Introduction to escheat

In the United States, escheat most commonly refers to the process by which unclaimed intangible property is transferred to the custody and safekeeping of the state. Unclaimed property typically consists of bank balances, uncashed checks, deposits and even royalties. In general, the property becomes unclaimed when there is neither communication between the entity holding the property (the holder) and its owner, nor owner activity for a statutorily specified period of time. Some of the most common reasons for the lack of activity or communication are: change of address without notification to the holder; failure to cash checks; and the death of the owner. The state is deemed to "step into the shoes" of the missing owner and maintain custody of the property in perpetuity. If the owner or the owner's heirs are located or remember the abandoned property, the owner may reclaim it at any time. Every year about $4 billion dollars is reported to the states.

Purpose of escheat laws

The underlying purpose of the escheat or unclaimed property law is consumer protection. Businesses (or “holders”) change hands, names, and locations and records may be lost as time passes. Having the state maintain custody of abandoned property preserves the property in the name of the owner as shown on the records of the bank or company that reported the account and other identifying information. With states now maintaining databases of unclaimed owners online and participating in a centralized national database (www.missingmoney.com), an owners or his or her heirs will have many fewer places to search for unclaimed property and a much great likelihood of reclaiming it.

Holders benefit from state unclaimed property laws as well, because the state laws relieve holders of further liability for this property, and the states assume the responsibility of satisfying owner claims.

Finally, the citizens of the states benefit, because the economic windfall of unclaimed property ensures to the benefit of state revenues and programs and not to the individual holder.

While it is true that all states have laws with similar underlying purposes, specifics of those laws, such as periods of abandonment, reporting requirements, and reporting formats differ for each state. Most states now have abandonment periods (the length of time during which there has been no owner activity) of three to five years. For a company to report correctly, it must either develop its own escheat expertise within the company or outsource the process. While software 1, a valuable tool, is available, law and reporting format changes occur frequently, and the company administrator who manages the escheat process will benefit from courses offered by states or others to keep abreast of the changes.

Reporting guidelines

The determine to which state a specific owner’s account or check should be reported is relatively simple. As a result of the decisions in a series of United States Supreme Court opinions, a holder reports unclaimed property to the state of the apparent owner’s last known address as shown on the holder’s books and records. If there is no address, or if the owner is unknown, the holder reports the property to the holder’s state of incorporation. The Supreme Court was called upon to decide these priority reporting rules because different states were claiming the same abandoned property under different rules. Since it was unfair to expect a holder to pay over the same property to different states, a

1 Free reporting software is available at www.wagers.net
simple national approach and common set of rules was very desirable. Several subsequent decisions of the U.S. Supreme Court affirmed and further clarified these rules, which have eliminated most disputes among states and have given holders clear guidelines.

Uniform laws
Laws regarding unclaimed property have been the subject for the drafting of uniform law provisions by the National Conference of Commissioners on Uniform State Laws. Uniform laws, such as the uniform Commercial Code and the Uniform Probate Code, are drafted by legal experts as model laws. Several versions of Uniform Unclaimed Property Acts have been approved by the National Conference and have been proposed and enacted with numerous exceptions by state legislatures. The most recent model is the Uniform Unclaimed Property Act (1995). This version included an express provision with regard to mineral proceeds, including language covering current balance.

Current balance means that when the earliest payment to a royalty or mineral proceeds owner becomes abandoned, then all ensuing payments are deemed abandoned as well. Some 25 states now have current balance provisions. (Additional discussion regarding current balance appears below.)

Another provision of the 1995 Uniform Unclaimed Property Act that many states have adopted prohibits provisions in agreements to locate property that call for the payment of compensation including a portion of the underlying minerals or including any mineral proceeds not then presumed abandoned.

Due diligence
An important precursor to the escheat of unclaimed property is a process stipulated in most state laws that requires the holder to send written notice, or due diligence letters, to the owner at the owner’s last known address at some specified period before the property is remitted to the state. Commonly, the letters notifying owners that their property is subject to escheat unless they promptly claim it should be sent 60 to 120 days before the property is due to be remitted. This gives the owner one last chance to reclaim the property from the holder before it is remitted to the state. However, these letters are not required under certain dollar amounts varying from 25 to 100 dollars. Also, due diligence letters are not required to be sent to addresses from which mail has already been returned as undeliverable. For suspended royalties or owner accounts, it is desirable to note on company records that mail to the owner has been returned as undeliverable.

Special provisions
Several states have unique provisions worth noting here.

- Kentucky exempts reporting royalties entirely. However, because of the operation of the priority rules, most states take the position that if property is exempted from reporting in one state, it should be reported to the holder’s state of incorporation, if that state has an applicable law.

- In Oklahoma, mineral proceeds arising from forced pooled units are placed in the custody of the Oklahoma Corporation Commission. If these monies are held for seven years or more after the date of pooling, they are then transferred to the Oklahoma treasury and held in the Unclaimed Property Fund. The Oklahoma treasury will ordinarily transfer these monies to the state of the last known address.
Wyoming requires production proceeds that cannot be paid within a prescribed time period to be placed in a Wyoming bank or saving and loan escrow account. If the proceeds are still unclaimed after three years, the payments are then remitted to the Wyoming State Treasurer’s Unclaimed Property Division. The Wyoming Unclaimed Property administrator will transfer the payments to the state of the last known address if it is other than Wyoming.

Other states have adopted business-to-business exemptions that may be relied upon to exempt certain checks or accounts from reporting to the state of the last known address. However, these vary significantly from state to state, and most companies have elected not to claim these exemptions.

Reportable property types

Mineral proceeds. The Uniform Unclaimed Property Act (1995) defines mineral as “gas; oil; coal; other gaseous, liquid, and solid hydrocarbons; oil shale; cement material; sand and gravel; road material; building stone, chemical raw material; gemstone; fissionable and nonfissionable ores; colloidal and other clay; steam and other geothermal resource; or any other substance defined as a mineral by the law [of the adopting state]. The act defined mineral proceeds as “amounts payable for the extraction, production or sale of minerals, or upon the abandonment of those payments, all payments that become payable thereafter.” Thus, in addition to royalties and production payments, such outstanding liabilities as uncashed delay rentals, bonuses and other payments are covered. The definitions for mineral and mineral proceeds were meant to be expansive in order to avoid any confusion about what was subject to abandonment regulations.

States that do not include definitions of mineral or mineral proceeds in the unclaimed property statues still interpret their laws as applying to abandoned property. The statutory provisions that relate to undefined property types is covered in a general rule, such as this one contained in the Uniform Unclaimed Property Act (1981) §2A:

Except as otherwise provided by this Act, all intangible property, including any income or increment derived therefrom, less any lawful charges, that is held issued, or owing in the ordinary course of a holder’s business and has remained unclaimed by the owner for more than 5 years after it became payable or distributable is presumed abandoned.

This type of provision is a catch-all that covers property not otherwise defined or for which an abandonment period is not expressly stated.

It bears repeating that mineral proceeds are not, with one exception noted below, reportable to the state in which the minerals are produced. Because of the rulings by the Supreme Court, proceeds such as these are reportable to the state of the last known address of the owner, not the state of production.

Suspended accounts

Most companies are aware that accounts held in suspense are subject to escheat, but often there is confusion about which suspense codes must be reviewed to determine if the property is abandoned according to that code. It is not uncommon for a company to conclude that only accounts included in a code denoting “bad address” or “returned by post office” are reportable. This is incorrect. If the liability is owed and the account has had no owner activity for the requisite period of time, the account should be examined for escheat.
For example, if an account is placed in suspense because the company has received notice that the owner is deceased, and there is no documentation of subsequent probate or heirship determination, that account is reportable. This is also true if there is no contact from any executor, administrator, or heir for the abandonment period. Of course, both good business practices and most escheat laws would suggest that the company should attempt to contact the decedent’s representative or heirs in a final due diligence effort before the suspended account is reported to the state.

Current balance

As mentioned above, current balance or pay to current refers to the escheatment of subsequent royalties or other payments for the account of an owner that has been escheated to the state. The question arises: Are subsequent payments for this owner reportable to the state as they accrue, or should the current payments for this owner be consolidated in the next annual report? Most states have concluded that the best practice is to consolidate the payments and report the owner in the year after the account first became escheatable, rather than reporting to the state monthly, quarterly or semi-annually. However, reporting instructions from a specific state should be reviewed annually to verify current instructions.

Other property types

In addition to the types of property associated with the production or sale of minerals discussed above, oil and gas companies also have abandoned property common to other businesses: vendor and payroll checks, uncashed employee benefit checks, uncased dividends and undelivered or underlying shares. However, it is beyond the scope of this chapter to discuss all escheatable property types that are held by mineral producers.

Underlying mineral interest

Because most states’ unclaimed property laws deal almost exclusively with intangible property, the underlying mineral real property interest owned by an owner whose royalties have been deemed abandoned is not placed in the custody of the state. However, Oklahoma has a specific provision relating to mineral interests in land that have generated intangible unclaimed property (royalty payments, for example). Oklahoma requires, in addition to other reporting, that the holder report to the state treasurer (1) the names and last known addresses of owners of record of the unclaimed mineral interest, (2) the legal description of the land affected, and (3) the extent of the property rights in the mineral interest.

This information need only be reported by the holder once to the state treasurer. The state treasurer then sends a copy of the report filed by the holder to the Attorney General and the district attorney of the county in which the land is located. This information is deemed confidential and is not released to the general public. The state treasurer also sends a report of the owners and the last known addresses of the owners of record to the county clerk of the county in which the land is located. This report is available for public viewing. If the proceeds derived from the mineral interest are abandoned for fifteen (15) years, the mineral interest that generates the abandoned mineral proceeds are subject to judicial sale by the state.

State enforcement of unclaimed property laws

Penalties and interest. Unclaimed property statues typically include imposition of interest on property reported late, along with penalties for failure to file the report or willful failure to file the report and deliver the property. For example, California’s statute calls for annual...
interest of 12% to be paid on late reported or delivered property to run from the time the property should have been reported, paid, or delivered. Additionally, a fine of up to $100 per day, not to exceed $10,000, may be imposed for each past due report or other duty not performed by the holder.

Most states will waive interest and penalties for first time filers; they also offer programs to help holders who may be past due in reporting. Some states have voluntary disclosure agreement procedures in place. Holders negotiate these agreements on a state-by-state basis.

A holder also has the option to work with the Unclaimed Property Clearing-house, an association of more than forty-five states which provide services to out-of-compliance holders on behalf of the participating states. The Clearinghouse simplifies reporting and payment mechanisms by providing a uniform method, agreed to by its member states, for cooperating holders. The Clearinghouse also conducts audits on behalf of member states when requested to do so.

**State audits.** State unclaimed property laws authorize the state to conduct audits of holder records to determine if the holder has complied with the requirements of the law. Under some state statutes, the state may audit a holder’s records if there is reason to believe that the holder is not in compliance with the state’s law. A state may choose to audit a holder for many reasons: (1) failure to file any report; (2) filing a report which, on analysis, appears to be significantly less than the reports of similar-size holders in the same industry; and (3) filing reports that appear to omit certain property types that the state would expect to see reported by that type of holder.

Some states, such as Colorado, permit the state administrator to assess a daily rate for the auditor’s time spent conducting the audit, so holder cooperation with the audit is important. State audits generally begin with an opening conference in which the state auditors and the holder representatives discuss the scope of the audit, which states are involved in the audit, and what types of records will be examined. If records are unavailable for periods under audit or the expense of obtaining last known address information far outweighs the value of the property reportable, companies will need to negotiate with states and their representatives to arrive at a fair solution. A company cannot avoid its reporting obligations by failing to maintain adequate records.

A common question holders have is how far back in time may a state auditor examine company records. Not surprisingly, the answer lies in each state’s law. For a holder that has never filed a report, the audit may extend back to the inception of the corporation if records indicate amounts abandoned are material.

**State custody and owner claims**

When an owner comes forward to reclaim abandoned property, the state should be able to honor or deny the claim based on the information supplied by the holder. Some states will seek additional owner identifying information from the holder (which may or may not be available) if there is inadequate owner information on the report or if the claimant is unable to supply corroborating information in pursuit of the claim.

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2 [www.acsupch.com](http://www.acsupch.com)

3 Some states either conduct joint audits with other states or appoint a single contract auditor to work on behalf of a number of participating states.
Conclusion

Filing state unclaimed property reports requires understanding and attention to state formatting and reporting requirements. For the division order analysts or company staff maintaining mineral proceeds records, these concerns may vie with other job responsibilities. Ensuring that good company reporting policies are in place and making every effort to reduce the number of owners whose accounts become escheatable will facilitate unclaimed property auditing.