Uniform Law Commission Holders Coalition

Recommendations for the Revision of the Uniform Unclaimed Property Act

May 15, 2015

Table of Contents

EXECUTIVE SUMMARY

The Uniform Law Commission Holders Coalition strongly recommends the following revisions to the 1995 Uniform Unclaimed Property Act:

Administrative Appeals Process. An administrative appeals process should be incorporated that provides for an independent and fair review of the state administrator's determination of unclaimed property liability, couple with a defined interim audit conference process.

Burden of Proof. The ULC should amend the Burden of Proof requirement of Section 6 of the revised UUPA to follow the U.S. Supreme Court's ruling in *Delaware v. New York*, so that state's burden of proof matches that of the creditor in the creditor-debtor relationship. This is particularly important to clarify that the mere recordation on the holder's books of a credit or an accrual for an estimated or contingent liability is not sufficient, in and of itself, to satisfy the state's obligation to establish a prima facie case that a fixed and certain obligation exists or to shift to the holder the burden of establishing that such entries do not represent abandoned property.

Business-to-Business Exemption. Business-to-business transactions should be exempted from unclaimed property reporting requirements, as businesses are in the best position to determine whether another business holds their property. The UUPA should be amended to include the business-to-business exemption language advanced by the American Bar Association. This language is clear and does not employ the vague "ongoing business relationship" test contained in the Drafting Committee's draft business-to-business exemption.

Contingency Fee Audits. The ULC should consider more restrictive requirements on the hiring of private contract auditors. This includes a prohibition on the use of contingency fee arrangements between states and private auditors in contracts to conduct unclaimed property audits. In addition to this prohibition, the Coalition recommends adopting a set of best practices to increase transparency, oversight, and accountability in all contracts.

Derivative Rights Doctrine. The revised UUPA should recognize and incorporate the fundamental principles of unclaimed property law that has become known as the "derivative rights doctrine." This doctrine provides that the state's right to claim unclaimed property is derived of the owner's right to the property and therefore the state should, as a general matter, have no greater right to the property than the owner.

Dormancy Triggers. The 1995 Uniform Unclaimed Property Act should be revised to reflect that all securities-related dormancy periods will commence with a triggering event of two pieces of returned first class mail on the account. Additionally, tax deferred accounts should be not be considered abandoned until the owner of the property reaches age 70.5 or 30 years have elapsed from the date the account was opened, depending on the type of account.

Early Reporting. The Act should permit holders to remit property (other than securities, interest bearing, or fluctuating value property) prior to the abandonment period upon disclosure to the administrator, and provide indemnification to the holder when the holder so remits.

Foreign Addressed Property. The 1995 Uniform Unclaimed Property Act should be revised to provide that no state may require the reporting and remittance of Foreign Addressed Property, based on the Supremacy Clause, the Due Process Clause, and the Foreign Commerce Clause of the U.S. Constitution.

Proof of Death. A Social Security Death Master File match is insufficient to constitute "proof of death" for making an insurance policy (or other intangible property) "due and payable" and insufficient to trigger dormancy periods toward escheatment of property. "Proof of death" is defined by state law and/or the courts of the states to be an evidentiary standard sufficient to prove that the event actually occurred. Modification of the Act to include DMF Matching as proof of death will create conflicts with existing insurance laws and the standards for proof of death that have been established over decades within each individual state.

Securities: Non-Freely Transferable. Securities which are worthless, unpriced, or not transferable should be reported to the states as unclaimed property if the conditions for escheatment are met, but such securities should not be remitted to the states. Holders may maintain on their books and records certain securities that are non-transferable to escheat to the states. As many of these securities have no value, and would otherwise result in an expense to the states to custody such assets, this recommendation is viewed as beneficial to all stakeholders by reducing costs and related operational inefficiencies, without impacting the owners.

Securities: Restricted. The UUPA should reflect the fact that some securities are ownership interests which are subject to restrictions that prevent the owner from legally negotiating the interests until such time as the restrictions are removed. In some instances, the restriction is imposed pursuant to federal law, and in others, the restrictions are due to contract where there is no market value unless and until the conditions for vesting have been met.

Statute of Limitations. The statute of limitations provision in Section 19(b) of UUPA should be revised to provide greater certainty and protection to holders of unclaimed property. Specifically, the American Bar Association's recommendation should be adopted, including a three-year statute for filed reports (with seven years for fraud or failure to file a report). Also critically, there should be no requirement to specifically identify property in a report filed with the administrator for the statute of limitations to apply.

ADMINISTRATIVE APPEALS PROCESS

Recommendation:

The members of the Holders Coalition strongly recommend that an administrative appeals process be added to the Act that provides for an independent and fair review of the state administrator's determination. Further, although the current draft of the Revised Uniform Unclaimed Property Act includes an opportunity for holders to request an informal conference with the Administrator during the audit, the Holders Coalition recommends specific parameters for such conferences be incorporated into the law so as to fully protect the interests of both holders and states during the audit.

The administrative appeals process should include:

- Interim Audit Conference
- Three appeals options
  - Judicial
  - State's Administrative Procedures Law
  - Elective Administrative Appeal
- No requirement to exhaust administrative remedies
- De novo court review
- No requirement to pay disputed amount to file an appeal
- Independent/Objective Review Process
  - Joint selection of Hearing Officer
    - Qualifications – former member of judiciary or licensed attorney; not current employee or agent of the Administrator
- Written decision from the Hearing Officer that includes findings of facts and conclusions of law
- Award of attorney's fees to prevailing party, except state may be awarded fees only if state demonstrates holder acted with fraud or willful misconduct
- Timing
  - Holder has 60 days from the final examination report date to file an appeal
  - Hearing Officer must be selected within 60 days of the appeals filing date
  - Hearing must be held within 30 days of the Hearing Officer selection
  - Hearing Officer must issue written decision within 60 days of the hearing
  - Parties have 45 days after the Hearing Officer's decision to request a judicial or administrative review

Discussion in Support of Recommendation:

The Drafting Committee of the Uniform Law Commission expressly recognized that many states do not provide any official administrative appeals process for holders under audit. An administrative appeals process would be beneficial to both holders and administrators, allowing for the resolution of legitimate questions without the expense and other burdens of formal litigation. In addition, as the current draft acknowledges, Administrator review should be available during the audit, especially when a private audit firm is conducting the audit. Aggrieved holders should not be required to acquiesce to what they perceive as a burdensome and unreasonable process without having an opportunity to be heard by the state administrator. The recommendation below includes language that would clarify the informal conference process for all parties involved.

The post-audit administrative appeals process should reflect a truly independent review of the Administrator's determination, which is not unfairly weighted toward either the state or the holder. Such an administrative appeals procedure is essential to sound state administrative processes as forums independent of, and uninfluenced by, agencies that can render adverse decisions against citizens. Furthermore, meaningful and fair review is required by due process and the courts have recognized that due process requires an impartial decision maker. It would be nearly impossible for an administrative appeal to be meaningful and unbiased if holders were required to appeal to a tribunal or a decision-maker whose interest were aligned with the agency charged with administering the state's unclaimed property laws. This is because the holder's interests and the agency's interests necessarily diverge – the state has assessed the liability and the holder disagrees with it.

Recommended Revision:

Section 16: ACTION TO ESTABLISH CLAIM. An owner aggrieved by a decision of the administrator or a person whose claim for property has not been acted upon within 90 days after its filing may maintain an original action to establish the claim in the [appropriate] court, naming the [administrator] as a defendant.

Section 22(A) ENFORCEMENT OF FINAL DETERMINATION

1) The administrator may maintain an action in this or another State to enforce this Act after the issuance of a final examination report, as defined in subparagraph (3) below, so long as the administrative appeal rights of the holder have expired. The court may award reasonable attorney's fees to the prevailing party; except that the state may be awarded fees only where it is the prevailing party and the holder acted with fraud or willful misconduct.

2) Any holder aggrieved by a final examination report may, within 60 days from the date such final examination report is issued, pursue a judicial or administrative appeal pursuant to [STATE's administrative procedures law] or, any holder so aggrieved may elect to pursue first an Elective Administrative Appeal as set forth in this Section without waiver of any right to later pursue a judicial or administrative appeal pursuant to [STATE's administrative procedures law].

3) Elective Administrative Appeal by Holder.

a) Within 60 days from the date of a final examination report issued by the state administrator, a holder may file a written appeal with the Administrator's Office.

b) If the holder files neither a written appeal pursuant to this section within 60 days nor elects to pursue its judicial or administrative appeal rights in accordance with [STATE's administrative procedures act] the holder will be presumed to have agreed to the final examination report.

c) For purposes of this section a "final examination report" is a report issued by the Administrator and contains findings that specify the property types audited, the years audited, and the final amount allegedly due the Administrator.

4) The written appeal must be dated and signed by the holder and contain the following information:

a) The names of all parties involved in the audit at issue;

b) The specific findings the holder is protesting including any amounts in question, property types, and the years audited. The holder is presumed to have agreed to any findings not contested;

c) A clear and concise description of each error that the holder is alleging the Administrator's Office made in its findings;

d) The argument and legal authority upon which each assignment of error is made; provided, that the applicant shall not be bound or restricted in any hearing to the arguments and legal authorities contained and cited in said appeal;

e) The relief requested; and

f) Whether or not the holder is requesting a hearing.

5) Within 10 calendar days from the Administrator's acknowledgement of his or her receipt of the written appeal, the holder must pay the undisputed amount of the audit findings to the Administrator.

6) Hearing.

a) If the holder files a written appeal, a designated hearing officer shall be selected by the process described in paragraph (9).

b) If requested by the holder, the designated hearing examiner shall schedule a hearing, to be conducted within 30 calendar days from the date of the notice of his or her selection. The Administrator, designated hearing examiner and the holder shall agree upon a date(s) for the hearing which are within the 30 calendar day period.

c) The designated hearing examiner shall issue a Notice of Hearing, notifying the Administrator and holder of the date, time, and place of the hearing.

d) The Notice of Hearing shall notify the Administrator and the holder that:

i) The Administrator and holder may present witnesses and documents at the hearing.

ii) Failure to appear for the scheduled hearing without good cause shall be treated as a withdrawal of the Request for Hearing, and the designated hearing examiner will make a final determination based upon the record.

iii) The designated hearing examiner may reschedule a hearing upon determining that good cause exists.

e) The designated hearing examiner shall have the discretion to allow the Administrator or the holder to provide additional information subsequent to the hearing and will supplement the record accordingly.

7) Final Determination. Within 60 calendar days, after the hearing is held and the record is complete, the designated hearing examiner will issue a written decision (the Final Determination) to the Administrator and holder. The Final Determination will include findings of fact and conclusions of law.

8) Record. The designated hearing examiner shall prepare an official record of the appeal that includes, but is not limited to, a transcript of all testimony and all papers, motions, documents, evidence and records reviewed in the appeal process, and a statement of matters officially noted.

9) Designated Hearing Examiner Selection: The designated hearing examiner shall be a former member of the judiciary or a licensed attorney who is qualified by experience or training to serve and shall not be any current employee of Administrator or agent of Administrator. The designated hearing examiner will be mutually selected by the parties through the following process:

a) Within 45 calendars days after the request for an Elective Administrative Appeal by the Holder, each party shall provide to the other a list of no more than 5 people who are qualified to be a designated hearing examiner.

b) Within 5 calendar days from receipt of the list, the parties may, without cause, remove 2 names from the list.

c) Within 5 calendar days from communicating the removal of names, the parties shall agree to a random selection process for choosing the designated hearing examiner from the remaining names and shall select the designated hearing officer in accordance with such process.

d) The Administrator shall notify the hearing officer of his or her selection within 5 calendar days from the selection.

e) The designated hearing examiner may award reasonable attorney's fees and the costs of the designated hearing examiner to the prevailing party; except that the state may be awarded fees only where it is the prevailing party and the holder acted with fraud or willful misconduct.

10) Judicial or Administrative Review.

a) Any party adversely affected by the designated hearing examiner's decision is entitled to judicial or administrative review and may pursue such review by filing notice within 45 calendar days from the date that the designated hearing examiner's final determination is received by that party, in accordance with [STATE's laws or administrative procedures act].

b) The review shall be a de novo review of the issue (s) in dispute at the time of initiating the judicial or administrative review.

11) Decisions of the designated hearing examiner shall not be considered as precedent.

12) A holder's decision to forego the Elective Administrative Appeal shall not constitute a failure to exhaust administrative remedies, nor shall a holder's decision to request Elective Administrative Appeal preclude the holder from commencing a proceeding with other administrative or judicial remedies with respect to any issue not resolved.

Section 22(B) AUDIT CONFERENCE

1) Upon written request of a holder, third-party auditor, or upon its own motion, the Administrator may convene a conference during the course of the audit to resolve disputes concerning the scope and methodology of the audit itself.

2) The Administrator, as well as a representative of the holder and a representative of the third-party auditor must all be present at the conference.

3) All written requests for a conference must state the years audited, property types, the amounts in question, and the reason the conference is necessary.

4) The conference may be conducted telephonically or in person at the Administrator's offices.

5) A holder's or third-party auditor's initial request for a conference shall be granted.

6) Any guidance provided by the Administrator will apply to the particularities of the audit of the holder requesting the conference only and will not constitute a binding decision or determination subject to any appeal.

BURDEN OF PROOF

Recommendation:

The members of the Holders Coalition strongly recommend that the ULC amend the Burden of Proof requirement of Section 6 of the revised UUPA to follow the U.S. Supreme Court's ruling in *Delaware v. New York*,[1] so that state's burden of proof matches that of the creditor in the creditor-debtor relationship. This is particularly important to clarify that the mere recordation on the holder's books of a credit or an accrual for an estimated or contingent liability is not sufficient, in and of itself, to satisfy the state's obligation to establish a prima facie case that a fixed and certain obligation exists or to shift to the holder the burden of establishing that such entries do not represent abandoned property.

Discussion in Support of Recommendation:

In the U.S. Supreme Court's ruling in *Delaware v. New York*, the court held that a state's power to escheat unclaimed intangible property is defined by the debtor-creditor relationship that exists under the law that created the property at issue.[2] Since the state's power to escheat is derived from that of the creditor, the state's burden of proof must match that of the creditor; otherwise, the process of escheat would result in a change to the nature of the debtor-creditor relationship, which the Supreme Court held cannot be done.

The burden of proof is extremely important in any legal proceeding, including unclaimed property audits. As explained by the U.S. Supreme Court in *Director v. Greenwich Collieries*,[3] the "burden of proof" refers to the obligation to convince the trier of fact of the truth of a disputed fact. This concept is often conflated with the "burden of production of evidence," which refers to a party's obligation to come forward with evidence that supports a claim.[4] The members of the Holders Coalition propose to expand the existing language of UUPA 1995

[1] 507 U.S. 490, 501(1993).
[2] *Id.* ("In framing a State's power of escheat, we must first look to the law that creates property and binds persons to honor property rights…."); *id*. at 499 ("First, we must determine the precise debtor-creditor relationship as defined by the law that creates the property at issue. . . . In the absence of any controlling federal law, 'property' and 'interests in property' are creatures of state law. [The] law that creates property necessarily defines the legal relationships under which certain parties ("debtors") must discharge obligations to others ("creditors")." (internal quotes and citations omitted)).
[3] 512 U.S. 267 (1994).
[4] As *Director v. Greenwich Collieries*, 512 U.S. 267, 272-75 (1994), explains, "The burden of proof is the obligation which rests on one of the parties to an action to persuade the trier of the facts . . . of the truth of a proposition which he has affirmatively asserted. . . . The proper meaning . . . is 'the duty of the person alleging the case to prove it,' rather than 'the duty of the one party or the other to introduce evidence.'" In *Greenwich Collieries*, the U.S. Supreme Court provided a detailed history of the use of the term and explains that "burden of proof" is used to describe "burden of persuasion"—the notion that where the evidence is evenly balanced, the party that bears the burden of persuasion must lose, unless an unusual "standard of proof" is imposed. "Burden of proof" is a distinct concept from the "burden of production"—a party's obligation to come forward with evidence to support its claim—and a "standard of proof, such as preponderance of the evidence," that "can apply only to a burden of persuasion, not to a burden of production." *Id.* at 233.

Section 6 to clarify this distinction and the significance of each term with respect to unclaimed property audits in particular.

Further arguments in support of a revised Section 6 include:

- The proposed revised section would expressly refute an important point that is often wrongly used against holders (*i.e.*, debtors) in unclaimed property audits: that the mere recordation on the holder's books of an accrual for an estimated or contingent liability (which is often required by generally accepted accounting principles although the amount of such potential or contingent liability is not liquidated, fixed and certain) or the mere recordation of a credit on the holder's books, is not sufficient, in and of itself, to satisfy the state's obligation to establish a prima facie case that a fixed and certain obligation exists or to shift to the holder the burden of establishing that such entries do not represent abandoned property.
- The proposed revised section would affirm that, if the administrator seeks to use estimation to establish a holder's liability, the administrator has the affirmative burden to establish both (a) that the records of the holder are insufficient to permit the preparation of a report and (b) that the proposed method of estimation is reasonably crafted to result in an appropriate estimation of the amount actually owed by the holder to the state.

<u>Recommended Revision:</u>

The members of the Holders Coalition would recommend adoption of the language recommended by the American Bar Association (ABA) in Section 6, which is as follows:

> (a) <u>Controlling Law</u>. In the absence of any controlling federal law, the law that determines the precise debtor-creditor relationship for an obligation potentially subject to escheat under this Act is the substantive law of the State or foreign jurisdiction that creates the property at issue.
>
> (b) <u>Burden of Production</u>. The administrator, as the party claiming property, has the initial burden of producing evidence to establish a prima facie case that a particular property right exists and that such property is an outstanding fixed and certain obligation of the purported holder. A prima facie case is the production of sufficient evidence to allow an inference that a particular property right exists and that such property is an outstanding fixed and certain obligation of the purported holder.
>
> (c) <u>Burden of Proof</u>. At all times, the administrator bears the burden of proof under the controlling state law to establish that a particular property right exists, that such property is an outstanding fixed and certain obligation of the purported holder, and passage of the requisite period of abandonment. The burden of proof refers to the burden of persuading the trier of fact.

(d) Property Evidenced by Record of Check or Draft. A record of the issuance on a particular date of a check, draft, or similar instrument, in a stated amount, to a third party under circumstances that normally indicate delivery creates a prima facie case of the existence of an outstanding fixed and certain obligation of the issuer. In claiming property from a holder who is also the issuer, if an administrator presents evidence sufficient to create a prima facie case, then the burden of production shifts to the purported holder to produce evidence that tends to disprove issuance on a particular date, delivery or amount of the obligation evidenced by the record of the check, draft, or similar instrument, or otherwise show that it never was or no longer remains the fixed and certain obligation of the purported holder. Evidence that tends to disprove a prima facie case includes, but is not limited to, evidence that:

1) the check, draft, or similar instrument was issued as an offer in settlement of an unliquidated amount;

2) the check, draft, or similar instrument was issued to a governmental entity, a charitable organization, or an affiliated entity of the issuer;

3) the check, draft, or similar instrument was voided within 90 days of issuance;

4) the check, draft, or similar instrument was never delivered to a third party; and

5) the obligation evidenced by the check, draft, or similar instrument was paid, satisfied, or discharged, or there was a want of consideration therefor or a failure of consideration therefore.

When a purported holder has produced evidence that tends to disprove a prima facie case, the purported holder has satisfied any shifted burden of production, and the burden of proof remains with the administrator. If the administrator has created a prima facie case with respect to a check, draft or similar instrument and the purported holder has not satisfied its shifted burden of production, the administrator has met its burden of proof with respect to such check, draft or similar instrument upon showing the passage of the requisite period of abandonment.

(e) Property Evidenced by Record in a Holder’s Books or Records. The record of a liability in a holder’s books or records is some evidence of an obligation but is not by itself sufficient to create a prima facie case of a fixed and certain obligation. Examples of such evidence by itself insufficient to create a prima facie case include, but are not limited to, the record of:

1) an accrual of an estimated liability;

2) an accrual of a contingent liability; and

3) a credit on a holder's books recorded for accounting purposes.

(f) Negative and Affirmative Defenses. The purported holder may raise any defenses, whether negative or affirmative, to an administrator's claim to property. A negative defense negates the elements of the administrator's prima facie case. Asserting a negative defense does not shift the burden of proof to the purported holder; rather, the burden of proof remains with the administrator. An affirmative defense precludes liability even if all of the elements of the administrator's claim are proven. The purported holder bears both the burden of proof and the burden of production with respect to any affirmative defense it raises.

(g) Estimation. In order for an administrator to impose estimation under Section 20(f), the administrator has the evidentiary burden to show that the records of the holder were insufficient to permit the preparation of a report and that unclaimed and dormant property was held by the holder. If such burden is met, the administrator shall use a method of estimation that is reasonably crafted to determine the amount of unclaimed property that would have been owed to the state, but was not paid to that state. If the holder disputes the method of estimation and offers an alternative method of estimation, the trier of fact shall apply the method that is more likely to approximate the actual amount of unclaimed and dormant property owed to the state by the holder.

The members of the Holders Coalition further recommend that comments be added to explain that the usual burdens of production and persuasion apply to establishing the existence of unclaimed property. In particular, consistent with the ABA's recommendations, we recommend the following:

Comment

This section has been modified to follow the U.S. Supreme Court's ruling in *Delaware v. New York*, which holds that a state's power to escheat unclaimed intangible property is defined by the debtor-creditor relationship that exists under the law that created the property at issue. *Delaware v. New York*, 507 U.S. 490, 499 (1993) ("First, we must determine the precise debtor-creditor relationship as defined by the law that creates the property at issue. . . . In the absence of any controlling federal law, 'property' and 'interests in property' are creatures of state law. [The] law that creates property necessarily defines the legal relationships under which certain parties ("debtors") must discharge obligations to others ("creditors")." (internal quotes and citations omitted)).

This section also clarifies the distinction between the "burden of proof" and the "burden of production" as explained by the U.S. Supreme Court in *Director v. Greenwich Collieries*, 512 U.S. 267, 272-75 (1994). In *Greenwich Collieries*, the U.S. Supreme Court held that the ordinary and natural meaning of the term "burden of proof" was the "burden of persuasion" – the notion that where the evidence is evenly balanced, the party that bears the burden of persuasion must lose, unless an unusual "standard of proof" is imposed. *Id*. at 272. Noting that courts have often confused the terminology, the court clarified that the "burden of proof" is a distinct concept from the "burden of production" – "a party's obligation to come forward with evidence to support its claim" – and a "standard of proof, such as preponderance of the evidence," that "can apply only to a burden of persuasion, not to a burden of production." *Id.* at 272, 278. As the Court explained, "[t]he burden of proof is the obligation which rests on one of the parties to an action to persuade the trier of the facts . . . of the truth of a proposition which he has affirmatively asserted. . . . The proper meaning . . . is 'the duty of the person alleging the case to prove it,' rather than 'the duty of the one party or the other to introduce evidence.'" *Id.* at 276 (citations omitted).

This section is consistent with those cases that have held that the ordinary default rule is that the plaintiff, as the party seeking relief, bears the initial burden of production to create a prima facie case and also bears the burden of proof. Further, such cases hold that upon the creation of a prima facie case, the defendant is not required to, but may, rebut the prima facie case by raising any defense. The assertion of a negative defense, which tends to disprove one or all of the elements of the prima facie case, does not shift the burden of proof to the defendant. If, however, the defendant raises an affirmative defense, which accepts the state's claim that an obligation exists, but nonetheless defeats liability, the defendant bears its own burden of proof with respect to its affirmative defense. *See, e.g.*, *Schaffer v. Weast*, 546 U.S. 49, 57 (2005). Thus, when applied to the unclaimed property context, the administrator, as the party claiming property, bears the initial burden of producing sufficient evidence to create a prima facie case and the ultimate burden of proof, that is, the burden of persuading the trier of fact. A prima facie case is a "party's production of enough evidence to allow the fact-trier to infer the fact at issue and rule in the party's favor." BLACK'S LAW DICTIONARY 1382 (10th ed. 2014).

This section also is consistent with those cases holding that when claiming abandoned property, the state steps into the shoes of the owner. *See* Epstein, McThenia and Froslund, "Unclaimed Property and Reporting Forms," sec. 3.02 (Matt. Bend. 1984). As the state can claim no more than the interest of the unknown or absentee owner of property, a necessary element that it must prove before property may escheat, is the existence of a liquidated and certain obligation. *See, e.g.*, *California ex rel. v. Bank of America*, 120 Cal. Rptr. 3d 204, 216 (Cal. Ct. App. 2011); *Employers Ins. of Wausau v. Smith*. 453 N.W.2d 856, 861-63 (Wis. 1990); *Revenue Cabinet v. Blue Cross & Blue Shield* (Ky. 1986) 702 S.W2d 433, 434-35. Because the mere issuance of a check, draft or similar instrument alone does not create liability, *see Kane v. Insurance Co. of N.A.*, 392 A.2d 325, 329 n.5 (Pa. 1978), this provision clarifies that some evidence of delivery of a check or obligation must be shown. Similarly, a mere accounting entry, without more, does not create a fixed and certain obligation.

BUSINESS-TO-BUSINESS EXEMPTIONS

Recommendation:

The members of the Holders Coalition strongly recommend that business-to-business transactions be exempted from unclaimed property reporting requirements. Businesses are in the best position to determine whether another business holds their property, and they do not need the assistance of government in making such determinations. When two companies reconcile and settle their accounts, there is no need for a state to re-open those closed books and records years later to determine whether one business holds property that belongs to another business.

Discussion in Support of Recommendation:

State unclaimed property laws were primarily designed to protect the rights of individuals, particularly consumers, who lost track of their property or that never received payments owed to them. These laws were not intended to safeguard the property of businesses.

Large businesses typically operate through thousands of commercial accounts. Often, the so-called “debt” may instead be a bookkeeping entry or systems error that is either automatically reconciled by electronic systems when future transactions are entered, offset intentionally in the next transaction pursuant to industry practice, settled at some future date or by some other means, or has otherwise been resolved between the businesses. Even if an amount is in fact owed to a business, the business may have made an affirmative decision not to pursue the debt on the basis that is it immaterial or for other reasons.

Outstanding credit balances in these accounts are frequently small dollar amounts. A common practice during a state audit is to conduct a statistical sample of a company’s commercial accounts for a specific period to identify outstanding credit balances. The results of that sample are then extrapolated back to a point in time chosen by the auditor, and the holder is presented with an assessment for “unremitted credit balances.” However, business-to-business credit balances are frequently not property actually due a creditor, and are so common in commercial transactions that requiring such items to be turned over to the government unnecessarily increases the cost of doing business. Indeed, because businesses have the incentive, opportunity, and wherewithal to collect what is owed to them, legitimate credit balances between businesses are inherently reconcilable, and credit balances between businesses should be exempted from unclaimed property reporting requirements. Such a rule places the recordkeeping burden on the appropriate party in the business transaction: the party with the financial incentive to collect legitimate outstanding amounts.

Further arguments in support of a business-to-business exemption include:

- A business-to-business exemption is consistent with the principles set forth in *Delaware v. New York* because that case acknowledged the UCC, which governs business transactions in general, as controlling for purposes of determining a debtor in an unclaimed property transaction.
- A strong policy reason exists to distinguish individual and business owners. From a practical perspective, businesses have a much more detailed process of bookkeeping than individuals. If "debts" between businesses are left unresolved/unpursued, it is a far more likely presumption that this is because the business that is owed the money has concluded that it is not truly owed the money. It is far more likely that the business has not booked this as an asset or if it was booked as an asset, the business has subsequently written it off. It should not result in a presumption that money is owed and just forgotten.
- While equity in the law may "abhor a forfeiture," the UCC does not operate to result in a forfeiture of rights by one party to another. Rather, the UCC, particularly the statute of limitations on claims, provides a protection to all businesses. It is also important to note that the law does in fact provide for forfeiture in certain circumstances: for example, see the treatment of advance deposits (*e.g.*, lay-away payments) for unclaimed property purposes. Indiana specifically forfeits an owner's right to seek a refund of unclaimed property the State holds, if the owner does not make a claim within 25 years.
- Hesitation for the State to give up revenue is not a valid policy reason to reject a business-to-business exemption. Just as NAUPA has asserted that there is a policy reason behind not allowing a corporate windfall as a holder, the state should not be allowed a windfall because it does not want to "eliminate that amount of unclaimed property." Further, since most business property is identifiable, the state should have corresponding liability (at least in theory, assuming the businesses ultimately claim funds), so this exemption should have a neutral revenue impact to the state. The "estimation" process applied to business-to-business property assures the State a windfall.
- The benefit to small business of the existing unclaimed property reporting regimes in the states is overstated. Small businesses generally do not comply with unclaimed property reporting requirements, and, regardless, on a national scale, the amount claimed back by businesses is typically a small fraction of the amount reported. NAUPA presents one state – West Virginia's – business-to-business property reported in one year and claims the vast majority of such property is made up of "fixed and certain obligations." In that case, is NAUPA willing to concede that business-to-business property falling outside of categories related to banking, insurance, and equity property could be exempted without major consequence to owners or the states?
- Further, the benefit to small businesses is likely significantly overstated through the inclusion of *de minimis* amounts returned. Understanding that smaller amounts are significant to small businesses, there is a point of diminishing return. In the aggregate these amounts are large; for individual small businesses, likely not so. Due to the low value of these properties, there is no 'unjust enrichment" of one business at the expense

of another, or of the public. In reality, the cost to manage these records exceeds the value of the properties, thereby costing the economy more than it benefits.

For all these reasons, fourteen states have adopted business-to-business exemption in their unclaimed property laws, including Arizona, Illinois, Indiana, Iowa, Kansas, Maryland, Massachusetts, Michigan, Missouri, North Carolina, Ohio, Tennessee, Virginia, and Wisconsin (New York and Texas have recognized limited business-to-business exemption as a matter of administrative practice, although New York recently discontinued its practice).[5] State legislatures continue to discuss and act on measures to exempt business-to-business property, including Missouri, which enacted a broad business-to-business property exemption in 2014 (see H.B. 1075, enacted July 9, 2014). Significantly, this proposal became law in large part as a result of the Missouri Chamber of Commerce and Industry's commitment to unclaimed property reform.[6] Other states are poised to follow suit.

Recommended Revision:

Consistent with the American Bar Association's recommendation, Section 2 of the UUPA should be amended by adding the following provision:

> Notwithstanding any other provision of this [Act], any property due or owing from a business association to another business association, including, but not limited to, checks, drafts or similar instruments, credit memoranda, overpayments, credit balances, deposits, unidentified remittances, nonrefunded overcharges, discounts, refunds and rebates, shall not constitute unclaimed property under this [Act]. This section also applies to all amounts due or owing from a business association to another business association that, on the effective date of this section, are in the possession, custody, or control of a business association.

The Holders Coalition strives for an unambiguous exemption which is easy to administer. As such, we recommend the adoption of the American Bar Association's approach, which reflects sound public policy and ease of administration, and has broader support than an exemption modeled after Tennessee's statute, which is subjective, complex, and difficult to administer and comply.

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[5] For more detail on these exemptions, see Douglas L. Lindholm and Ferdinand S. Hogroian, *The Best and Worst of State Unclaimed Property Laws*, Council On State Taxation (Oct. 2013), available at http://www.cost.org/WorkArea/DownloadAsset.aspx?id=85349.

[6] More on the Missouri Chamber's advocacy on this issue is available at: http://mochamber.wordpress.com/tag/unclaimed-property/.

CONTINGENCY FEE AUDITS

Recommendation:

The members of the Holders Coalition strongly recommend that the Drafting Committee consider more restrictive requirements on the hiring of private contract auditors.

Contingency Fee Prohibition

The Drafting Committee should prohibit the use of contingency fee arrangements between states and private auditors in contracts to conduct unclaimed property audits.

Transparency Best Practices

The Drafting Committee should require unclaimed property administrators to:

- Make a written determination prior to engaging a private auditor that such engagement is both cost-effective and in the *public interest*.
- Post such determination on the unclaimed property administrator's website.
- Subject contracts for private audit services to an open, competitive bidding process.
- Post contracts on the unclaimed property administrator's website for public inspection throughout the duration of the contract.

Contract Best Practices

The Drafting Committee should require unclaimed property administrators to:

- Require private auditors acting on behalf of the state to act with the highest ethical standards befitting representatives of the state, to conduct all audits within the boundaries of applicable unclaimed property law, and to refrain from pursuing abusive, unreasonable or cumbersome audit procedures.
- Provide that the unclaimed property administrator shall at all times retain complete control over the course and manner of any audit conducted by a private auditor and shall not delegate to private auditors substantive decision-making authority regarding the types of property to be pursued, the legal theories underlying audit practices, or the initiation, resolution, or termination of an audit.
- Require private auditors acting on behalf of the state to issue formal audit findings at the conclusion of an audit when requested by the holder of unclaimed property.
- Provide that any holder of unclaimed property subject to audit by a private audit firm may contact the unclaimed property administrator's staff directly on any matter pertaining to the scope of, legal justification for, or resolution of the audit.

<u>Discussion in Support of Recommendation</u>:

State unclaimed property laws, when responsibly and fairly enforced, serve several important functions. Such laws, among other things, help reunite rightful owners with their property and ensure companies are incentivized to protect abandoned consumer property. However, in recent years, not all states have enforced unclaimed property laws fairly or within the boundaries of the law. These states are often enticed by profit-driven private auditors, rather than returning property to rightful owners. However fairly a state administers its unclaimed property laws, it is important to adhere to best practices when enforcing the law, especially when that enforcement responsibility relies heavily on outside auditors.

Although the enforcement of unclaimed property laws extend far beyond the life insurance industry, recent events surrounding audits targeting life insurance companies demonstrate the perils of contingency fee arrangements with private unclaimed property auditors. In 2009, a private audit firm began a practice of requiring life insurance companies to cross-reference their policy records against the Social Security Administration's publicly available Death Master File ("DMF") – a partial and unverified database of deaths recorded in the United States – in order to identify policyholder deaths that had not yet been reported to the insurance company and corresponding benefits that had been "abandoned." Insurance companies maintained that the private auditors' requirements had no legal basis, but the companies had scant opportunity to challenge them. The auditors failed or refused to issue formal audit findings that an insurance company could challenge in an administrative proceeding, thereby evading review of their legal positions. At the same time, unclaimed property administrators fueled significant adverse publicity for the life insurance industry premised on the assumption that insurers had been legally obligated to search the DMF for potentially deceased policyholders but had failed to do so, and the number of life insurance companies facing private audits continued to grow.

The audits imposed substantial costs and burdens on companies, often requiring the hiring or redeployment of dozens of employees to meet the private auditors' demands. Faced with burdensome audits, numerous companies entered into multi-state settlements, agreeing, despite strong legal defenses, to search the DMF for escheatment purposes, to pay interest calculated from the date of death on all amounts escheated (regardless of when the company actually learned of the death and would have been in a position to process a claim or escheat funds absent DMF searching), and to pay to the states millions of dollars to cover their costs of investigation.

Recent legal developments have made clear, however, that the industry was correct: the private audit firms' demand that insurance companies cross-reference their book of business against the DMF, which resulted in substantial contingency fees for the audit firms and substantial revenues to the states, is not supported by law.[7] There have been no countervailing rulings to date by a federal or state court upholding the position taken by unclaimed property administrators and private auditors with regard to DMF searching.

The experience of the life insurance industry is a cautionary tale about the risks of inadequately supervised private audit firms operating on a contingency fee basis. The enforcement of unclaimed property should strike a balance between the interests of returning property to rightful owners and the fair application of the law. To obtain this balance, the Drafting Committee should prohibit contingency fee auditors and require state unclaimed property administrators to follow transparency and contracting best practices when engaging private auditors. The recommendations below provide sensible safeguards to maintain the credibility and integrity of the enforcement of a state's unclaimed property law.

Contingency Fee Prohibition – The use of contingency fee private audit firms to conduct unclaimed property audits on behalf of the state have become increasingly common. These contingency fee arrangements carry significant potential for abuse, as the recent experience of the life insurance industry amply demonstrates. Several states have already enacted statutes barring or restricting the use of contingency fee auditors in recognition of the problematic incentive structure of such arrangements,[8] and several other states have recently considered banning such arrangements.[9] Requiring unclaimed property administrators to compensate private audit firms on an hourly basis will eliminate the risk of overly aggressive enforcement that exceeds the boundaries of the law and will help ensure that private audit firms prioritize accuracy and operate under the highest ethical standards, befitting their role as representatives of the state. Any resource challenges associated with hourly fee arrangements can be mitigated by implementing a robust voluntary disclosure program or structuring contract payments to be due after the auditor remits unclaimed property to the state.

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[7] *See, e.g., Total Asset Recovery Servs. v. MetLife, Inc.*, Case No. 2010-CA-3719 (Fl. Cir. Ct. Aug. 20, 2013) (holding that Florida's unclaimed property law does not require DMF searches), *aff'd*, Case no. 1D13-4420 (Fla. App., 1 Dist., Sept. 19, 2014) Sept. 19, 2014; *Thrivent Financial for Lutherans v. State of Florida, Dep't of Financial Services*, Case No. 1D13-5299 (Fl. App., 1 Dist., Aug. 5, 2014) (same); *State of West Virginia ex rel. John Purdue v. Nationwide* (Dec. 27, 2013) (dismissing lawsuits brought by West Virginia Treasurer against 69 life insurance companies on the ground that the West Virginia unclaimed property law does not require DMF searches); *Feingold v. John Hancock Life Ins. Co. (USA)*, Civ. Action No. 13-10185-JLT, 2013 WL 4495126, at *2 (D. Mass. Aug. 19, 2013) (insurance laws of Massachusetts and Illinois do not require insurer to search out potentially deceased policyholders), *aff'd*, 753 F.3d 55 (1st Cir. May 27, 2014); *Andrews v. Nationwide Mut. Ins. Co.*, No. 97891, 2012 WL 5289946, at *5 (Ohio Ct. App. Oct. 25, 2012) (insurance company under no legal duty to search the DMF to determine whether policyholders had died).

[8] In recognition of this problematic incentive structure Illinois, Virginia, and North Carolina have enacted statutes that limit or bar the state's unclaimed property administrators from relying on contingency fee auditors to collect unclaimed property. *See* 765 ILCS 1025/24.5 (banning the use of contingency fee auditors for in-state businesses); Va. Code Ann. 55-210.24(D) (banning the use of contingency fee auditors for in-state businesses); N.C.G.S. § 116B-8 (banning the use of contingency fee auditors except with regard to the life insurance industry).

[9] Oklahoma H.B. 1741 (2015); Delaware S.B. 215 (2014); Michigan H.B.5524 (2012); Michigan H.B. 5525 (2012); Michigan H.B. 5526 (2012).

Transparency Best Practices – These transparency best practices will ensure that unclaimed property administrators retain the highest quality private audit firms that deliver the best value to the state and are in the best interest of the public. In addition, public posting of the contracts will ensure that unclaimed property administrators and private audit firms are accountable to the public for fee arrangements impacting public funds and ward off any inclination for private auditors to engage in "pay-to-play" activity to receive a state unclaimed property contract award.

Contract Best Practices – These best practices will ensure an appropriate degree of transparency, oversight, and accountability for private audit firms purporting to act on behalf of unclaimed property administrators and will help ensure that all audits are conducted within the boundaries of the law. Requiring private audit firms to issue formal audit findings, which should be standard in any audit, will help ensure that companies subject to audit may, in appropriate circumstances, exercise their legal right to contest the legal basis for audit findings in an administrative proceeding. In addition, providing a direct line of communication to the unclaimed property administrator's staff will help ensure appropriate oversight and protection of the legal rights of companies subject to audit.

DERIVATIVE RIGHTS DOCTRINE

Recommendation:

The members of the Holders Coalition strongly recommend that the revised UUPA recognize and incorporate the fundamental principles of unclaimed property law that has become known as the "derivative rights doctrine." This doctrine provides that the state's right to claim unclaimed property is derived of the owner's right to the property and therefore the state should, as a general matter, have no greater right to the property than the owner.

Discussion in Support of Recommendation:

The U.S. Supreme Court has recognized the derivative rights doctrine in *Delaware v. New York*.[10] In that case, the Court stated that, in determining whether a state has the right and power to escheat unclaimed property, the first step is to "determine the precise debtor-creditor relationship as defined by the law that creates the property at issue."[11] The Court then held that "[i]n framing a State's power of escheat, we must first look to the law that creates property and binds persons to honor property rights…," and specifically acknowledged that "the holder's legal obligations… define[] the escheatable property at issue."[12] Accordingly, the Court found that the "holder" of unclaimed property is the "debtor" or the "obligor"; conversely, if a person is not a legal debtor, then it is not a "holder" and has no obligation to report or remit property to the state. Lower courts have also widely recognized the derivative rights doctrine.[13]

The UUPA was revised in 1995 to attempt to codify the federal common law rule in *Delaware v. New York*. The UUPA thus currently defines a "holder" to mean "a person obligated to hold for the account of, or deliver or pay to, the owner property that is subject to this [Act]."[14] The Comment to the 1995 UUPA further clarifies that "As held by the Supreme Court in *Delaware v. New York*, the holder is the person indebted under the applicable state law….The holder thus is 'a person obligated,' i.e., a person who could be sued successfully by the owner for refusing to make payment." However, other provisions of the 1995 UUPA are inconsistent with the

[10] 507 U.S. 490, 503 (1993).
[11] *Id.* at 499.
[12] *Id.* at 501.
[13] *See, e.g.*, *State Dep't of Revenue v. Puget Sound Power & Light Co.*, 694 P.2d 7, 11 (Wash. 1985) ("[T]he state's right [is] purely derivative and therefore no greater than the owner's."); *Presley v. City of Memphis*, 769 S.W.2d 221, 224 (Tenn. Ct. App. 1988) ("The state acts under the statute to protect the rights of the property owners. Any rights and obligations of the state in the property are derivative of the rights of the owners of the property."); *S.C. Tax Comm'n v. Metro. Life Ins. Co.*, 221 S.E.2d 522, 523 (S.C. 1975) ("The Commission's rights under the act are derivative. It succeeds, subject to the act, to the rights of the abandoned property's owners. It takes only the interest of the absent or unknown owner."); *S. Pac. Transp. Co. v. State*, 380 S.W.2d 123, 126 (Tex. Civ. App. 1964) ("[T]he State in escheating such claims did not acquire any better or greater right to enforce the claims than was possessed by the former owners. The State cannot acquire by escheat property or rights which were not possessed at the time of escheat by the unknown or absentee owners of such property or rights.").
[14] *See* 1995 UUPA, section 1(6).

derivative rights doctrine and should be amended, including, among others, Section 2(a)(7), Section 5, and Section 19(a) of the 1995 version of the UUPA (the "1995 UUPA").

NAUPA has cited the U.S. Supreme Court's decision in *Connecticut Mutual Life Ins. Co. v. Moore*[15] as somehow inconsistent with the derivative rights principle. However, that case involved the narrow issue of whether New York's escheat statute applicable to life insurance proceeds violated the Contracts Clause of the U.S. Constitution. Thus, the Court did ***not*** hold, as NAUPA suggests, that a state may simply ignore all contract conditions that exist between a debtor and creditor, and thereby claim property that is not owed. To the contrary, the Court pointed out that the New York Court of Appeals had construed the escheat law to leave "open to the insurance companies all defenses except the statute of limitations, noncompliance with policy provisions calling for proof of death or of other designated contingency, and failure to surrender a policy on making a claim." Thus, the Court addressed only formalistic contract conditions on property that was already classified as "abandoned" by the unclaimed property statute and "which normally [the insurance companies] would have been required to pay." The Court's holding would therefore not support a state escheat law that provides that the state need not satisfy a substantive condition of ownership. Indeed, one court in distinguishing the *Connecticut Mutual* decision stated that the decision excused compliance with contract conditions "which only go to formalism of interest, such as proof of death…but it is nevertheless held to compliance with matters that deal with substantive determination of ownership."[16] Furthermore, a number of courts have subsequently denied state claims to property where the purported owner of the property had not satisfied certain conditions to claim the property.[17]

Even if a state could adopt escheat laws that would override other, more substantive, conditions without violating the Contracts Clause, that does not mean that such laws would not violate the federal common law rules set forth in *Delaware v. New York*, the Takings Clause, substantive due process or other laws. Such issues were never considered by the *Connecticut Mutual* Court and thus that decision cannot stand for the proposition that such escheat laws are valid.

Finally, even if such laws were valid, it does not mean that they would constitute sound public policy, and that they should be incorporated within the UUPA. To the contrary, the Holders

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[15] 333 U.S. 541 (1948).

[16] *Kane v. Insurance Co. of North America*, Ct. of Common Pleas, Opinion at 21, Jan. 20, 1976.

[17] *See, e.g., State v. Elizabethtown Water Co.*, 191 A.2d 457 (N.J. 1963) (holding that New Jersey had no right to escheat funds resulting from unrefunded deposits for water utility main construction based on the contract terms among the parties, and noting that "the State's claims are nonetheless derivative and certainly no broader than the [owners'] claims."); *State v. Sperry & Hutchinson Co.*, 153 A.2d 691 (N.J. Super. App. Div. 1959), *aff'd per curiam*, 157 A.2d 505 (N.J. 1960) (holding that the state had no right to escheat the value of unredeemed trading stamps when the contractual terms required a person to obtain a minimum quantity of stamps before they could be redeemed for cash and the state could not show such minimum quantity was held by any particular owner); *Oregon Racing Comm'n*, 411 P.2d at 63 (holding that an unpresented pari-mutuel ticket that was payable on demand was not "payable or distributable" because the ticket did not become "due" until it was presented).

Coalition believes that escheat laws should be written to fulfill their intended purpose of returning missing property to rightful owners and should not be used to alter the contractual relationships among debtors and creditors, directly or indirectly.

Recommended Revision – Add/Modify Language

Incorporation of the derivative rights doctrine will impact the UUPA in a number of ways, including the following:

- Section 2(a)(7) of the 1995 UUPA currently requires the escheat of 60% of the value of a "gift certificate" that is redeemable in merchandise only. However, the owner of a gift certificate that is redeemable in merchandise only is not entitled to cash equal to 60% of the certificate's face value. Thus, this provision is inconsistent with the derivative rights doctrine insofar as it provides the state with a right that is different than the rights of the owner. The members of the Holders Coalition would therefore recommend that the UUPA be amended to provide that only gift certificates that are redeemable in cash are escheatable.[18] These changes are consistent with the majority of states which generally exempt gift certificates and similar items from escheat.[19]

- Section 5 of the 1995 UUPA provides that a holder may deduct a dormancy fee from property presumed abandoned only if certain requirements are met, including that the amount of the fee is not unconscionable and that the fee is not regularly reversed or otherwise canceled. This provision is inconsistent with the derivative rights doctrine because a fee may still be legally enforceable as against the owner of property even if it is regularly reversed or waived. This provision is also unnecessary, as the enforceability of such fees is already subject to regulation under a state's consumer protection laws, including laws prohibiting deceptive or unfair trade practices.[20] The purpose of the UUPA is simply to return unclaimed property to the rightful owner and not to be used as a "back door" to impose additional substantive regulations that may impact the debtor's obligations to a creditor. The members of the Holders Coalition therefore recommend that this provision be deleted and that the language from the 1981 version of the UUPA (the "1981 UUPA"), which simply permits a deduction for "any lawful charges", be reinstated, as that prior language more appropriately defers to the underlying applicable substantive law.

[18] Such a change also serves the interest of owners, as many owners would prefer to retain a gift certificate in a certain specified amount rather than receiving cash equal to 60% of the amount of the gift certificate.

[19] The following states generally do not require the escheat of gift certificates or similar items (though some of these states exempt gift certificates only if they do not have fees or expiration dates): Alabama, Arizona, Arkansas, California, Colorado (exempting gift certificates but only some gift cards), Connecticut, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Maryland, Massachusetts, Michigan, Minnesota, Nebraska, Nevada, New Hampshire, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Washington, Wisconsin and Wyoming.

[20] State consumer protection laws vary significantly from state to state. For example, some states may prohibit the use of dormancy fees entirely on gift cards, while other states may permit them after a certain period of inactivity or if certain disclosures are made.

- Section 19(a) of the 1995 UUPA provides that a limitation imposed on an owner's right to claim property from the holder, whether imposed by contract, statute or court order, is not enforceable as against the state for unclaimed property purposes even if it is enforceable as against the owner of the property. The language permitting the state to disregard limitations imposed by contract or court order clearly and directly conflicts with the derivative rights doctrine and the members of the Holders Coalition therefore strongly recommend that this language be deleted. Otherwise, a holder's obligations to pay money under the unclaimed property laws may exceed the holder's obligations to the owner under the terms of a contract or court order. In such case, an owner could potentially use the unclaimed property laws to circumvent a legally enforceable contractual limitation or a court order. Rather, to the extent that the contractual limitation (or court) is enforceable under applicable laws, then the holder should be entitled to enforce it as against the state as well as the owner.[21] NAUPA's concern that omitting this "contract" language from Section 19(a) would somehow "emasculate" the UUPA is contradicted by the fact that 14 states—including major states such as California, New York, Illinois, Massachusetts, Pennsylvania and Tennessee—have not included such a provision in their unclaimed property laws and yet their unclaimed property programs remain some of the most active in the country.[22]

[21] This does not prevent an owner, or the state on the owner's behalf, from seeking to claim property on the basis that the contractual limitation is unenforceable under other applicable laws, such as unfair or deceptive trade practice laws. But such a claim should be premised on the state's substantive laws rather than on the state's unclaimed property laws.

[22] The other states that have not adopted such language in their unclaimed property laws include Iowa, Kentucky, Maryland, Mississippi, Missouri, Nebraska, Oregon and Virginia.

DORMANCY TRIGGERS

Recommendation:

The members of the Holders Coalition strongly recommend that the trigger for dormancy be the "returned mail" standard, particularly with respect to securities and other long-term investments.

Discussion in Support of Recommendation:

The revised Act should take into account two important assumptions that many, if not most investors are still operating under. First, is that it is an acceptable – and in fact desirable - strategy to purchase securities and not expect to sell them for a long time. The advice to "invest in equity securities and leave it alone" or "forget about it" is often cited to encourage investors to put money aside in an investment vehicle and let it grow over the years to be used at some future time for children's college tuition, retirement, or a rainy day fund. This mind-set is pervasive and the second assumption is linked to it, namely, that an investment in securities is liquid so when the investor needs the money, he/she will be able to get it in short order – typically within a three day settlement period.

If we require that an investor "indicate interest" in his/her property every three years, this violates the peace of mind that accompanies the notion of setting something aside for the future and not having to worry about it until it's needed. It is an unnecessary burden to place on an investor and a responsibility that is not widely known or understood. A person who has not changed residence may have no reason to contact the holder yet an escheatment law based on inactivity would force the owner to take action for no other reason than to "show interest".

Furthermore, once a security has been escheated it is no longer immediately available, but may take months to be claimed and worse yet, may have lost its current market value in addition to other earnings which may have accrued since it was escheated. While other property types can be claimed for an equivalent cash value, property that is tied to market value is unique and must be treated with more care in order to truly protect owners. In addition to the potential of losing market value and dividends, security holders also lose their rights to vote on important shareholder decision-making opportunities through their Proxy voting.

The Holders Coalition recommends that a "returned mail" standard be applied to all securities to prevent property from being escheated when it has not been "abandoned" but has merely been invested and, from the owner's point of view, does not require constant attention.

Recommended Revision:

SECTION 3. PRESUMPTIONS OF ABANDONMENT.

(a) Property is presumed abandoned if it is unclaimed by the apparent owner during the time set forth below for the particular property~~:~~. However, note that any property held in an ERISA plan is excluded from escheatment.

(1) traveler's check, 15 years after issuance;

(2) money order, seven years after issuance;

(3) any security, other than a debt obligation, three years after the date of a second consecutive first class mailing to the owner was returned as undeliverable by the U.S. Postal Service, unless a subsequent first class mailing to the owner was not returned as undeliverable. ~~stock or other equity interest in a business association or financial organization, including a security entitlement under [Article 8 of the Uniform Commercial Code], upon (i) the completion of the mandated SEC 17-Ad-17 searches after an apparent owner is identified as a "lost security holder" for owners who receive communications from the holder by United States mail provided that not less than three years have elapsed since the owner's last indication of interest in the stock or other equity interest, or (ii) three years after the owner's last indication of interest in the property for owners who do not receive communications from the holder by United States mail, provided, however, that as to stock or other equity interest in a business association held within a plan that allows for automatic re-investment of dividends, three years after the return date of the second mailing of a statement of account or other notification or communication that was returned as undeliverable.~~

(5) a demand, savings, or time deposit, including a deposit that is automatically renewable, five years after the date of a second consecutive first class mailing to the owner was returned as undeliverable by the U.S. Postal Service, unless a subsequent first class mailing to the owner was not returned as undeliverable. ~~the earlier of maturity or the date of the last indication by the owner of interest in the property; but a deposit that is automatically renewable is deemed matured for purposes of this section upon its initial date of maturity, unless the owner has consented to a renewal at or about the time of the renewal and the consent is in writing or is evidenced by a memorandum or other record on file with the holder;~~

(7) gift certificate and stored value card, five years after December 31 of the year in which the gift certificate was sold or stored value card issued, or the most recent activity by the owner involving the gift certificate or stored value card, or any verification or review of the balance. The amount abandoned is deemed to be the value remaining at the time it is presumed abandoned, unless it is redeemable only in merchandise or services, in which case the amount abandoned is deemed to be [60] percent of the value remaining on it at the time it is presumed abandoned;

Coalition Comment: The Coalition supports exemption of stored value cards.

(8) amount owed by an insurer on a life or endowment insurance policy or an annuity that has matured or terminated, three years after the obligation to pay arose or, in the case of a policy or annuity payable upon proof of death, three years after the insured has attained, or would have attained if living, the limiting age under the mortality table on which the reserve is based;

Coalition Comment: Life Insurance issues are being addressed separately by representatives from the insurance industry.

(14) notwithstanding any other provision of the [Act], property held in an account or plan which is qualified for tax deferral under the income tax laws of the United States, as well as property held in custodial accounts for the benefit of minors such as those created pursuant to the Uniform Gifts for Minors Act and Uniform Transfers to Minors Act, as follows:

~~property which is qualified for tax deferral under the income tax laws of the United States consisting of the following:~~

(A) property in any individual retirement account or any retirement health saving account, three years from the later of (i) the date of a second consecutive first class mailing to the owner was returned as undeliverable by the U.S. Postal Service (unless a subsequent first class mailing to the owner was not returned as undeliverable); and (ii) the date the owner has attained the age of 70.5, if determinable by the holder, or the date the holder has received proof of death of the owner in the form of a claimant's presentation of a certified death certificate; provided, however, that this section shall not be construed to require the holder to solicit such a death certificate or otherwise attempt to confirm whether the owner is deceased.

~~property in any individual retirement account or any [retirement health saving account], [three] [ten] years from the later of (i) the date a mailing to the owner was returned as undeliverable by the U.S. Post Office (unless a subsequent mailing to the owner was not returned as undeliverable); (ii) the date of the last contact by the owner with respect to the property and (iii) the date, if determinable by the holder, that the owner of the account reaches age 70.5;~~

(B) property in any other such account or plan, three years from the later of (i) the date of a second consecutive first class mailing to the owner was returned as undeliverable by the U.S. Postal Service (unless a subsequent first class mailing to the owner was not returned as undeliverable); and (ii) thirty (30) years have elapsed from the date the account was opened." ~~property in a [non-retirement health savings account] [three] years from the later of (i) the date a mailing to the owner was returned as undeliverable by the U.S. Post Office (unless a subsequent mailing to the owner was not returned as undeliverable); (ii) the date of the last contact by the owner with respect to the property and (iii) the date, if determinable by the holder, that the owner of the account reaches age 82;~~

Coalition Comment: Subsection 3(a)(14)(B) is intended to apply to any tax deferred accounts other than IRAs or retirement HSAs, and therefore we did not name 529s, ABLE accounts or other types of tax deferred accounts specifically. This way, the provision is sufficiently broad to include other similar types of accounts that may be created in the future.

~~(C) property in a [529 Plan], [three] year from the later of (i) the date a mailing to the owner was returned as undeliverable by the U.S. Post Office (unless a subsequent mailing to the owner was not returned as undeliverable); (ii) the date of the last contact by the owner with respect to the property; and~~

(c) Notwithstanding any provision of this part to the contrary, any outstanding check, draft, credit balance, customer's overpayment or unidentified remittance issued to a business entity or association as part of a commercial transaction in the ordinary course of a holder's business shall not be presumed abandoned if the holder and such business entity or association have [a substantial] ongoing business relationship. An ongoing business relationship shall be deemed to exist if the holder has engaged in a commercial, business or professional transaction involving the sale, lease, license, or purchase of goods or services with the business entity or association or a predecessor-in-interest of the business entity or association within the dormancy period immediately following the date of the check, draft, credit balance, customer's overpayment, or unidentified remittance giving rise to the unclaimed property interest. As used herein "dormancy period" means the period during which the holder may hold the property interest before it is presumed to be abandoned. A transaction between the holder and a third party insurer of another is a commercial transaction which constitutes a business relationship between the holder and the insurer. A "predecessor-in-interest" is a person or entity whose interest in a business entity or association was acquired by its successor-in-interest, whether by purchase of the business ownership interest, purchase of business assets, statutory merger or consolidation and includes successive acquisitions by whatever means accomplished. [As used herein "substantial" means a total amount of [one hundred thousand] dollars or more in each fiscal year of the holder.]

Coalition Comment: The Coalition supports a business to business exemption consistent with the ABA's proposal and not modeled on the Tennessee statute.

Reporter's Comment
This provision is adapted from Tenn. Code Ann. § 66-29-104.

(d) Except as otherwise provided in this section for specific property types, p~~P~~roperty is unclaimed if, for the applicable period set forth in subsection (a), the apparent owner has not communicated in writing or by other means reflected in a contemporaneous record prepared by or on behalf of the holder, with the holder concerning the property or the account in which the property is held, and has not otherwise indicated an interest in the property. A communication with an owner by a person other than the holder or its representative who has not in writing identified the property to the owner is not an indication of interest in the property by the owner.

(e) An indication of an owner's interest in property includes those listed below. If such an indication of interest is made by the owner, this will rebut any presumption of abandonment triggered by the return of first-class mail as undeliverable by the U.S. Postal Service.:

(i) any written communication, irrespective of the mode, including any electronic communication, facsimile, or email by the owner to the holder or agent of the holder concerning the property or the account in which the property is held;

(ii) any oral communication, including but not limited to phone contact, in-person contact, or interactive voice response (IVR) by the owner to the holder or agent of the holder concerning the property or the account in which the property is held, if the holder or its agent makes and preserves a contemporaneous record of the owner's communication;

(iii) the presentment of a check or other instrument of payment of a dividend, interest payment or other distribution made with respect to an account or underlying stock, bond, debt or other interest in a business association, non-profit organization, or financial organization or, in the case of a distribution made by electronic or similar means, electronic or other evidence that the distribution has not been returned as undeliverable ~~received~~;

Coalition Comment: This should read as follows:

Distribution made by electronic or similar means, evidence that the distribution has not been returned as undeliverable.

Non return of Federal Tax Forms.

Note: Payments made through the automated clearing system are governed by the National Automated Clearing House Associations (NACHA) Operating Rules and Guidelines. These rules state the requirements that must be followed if a payment cannot be successfully delivered. The general process is to not provide evidence that a payment has been successfully delivered, rather to notify and reject a payment that cannot be delivered.

(iv) owner-directed activity in the account in which the property is held, including accessing the account in any way (including internet access), or a direction by the owner to perform any account maintenance functions, account consolidations, transfers, exchanges, redemptions, or to increase, decrease, or otherwise change the amount or type of property held in the account;

(v) the making of a deposit or withdrawal from an account in which the property is held, including automatic deposits or withdrawals previously authorized by the owner, including Fedwire transactions and automatic reinvestment of dividends or interest;

(vi) the payment of a premium with respect to a property interest in an insurance policy, but the application of an automatic premium loan provision or other nonforfeiture provision contained in an insurance policy does not prevent a policy from maturing or terminating if the insured has died or the insured or the beneficiary of the policy has otherwise become entitled to the proceeds before the depletion of the cash surrender value of a policy by the application of those provisions;

Coalition Comment: Life insurance issues are being addressed separately by representative from the insurance industry.

(vii) any other action by the owner that demonstrates that the owner is aware that the property exists;

(viii) any action by an agent or other representative of an owner, if done on behalf of the owner, is deemed an action by the owner;

(ix) non-return of first-class mail, including federal forms;

(x) opening a new account;

(xi) activity in a linked account;

(xii) current employment status when the owner is employed by the holder.

(xiii) proxy vote by any method including but not limited to mail, phone, internet.

Coalition Comment: Although this may seem redundant (since owner activity is already covered above), we feel that it is important to explicitly identify proxy voting as an activity which qualifies as "contact."

(h) ~~Property is payable or distributable for purposes of this [Act] notwithstanding the owner's failure to make demand or present an instrument or document otherwise required to obtain payment.~~

Reporter's Comment
This provision is left intact despite the arguments made concerning the Derivative Rights Doctrine. This is an example where the Courts have made an exception and allowed the unclaimed property Administrator to have custody of assets even though the owner would have had to make a demand or present an instrument to obtain payment.

Coalition Comment: The Coalition supports the position of the ABA regarding the Derivative Rights Doctrine.

EARLY REPORTING

Recommendation:

The members of the Holders Coalition strongly recommend that the Uniform Act permit holders to remit property prior to the abandonment period upon disclosure to the administrator, providing the property is not interest bearing or securities, or items that change in value. Further, the Holders Coalition recommends that the Uniform Act provide indemnification to the holder upon remitting property early. Section 17 of the Committee's current draft revision, circulated in February 2015, incorporates these recommendations and thus, the Holders Coalition supports the current draft revision. In support of maintaining the language as currently proposed, the Holders Coalition provides this discussion for the Committee's review.

Discussion in Support of Recommendation:

In certain instances, it may be in the best interest of the parties – owner, holder and the state – to allow the holder to report and remit property to the state prior to the running of the full abandonment period (e.g., reporting and remitting property with a five year abandonment period to the state three years after the property became due and payable). These instances may arise, for example, where the owner is unknown or the holder is ceasing to do business.

By allowing certain property to be reported early, this will assist with protecting and preserving the owner's property along with allowing the holder to reprieve the unclaimed property liability from its books and records early in order to avoid the administrative burden of tracking the balance until the dormancy period ends.

Further, early reporting and remitting should be left to the discretion of the holder, as opposed to requiring the holder to obtain advance permission from the state. This is consistent with the intent of the provision to alleviate administrative burden.

However, the Holders Coalition agrees that early reporting and remitting should not be permitted for property with a value that is subject to fluctuation (e.g., debt and equity securities, mutual funds, interest bearing accounts, etc.) unless there is a guarantee by the state to pay the current market value for claims submitted prior to the running of the full abandonment period. Furthermore, the state should be required to hold the early reported property in its remitted form until a claim is submitted or the full abandonment period has run.

Finally, the indemnification provision should extend the release of holder liability to the property remitted early. To assist the state, holders should be required to identify to the state administrator, all property being reported and remitted early.

For example, where Company A has issued a check to Company B, and Company B has dissolved and is no longer in existence, Company A should be permitted to report and remit the funds to the state before the full dormancy period has run. Company A should notify the state that it is reporting the property in advance of the dormancy period, and state law should extend indemnification to Company A with respect to the reported and remitted funds.

To the extent that the Uniform Act requires Company A to seek and obtain advance consent or permission before being permitted to report the check to the state, the costs associated with seeking such approval may outweigh the benefit of the early reporting. In that case, Company A will be required to continue to track the outstanding check and wait for written permission from the state. The state, on the other hand, will not have use of the property for the time prior to the full abandonment period.

In this example, there is no detriment to the owner, the holder, or the state in remitting the property early, and there is a benefit to both the state and the holder. Where property fluctuates in value, other concerns arise, such as whether remitting the property early results in a loss for the owner. For that reason, such property should be expressly excluded from this provision unless the state provides the guarantee discussed above.

Recommended Revision:

Add/Modify Election to Take Payment or Delivery Language.

Section 17. Election to Take Payment or Delivery

(a) The administrator may decline to receive property reported under this [Act] which the administrator considers to have a value less than the expenses of notice and sale.

(b) A holder~~, with the written consent of the administrator and upon conditions and terms prescribed the administrator,~~ may report and deliver property before the property is presumed abandoned, so long as the holder discloses to the state upon reporting and delivering the property that the dormancy period has not yet expired. Property ~~so~~ delivered under this subsection must be held by the administrator and is not presumed abandoned until such time as it otherwise would be presumed abandoned under this article.

(c) Upon delivering property to the state, the holder shall immediately and thereafter be relieved of and held harmless by the State from any and all liabilities for any claim or claims which exist at the time with reference to the property or which may thereafter be made or may come into existence on account of or in respect to any such property.

FOREIGN ADDRESSED PROPERTY

<u>Recommendation</u>:

The members of the Holders Coalition strongly recommend that….

> The ULC amend the Uniform Unclaimed Property Act to provide that no state has the authority to require the reporting and remittance of property where the last known address of the owner is in a non-U.S. jurisdiction. Holders should be allowed voluntarily to remit such foreign addressed property, and be covered by the release of further liability and indemnification against future claims provided under the statute for other property remitted in compliance with the law.

The members of the Holders Coalition acknowledge and appreciate that the initial discussion draft of the Revised Uniform Unclaimed Property Act (February 18, 2015) reflect this recommendation in the proposed revisions to Section 5(4) and Section 26, and urge the Drafting Committee to retain these proposed changes in the final Revised Uniform Unclaimed Property Act.

<u>Discussion in Support of Recommendation</u>:

The Holders Coalition respectfully submits that neither the holder's state of domicile, nor any other U.S. state, should be entitled to escheat foreign-owned property and thus it should be excluded from the definition of "unclaimed property" in the revised Act.[23] Our reasoning is based on the Supremacy Clause, the Due Process Clause, and the Foreign Commerce Clause of the U.S. Constitution.

Grounds for Exclusion

First, the U.S. Supreme Court, which promulgated the federal priority rules governing which states have rights to escheat unclaimed property, has never given any indication that such rules were meant to extend to owners residing in foreign countries. Indeed, the Supreme Court has clearly indicated that it intended the rules to be exclusive of all other possible rules. The Court has repeatedly rejected attempts by states to "extend" the two rules articulated by the Court in

[23] The Holders' Coalition notes that in reliance on the 1981 and 1995 UUPAs, some states have demanded the reporting of foreign owned property, and a number of holders have been escheating foreign addressed property to their state of incorporation based on these state demands. The Coalition is unaware of any holder legally challenging the position through a declaratory judgment or similar proceeding. This document is intended to communicate agreement with the provisions in the current draft of the Revised Uniform Unclaimed Property Act which will not require the reporting of foreign addressed property in the future, for the reasons stated herein. It is not an opinion on any current case, not an attempt to litigate any current controversy, and not an indication or acknowledgement of the legality or illegality of past actions or inactions.

Texas v. New Jersey.[24] Nevertheless, the Official Commentary to both the 1981 and 1995 UUPA state that the ULC considered allowing the state of domicile to claim custody of foreign owned property to be "…a rational extension of (the Court's) ruling."

This extension of states' rights to demand custody of intangible property beyond the rules established by the U. S. Supreme Court is severely problematic. First, a State's attempt to extend its unclaimed property laws to foreign-owned property would violate the Supremacy Clause of the U. S. Constitution because it would conflict with federal common law.[25]

Second, there is insufficient nexus or connection between foreign-owned property and the holder's state of domicile to justify, either on an equitable basis or as a constitutional matter, the state of domicile asserting a right to custody of such property. By asserting jurisdiction over the property owned by persons with whom the State lacks even minimum contacts and connections, a State's attempt to extend its unclaimed property laws to foreign-owned property would violate the Due Process Clause of the U. S. Constitution.[26]

Third, a critical underlying purpose of unclaimed property laws is to help reunite missing owners with their property. A foreign owner is not likely to be reunited with his or her property via delivery of custody of such property to any state, particularly to the state of incorporation of the holder. It is highly unlikely that the state of incorporation of the holder will even be known to any owner, and particularly a foreign owner who will very likely have no connection whatsoever with that State.

Fourth, application of state unclaimed property laws to foreign-owned property is likely to subject holders to multiple conflicting claims for the same property in violation of the United States Constitution. In the past several decades, a number of foreign countries have implemented unclaimed property laws,[27] many others are currently considering doing so, and it is likely that such trend will continue for the foreseeable future. The Supreme Court long ago held that the Due Process clause protects a holder against multiple escheat claims for the same property. In *Western Union Telegraph and Telephone Company v. Pennsylvania*,[28] the Supreme Court rejected Pennsylvania's claim to property as violating the Due Process rights of the holder under circumstances where the state asserting the claim to escheat was unable to provide protection to the holder against conflicting claims by other states. As neither the courts of any state asserting a claim for foreign-owned property, nor even the United States Supreme Court, could protect a holder against a subsequent claim that might be asserted for the property by the country of

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[24] *See Pennsylvania v. New York*, 407 U.S. 206 (1972); *Delaware v. New York*, 507 U.S. 490 (1993).

[25] U.S. Const. Art. VI, cl. 2; *See New Jersey Retail Merchants v. Sidamon-Eristoff*, 669 F.3d 374, 392 (3d Cir. 2012).

[26] *See e.g., Shaffer v. Heitner*, 433 U.S. 186 (1977) (stock ownership in Delaware-incorporated entity insufficient for jurisdiction over stockholder).

[27] For example, Australia, Alberta, British Columbia, France, Germany, Kenya, New Zealand, the United Kingdom, and Quebec have all adopted unclaimed property laws.

[28] *See Western Union Tel. Co. v. Pennsylvania*, 368 U.S. 71 (1961).

residence of the owner, or the country of citizenship of the owner, or some other foreign jurisdiction that might have a basis to assert such a claim, Due Process precludes *any* U. S. State, including the holder's state of domicile, from claiming such property.

Finally, under the most recent Supreme Court precedent involving state taxation of foreign-owned property, a demand for custody of foreign-owned property by any state, including the holder's state of domicile, would violate the Foreign Commerce Clause of the Constitution. The Commerce Clause of the Constitution provides that Congress shall have the power to regulate commerce "with foreign Nations, and among the several States, and with the Indian Tribes." [29] In *Japan Line, Ltd. v. County of Los Angeles,*[30] the Supreme Court recognized that special considerations beyond those that govern the taxation of property owned by U.S. citizens come into play when states seek to tax property owned by foreign citizens, even when that property is physically used in the U.S. and is subject to the State's Due Process jurisdiction to tax. In *Japan Line*, at issue was an attempt by Los Angeles County to impose a fairly apportioned property tax on shipping containers physically located at the port of Los Angeles on tax day. Although the Court found that such taxation would have been permitted if the containers were owned by U.S. persons, the fact that they were instead owned by foreign companies precluded their taxation by *any* U.S. jurisdiction, the Court concluded. The analysis by which the Court reached that conclusion is equally applicable to a state's attempt to take custody of foreign owned property under its unclaimed or abandoned property laws.

Specifically, the Court noted that because foreign-owned instrumentalities of commerce are clearly subject to taxation in their home countries, if a U.S. state were permitted to tax such property, no court, including the Supreme Court, could protect that foreign-owned property against a risk of multiple taxation that the Commerce Clause prohibits. Likewise, because it is equally clear that foreign-owned intangible property may (and often is) subject to unclaimed property laws in the country where the property's owner resides, no court, including the U.S. Supreme Court, would have the power to protect such foreign-owned property against multiple claims of escheat, which the Court held in *Western Union Tel. & Tel. Co. v. Pennsylvania, supra,* is likewise prohibited by the Constitution.

Moreover, the Court in *Japan Lines* noted that the imposition by a State of any tax on a foreign-owned instrumentality of commerce would "impair federal uniformity in an area where federal uniformity is essential." In *Michelin Tire Corp. v. Wages,*[31] the Court noted the overriding concern of the framers of the Constitution that "the Federal Government must speak with one voice when regulating commercial relations with foreign governments." In *Japan Lines,* the Court said:

[29] U. S. Const. Art. I, Sec. 8 Cl. 3.
[30] 441 U.S. 444 (1979).
[31] 423 U.S. 276 (1976).

> [A] state tax on instrumentalities of foreign commerce may frustrate the achievement of federal uniformity in several ways. If a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned [property] present in their jurisdictions. Such retaliation, of necessity, would be directed at American [property] in general, not just that of the taxing State, so that the Nation as a whole would suffer. If other States followed the taxing State's example, various instrumentalities of foreign commerce could be subjected to varying degrees of multiple taxation, a result that would plainly prevent this Nation from 'speaking with one voice' in regulating foreign commerce.[32]

For these reasons – because the tax claim asserted by Los Angeles subjected foreign-owned property to a risk of multiple taxation not borne by property owned by a U.S. person, and because the tax as applied to foreign-owned property "prevents the Federal Government from 'speaking with one voice' in international trade . . . [w]e hold the tax, as applied [to foreign-owned property], unconstitutional under the Commerce Clause."[33]

Likewise, because foreign nations clearly have the power and authority to claim unclaimed or abandoned property owed to their citizens or residents – which power and authority foreign nations are increasingly now exercising – allowing any U.S. State to demand custody of foreign-owned property held by a U.S. holder would (1) subject that holder to a risk of multiple claims for the same property and (2) risk retaliatory claims by foreign countries to custody of property owned by their citizens to U.S. owners, thereby preventing the U.S. from speaking with one voice in commercial dealings with such foreign countries.

Accordingly, UPPO believes that neither the state of domicile, nor any other U.S. state, can constitutionally demand custody of foreign-owned property. We urge the ULC to make a clear statement to that effect in the jurisdictional rules of the revised Uniform Unclaimed Property Act.

<u>Recommended Revision:</u>

The revisions to Sections 5(4) and Section 26 reflected in the initial Discussion Draft of the Revised Uniform Unclaimed Property Act (February 18, 2015) are acceptable to the members of the Holders Coalition.

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[32] 441 U.S. 450 [Citations omitted]. *Accord, America Insurance Association, et al., v. Garamendi*, 539 U.S. 396 (2003).
[33] 441 U.S. at 453-454.

PROOF OF DEATH

Recommendation:

The members of the Holders Coalition strongly recommend that a Social Security Death Master File match is insufficient to constitute “proof of death” for making an insurance policy (or other intangible property) “due and payable” and insufficient to trigger dormancy periods toward escheatment of property. First, potential insurance proceeds as of the insured’s date of death do not constitute “Property” as defined by the Act, since a beneficiary does not have a “fixed and certain interest” in the insurance proceeds until contractual conditions precedent have been satisfied. Second, “proof of death” is defined by state law and/or the courts of the states to be an evidentiary standard sufficient to prove that the event actually occurred. Third, modification of the Act to include DMF Matching as proof of death will create conflicts with existing insurance laws and the standards for proof of death that have been established over decades within each individual state.

Discussion in Support of Recommendation:

The Uniform Law Commission (“the Commission”) currently is engaged in deliberations regarding proposed revisions to the Uniform Unclaimed Property Act (“the Act”). In that context, one section of the Act that has been a focus of discussion is the section concerning life insurance policy proceeds. One potential revision that has been discussed is a revision that would redefine “proof of death” to include identification of an insured within the Social Security Administration’s Death Master File (“DMF”), or a similar database.

Prior submissions to the Commission have addressed concerns regarding problems with the accuracy of the DMF, along with pointing out that a revision to the Act providing that life insurance policy proceeds become due and payable upon the inclusion of the insured’s name in a database will (1) constitute a significant change as compared to each of the previous Uniform Acts, and (2) conflict with the substantive contract law upon which life insurance is based. In addition, however, we believe that it is important to appreciate that the specific substantive contours of what constitutes sufficient proof of death has always been a state law question. For more than one hundred years, state courts have devoted resources and developed jurisprudence discussing what constitutes sufficient proof of death that will establish a beneficiary’s fixed and certain interest in the proceeds and entitle a beneficiary to the proceeds of a life insurance policy. Although the contours of what constitutes “proof” in this context may vary from state to state, states have consistently recognized that the proof must satisfy an evidentiary standard. By contrast, there has been no discussion or assessment by the Commission as to whether inclusion of an insured’s name in the DMF—by itself, without additional evidence—would satisfy the evidentiary standards for proof of death that courts around the country have developed over the course of decades. Nor is it apparent that inclusion in the DMF *would* satisfy those standards. As a result, we believe that adopting a proposed *uniform* standard, that would purport to dictate to states on a national basis that inclusion in the DMF constitutes proof, would contradict and undermine the well-developed state-law jurisprudence on this point, in a manner that is simply contrary to the principle of a uniform law.

To the extent that "proof of death" constitutes a developed standard that signifies the satisfaction of a beneficiary's legal obligations under a life insurance policy (thereby entitling the beneficiary to the policy's proceeds), an insured's inclusion in a database like the DMF cannot be equated to the satisfaction of those obligations. Indeed, for over a century, courts and commentators have recognized that proof of death must be just that: *proof*, which satisfies certain legal and evidentiary standards. While courts and commentators have recognized that the nature of the proof can take different forms, sufficient proof of death "must be made *by evidence* in any form which is substantial and trustworthy enough to enable the insurer to form an intelligent estimate of its rights and liabilities under its contract." 13 Couch on Ins. § 189:77. Thus, Couch observes that "[r]egardless of the standard of proof required by a particular court, *the evidence presented must be in admissible form and sufficient to meet the insured's burden of proof*." *Id.*

Accordingly, courts have long recognized that proof of death must satisfy certain evidentiary standards in order to satisfy contractual requirements. Thus, for example, over a century ago the Montana Supreme Court explained that "a mere informal notice does not ordinarily supply the place of formal proof." *Da Rin v. Casualty Co. of America*, 108 P. 649, 651-52 (Mont. 1910). Instead, the court explained, "the evidence furnished must be such as would be adjudged by a court admissible under the rules applicable in judicial proceedings." Although the proof "need not be that full, clear, and explicit proof which would be required upon the trial of an issue upon the question," the court explained that "it must be such reasonable evidence as the party can command at the time, to give assurance that the event has happened upon which the liability of the insurers depends." *Id.* at 652. Similarly, the Illinois Supreme Court recognized long ago the "general rule that sufficient proof of death is made *by evidence* in any form which is substantial and trustworthy enough to enable the insurer to form an intelligent estimate of his rights and liability under his contract." *Anderson v. Inter-State Business Men's Accident Ass'n*, 188 N.E. 844, 847 (Ill. 1933).

Courts have also had occasion to discuss the due proof of death requirement in the context of the historic requirement that an insured who disappears must be missing for seven years before a legal presumption of death attaches. In this respect, on many occasions courts around the country have rejected arguments that proof of death could be made prior to the expiration of the seven-year period, in instances where the submitted evidence was determined to be insufficient. For example, in *Campbell v. Northwestern Mutual Life Insurance Company*, the Illinois appellate court explained that "[i]f a person is absent from his home and no word has been received from him within seven years, such disappearance creates a rebuttable presumption that such absent one is dead. This presumption arises at the end of the seven-year period and his death is to be regarded as having taken place seven years from the date of his disappearance. As a matter of law, therefore, *unless there are facts and circumstances proven which are sufficient to justify an* *inference that he died at an earlier date, it must be presumed* that the insured…lived until [the expiration of the seven-year period].” 281 Ill. App. 158, 165-166 (Ill. Ct. App. 1935) (emphasis added). The court in *Campbell* further explained that the “presumption of fact which will justify the conclusion of death before the lapse of the time required for the legal presumption must arise from circumstances tending to show death.” *Id.*

In addition, the judicial treatment of the proof of death requirement takes on further significance in connection with addressing the question of when a beneficiary must provide proof of death to the insurer in order to satisfy applicable limitations periods. For example, in *Howard v. Equitable Life Assurance Society,* the Washington Supreme Court addressed a case where the decedent had financial problems, was in poor health, made statements suggesting that he was suicidal, and then disappeared from a ferry. But the court held that this evidence was not sufficient to prove that the insured was dead, absent the expiration of the seven-year presumption. In this respect, the court noted that “[t]he law presumes that a person shown to be alive at a given time remains alive until the contrary is shown by some sufficient proof or, in the absence of such proof, until a different presumption arises. *In our opinion there were not sufficient facts presented to prove the death of the insured without the aid of the presumption arising*.” 85 P.2d 253, 255 (Wash. 1938) (emphasis added). Similarly, in *Benjamin v. District Grand Lodge*, the California Supreme Court held that the insured’s disappearance, coupled with a letter he had written stating his intention to commit suicide “would not furnish satisfactory proof of death.” 171 Cal. 260, 263-64 (Cal. 1915). The court held that proof of death could not be provided before the expiration of the seven-year period, because “the plaintiff was not in a position to prove the *fact* of death without the aid of the statutory presumption.” *Id.* (emphasis in original).

The above discussion should demonstrate that courts have developed evidentiary criteria to identify what constitutes sufficient proof of death that would entitle a beneficiary to life insurance proceeds. As an initial matter, we do not believe that inclusion in a database such as the DMF comes close to satisfying those standards. But in addition, the above discussion should also make clear that the development of the standards as to what constitutes “proof of death” is a question of state law, which has been developed on a state-by-state basis over the course of many years. Prior versions of the Uniform Act have specified that proof of death must be provided in order for life insurance proceeds to be covered by the Act, but the *meaning* of what constitutes proof of death has always been determined by the State according to its own law, to the extent a State adopts the Uniform Act. No prior version of the Uniform Act has attempted to impose its own substantive definition of what constitutes proof of death upon any adopting State, in a manner that would likely conflict with that State’s developed case law addressing the evidentiary standards by which the proof of death requirement can be satisfied. We do not believe that the proposed revisions to the Act should attempt to do so.

<u>Recommended Revisions</u>:

Maintain Current 1995 UUPA Language which maintains the integrity of state insurance laws, court opinions, and contract law principles: “Intangible Property means a fixed and certain interest in intangible property evidenced by amounts due and payable under the terms of an insurance policy or annuity contract.”

SECURITIES: NON-FREELY TRANSFERABLE

Recommendation:

The members of the Holders Coalition recommend that securities which are worthless, unpriced, or not transferable be reported to the states as unclaimed property if the conditions for escheatment are met, but that such securities not be remitted to the states. Consistent with agreement from NAUPA, a NAUPA code would be developed to identify worthless, unpriced and non-transferable securities on holders' reports so that these categories are easily identifiable. This recommendation is made because holders may maintain on their books and records certain securities that are non-transferable to escheat to the states. As many of these securities have no value, and would otherwise result in an expense to the states to custody such assets, this recommendation is viewed as beneficial to all stakeholders by reducing costs and related operational inefficiencies, without impacting the owners.

Discussion in support of recommendation:

Worthless securities means securities of a defunct, bankrupt, or delisted issuer, or securities for which the cost of liquidation and delivery would exceed their value on the date a report is due pursuant to RUUPA §8. By utilizing this definition, holders and the states can objectively measure whether or not securities are in fact worthless. It is recommended that worthless securities be reported to the states with a newly developed NAUPA code designating the securities as worthless. However, the securities would not be remitted to the states, as there is either no value, or the cost of liquidation and delivery exceeds the value on that date. With the new code, NAUPA would be able at any time to audit reports to determine whether they agree that securities could or should have been escheated. Further, if at some time in the future the securities achieve a higher valuation, they could be remitted to the states. This recommendation provides the greatest efficiency for states and holders, without jeopardizing the rights of owners in any way.

In order to implement this recommendation, we suggest that a definition of "worthless securities" be added to RUUPA §2; that §8 include a requirement that worthless securities be identified as such on the report; that §9 include an acknowledgement that worthless securities need not be remitted; and that NAUPA develop coding to facilitate the identification and tracking of worthless securities, e.g., NT01. There should also be an exception to state notification/publication requirements for securities coded as worthless in RUUPA §10. The Securities Working Group has drafted suggestions for each of these sections.

Unpriced securities means securities for which no market valuation is available. Such securities rely upon third parties to determine value, and are often illiquid. In many instances it is impossible to sell an unpriced security, because the issuer can limit redemptions per year, or even prohibit redemptions. Due to these restrictions, a similar approach as that proposed for worthless securities is advisable. Accordingly, the Securities Working Group has developed suggested language for unpriced securities for §§ 2, 8, and 9 of the RUUPA, and suggests a NAUPA code tracking these securities, e.g., NT02.

Not transferable refers to securities which cannot be delivered to the state via the The Depository Trust & Clearing Corporation or a similar custodian, or because there is no agent to effect transfer. As with the prior two categories, a similar approach has been developed which will address RUUPA §§ 2, 8, and 9. Additionally, § 2 should also include a definition for The Depository Trust & Clearing Corporation, and a new NAUPA code utilized, e.g., NT03. Reporting is appropriate for non-freely transferrable securities, but remittance may not be. As such, simple definitions have been drafted for §2 to clarify narrow circumstances which render securities not-freely transferrable. The language necessary to accomplish reporting in an efficient, transparent manner is offered for §§ 8 and 9, and additions to §§ 9 and 10 are included to streamline securities processing for the states.

Recommended Revisions:

To be added to RUUPA §2:

*"**Non-freely transferrable securities** means securities which cannot be delivered to the state via the The Depository Trust & Clearing Corporation or a similar custodian, or because there is no agent to effect transfer." It also includes unpriced and worthless securities.*

*"**The Depository Trust & Clearing Corporation**" is a United States based central custodian of securities, providing post-trade, clearing and settlement services to the financial markets."*

*"**Unpriced securities** means illiquid securities for which no market valuation is available."*

*"**Worthless securities** means securities of a defunct, bankrupt, or delisted issuer, or securities for which the cost of liquidation and delivery would exceed their value on the date a report is due pursuant to §8 of this Act."*

To be added to RUUPA §8:

8(b)(9) "an indication that the property is not freely transferrable, if applicable pursuant to §2 of this Act."

To be inserted in RUUPA §9, in place of current (f):

"A holder of a non-freely transferrable, unpriced or worthless security is not required to deliver the security to the Administrator if the holder has determined in good faith that the security is non-freely transferrable, and has so indicated on the report required pursuant to §8.

To be inserted to current RUUPA §10(a)(2):

"(2) The holder is not required to send a notice if the records of the holder indicate the address of the apparent owner is incorrect, or if the total value of the property due is less than $50, *or if the property is a security which has been reported as non-freely transferrable."*

To be inserted to current RUUPA §10(b):

"(4) notwithstanding the foregoing, this section does not apply to property that has been reported as non-freely transferrable."

SECURITIES: RESTRICTED

Recommendation:

The members of the Holders Coalition recommend that the UUPA reflect the fact that some securities are ownership interests which are subject to restrictions that prevent the owner from legally negotiating the interests until such time as the restrictions are removed. In some instances, the restriction is imposed pursuant to federal law, for example in recognition of OFAC prohibitions or similar statutes which prevent the holder from making the asset available to certain individuals. In some instances, the restrictions are due to contract, for example in the case of "restricted stock", which has no market value unless and until the conditions for vesting have been met.

Discussion in support of recommendation:

Federal Law. The Office of Foreign Assets Control is a financial intelligence and enforcement agency of the United States government charged with the execution of sanctions which support U.S. national security and foreign policy objectives. For example, OFAC maintains a list of countries, organizations, and foreign nationals with whom the United States is prohibited from conducting business. There are similar objectives, with corresponding lists created by different statutes and enforced by different agencies, pursuant to the USA Patriot Act. No matter which federal agency has issued the prohibition against conducting business with a particular owner, the holder is not able to make the funds available to, or to escheat property, which is due to an owner subject to OFAC or similar structure, unless and until the restrictions have been lifted. Therefore we recommend that RUUPA's definitional section include references to these restrictions (securities or cash) in recognition of federal law. If the restrictions are lifted, the property would be subject to escheat if the presumption of abandoned is satisfied. A suggested draft for insertion in §2 is proposed below.

Contract. Restricted stock or securities commonly refers to stock of a company that is not vested and cannot legally be transferred until certain conditions have been met. Upon satisfaction of those conditions, the stock will become transferable by the person holding the award. Restricted securities are acquired from the issuer in an unregistered, private transaction. Restricted stock bears a "restrictive" legend, which clearly provides that the shares cannot be sold in the public marketplace unless they are exempt from the SEC's registration requirements. Rule 144 under the Securities Act of 1933 provides the exemptions allowing shareholders to transfer restricted securities. Rule 144 requires several conditions to be met before it can be invoked.
Restricted stock is often used as a form of employee compensation, in which case it typically vests, or becomes transferrable, only upon the satisfaction of certain conditions, such as continued employment for a period of time, and sometimes the achievement of particular earnings goals or other financial targets. Restricted stock is a popular alternative to stock

options[34], particularly for executives, due to favorable accounting rules and treatment for income tax purposes[35]. Gaining popularity with Fortune 1000 companies beginning in 2004, restricted securities have also become popular among technology companies and venture capital backed firms, as they offer a convenient way to insure key employees have incentive to stay and devote their best efforts to the success of the company awarding the stock for a guaranteed period of time.

Sample vesting conditions

Typical conditions that are required to be met before restricted stock awards become vested often include the following:

- A vesting period, during which the employee must continue to work for the company. This period is intended to prevent employees from leaving the company when the key employees' work is most needed. This is usually followed by a more gradual vesting over a four-year schedule representing incremental growth stages.
- Double trigger acceleration provisions, which provide that the restricted stock vests, or the vesting period is accelerated, if the company is acquired by a third party and the employment of the grantee is terminated within a certain time frame. This protects employees from being forced out by new management after a change in control.
- Market standoff provisions provide that holders of restricted stock may not sell for a certain period of time (usually 180 days) after an initial public offering. This is intended to stabilize the stock price of the company after the IPO by preventing a large sale of stock on the market by key employees.

When a company awards restricted stock, the stock cannot be sold or transferred by any party unless and until all of the conditions have been met. Restricted stock is not liquid. The right to receive the stock is not fixed and certain. Accordingly, even though restricted stock is reflected on the books and records of the issuer, there is no obligation, and no ability, to make a payment relating to, or allow transfer of, restricted stock unless and until the vesting conditions are satisfied.

Unclaimed property statutes do not apply to contingent liabilities. Rather, they only apply to

[34]Restricted stock should not be confused with stock options. Stock options give the owner of the option the right, but not obligation, to buy or sell stock at a specified price at a specified time.

[35] Under Section 83 of the Internal Revenue Code, the value of property transferred in connection with the performance of services is included in gross income on the date on which the property becomes transferable, generally known as the "vesting date". Employees pay income tax on the value of the restricted stock in the year in which it vests, and then pay capital gains tax on any subsequent appreciation or depreciation in the value of the restricted stock in the year in which it is sold.

obligations that are fixed and certain. See, e.g., *Insurance Company of North America v. Kane*, 392 A.2d 325(1978). In this early case, the court held that if an owner does not fulfill the requirements of the contract that purportedly entitles the owner to payment, then there is no obligation for the insurer to pay the insured, and therefore no obligation exists to escheat. In *Mason & Dixon Lines v. Eagerton*, 555 F. Supp. 434 (Ala. 1982), the court held that liabilities had to be unqualifiedly due and owing in order to be escheatable. In recognizing that the contract that gave rise to potential obligation to pay was key, the court held that "[a]ny attempt to abrogate [these] contractual limitations by statute might be met with the constitutional prohibition against impairing the obligation of contracts." These cases follow the seminal case of *State of New Jersey v. The Sperry & Hutchinson Co*., 153 A.2d 691 (1959). In this landmark case, the court held that inchoate rights are merely contingent liabilities for the holder, and are not subject to being escheated.

Following these cases, there is no property for the state to escheat if the owner has not fulfilled the requirements for payment. Accordingly, if a shareholder's rights to stock have not vested, there is no right for the state to escheat. Put simply, if the issuer has not received the benefit of the bargain, for example, if the shareholder left employment before the vesting period concluded, or the executive never reached the earnings goals required for the restricted stock to be vested (put differently, for the restrictions to be lifted), then there is no value for the state to escheat.

The fact that the issuer's books and records reflect outstanding shares does not make the shares escheatable. Rather, the SEC requires the stock to be noted as restricted in order to prevent transfers that would violate the terms of the award. As such, requiring the transfer agent to remove restrictions in order to transfer the shares to the custody of the state would be unlawful. Before removing restrictions, the transfer agent typically must have an opinion letter from the issuer's counsel indicating that the restrictions are appropriate to be lifted in order to allow transfer. Short of this, any lifting of restrictions would likely violate Rule 144 under the Securities Act of 1933. Although Rule 144 provides several exemptions to allow the transfer of restricted shares, enabling escheatment is not one of the permissible exemptions.
In 2014 the Securities and Exchange Commission barred from the securities industry the president of a transfer agent who lifted restrictions on restricted stock without the appropriate exemption or letter from counsel indicating that the restrictions were removed and the securities were now transferrable.[36] This severe penalty demonstrates that transfer agents cannot escheat restricted securities without violating federal law. Further, NAUPA should not need to dedicate the state's resources to requesting and considering letters from the issuer's counsel allowing for the lifting of the restrictions, and making subsequent instruction to the transfer agent. Rather, the shares should simply be escheated if and when the conditions for vesting have been met and the

[36] *In the Matter of Registrar and Transfer Company and Thomas L. Montrone*, SEC Administrative Proceeding File No. 3-16157. See also *Securities and Exchange Commission against Pagnano and Heathrow Natural Food & Beverage, Inc.*, 14 CV 7691 (2014).

restrictions lifted, and the requirements for escheat have also been satisfied. The issuer is required to maintain the conditions for vesting in its books and records.

Accordingly, it is the recommendation of the Securities Working Group that the RUUPA specifically acknowledge that unless and until the requirements for vesting have been met, there is no property right, and no value to escheat. Further, there is no way to accomplish escheatment without jeopardizing the transfer agent and issuer. As such, draft language for RUUPA §2 has been prepared.

Recommended revision:

Suggested insertion to RUUPA §2 (19) in *italics*:

(iii) stock or other evidence of ownership of an interest in a business association or financial organization, *provided that the ownership interest has market value and is free from any lien, legal hold or restriction. Said lien, legal hold or restriction must be evidenced on the books and records of the holder, or imposed pursuant to federal law, thus limiting the owner's ability to receive, transfer, sell or otherwise negotiate the ownership interest;*

STATUTE OF LIMITATIONS

<u>Recommendation</u>:

The members of the Holders Coalition recommend that the statute of limitations provision in Section 19(b) of the 1995 UUPA be revised to provide greater certainty and protection to holders of unclaimed property. Specifically, the Coalition recommends that Section 19(b) of the 1995 UUPA be replaced with the following language, which is based on the statute of limitations provision in the 1981 UUPA, the statute of limitations in the Virginia unclaimed property act and on certain statute of limitation provisions in the state tax area.

<u>Discussion in Support of Recommendation</u>:

Statute of limitations provisions serve a number of important purposes, including providing certainty, encouraging diligent prosecution of claims, and preventing fraudulent and stale claims. These purposes apply equally whether the claimant is an owner or the state acting on the owner's behalf.

The fair and equitable administration of unclaimed property requires reasonable periods of limitations for unclaimed property reporting and liabilities. Reporting requirements should be uniform and correspond with the recordkeeping requirements of the Internal Revenue Code, state tax laws, and normal business practices.

The 1995 UUPA statute of limitations provision is inadequate because it applies only after the holder specifically identified the property in a report filed with the administrator or gave express notice to the administrator of a dispute regarding the property address, neither of which is likely to occur.

<u>Recommended Revision:</u>

Consistent with the American Bar Association's recommendation, Section 19(b) of the 1995 UUPA should be replaced with the following language:

> (i) Except as otherwise provided in subsection (ii) or (iii) of this section, in the event that a holder files an unclaimed property report with the administrator for a particular period, including a zero or negative report, no action or proceeding shall be initiated or maintained against the holder to enforce this [Act] with respect to any unclaimed property that became presumed abandoned during or prior to such period more than three years after the later of (A) the date the report was filed and (B) the date the report was due (including any extensions).

(ii) No action or proceeding shall be initiated or maintained against the holder to enforce this chapter with respect to any property more than seven years following the date on which such property first became reportable if the holder (A) filed a fraudulent report with the intent to evade delivery of property otherwise subject to this chapter or (B) failed to file a report with the administrator. The state shall have the burden of proving fraudulent activity of the holder by clear and convincing evidence, and if the state cannot meet such burden, then the limitations period set forth in subsection (i) shall apply to any demand, claim or assessment by the state. The holder shall have the right to appeal any determination of fraud by the state, under the same procedures as set forth in Section [ ] of the [Act].

(iii) If, before the expiration of time prescribed in subsections (i) or (ii), the holder and the administrator have so consented in writing, an action or proceeding may be initiated or maintained at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

This language is based on the statute of limitations provision in the 1981 UUPA, the statute of limitations in the Virginia unclaimed property act and on certain statute of limitation provisions in the state tax area. Subsection (i) has been substantially revised from the Virginia provision to simplify that provision and clarify that the filing of a report will start the running of a statute of limitations for all unclaimed property that was presumed abandoned during or prior to the year covered by the report. Subsection (i) also proposes a 3-year limitations period rather than the 5-year period in the Virginia Act to be more consistent with statute of limitations provisions in other areas, such as tax, and also in recognition that the state's claim may already be made after the owner's statute of limitations has expired. The 7-year limitations provision in subsection (ii) where no return is filed or a fraudulent return is filed is also intended to be more consistent with statute of limitations provisions in other areas, such as tax. This subsection also includes a higher standard of proof that must be satisfied by the state in order to prove fraud. Subsection (iii) is based on similar provisions in the state tax area granting statutory authority to waive the statute of limitations, and is designed to give both holders and states some flexibility to contract around the general rules.