions of 'creditor' and 'debtor' merely for descriptive convenience. Rather, we have grounded the concepts of 'creditor' and 'debtor' in the positive law that gives rise to the property at issue. ***In framing a State's power of escheat***, we must first look to the law that creates property and binds persons to honor property rights.

Id. at 501 (emphasis added). Thus, as a threshold matter Defendants were required to identify the ***precise intangible property interests*** to establish the "State's power to escheat." *Id.*; *see also id.* at 503 ("Our rules regarding interstate disputes over competing escheat claims cannot be severed from the law that creates the underlying creditor-debtor relationships.").

Defendants cannot merely estimate the existence of property rights by extrapolation and bypass the first critical step in determining the "state's power of escheat" in the property. *Id.* The Supreme Court stated that, "[i]n *Texas* and *Pennsylvania,* our examination of the holder's legal obligations ***not only defined the escheatable property at issue*** but also ***carefully identified*** the relevant 'debtors' and 'creditors.'" *Id*. at 503 (emphasis added). Indeed, the Supreme Court rejected New York's proposal to use a statistical surrogate to estimate the amount of distributions that would have owners with addresses in New York because the intermediaries operated in New York and likely served customers with New York addresses. Noting that such an approach had previously been rejected, the Court stated: "New York may object to the cost and difficulty of culling creditor's last known addresses from brokers' records, but in *Pennsylvania* [*v. New York*], we expressly refused 'to vary the application of the [primary] rule ***according to the adequacy of the debtor's records***.'" *Delaware*, 507 U.S. at 509 (emphasis added) (quoting *Pennsylvania*, 407 U.S. at 215). The Court then admonished the states who sought to estimate because records were inadequate to identify the owners: "New York and other States could have anticipated and prevented some of the difficulties stemming from incomplete debtor records, for nothing in our

decisions 'prohibits the States from requiring [debtors] to keep adequate address records.'" *Id.* (quoting *Pennsylvania v. New York*, 407 U.S. at 215).[1]

Here, Defendants ignored the first step in the three-step escheat analysis and used statistical surrogates rather than Plaintiff's records in direct violation of federal common law. Defendants' unlawful methodology ensures that Delaware will take by escheat "property" that is not unclaimed by an owner who could reclaim it thereby seizing significant revenue for the state, because without estimation, Delaware typically claims very little unclaimed property under the primary rule. Indeed, here Kelmar found that Plaintiff had only $147.30 of unreported unclaimed payroll escheatable to Delaware in years 2003 through 2009 under the primary rule.

Plaintiff has a reasonable probability of success of proving Defendants violated federal common law by demanding payment of an estimate of unclaimed property interests.

2. Defendants violate the U.S. Constitution's ban on ex post facto laws by retroactively applying an amendment to the Delaware Escheat Law

When Plaintiff objected to an estimate of unreported unclaimed property, Defendants responded that their authority to estimate arises from 12 *Del. C.* § 1155, as a result of an amendment made by Senate Bill No. 272 ("S.B. 272") § 4. S.B. 272 § 4 amended § 1155 purportedly to permit the State Escheator to estimate a liability for unclaimed property reporting and payment "[w]here the records of the holder available for the periods subject to [examination] are insufficient to permit the preparation of a report." In that event,

[1] Although the Court was rejecting New York's attempt to use estimation for purposes of claiming property under the primary rule, the same rationale applies to Defendants' attempt to use estimation for purposes of identifying unclaimed intangible property and claiming it under the secondary rule. The purpose of the escheat laws is to reunite property with owners. Estimating an amount of unclaimed property that a debtor might have is not consistent with this purpose and makes it impossible to determine rights and obligations giving rise to the property. Indeed, to claim property in Delaware's custody under the Delaware Escheat law, an owner must provide proof of identity and documentation ***proving a legal right to claim the particular property***. *See* http://revenue.delaware.gov/unprop/unprop_search.shtml. An owner cannot prove that Delaware has custody of particular property where Delaware has merely seized a gross amount that is estimated.

> [T]he State Escheator may require the holder to report and pay to the State the amount of abandoned or unclaimed property that should have been but was not reported that the State Escheator reasonably estimates to be due and owing on the basis of any available records of the holder or by any other reasonable method of estimation.

12 *Del. C.* § 1155. However, to the extent § 1155 purports to permit the State Escheator to bypass the critical threshold step in the escheat analysis discussed in Part IV.B.1, *supra*, it violates and is preempted by federal common law.[2]

What the Delaware General Assembly actually did in amending § 1155 was to create a substantive document retention requirement and authorize a penalty for failure to comply. Only as a penalty for failure to keep records does § 1155's authorization to estimate not conflict with federal law. The State Defendants have admitted that § 1155 is based on § 20(f) of the 1995 Uniform Act, which is ***a penalty*** provision. Section 20(f) of the 1995 Uniform Unclaimed Property Act provides:

> If, after the effective date of this [Act], a holder does not maintain records as 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 other reasonable method of estimation, should have been but was not reported.

Section 21 of the 1995 Uniform Act requires holders to retain certain records for 10 years. In a comment to § 20(f) of the 1995 Uniform Act, the National Conference of Commissioners on Uniform State Laws ("NCCUSL") made clear that § 20(f) was a penalty provision and was not

[2] Delaware "may object to the cost and difficulty of culling creditor's last known addresses from [Plaintiff's] records, but in *Pennsylvania*, [the Supreme Court] expressly refused 'to vary the application of the [priority] rule[s] according to the adequacy of the debtor's records.'" *Delaware*, 507 U.S. at 509. As the Supreme Court noted, "[i]f the States are dissatisfied with the outcome of a particular case, they may air their grievances before Congress." *Id.* at 510 (internal citations omitted) (citing *Texas*, 379 U.S. at 679 and *Pennsylvania*, 407 U.S. at 215).

authority to bypass the Supreme Court priority rules, the purpose of which was to avoid imposing multiple liability on holders:

> Subsection (f) permits the use of estimates in instances where the holder has failed to report and deliver property that is abandoned and no longer has reasonably accessible records sufficient to prepare a specific report. ...While the holding in *Texas v. New Jersey* is intended to prevent multiple liabilities of holders, this subsection, ***viewed as a penalty*** for failure to maintain records of names and last known address, is not inconsistent with that decision.

See Uniform Unclaimed Property Act § 20(f) cmt. (1995) (emphasis added). Apparently recognizing the due process issues that would arise from retroactive enforcement of § 20(f), the NCCUSL emphasized "[t]hat part of subsection (f) which permits the State to make estimates was prospective only from the date of adoption." *Id.*

Similarly, while other remedial sections of S.B. No. 272 were expressly applicable to uncompleted audits (*i.e.*, retroactively), the estimation penalty provision in § 4 was not and was effective only prospectively upon enactment. *See* S.B. No. 272 §13(a)-(c).

S.B. 272 § 4 created a substantive new document retention requirement and authorized the State Escheator to enforce it by imposing an estimation penalty on holders that fail to comply. By applying S.B. 272 § 4 retroactively here, Defendants violate Plaintiff's right to substantive due process and Article I, Clause 1 of the U.S. Constitution (barring states from enacting ex post facto laws) because it would require that Plaintiff pay a penalty for failure to maintain records in periods prior to 2010 when, at the time, there was no such obligation and Plaintiff had no notice it was required to do so or face significant penalties.

Moreover, Delaware has a presumption against retroactive application of laws. "The presumption against retroactivity ensures that, absent a clear expression of intent by the General Assembly, citizens are not, for example, told in 2005 that what they did in 2004 is now a

violation of civil law, even though it was perfectly legal at the time …." *State v. Pettinaro Enterprises*, 870 A.2d 513, 529 (Del. Ch. 2005). Until enactment of S.B. No. 272 in July 2010, the State Escheator was authorized only to "examine the records of any person," 12 *Del. C.* § 1155, he/she had no authority to penalize those persons for failing to have records for a 30- year audit period. Indeed, because the State Escheator is required to conduct examinations "as soon as is practicable after receipt of any report," 12 *Del. C.* § 1158, and "upon reasonable notice," 12 *Del. C.* § 1155, Delaware corporate citizens, including Plaintiff, had no notice in 1986-2003 that Defendants would wait as many as 30 years to begin examining records for unclaimed property reporting compliance and would be penalized for failing to keep records for that period. Plaintiff has a likelihood of success on the merits of its claims.

3. Even if estimation was permissible (which Plaintiff refutes), Defendants' methodology results in violations of federal common law, the Full Faith and Credit Clause, the Commerce Clause and the Takings Clause of the U.S. Constitution

Even if Defendants could estimate purported unreported unclaimed property, the manner in which Defendants estimated the Demand violates the federal common law, the Full Faith and Credit Clause and the Commerce Clause. For example, Defendants extrapolated one check issued in 2007 payable to a Tennessee vendor in the amount of $1,312.72 to estimate unreported unclaimed property escheatable to Delaware for ***each*** of the sixteen years from 1986 through 2002. (Cmpl. ¶ 78a). However, in Tennessee (whose law governs the check under the priority rules), property arising from a business-to-business transaction is not presumed abandoned while the debtor and creditor have an ongoing relationship. (*Id.*). Plaintiff proved that it did business with the vendor in June 2012 and, therefore, that item was not reportable as unclaimed property. Nevertheless, Defendants extrapolated that $1,312.72 check to estimate unreported unclaimed property escheatable ***to Delaware*** in each year from 1986 through 2002 and assessed Plaintiff

$101,463.27. (*Id.*). In addition to violating the priority rules, this treatment interferes with commerce in Tennessee in violation of the Commerce Clause and gives no effect to the business friendly Tennessee law in violation of the Full Faith and Credit Clause.

Defendants also extrapolated a liability to Delaware based on a check issued in 2006 in the amount of $3,050.49 made payable to a person located in Amite, Louisiana. (*Id.* ¶ 78b). The check was voided because it was written to the payee in error. (*Id.*). Plaintiff owed no obligation to the payee under state law. Defendants nevertheless extrapolated it for the period 1986 through 2002 and assessed a liability payable to Delaware in the amount of $144,028.97 based on this $3,050.49 check. (*Id.*). This required Plaintiff to escheat to Delaware an obligation that it did not owe.[3]

Defendants also extrapolated a liability to Delaware based on four accounts payable checks issued in 2006 and 2007 in the total amount of $4,335.19 which were payable to payees with addresses in other states. (*Id.* ¶ 78c). The checks were voided and reissued, and the reissued checks cleared the bank before the dormancy period expired; thus, these items are not unclaimed property. Defendants violate federal common law, due process and the Takings Clause by estimating a liability for unreported unclaimed property to Delaware for the period 1986-2002 in the amount of $237,339.18 based on these four checks. The Demand requires Plaintiff to pay these obligations both to the payees ***and*** Delaware, thereby resulting in multiple liability.

[3] The Demand also violates the Takings Clause because it requires Plaintiff to escheat its own property (because no intangible unclaimed property exists). The Takings Clause of the Fifth Amendment to the U.S. Constitution provides that private property shall not "be taken for public use, without just compensation." *See* U.S. Const. amend. V. By seeking to take what effectively is Plaintiff's own property without just compensation, the Demand violates the Takings Clause.

Defendants did the same thing in the payroll account by extrapolating three checks totaling $8,355.94 issued in 2006 and 2008 that were voided and reissued to the payees with addresses in other states. (*Id.* ¶ 78f). Defendants created multiple liability by improperly assessing $174,223.29 for the period 1986 through 2003 payable to Delaware based on these three checks.

Further, Defendants extrapolated a liability for unreported unclaimed property to Delaware based on a $100 check that Plaintiff issued in 2006 to a payee with a Texas address. (*Id.* ¶ 78d). However, because the payee did not cash the check, Plaintiff escheated the $100 to Texas in 2010. Extrapolation of this item resulted in multiple liability. First, Defendants placed this check in the category of "uncashed checks" and extrapolated a liability payable to Delaware for each year 1986 through 2002 based on it. Then, Defendants extrapolated this check a second time under a separate category of "prior filed items." This double counting occurred because Defendants did not comply with the threshold step of a priority rule analysis — they failed to identify the precise obligation under state law.

Defendants also extrapolated a liability for unreported unclaimed payroll escheatable to Delaware based on a check issued in 2006 that was erroneously issued to an employee with an address in Arizona for vacation pay that already had been paid in the amount of $619.60. (*Id.* ¶ 78e). Defendants nevertheless used the voided check as evidence of unclaimed property and extrapolated a liability owed to Delaware for the period 1986 through 2002 in the amount of $87,386.75. Plaintiff thus is required to pay both the employee and Delaware.

Defendants originally extrapolated a liability for unreported unclaimed property payable to Delaware based on a check in the amount of $1,641.50 that was escheated in 2011 to Arizona because the employee had an Arizona address. (*Id.* ¶ 78g). This is another example of how

Defendants' failure to satisfy the threshold step in the priority rule analysis resulted in multiple liability. First, Defendants extrapolated it under the category of unclaimed payroll, because the original check was issued out of the payroll disbursements account. But the check was voided and reissued out of the accounts payable disbursements account. So, Defendants extrapolated this check ***again*** under the category of unclaimed accounts payable obligations. Defendants extrapolated a liability payable to Delaware of $95,090.73 based on this $1,641.50 check.

The Supreme Court required the threshold step of identifying and defining the obligation under state law to prevent the type of multiple liability that estimation creates. Unclaimed property is not a tax; there is no statutory rate to multiply by revenues (or another benchmark) that can identify unclaimed property interests. Rather, the double entry system of accounting ensures that when an entity enters into a transaction giving rise to an obligation, the entity's books and records will record those obligations. Only by examining books and records can the State Escheator identify unsatisfied obligations that are potentially subject to escheat.

As the foregoing examples demonstrate, Defendants' estimation methodology necessarily results in multiple liability in violation of federal law and the U.S. Constitution.

4. Defendants' Demand violates the Full Faith and Credit Clause of the U.S. Constitution

By bypassing the first step of federal priority rules, the Demand contravenes the Full Faith and Credit Clause in Article IV § 1 of the U.S. Constitution. The Full Faith and Credit Clause provides that "full faith and credit shall be given in each state to the public acts, records, and judicial proceedings of every other state." *See* U.S. Const. art. IV § 1. The Full Faith and Credit Clause expresses "a unifying principle … looking toward maximum enforcement in each state of the obligations or rights created or recognized by the statutes of sister states," *id.,* and "preserve[s] rights acquired or confirmed under the public acts and judicial proceedings of one

state, by requiring recognition of their validity in others." *Pink v. A.A.A. Highway Exp., Inc.*, 314 U.S. 201, 246 (1941). The priority rules prevent violations of the Full Faith and Credit Clause.

In *New Jersey Retail Merchants Association,* the U.S. Court of Appeals for the Third Circuit granted a preliminary injunction against enforcement of an amendment to the New Jersey unclaimed property law that sought to escheat to New Jersey unredeemed gift cards issued by holders incorporated in other states. Because the holders' records lacked addresses of the owners, the holders' states of incorporation could claim the unredeemed gift cards under the secondary rule. Some of those states exempted unredeemed gift cards from escheat, so the New Jersey law effectively overrode those states' laws by claiming escheat of the property. 669 F.3d at 395. The Third Circuit, in upholding the preliminary injunction enjoining New Jersey from claiming the unredeemed gift cards by escheat, recognized that "[t]he Supreme Court has long recognized that the sovereign maintains authority over abandoned property, including the right to escheat the property." *Id.* Further, "[t]he ability to escheat necessarily entails the ability not to escheat. To say otherwise could force a state to escheat against its will, leading to a result inconsistent with the basic principle of sovereignty." *Id*. "[T]he Supreme Court 'detect[ed] no inequity in rewarding a State whose laws prove[d] more attractive to firms that wish to incorporate.'" *Id.* (quoting *Delaware*, 507 U.S. at 507). "When fashioning the priority rules, the Supreme Court did not intend [to] … give states the right to override other states' sovereign decisions regarding the exercise of custodial escheat." *Id*.

Because the Demand overrides business-to-business exemptions in other states, it violates the Full Faith and Credit Clause of the U.S. Constitution.

5. The Demand violates the Commerce Clause of the U.S. Constitution

The Commerce Clause grants Congress the power "to regulate Commerce … among the several States." *See* U.S. Const. art. I, § 8 cl. 3. An implied requirement in the Commerce

Clause, referred to as the "negative" or "dormant" Commerce Clause, is that states may not adopt laws and regulations that adversely affect interstate commerce, even where a federal statute does not preempt such state laws. The "'Commerce Clause … precludes the application of a state statute to commerce that takes place wholly outside the State's borders, whether or not the commerce has effects within the State.'" *Healy v. Beer Institute*, 491 U.S. 324, 336 (1989) (quoting *Edgar v. MITE Corp.*, 457 U.S. 624, 642-43 (1982) (plurality opinion)). "Generally speaking, the Commerce Clause protects against inconsistent legislation arising from the projection of one state regulatory regime into the jurisdiction of another State." *Id*. at 336-37.

Here, for the same reasons the Demand violates the Full Faith and Credit Clause, the Demand has the "practical effect of requiring out-of-state commerce to be conducted at [Delaware's] direction" in violation of the Commerce Clause. *See Am. Booksellers Found. v. Dean*, 342 F.3d 96, 102 (2d Cir. 2003); *Healy*, 491 U.S. at 336. By claiming property by escheat arising in transactions in and governed by other states, Defendants effectively regulate business-to-business transactions in those other states in violation of the Commerce Clause.

C. PLAINTIFF HAS ESTABLISHED THAT IT WILL BE IRREPARABLY HARMED IF PRELIMINARY INJUNCTIVE RELIEF IS NOT GRANTED

A preliminary injunction is proper if Plaintiff can prove that there is a serious risk that it will suffer actual, immediate irreparable injury absent such relief. "The irreparable harm requirement is met if a plaintiff demonstrates a significant risk that he or she will experience harm that cannot adequately be compensated after the fact by monetary damages." *Adams v. Freedom Forge Corp*., 204 F.3d 475, 485-86 (3d. Cir. 2000).

Plaintiff has established irreparable harm where, as here, Plaintiff "must either face prosecution and fines for noncompliance or turn over, in cash," the amount of the Demand. *See New Jersey Retail Merchants Ass'n,* 669 F.3d at 388. In *New Jersey Retail Merchants*

Association, the Third Circuit affirmed a preliminary injunction enjoining enforcement of an amendment to New Jersey's escheat law, finding that the plaintiff retailers would be irreparably harmed because the retailers would have to turn over, in cash, the amount of unredeemed gift cards or face fines and prosecution for noncompliance. *Id*. The Third Circuit stated that the retailers could not receive a refund of those funds if the unclaimed property law was later found to be unconstitutional, due to state sovereign immunity. *Id*. (citing *Edelman v. Jordan*, 415 U.S. 651, 663 (1974)) ("[S]uit by private parties seeking to impose a liability which must be paid from public funds in the state treasury is barred by the Eleventh amendment").

Here, Plaintiff faces potential enforcement action by the State Escheator if Plaintiff fails to make payment by May 23, 2014, and Defendants and the State of Delaware would be immune from any suit for damages for funds improperly paid by Plaintiff, even if later found to be invalid or unconstitutional. Therefore, Plaintiff would not be able to recover funds paid to Defendants and would be irreparably harmed. *See generally A.W. Fin. Services, S.A. v. Empire Res., Inc.*, 981 A.2d 1114 (Del. 2009) (holding that an amendment to the Delaware Escheat Law could not be applied retroactively and stating that, if the holder turned the property over to the State Escheator, the holder would be barred from recovering the property "from the State under sovereign immunity.").

Further, the State Escheator continues to audit Plaintiff, interfering with its normal business operations by requesting voluminous documents, primarily documenting obligations of creditors with addresses in other states. Defendants are requiring Plaintiff to prove that property is not unclaimed property, even though Delaware cannot claim that property under the priority rules even it if is unclaimed property. Defendants have asked Plaintiff to prove that hundreds of such transactions did not result in accounts receivable credits. Defendants should be barred from

enforcing the Demand and/or assessing interest and penalties, and continuing to abuse their subpoena power to demand more documents and information from Plaintiff, until a resolution can be made on the merits of Plaintiff's claims.

D. A BALANCING OF THE HARMS FAVORS GRANTING A PRELIMINARY INJUNCTION

Weighing the balancing of the harms of the parties clearly favors Plaintiff. Defendants will not be harmed by the granting of a preliminary injunction because Plaintiff merely seeks to maintain the status quo until a decision on the merits can be made. "The purpose of a preliminary injunction is merely to preserve the relative positions of the parties until a trial on the merits can be held." *Southco, Inc. v. Kanebridge Corp*., 324 F.3d 190, 195 (2003*), rev'd en banc on other grounds*, 390 F.3d 276 (3d Cir. 2004) (citation omitted). In *New Jersey Retail Merchants Association*, the Third Circuit found that a balance of the harms favored granting the retailer plaintiffs preliminary injunctive relief to preserve the status quo until the validity of the New Jersey escheat law could be decided on the merits. The court stated that "[g]ranting the preliminary injunction would not result in a greater harm to the State because the State 'does not have an interest in the enforcement of an unconstitutional law[.]'" 669 F.3d at 388-89. Similarly here, Defendants do not have an interest in enforcement of conduct that violates federal common law and is unconstitutional. Thus, preliminary injunctive relief should be granted.

E. PRELIMINARY INJUNCTIVE RELIEF IS IN THE PUBLIC INTEREST

Finally, a preliminary injunction is properly granted where, as here, the requested relief is in the public interest. *Id.* at 389. Here, it is clearly in the public interest to maintain the status quo pending a decision on the merits of the litigation. In *New Jersey Retail Merchants Association,* the Third Circuit affirmed entry of preliminary injunctive relief under similar circumstances, stating that "granting preliminary injunction would be in the public's interest

...because 'the public interest [is] not served by the enforcement of an unconstitutional law.'" *Id.* (citing *Am. Civil Liberties Union v. Ashcroft,* 322 F.3d 240, 247 (3d Cir. 2003)). The same circumstance applies here. Therefore, preliminary injunctive relief should be granted.

V. CONCLUSION

For all of the foregoing reasons, Plaintiff respectfully requests that this Court enter a preliminary injunctive enjoining Defendants from: (1) enforcing the Demand and/or assessing interest and penalties; and (2) continuing to conduct an audit of Plaintiff's compliance with the Delaware Escheat Law, until a decision on the merits of Plaintiff's claims.

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Respectfully submitted,

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