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## Massachusetts High Court Rejects Retroactive Escheat Regulations

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The Massachusetts Supreme Judicial Court (SJC) recently tackled the thorny question of retroactive application of an amended interpretive regulation in the context of Massachusetts's Abandoned Property Law (APL), and issued a significant victory to Biogen Idec MA, Inc.<sup>[1]</sup> The court rejected the state treasurer's attempt to narrow the APL's business-to-business exemption by excluding uncashed accounts payable checks through the 2004 amendment of regulations that had been issued contemporaneously with the 2000 APL legislation and that were in effect at the time of Biogen's 2002 amnesty filing.

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### Massachusetts APL Background

Massachusetts first enacted its APL in 1950.<sup>[2]</sup> Then-Gov. Paul A. Dever, in his January 4, 1950, message supporting the enactment of the APL, said:

It is a means which at once will provide substantial revenues to the commonwealth; work a hardship to no one; protect the owners' rights and prevent unjust enrichment of banks, insurers, debtors, companies and individuals who are the recipients of accidental windfall — the windfall of finding in their hands the abandoned property of others.<sup>[3]</sup>

Substantiating owners' claims to property under the APL was problematic. It was acknowledged that for "years and years, if not decades and decades," holders of abandoned property may not have provided any information identifying the owners of the property remitted.<sup>[4]</sup> Of the \$20 million of property one holder turned over to Massachusetts, only \$3.5 million had the names and addresses of the owners; the company had purportedly been instructed by the treasurer's office to mark as "unknown" any amounts when it had incomplete information.<sup>[5]</sup> Because of lax reporting and enforcement, several fraudulent schemes were undertaken that resulted in the theft of substantial abandoned property money.<sup>[6]</sup>

While the treasurer's office may have been lax in enforcing reporting requirements, Treasurer Joseph D. Malone, who held that office from 1991 through 1999, was at the same time criticized for "aggressively

[seizing] abandoned assets, much of which he eventually transferred to the state's general fund without diligently seeking owners."<sup>[7]</sup> Businesses were also troubled by what they perceived to be the draconian audits under Malone and, in particular, the focus of contingency auditors on credit balances and the "endless requests for information dating back to a company's founding."<sup>[8]</sup> Credit balances were viewed as an "attractive target for auditors" that were paid on a contingency fee basis.<sup>[9]</sup>

When Treasurer Shannon O'Brien took office in 1999, she indicated that more vigorous attempts would be made to reunite property with its owners than were made under Malone, and her office maintained that the APL "should not be about generating money for the state."<sup>[10]</sup> In response to the concerns of the business community, O'Brien established a task force composed of business associations and lawmakers to review and make recommendations regarding the APL. Massachusetts businesses advocated for the enactment of a business-to-business exemption to provide relief from the Abandoned Property Division's enforcement of the APL "against apparent aged and unresolved business debts reflected in companies' financial records, including uncashed checks."<sup>[11]</sup> The business-to-business exemption, which exists in some states, is predicated on the notion that abandoned property provisions were intended to protect consumers, and that businesses had the ability to address outstanding issues on their own with their business counterparts.<sup>[12]</sup> Further, the task force was troubled by the practice of treating as abandoned property checks that were issued between companies but remained uncashed.<sup>[13]</sup> Common business practice is for a company to simply reissue a check without removing the original check from its books and later to write off the uncashed check, without undertaking the costly step of reconciliation. The task force maintained that a lack of precision in accounting for those transactions should not convert a routine business transaction to an unclaimed property transaction.<sup>[14]</sup>

The task force, backed by O'Brien, proposed revisions to the APL that were enacted in 2000, including the right to appeal from an audit, the provision of a nine-year limit for filers regarding their liabilities, and as the business community had urged, the exemption for business-to-business credit balances, the question that would be at issue in *Biogen*. The business-to-business exemption provision excluded from the scope of the APL "any outstanding credit balances to a vendor or commercial customer from a vendor resulting from a transaction occurring in the normal and ordinary course of business."<sup>[15]</sup>

The 2000 legislation also provided for the adoption of an amnesty program and directed the treasurer to conduct "an outreach and publicity program to notify business entities and other holders of abandoned property of their obligations under the General Laws, and the amnesty program."<sup>[16]</sup> The need for heightened awareness of the state's abandoned property provisions was evident. It was estimated that in 1998 only 3.3 percent of Massachusetts businesses filed the required APL reports.<sup>[17]</sup> Massachusetts's APL amnesty program followed on the heels of a similar 1999 amnesty program sponsored by the National Association of Unclaimed Property Administrators, in which 40 states had participated; some of those states extended the program through October 31, 2000.<sup>[18]</sup> Limited lookback and waiver of penalty and interest were the incentives generally offered by the states participating in the 1999 program.<sup>[19]</sup>

In 2001 O'Brien promulgated regulations that defined credit balances and addressed the scope of the exemption of credit balances from the APL.<sup>[20]</sup> The definition of credit balances was broad in scope and included "payments to satisfy other obligations between two commercial customers, and may take the form of credits, credit memos, refunds, vouchers, discount points or programs, and other transactions between the parties."<sup>[21]</sup> The regulations were made applicable to "all prior and current reporting years."

A new treasurer, Timothy Cahill, took office in 2003. On February 12, 2004, he filed emergency regulations to restrict the definition of outstanding credit balances to "outstanding balances that are recorded as current accounts receivable or accounts payable of a holder."<sup>[22]</sup> The final revised regulations were promulgated on June 18, 2004. Since accounts payable credit balances are eliminated on the issuance of a check, under the amended regulation uncashed or voided business checks would be excluded from the exemption.

### **Biogen Facts**

Biogen took advantage of the state's amnesty program and filed reports in October 2002, but consistent with the 2001 regulations, did not include its commercial accounts payable credit balances in those reports. Biogen received notification dated September 17, 2003, that it had been selected for audit. The state used a contract auditor, Kelmar Associates LLC, to conduct the audit. Kelmar, which was formed in

2001, sells its abandoned property auditing services to various states, generally on a contingency fee basis. As the president of Kelmar testified:

We conduct audits in a multi-state environment for a multiple of clients. As a result, the fee structure on that is generally contingency, although it can be different, and that has been found to be really the only way to allocate the cost amongst the states in such a way that not each state is paying an hourly rate or flat fee whereas they may or may not have findings relating to abandoned property for their state.<sup>[23]</sup>

Four days after Kelmar's first meeting with Biogen, Cahill issued the emergency regulations retroactively adopting a restrictive interpretation of credit balances.

Biogen's audit, which covered 1984 through 2004, was characterized by the New England Legal Foundation and the Associated Industries of Massachusetts as "lengthy, costly and disruptive."<sup>[24]</sup> Given the lack of detailed records for such an extensive audit period, Kelmar used estimation techniques to generate the \$781,000 portion of Biogen's \$1.234 million final examination report that related to the new, narrow interpretation of the business-to-business exemption.

Biogen challenged the report administratively. Cahill issued a final decision upholding the final examination report, and Biogen proceeded to challenge the assessment in the superior court. Discovery obtained by Biogen during the superior court proceedings included e-mail correspondence among Treasury officials before the promulgation of the amended regulation, which confirmed that the "prior administration when applying the credit balance exemption extended it to vendor checks when the holder could show that the underlying source of the check was a vendor credit balance" and that the current treasurer could "offer a different interpretation" if the regulations were amended.<sup>[25]</sup>

The superior court held that O'Brien's original regulations "best comport" with the "apparent intent and purpose" of the 2000 legislation, which was to exempt business-to-business transactions from the APL.<sup>[26]</sup> The treasurer appealed to the SJC.

### **SJC Opinion**

The SJC concluded that the general deference afforded by courts to an agency's interpretive regulations applied to the original 2001 regulations and not the 2004 amended regulations. The "pivotal threshold question" in the court's view was whether O'Brien had originally interpreted credit balances as including uncashed accounts payable checks as part of her "policy-making discretion."<sup>[27]</sup> Although Cahill had objected to the admission of the e-mails confirming the earlier internal policy, the court pointed out that Cahill "does not dispute" the substance of the e-mails and held that "administrative agencies must abide by their own internally promulgated policies."<sup>[28]</sup> The court noted that the 2001 regulations were enacted "contemporaneously" with the statute, were "reasonable," were not the "product of rash, uninformed rulemaking," and that "Treasurer Cahill does not suggest that Treasurer O'Brien failed to engage in thoughtful, reasoned deliberation in promulgating the regulations."<sup>[29]</sup> Having determined that the 2001 original regulations governed, the court did not have to reach the propriety of the attempt of the 2004 regulations to retroactively change the treasurer's administrative position, or Cahill's defense that the 2004 regulations could be applied retroactively because they were "curative."

### **Observations**

The 2001 original regulations and their interpretation by O'Brien are consistent with the purpose of the 2000 legislation to exempt business-to-business credit balances from the scope of the APL. Therefore, the relevant inquiry under the APL should be whether the underlying transaction is a business-to-business transaction. Businesses that attempt to repay outstanding credit balances to their business customers should not be treated differently from businesses that have not attempted to repay those amounts. Although the SJC reached the right result, it held only that the original regulations were properly enacted. The focus of the superior court on the underlying legislative purpose of exempting all business-to-business transactions was correct, as was its realization that the 2004 regulations would "hobble the statute's effectiveness."<sup>[30]</sup>

Furthermore, although the APL is not a tax imposition, businesses rightfully view unclaimed property

remittances as taxation, particularly when the amounts required to be remitted are based on arbitrary estimation techniques used by contingency fee auditors and when the lion's share of the money is deposited in the state's general fund for its general revenue needs. As Justice John Harlan said, "the tax laws exist as an economic reality in the businessman's world, much like the existence of a competitor. Businessmen plan their affairs around both, and a tax dollar is just as real as one derived from any other source."<sup>[31]</sup> Retroactive impositions, whether under legislation or regulation, whether they relate to taxes or "quasi-taxes," and whether they are denominated "curative" or "clarifying," should not be countenanced by the courts. As former Massachusetts Gov. Mitt Romney correctly understood in the context of tax impositions: "It is fundamentally unfair to tax people retroactively."<sup>[32]</sup> That sentiment was echoed by Massachusetts House Minority Leader Bradley H. Jones Jr. (R), who said, "it is wrong for us to surprise taxpayers with an unexpected demand for more money. Fairness and equality are the underpinnings of any good tax code."<sup>[33]</sup> Fairness and equality should also be the underpinnings of unclaimed property laws, which have become a "tax" of choice used by many state legislatures.

It is also wrong for governments to take money under the guise of uniting that money with its "owner" using questionable estimation techniques that are then applied to scores of years, based on the absence of supporting documentation for years in the distant past and that businesses had no reason to retain.<sup>[34]</sup> In this case, even if Biogen had retained records regarding those uncashed accounts payable checks, the treasurer's 2001 regulations eliminated the need for that documentation, and a change in regulation in 2004 should not resurrect a need to retain records.

Neither the parties nor the court focused on the fact that Biogen came forward as part of the state's amnesty program. However, the treasurer's attempted retroactive interpretation was all the more egregious because it arose in the context of the state's amnesty program. Although the acknowledged underlying premise of amnesty programs is that there has been noncompliance with reporting and remittance requirements, some states have used unclaimed property amnesty programs as a carrot and then proceeded to try to kill the donkey by the use of contract auditors who not only conjure up assessments but also get to share in the bounty they bring to governments. Contrary to Dever's 1950 statement, the APL can "work a hardship" to businesses that not only undergo onerous and oppressive audits reaching back into the distant past, but whose costs of doing business can increase significantly because of questionable unclaimed property liabilities.

*Biogen* reveals the ingenuity of the treasurer in devising methods to reopen the abandoned property revenue spigot<sup>[35]</sup> and highlights the many serious practical problems faced by businesses regarding their unclaimed property obligations around the country. More importantly, the *Biogen* result shows that holders can successfully challenge states' administration of unclaimed property laws.

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## Footnotes

<sup>[1]</sup> *Biogen Idec MA, Inc. v. Treasurer & Receiver Gen.*, 454 Mass. 174 (2009).

<sup>[2]</sup> Act of 1950, ch. 801, 1950 Mass. Acts 687.

<sup>[3]</sup> Brief of the Appellant, at 10-11, *Biogen Idec MA, Inc. v. Treasurer & Receiver Gen.*, 454 Mass. 174 (2009) ("Brief of the Appellant") (quoting 1950 Sen. Doc. No. 1, at 22 (Message of Gov. Paul A. Dever)).

<sup>[4]</sup> Martin Finucane, *Abandoned Property Turned Over to Treasury Without Names*, Associated Press St. & Loc. Wire, Apr. 4, 2000.

<sup>[5]</sup> *Id.*

<sup>[6]</sup> Ellen J. Silberman, *O'Brien Administration Hit by Treasury Scam*, Boston Herald, Jan. 14, 2000, at 2.

<sup>[7]</sup> Tina Cassidy, *State Treasurer Plans to Shake Up Department*, The Boston Globe, Aug. 9, 1999, at C11.

- [8] Edward Mason, *Abandoning a Policy*, Boston Business Journal, Nov. 12, 1999, at 1.
- [9] Cromwell Schubarth, *Businesses Face New Abandoned Property Rules*, Boston Herald, Jan. 28, 2001, at A30.
- [10] *At the Statehouse — Audit Recommends Treasury Reforms*, Providence J.-Bull., Feb. 9, 2001, at 5C.
- [11] Brief for New England Legal Foundation and Associated Industries of Massachusetts as Amici Curiae for *Biogen Idec MA, Inc. v. Treasurer & Receiver Gen.*, 454 Mass. 174 (2009) (“Amicus Brief”), at 10.
- [12] Approximately a dozen states have some form of business-to-business exemption. However, the exemption may be of limited use since, for the benefit to apply, the jurisdiction of the owner’s last-known address (the first priority rule under *Texas v. New Jersey*, 379 U.S. 674 (1965)) and the jurisdiction of the holder’s corporate domicile (the second priority rule under *Texas v. New Jersey*) must both have the business-to-business exception.
- [13] Amicus Brief at 10-11.
- [14] *Id.* at 12.
- [15] Mass. Gen. Laws ch. 200A, § 5, as added by Act of 2000, ch. 198, § 2, 2000 Mass. Acts 990.
- [16] Act of 2000, ch. 198, § 4, 2000 Mass. Acts 991.
- [17] Michael Cohen, *Does That \$72,000 Belong to You?* Sunday Telegram (Mass.), July 25, 1999, at A1.
- [18] As reported in California Assembly Committee on Judiciary, AB 1888 – Bill Analysis (Mar. 28, 2000).
- [19] AICPA S&L Alert, *Amnesty Program Broadens as States Join Unclaimed Property Voluntary Compliance Program*, The Tax Adviser (Aug. 1999), available at <http://www.aicpa.org/pubs/taxadv/online/aug1999/alert.htm>.
- [20] 960 Mass. Code Regs. 4.00 (2001).
- [21] *Biogen*, 454 Mass. at 178 (citing 960 Mass. Code Regs. 4.03(13)(b) (2001)).
- [22] 960 Mass. Code Regs. 4.02 (2004).
- [23] *Informational Hearing: State Controller’s Office and Unclaimed Property* (Cal. Sen. Governmental Org. Oct. 22, 2007).
- [24] Amicus Brief at 16.
- [25] Brief of Plaintiff-Appellee, at 12, *Biogen Idec MA, Inc. v. Treasurer & Receiver Gen.*, 454 Mass. 174 (2009) (citation omitted).
- [26] *Biogen Idec MA, Inc. v. Cahill*, No. 06-0198-BLS1, 2007 Mass. Super. LEXIS 68, at \*22-23 (Mass. Super. Ct. Feb. 27, 2007).
- [27] 454 Mass. at 184.
- [28] *Id.* at 186 (quoting *Comm’r of Revenue v. BayBank Middlesex*, 421 Mass. 736, 739 (1996)).
- [29] 454 Mass. at 189.

[30]2007 Mass. Super. LEXIS 68, at \*23.

[31] *Comm'r v. Brown*, 380 U.S. 563, 579-80 (1965) (Harlan, J., concurring opinion).

[32] Press release, Massachusetts Executive Dep't (June 10, 2005).

[33] *Id.*

[34] Despite the laudable goal of returning property to its owners, of the \$729 million of property deposited with the state from 1991 through 1998, only \$167 million, or about 22 percent, was returned to owners. Cohen, *supra* note 17, at A1. It is surprising that even that much abandoned property made its way back to owners since the law requires only that the treasurer publish "once a week for two consecutive weeks in a newspaper of general circulation." Mass. Gen. Laws ch. 200A, § 8(a). During that time, during the tenure of Malone, purportedly any investigative function to seek out owners of abandoned property "was virtually eliminated." Cohen, *supra* note 17. A state audit report released in 1999 found that unclaimed tangible personal property, including 300 coins wrapped in socks, 1988 Boston Bruins tickets, and war medals, was not inventoried and was languishing in a vault. Ellen J. Silberman, *Treasury Audit Finds Safe Full of Unclaimed Valuables*, Boston Herald, Mar. 10, 1999, at 1.

[35] The original APL provided a 14-year dormancy period for intangible assets before the property would be considered abandoned and subject to the APL. However, the legislature has gone to the APL golden goose many times since 1950, steadily decreasing the dormancy period to a mere three years. Act of 1950, ch. 801, 1950 Mass. Acts 687 (14 years); Act of 1975, ch. 608, sec. 4, 1975 Mass. Acts 652 (10 years); Act of 1980, ch. 130, sec. 4, 1980 Mass. Acts 88 (7 years); Act of 1981, ch. 351, sec. 104, 1981 Mass. Acts 438 (5 years); and Act of 1992, ch. 133, sec. 533, 1992 Mass. Acts 570 (3 years), as cited in Brief of the Appellant at 10 n.28. The guise of owner protection is now an apparent afterthought supplanted by budgetary concerns. Having already reduced the dormancy period to an untenably short period, unless the legislature further reduces the dormancy period to an absurdity, that abandoned property spigot closed — at least regarding dormancy periods — in 1992, when the dormancy period for most property was reduced to three years. Act of 2002, ch. 510, 2002 Mass. Acts 1296.