

# New Delaware Unclaimed Property Decision Further Complicates Landscape

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Another federal judge slams Delaware's unclaimed property audit methodology but rejects the holder's reliance on the priority rules as a defense to the audit demands. [See \*Marathon Petroleum Corp. et al. v. Cook et al.\*, No. 1:16-cv-00080-LPS \(D. Del., Sept. 23, 2016\)](#). The court recognized the unjustness of Delaware's audit approach, but followed a previous case finding the priority rules can only be raised by states with competing claims.

## **Background**

Marathon Petroleum and its related entities are currently in the **ninth year** of an unclaimed property audit by Delaware (*i.e.*, soon, the audit will have spanned three separate US presidents). According to the memorandum opinion, the auditor has not found any material or systemic noncompliance. Two of the Plaintiffs, Marathon Petroleum and Speedway LLC, are organized under Delaware law and these entities cooperated with the auditor's document requests throughout the examination. However, after nine years of review, the auditor subsequently asked for extensive information for the two other Plaintiffs – Marathon Prepaid Card LLC and Speedway Prepaid Card LLC. These entities are not organized in Delaware (both are organized under Ohio law). The Ohio entities were in the business of issuing gift cards to be used at the Delaware entities facilities. The Plaintiffs did not provide the requested information and asserted that Delaware did not have standing to audit the Ohio entities under the priority rules established by the US Supreme Court.

Following its established playbook, the State known for its "business friendly environment" continued to trample on that reputation and threatened Plaintiffs with enforcement action through the Attorney General's Office, with the possibility of *additional* penalties (including treble damages if enforced under the False Claims Act).

As a result of this threat, Marathon sought relief in court, asserting the audit requests were preempted by the US Supreme Court's priority rules and the demands violated its rights under the Fourth Amendment. The State requested the case be dismissed for lack of subject matter jurisdiction

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and for failure to state a claim.

## **Good News**

The court not only found the claim was ripe for review, but it used very harsh language in describing Delaware's audit approach. The sound bites include:

- “The Court agrees with Plaintiffs that they are suffering a real harm due to Defendants’ actions.”
- “[T]he aggressive and persistent nature of Defendants’ audit, in conjunction with Defendants’ letter threatening referral to the Attorney General, place Plaintiffs in a difficult position. They can either cooperate with an intrusive, lengthy, and **potentially insatiable audit**, or they can resist the audit and risk an “enforcement action’ from the Attorney General and, potentially large penalties.” (emphasis added).
- [“The state’s] arguments ignore . . . the harm caused by the ongoing, and possibly unconstitutional audit process.”

By describing the audit as “potentially insatiable,” it is clear that the judge was feeling the pain of Delaware holders. The court distinguished this case from the recent *Plains All American* case. The court noted *Plains All American* involved a challenge to the audit process before the audit had begun. The issue in *Plains All American* was also different as the holder raised a factual question regarding the validity of Delaware's estimation methodology, not a challenge to the ability of the state to audit certain entities at all.

## **Bad News**

Unfortunately, the court found that the priority rules, established by the US Supreme Court starting with the seminal case of *Texas v. New Jersey*, only apply to resolve disputes between states with competing claims. Thus, the Plaintiffs could not invoke the priority rules as a defense to the audit demands. The court specifically followed the finding in the [Temple-Inland case earlier this summer](#). The court distinguished a case seemingly on point from its own appellate court – *N.J. Retail Merchs. Ass’n v. Sidamon-Eristoff*, 669 F.3d 374 (3d Cir. 2012). In that case, the Third Circuit specifically found preemption applied to a holder's challenge based on the priority rules. According to the memorandum opinion, the distinguishing feature is that as to the Marathon Plaintiffs, Delaware is alleging some type of fraud related to the use of the Ohio entities. No fraud allegations were involved in *N.J. Retail Merchs*.

Finally, the court found no Fourth Amendment violation (*i.e.*, unreasonable search and seizure) because the Plaintiffs could always decline to produce the documents. The auditor would then have to seek an enforcement action, at which point the Plaintiffs could present a defense prior to the documents being produced.

## **Practice Notes:**

(1) To ensure ripeness, holders seeking court review of a pending audit should wait until they receive a threat of enforcement or some other immediate penalty risk. Merely receiving document requests is

insufficient in this court to meet the ripeness standard.

(2) The court's decision that holders cannot rely on the priority rules as a defense to an audit request is potentially very confusing. Since another judge of the same court already considered the preemption issue, the result here is unsurprising. However, the scope and effect of the decision is unclear. The judge in this case (Chief Judge Stark) seemed to reconcile the decision with the Third Circuit case based on the State's fraud allegations. However, the court did not explain why fraud allegations made a difference. Fraud could be a reason why the Ohio entities are ignored – thus switching the entity to which the priority rules apply. But fraud should not be a reason to ignore the priority rules entirely in a holder challenge. Furthermore, the *Temple-Inland* decision cited did not involve fraud allegations either.

Prohibiting holders from relying on the federal common law priority rules creates significant concerns. Fundamentally, this conclusion risks disrupting state authority over property otherwise subject to their custody. For example, the decision suggests that a holder incorporated in a state that exempts a certain type of property has no recourse if another state, without any claim to one of the federal common law priority rules, claims the property. This issue will surely reach the US Supreme Court at some point, but in the meantime holders will have to continue to carefully monitor developments in this area and take steps to alleviate the risks created by the ambiguity in the law.

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