Mich. Unclaimed Property Rulings Offer Hope For Auditees

By **Sara Lima, Georgios Tsoflias and Chandler Schalhoub** (February 23, 2022, 3:07 PM EST)

Sara Lima

Georgios Tsoflias

Chandler Schalhoub

In The Walt Disney Co. v. Rachael Eubanks and Dine Brands Global Inc. v. Rachael Eubanks, the Oakland Circuit Court in Michigan recently held that commencing an unclaimed property audit does not toll the state's time limit to demand unclaimed funds.[1]

Thus, as unclaimed property audits drag on, collectible years are expiring for the Michigan treasurer, and perhaps for other states. The decisions offer a glimmer of relief from burdensome, lengthy unclaimed property audits.

Generally, unclaimed property examinations are conducted by third-party audit firms that states hire either on a contingent-fee or billable basis. These firms often conduct their examinations of the subject entity, known as the holder, on behalf of dozens of states at a time — and thus may garner both billable and contingent fees from a single audit.

Unclaimed property examinations often have look-back periods of up to 15 years. In light of the number of states involved in the audit and the long look-back period, audits are exceptionally broad, tedious and time-consuming for the holder.

In Disney, the state of Michigan initiated its unclaimed property examination in 2013. The third-party firm conducting the examination of Disney on Michigan's behalf was Kelmar Associates LLC.

In 2020, Kelmar sent Disney lists of accounts payable and payroll checks, which were issued between 2002 and 2014, that Kelmar and Michigan determined were unclaimed property. Disney challenged this determination and raised the expiration of the statute of limitations period as a defense.

Michigan's law, modeled on Section 30 of the Uniform Unclaimed Property Act, limits the time during which the treasurer can bring "any unclaimed property action or proceeding regarding any duty of a holder" to no more than 10 years after the duty arose or five years for transactions between commercial entities.[2]

Upon Michigan's rejection of its defense, Disney filed an action in Michigan circuit court seeking declaratory judgment that the applicable statute of limitations bars Michigan from requiring Disney to remit payments amounting to nearly the total amount at issue in the case.

The facts were similar in Dine Brands. Both Disney and Dine Brands filed motions for summary disposition.

Both Disney and Dine Brands argued that a claim for unreported amounts discovered during an audit is a separate action or proceeding to the initiation of the audit itself. For that reason, the treasurer could not compel payment of transactions outside the 10- or five-year look-back period, even if the audit had continued for several years. In other words, years may roll off during an audit.

By contrast, the treasurer argued that merely by noticing the companies of the audit, it had commenced an action or proceeding, such that any findings of the audit were within the limitations period.

The treasurer claimed that the statute of limitations does not preclude collection of amounts pursuant to that audit, at any time, and that the examinations' length was directly due to the holders' delay in responding to various document requests made by Kelmar.

In other words, the treasurer implied that the state can audit for as long as it sees fit and require a holder to defend an action for unreported amounts even after that period.

The argument is not unfamiliar to companies defending multistate unclaimed property audits.

Unclaimed property audit firms conduct standardized, forensic, transaction-level reviews of decades of records. They often do not limit the particular legal entities under audit, instead noticing all affiliates and subsidiaries of a target company.

They request documentation regarding practices and procedures, systems changes and preacquisition records of merged entities. They require the company to research individual payments and credits from prior decades.[3]

They require officer-level certifications regarding the availability of historic information[4] and make demands for large-scale productions of personally identifiable details of employees, customers, account holders and shareholders, triggering required legal oversight of compliance with privacy obligations.[5]

And auditors routinely roll forward audit periods, so the audits will include years after the audit was initiated. In short, the breadth of auditors' typical requests leads to lengthy and burdensome audits that can take five, six, seven, or more years.[6]

Like the Michigan treasurer, states traditionally take the position that the duration of unclaimed property audits rests entirely on the holder's rate of response to the audit firm's standardized requests. However, in the Disney and Dine Brands cases, the court placed responsibility with the state to move audits forward in a reasonable amount of time.

The court agreed with the companies' legal interpretation of the state's obligation, finding that commencement of the audit or examination does not constitute commencement of the action or proceeding for purposes of tolling the limitation period under Michigan Compiled Laws Section 567.250(2).[7]

Throughout the statute, the Legislature explicitly referenced an "examination" when discussing an audit. Thus, the court found, the failure of the Legislature to reference that term in Section 567.250(2) indicates that the state's ability to bring an "action or proceeding" to enforce a finding is distinct from the audit or examination.

The court also pointed to Delaware's express tolling provision for audits, noting that

the Michigan Legislature did not make a similar change.

The court also was not persuaded by the treasurer's summary allegations as to the holder's delay in the audit. In declining to engage with those allegations, the decisions make clear that the treasurer bears at least some responsibility for ensuring expeditious audits.

The law reflects a balance between the auditors' process and the costs of maintaining large volumes of sensitive personal data for years beyond standard record retention expectations. The court noted its concern about unchecked audit requests, stating, "An interpretation … that places holders in indefinite jeopardy of having to defend themselves in an action, and requiring them to maintain documents in perpetuity, is untenable."[8]

In short, the court's decisions imply that while Michigan may choose to participate in broad, multistate unclaimed property audits, it cannot expect companies to maintain the voluminous and detailed records that such audits may require for an undefined period of time.

The conclusion is consistent with the purpose of the limitations period in the first instance, to provide some measure of relief against interminable examinations by imposing "a cut off date on which [a holder] can rely."[9] While Michigan can conduct lengthy examinations, its enforcement rights will not last forever.

Notably, Michigan is not the only state to have enacted this provision of the 1981 and 2016 model unclaimed property acts. Several other states, such as Florida, South Carolina, Tennessee and others, have the same or similar statutory limitations periods.[10]

In interpreting this provision, these court decisions hold that notice of an audit does not stop the clock in favor of the states for statute of limitations purposes. While enforcement can reach back to transactions which, in some cases, like in Michigan, may be 13 years old, once the limitations period expires, any custodial claims the state may have had are gone.

In light of similarities between Michigan's statute of limitations provisions and provisions enacted by several other states, holders subject to examinations in those states should consider challenging demands for any transactions that fall outside those periods.

The decisions mean that the period should be calculated by reference to the current date, and not the date the state issued the audit notice. This is true even though the audit has been ongoing for several years. Where amounts are material, holders also should consider whether other issues would impact the putative liability, such as the aging criteria the auditor applied and whether proof that the holder provided to the auditor has been rejected.

The Michigan Circuit Court's holdings — while not binding on sister states and currently on appeal — are persuasive authority that cast doubt on presumptions that auditors have applied routinely.

At the very least, there is growing support that a state may not prolong an audit with unnecessarily detailed review with no consequence.

Holders should ensure that any audit findings issued by Michigan, or any state with a similar limitations provision, are consistent with the court's holding.

Sara A. Lima is a partner, and Georgios I. Tsoflias and Chandler N. Schalhoub are associates, at Reed Smith LLP.

[1] See The Walt Disney Company v. Rachael Eubanks, No. 2021-189464-CZ, slip op. (Mich. Cir. Ct. Jan. 24, 2022), and Dine Brands Global, Inc. v. Rachael Eubanks, No. 2021-189420-CZ, slip op. (Mich. Cir. Ct. Jan. 24, 2022).

[2] MCL 567.250(2).

[3] See e.g., Siemens United States Holdings Inc. v. Geisenberger, No. 20-2991, 2021 U.S. App. LEXIS 32865 (3rd Cir. 2021).

[4] 104 Del. Admin. Code § 2.18.2.3.

[5] See e.g., Torsella v. PPL Corp., 272 M.D. 2019 (Pa. Comm. 2021).

[6] See, e.g., Temple-Inland v. Cook, 192 F.Supp.3d 527 (D. Del. 2016).

[7] MCL 567.250(2).

[8] Disney, at 14.

[9] Comment to Uniform Unclaimed Property Act of 1981, § 29(b).

[10] See Fla. Stat. § 717.129 (2), S.C. Code Ann. § 27-18-300 (B), Tenn. Code Ann. § 66-29-140 (b).