Bond Case Briefs

Municipal Finance Law Since 1971

The Gift-Card Budget.

Strapped for cash, state governments are plugging holes using unspent gift cards. Not everyone thinks it's a good idea.

Brenda Mayrack never intended to become an unclaimed-property czar. Even among legal specialties, the field is particularly obscure: During law school at the University of Wisconsin, she remembers hearing only a 10-minute lecture introducing the topic at the end of her trusts-an--estates class. But as the director of Delaware's unclaimed-property office, Mayrack now oversees a fund of $540 million a year, forgotten by people from Paris to San Francisco and then held temporarily by the state.

"You can think of all kinds of examples," says Mayrack. "The parent has an insurance policy, then they die, and no one knows about it." Or, Mayrack says, someone might have lost track of a bank account, and the records disappeared in a fire or flood. "The only way the beneficiary will know about it is through unclaimed property," she says. Because that money belongs to the consumer, not the insurance company or the bank, state offices of unclaimed property step in. Delaware's pot of unclaimed money includes a mix of forgotten securities, uncashed checks, insurance payments, and—more and more often—gift-card money that customers never spent.

As Starbucks and Amazon propelled gift cards into what was in 2018 a $95.7 billion market, the amount of unused money left on them has also grown. Somewhere in the range of $2 billion to $4 billion—experts aren't exactly sure—will languish on gift cards this year, according to figures provided by the business research firm Mercator Advisory Group. But there's little consensus as to who owns that cash. While in some regions, companies take it for themselves, an increasing number of state governments seize it as unclaimed property. Much of that money is then directed into government general funds, where states use it to patch up holes in their budgets—a strange and little-noticed chain of monetary custody in which cash intended for a Colorado Office Depot can wind up paying for infrastructure hundreds of miles away.

No state has had more success with this approach than Delaware. "Delaware does have the vast majority of gift-card money," says Michael Rato, a lawyer who works on unclaimed-property cases—a consequence of the fact that an outsize number of businesses incorporate there. Mayrack estimates that money from unused gift cards is the fourth most common type of unclaimed property her office encounters, after securities, uncashed checks, and accounts-receivable credits; all told, the state's unclaimed-property fund accounts for 10 percent of its entire annual budget.

Other states are following its lead. Earlier this year, Colorado tightened its rules regarding gift-card money as part of a broader law that also entitled the state, for the first time, to spend unclaimed property in its annual budget. Some lawyers have considered claiming unused money stored in video games and cryptocurrency. As the Trump administration continues to cut federal funding for state programs, legislators desperate to make up the shortfall are turning to a patchwork of forgotten microtransactions you meant to spend on lattes or in-game wardrobe upgrades to help.

Unclaimed-property laws date back to feudal England, when the Crown was quick to seize control of land owned by citizens who had no heirs. In the United States, too, states held on to the property of people who'd died without clear inheritors. But as the majority of unclaimed property shifted from physical objects such as cash and land to assets that lacked clear geographic origins—and, therefore, a clear state to claim them—the law has become more complicated.

"What became trickier is when there was a type of unclaimed property that touched many different states," Rato says. "When you have something like a share of stock, there are multiple different states that could have a claim." By the middle of the 20th century, American courts had to decide who gets to control unclaimed money that is, say, left in a bank account: the state where the holder lives, or the state where the bank is incorporated?

In the 1965 case Texas v. New Jersey, the Supreme Court ruled that, if the address of the owner is known, all the unclaimed property should revert to the state of residence. If not, the state of incorporation for the company that holds the property gets the money. That makes Delaware, the site of incorporation for more than 60 percent of public companies, one of the top recipients of unclaimed property across the globe.

Gift cards have been a particular boon. Since few companies retain the addresses of gift-card owners, jurisdiction is almost always awarded to the state of incorporation. And to make sure it gets its due of gift-card proceeds, Delaware has hired private auditors to inspect the books of companies that are not particularly eager to publicize their extra cash. From 2004 to 2014, for instance, Delaware paid the auditing agency Kelmar Associates $207 million to survey corporations registered within its borders for unclaimed property.

The state is probably right to be vigilant. In recent years, companies have become especially adept at circumventing unclaimed-property laws, according to Mayrack. Many now contract with third-party gift-card businesses based in states, such as Ohio and Virginia, that don't treat unused gift-card money as unclaimed property.

In these states, companies can funnel all unused gift-card money into their own coffers after five years, an expiration period mandated by Congress in 2009. One of the most prolific vendors of gift cards, Starbucks, is based in Washington, a state that says it won't take most gift-card money as unclaimed property—and because of its favorable location, the company made back $60.5 million in unspent gift-card money in 2017.

Even companies based in states with stricter laws are cutting corners just to avoid having their gift-card money seized as unclaimed property. Rather than contracting with legitimate third-party gift-card brands, some have allegedly set up shell companies to stash their unused gift money out of state. In one recent case, Delaware sued Overstock.com for contracting with a company that helped register gift cards out of state, even though Overstock.com—a Delaware company—remained the actual owner of the gift cards. In its complaint, Delaware called these out-of-state holdings a "sham" with the purpose of creating "a false paper trail." A jury agreed, and this past July, Overstock.com was required to pay the state a $7.3 million settlement.

Overstock, for its part, plans to file an appeal in September, telling me, "We did not violate the law." The company also noted that slightly less than 1 percent of its unspent gift-card money belonged to Delaware residents—but because of rules prioritizing the location of incorporation, it paid nearly all of it to the state.

Gift cards alone are not a massive revenue source for any state, but with many regions facing budget cuts, any extra wiggle room helps. Earlier this year, Claire Levy, who served in the Colorado legislature before becoming executive director of the Colorado Center on Law and Policy in 2013, pushed the state’s lawmakers to borrow money from its unclaimed-property fund—which had grown to $116 million—in order to pay for affordable housing.

“Colorado chronically has budget issues,” Levy tells me. “Public education is pitted against health care, which is pitted against child protective services, on and on and on.”

Although some opponents in the Colorado House of Representatives charged that Levy was “spending someone else’s money,” as one legislator put it to The Colorado Sun, Colorado citizens take back only about 40 percent of unclaimed property within 20 years. In 2015, the nationwide return rate was roughly the same: 42 percent. If the money just sits there, why not use it?

Legal advocates such as Levy see this approach as the future. “Are we just going to continue to just lock that money away and let it pile up and pile up and pile up?” she says. “It just makes no sense when we need to fund housing, when we need to fund mental health care, when we need so many other things taken care of.”

Yet an element of the low return rate is self-fulfilling. Without any incentive to do otherwise, some states allocate minimal funds—or none at all—toward notifying consumers that their property is on hold.

“We don’t have an outreach budget,” says Betty Yee, who oversees unclaimed property in California.

Since taking office in 2015, Yee has pushed the state to devote more resources to returning unclaimed money rather than spend it on government programs if no one reaches out to claim it. “The main objective of the unclaimed-property law is to protect unclaimed-property owners,” she says. “This is not the state’s property.”

Still, spending this money on state programs is a widespread practice. In her research, Levy discovered that the majority of states do spend unclaimed money, either by pouring it directly into the general fund or by putting it toward specific uses, such as housing and infrastructure.

Earlier this year, for instance, Louisiana pulled in $30 million to $40 million worth of unclaimed property to fill a hole in its annual budget. The Kansas legislature, too, decided to spend an extra $4 million from its unclaimed-property holdings. And California has long dumped its $400 million pot of unclaimed property into its general fund, making unclaimed property the state’s fifth-largest revenue source.

Government funding has always been a little bit weird—consider Iowa’s carved-pumpkin tax—but in an era of shrinking budgets, gift-card money has quietly begun bankrolling the month-to-month, year-to-year workings of American states.

THE ATLANTIC

by MICHAEL WATERS

AUGUST 27, 2019