



MEMORANDUM

TO: Drafting Committee to Revise the Uniform Unclaimed Property Act, Uniform Law Commission

FROM: Uniform Unclaimed Property Act Revision Committee, National Association of Unclaimed Property Administrators

RE: Utilizing Estimation and Statistical Sampling When Records are Not Available

DATE: May 9, 2014

Introduction

For more than 30 years, the Uniform Law Commission has recognized the necessity for estimation when an unclaimed property holder has failed to maintain the necessary records.¹ In explaining the Commission's rationale, the Commissioners' Comment to § 30(e) provided further guidance on the use of estimation in a manner consistent with Supreme Court jurisprudence:

[Subsection 30(e)] does not resolve the issue of whether the domiciliary state of the holder can also claim the property from the holder. While the holding in *Texas v. New Jersey* is intended to prevent multiple liability 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.

Based on this comment, the Commissioners considered a dual purpose for estimation. One purpose, where the holder has failed to maintain records consistent with a state's unclaimed property statute, is to utilize an estimate as a "penalty". The second purpose is the consistent application of the Supreme Court priority rules.² As no name and address information is available, the estimate of unclaimed property is subject to the "second priority rule."³

¹ See 1981 Uniform Unclaimed Property Act §30(e). "If a holder fails after the effective date of this Act to maintain the records required by Section 31 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 such amounts as may reasonably be estimated from any available records."

² *Texas v. New Jersey*, 379 U.S. 674 (1965). Also, *Pennsylvania v. New York*, 407 U.S. 206 (1972) & *Delaware v. New York*, 507 U.S. 490 (1993).

³ *Texas v. New Jersey*, 379 U.S. at 682.

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With the drafting of the 1995 Uniform Unclaimed Property Act, the Uniform Law Commission not only retained the use of estimation but expanded what information could be used in estimation from only the holder's available records to also include "any other reasonable method of estimation."⁴

Public policy behind estimation:

As clearly recognized by the Commissioners in both the 1981 and 1995 Uniform Unclaimed Property Acts, estimation is used when a holder fails to maintain the necessary records. This principle is consistent with the consumer protection goal to return property to the rightful owner and also acknowledges that the absence of records does not equate to the absence of an unclaimed property liability.⁵

In applying estimation to determine a holder's unclaimed property liability, the state requires the holder to bear the consequences of failing to comply with the legal requirement to maintain records. This policy has been uniformly upheld by the courts. For instance, in Employers Insurance of Wasau, the plaintiffs had argued that "requiring them to make the report is, in itself, burdensome and unworkable, given the scanty nature of their files." The court ruled that for states to "relieve companies of the requirement because their records are scanty. . . . would defeat the purpose of the statute: any company with bad records could legally avoid its statutory obligation—a result which. . . unfairly rewards the haphazard and penalizes the meticulous." *Employers Insurance of Wasau, et al. v. Charles Smith*, No. 86 CV 2283, at 14 (Dane County, WI Cir. 1986).

Similarly, In *Pentzer Corp. v. Textron Financial Corp.*, (No. 1:00-CV-03431 (N.D. Ill. (E. Div.) Apr. 10, 2001)) a federal District Court, applying Oregon's unclaimed property law, ruled that a state may reasonably estimate a holder's unclaimed property liability when the holder fails to maintain adequate records. The court held that "[a]ny confusion in determining the exact amount of unapplied proceeds taken as income by [the factor] is a direct result of [the factor's] failure to understand that it was bound by the Uniform Unclaimed Property Act and obligated to keep its records and hold the unclaimed property accordingly." (p.19).

And In *State v. Chubb Corp.*, 239 N.J. Super. 257, 259, 570 A.2d 1313, 1314 (1989), the court stated that implicit in the duty to report "is the obligation to maintain the records necessary to prepare an accurate report." In ruling on a motion for summary judgment, the court held that the

⁴ See 1995 Uniform Unclaimed Property Act § 20(f). "If, after the effective date of this [Act], a holder does not maintain the records 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 not reported."

⁵ "[T]he property interest in any debt belongs to the creditor rather than the debtor..." *Delaware v. New York*, 507 U.S. 490, 499 (1993). See also *Id.* at 403, quoting *Texas v. New Jersey*, 379 U.S. 674, 680 (1965). "Reasoning that 'debts owed by' a holder of unclaimed funds 'are not property to it, but rather a liability,' [the Supreme Court] concluded that 'it would be strange to convert a liability into an asset when the State decides to escheat.'"

state could prove its claim by estimation if the evidence offered is sufficiently reliable and the expert witness who is making the estimation has sufficient expertise to offer an opinion regarding the amount owing.²

Similarly, legislatures have viewed estimation by unclaimed property programs as “an accepted and routine practice used both by holders of abandoned and unclaimed property and by the [administrator] in determining holders’ liability to report and pay such property to the State with respect to periods for which inadequate holder records exist.”⁶ While the 1995 Uniform Unclaimed Property Act allows for any reasonable method of estimation,⁷ typically the holder’s own records are utilized to prepare the estimate for years where the holder did not retain records. There are two options to preparing a historical estimate based on the holder’s records. One method is to utilize the entire population by requiring the holder to determine the disposition of every obligation to calculate the estimate. The more common agreed upon approach between the state and the holder is to utilize a statistical sample of the population to determine the estimated liability. Sampling is used across many industries and in many facets. Also, sampling has been recognized by the courts for many years.⁸ In fact, for more than 50 years states have utilized estimation and sampling to determine various liabilities payable to the state.⁹

As estimation and sampling is clearly a recognized practice in unclaimed property, the question remains about how to prepare the sample. Below please find an example of how the estimation is typically prepared and the rationales for ensuring that the estimate is both reasonable and reflective of the holder’s prior business practices. In other words, the estimate is prepared by utilizing today’s records and applying the holder’s business rules from yesterday.

Example of Sampling and Estimation:

⁶ DE SB 272 (2010); adopted as The General Assembly finds
DECEDENTS’ ESTATES AND FIDUCIARY RELATIONS--ESCHEATS, 2010 Delaware Laws Ch. 417 (S.B. 272)

⁷ Commissioner’s Comment to the 1995 Uniform Unclaimed Property Act (“[T]he State may use estimating techniques – where a holder has not maintained records as required by statute – based on industry averages, and may rely on inferences that may be based on statistics drawn from a broader basis than that of the holder in question who has failed to keep records.)

⁸ *Muller v. Eno*, 14 N.Y. 597 (1856). (Where New York Court of Appeals reversed the trial court which had instructed the jury that it could not infer that all of the cotton bales that plaintiff bought from defendants were damaged based on the plaintiff’s testimony that he only inspected several of the bales and found such damage.) See also *Rosado v. Wyman*, 322 F. Supp. 1173, 1180 (E.D.N.Y. 1970). (“Sampling has long been considered an acceptable method of determining the characteristics of a large universe... Such mathematical and statistical methods are well recognized by the courts as reliable and acceptable in determining adjudicative facts) *aff’d*, 437 F.2d 619 (2d Cir. 1970).

⁹ *Hamilton v. United States*, 309 F. Supp. 468 (S.D.N.Y. 1969) *aff’d*, 429 F.2d 427 (2d Cir. 1970) (assessment of wagering in use taxes based upon samples of volume of taxpayer’s wagering activity); Wilham K. and Phyllis E. Coors, et al., 60 T.C. 368 (1973), *aff’d* in *Adolph Coors Co. v. I.R.S.*, 519 F.2d 1280 (10th Cir. 1974).

A holder is currently subject to an unclaimed property examination by several states including the state of incorporation. Per the state of incorporation's record retention statute¹⁰, the review of records will include past due property for the transaction years 2000 to 2010. Although statutorily required, the holder does not possess records for years prior to 2005.

Assume that the property subject to the multi-state review is obligations to owners which are evidenced by a check disbursement. The first question that often arises is whether the holder's records should be used for years where the property is not yet dormant. In this case, the standard approach is for the state to use any records that the holder has available which may include records for years where the property is not yet dormant. Non-dormant records are used because they are readily available, holders can more readily research whether the check is truly an outstanding obligation and in some instances, holders do not have many records for years where the property would be dormant in all states. For this last point, it is also important to remember that states have different dormancy periods which could drastically impact the sample selection process.

Now assume 5,000 disbursement checks represent the population subject to review for the years 2005 to 2010 where the holder has retained the records. In order to determine a liability for the years 2000 to 2004 without using statistical sampling, all 5,000 checks would need to be researched to determine the exact amount of unclaimed property associated with these checks. In the alternative, the parties agree that a statistical sample of the 5,000 check population is the preferable method to determine an estimated amount of unclaimed property. It is important to note that the population of checks is derived without regard for the address of the payee or any state specific exemptions, such as a business-to-business exemption. This practice is consistent with the purpose of the estimation, where the state of incorporation is not seeking to escheat the check in question, but rather using the check to determine the holder's unclaimed property exposure in years where it failed to maintain sufficient records. In the case of an exemption, the fact that the address state has chosen to not take custody of the funds associated with an obligation does not change the fact that the item is unclaimed property for the purposes of estimation.

In order to yield a more accurate and efficient sample, several steps are taken before selecting the sample from the 5,000 checks. First, the holder's prior filing history for transaction years 2005 to 2010 will be matched against the population of 5,000 checks. Any obligations within the 5,000 checks that have already been escheated will be removed from the population subject to sampling. The two advantages to removing these checks are that a smaller population of checks

¹⁰ See 1981 Uniform Unclaimed Property Act § 31(a). ("Every holder...shall maintain a record of the name and last known address of the owner for 10 years after the property becomes reportable, except to the extent that a shorter time is provided...by rule of the administrator."); 1995 Uniform Unclaimed Property Act §21(a) ("[A] holder...shall maintain the records containing the information required to be included in the report for 10 years after the holder files the report, unless a shorter period is provided by rule of the administrator.")

often results in a smaller number of sample items. Secondly, there is no reason to subject the holder to researching a check that already has a known disposition.

In addition, there is already known unclaimed property associated with obligations that were previously filed. Consistent with using today's records to determine yesterday's business rules, the checks that were previously filed will be used as a component for determining the estimated liability in years where records are not retained. The rationale is that there is no better way to estimate an unclaimed property liability for years where records are unavailable than to utilize known unclaimed property liabilities from years where records are available. The sample results will be combined with the predetermined prior filing information to determine the holder's estimated unclaimed property liability.

The next step is to evaluate high and low dollar transactions that should be removed from the sampling frame as well. An arbitrary line is not set to determine what constitutes a high dollar transaction. Rather, any disbursement that is an outlier as compared to other disbursements is removed as the outliers are not likely to represent historic transactions. Separate from the sampling process, the holder should determine if an outlier item is payable to the owner and therefore escheatable to the state of last known address. As for low dollar transactions, a dollar threshold is determined where even if all transactions were found to be unclaimed property; there would be a de minimis effect on a historical unclaimed property estimate so these items are removed to reduce the burden to both the holder and the state.

Once the population is refined based on the removal of prior filings, high dollar outliers and small dollar amounts, the sample will be selected. This refined population is called the sampling frame. The sampling frame is often stratified by dollar amount. In other words, obligations are grouped together by dollar amounts.

The primary reasons to stratify are efficiency and reliability. A stratified population also reduces the required sample size so a more accurate estimate can be attained with fewer items. Stratifying a sample also allows for different criteria to be applied to each stratified group. In turn, this allows for smaller samples for the less material strata. Lastly, stratified samples produce accurate estimates for each stratum which enables the state to evaluate the error rates and unclaimed property amounts that come from different groups of dollar transactions.

The sample size for each stratum is selected by identifying the minimum number of obligations that will accurately represent the amount of unclaimed property from each stratum. The appropriate sample size is determined based upon established goals of how reliable (i.e. confidence) and how accurate (i.e. precision) the samples are. Generally, the reasonable standard that is applied is 90% confidence and 10% precision.

Using the example above of 5,000 checks in the population to clarify the concepts of confidence and precision, assume there are 1,000 checks between \$10.00 and \$500.00 and the average value of these checks is \$100.00. Using the criteria of 90% confidence and 10% precision, the

expectation for the sample is that 90% of the randomly selected sample items would have an average dollar value within +/-10% of the population average (i.e. 9 of every 10 checks in the sample would have a dollar value between \$90 and \$110).

Once random samples are selected and the holder completes the research of the sample items, the unclaimed property calculation is performed in two stages. The first stage is calculating the unclaimed property liability for the years where records were available. In this case the sample results will be applied to the 5,000 checks issued between 2005 and 2010. The second stage is the application of the liability in the years where records are available to the years where records are unavailable. The period of years where records are available is called the base period.

The base period liability is calculated for each stratum by using a ratio. The ratio is calculated by dividing the dollar amount of unclaimed property in the stratum by the total dollar amount of the items in the stratum. This ratio is then multiplied by the total dollar amount of the items within that stratum in the population to determine the estimated unclaimed property in the population. This calculation is repeated for each stratum and the sum of liabilities from each stratum totals the estimated unclaimed property liability for the base period.

As discussed above, the estimated unclaimed property from the base period is added to the prior filing items that were previously removed before the sample was prepared. This sum represents what the holder actually filed as unclaimed property and what also should have been filed as unclaimed property based on the sample results. The sum of unclaimed property in the base period is then used to calculate the unclaimed property liability in the estimated years.

To determine the liability for the years where records are unavailable, a constant needs to be identified for the holder. This constant needs to be reliable and available for the entire period subject to review. Most often revenue is used as the constant but payroll expense, accounts payable or other mutually agreed upon constants can be used. To determine the estimated liability, the base period liability is divided by the constant for the same period. In our example, the dollar amount of the base period liability is divided by the sum of the holder's revenues from 2005 to 2010. The ratio from this calculation is then multiplied by the holder's revenue by year for the years outside the base period to determine the estimated unclaimed property by year. If a holder demonstrates that it has filed some unclaimed property in years where it did not retain sufficient records, the estimated liability is reduced by the actual amount of unclaimed property filed in that year.