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Mr. Rex Blackburn, Co-Chair
Mr. Michael Houghton, Co-Chair
Uniform Law Commission
Drafting Committee to Revise the Uniform Unclaimed Property Act
111 N. Wabash Avenue, Suite 1010
Chicago, IL 60602

Response To NAUPA's Memorandum To Uniform Law Commission

Dear Chairman Blackburn, Chairman Houghton, and Committee Members:

On behalf of the U.S. Chamber Institute for Legal Reform ("ILR"), I write in response to a May 9, 2014 memorandum submitted by the National Association of Unclaimed Property Administrators ("NAUPA") regarding "The State's Effective Utilization of Private Auditors for the Identification of Unclaimed Property." This document was prepared in large measure to address ILR's April 2014 "Best Practices Guide" for unclaimed property administrators to use in the engagement of private audit firms.[1] The proposed Best Practices – including transparency reforms, contract reforms, the elimination of contingency fee arrangements, and the adoption of robust voluntary disclosure programs – are intended to facilitate responsible and fair enforcement of state unclaimed property laws while minimizing the potential for abuse that can result from contingency fee arrangements with private auditors.

We are encouraged by NAUPA's submission because it has started an important national policy discussion about the use of private contingency fee auditors by state officials vested with the authority to enforce state unclaimed

[1] Unclaimed Property: Best Practices For State Unclaimed Property Administrators And The Use Of Private Audit Firms, available at http://www.instituteforlegalreform.com/uploads/sites/1/BestPractices.pdf

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property laws. And while we disagree with NAUPA's characterization of the facts and the law (as detailed further below), we find it equally encouraging that NAUPA has embraced many of the proposals embodied in the Best Practices Guide. NAUPA notes in their memorandum that they concur with our proposed transparency reforms, including a requirement that states make a public determination that private auditor services are needed prior to any hiring decisions; that contracts for private auditor services are subject to an open, competitive bidding process; and that, as a general matter, contracts are made publicly available. NAUPA similarly embraces our proposed contract reforms, including prohibiting the state from delegating substantive decision making authority and requiring auditors to act with the highest ethical standards; conduct all audits within the boundaries of the law; refrain from abusive, unreasonable, or cumbersome audit procedures; and issue formal audit findings at the conclusion of an audit. As discussed further below, the only material point of disagreement is with private auditor contingency fee arrangements.

1. The Proposed Best Practices Are Designed To Promote Responsible And Fair Enforcement Of Unclaimed Property Laws

ILR recognizes that unclaimed property laws serve several important functions when they are fairly and appropriately enforced, including among other things helping to reunite rightful owners with their property. Contrary to NAUPA's suggestion, the proposed Best Practices are designed not to preclude states from collecting unclaimed property or engaging private audit firms, but rather to ensure that appropriate safeguards are in place to keep unclaimed property enforcement efforts within the boundaries of the law. Despite its wide-ranging attempt to discredit the Best Practices Guide, NAUPA purports to agree with most of the recommendations set forth in that document and instead devotes its efforts to defending the use of contingency fee arrangements. *See* NAUPA Memo. p.14.

2. Numerous Courts Have Confirmed That Private Audits Of Life Insurance Companies Conducted On A Contingency Fee Basis Exceeded The Boundaries Of The Law

NAUPA's claim that private auditors operating on a contingency fee basis have consistently operated within the boundaries of the law is inaccurate, as the recent experience of the life insurance industry establishes. Private audit firms have made millions of dollars by requiring life insurance companies to cross-check their millions of policy records against the Social Security Administration's Death Master File ("DMF") – an idea developed by a private audit firm that has imposed enormous costs and burdens on life insurance companies nationwide. But every court that has considered the issue – including most recently the United States Court of Appeals for the First Circuit[2] – has found that life insurance companies are not in fact under any legal obligation to search their records against the DMF.

NAUPA's claim that these decisions by state and federal judges do not impact private auditors' authority to require life insurance companies to search the DMF is highly questionable as NAUPA surely knows from its own involvement in one such case: NAUPA has filed an amicus brief in support of the West Virginia Treasurer's appeal of a ruling that the West Virginia unclaimed property act does not require life insurance companies to search the DMF. NAUPA's concern about the West Virginia ruling is understandable as the West Virginia unclaimed property statute is based on a widely used model law adopted in numerous states. If the West Virginia decision had no impact on the scope of state and private auditor authority, NAUPA would have no need to file an amicus brief.

NAUPA nonetheless makes the argument that these decisions by state and federal judges hold only that an insurer is not required to search the DMF,

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2 *See Feingold v. John Hancock Life Ins. Co. (USA)*, No. 13-2151, __ F.3d ___, 2014 WL 2186595, (1st Cir. May 27, 2014) (holding that insurers' practice requiring "proof-of-death notice . . .complies with Illinois law").

not that a private auditor cannot require them to do so. NAUPA's theory appears to be that the authority of private auditors to enforce unclaimed property laws exceeds the scope of those laws – an argument that perfectly illustrates the very overly aggressive and extra-legal enforcement techniques that the Best Practice Guide is intended to address. NAUPA's position has no conceivable legal basis, and NAUPA's defiance of multiple court rulings serves only to highlight the critical need for oversight and reform.[3]

Notably, NAUPA is presently advocating for a revision to the Uniform Unclaimed Property Act that would create an affirmative duty on the part of life insurance companies to search the DMF and provide that the dormancy period for benefits would begin to run on the date of an insured's death.[4] NAUPA's present efforts to change the language of the uniform statutes undermines its argument that this duty already exists under the law, and demonstrates that the audits undertaken to date were based on a faulty legal premise.

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3 NAUPA's reliance on *Chiang v. Am. Nat'l Ins. Co.* underscores the weakness of NAUPA's position. *Chiang* dealt solely with an insurer's obligation to make documents available to the Controller at the preliminary injunction stage so that the Controller, through its auditor, could *determine* whether the insurer complied with the law – it did not even consider any of the legal issues actually relevant to the appropriateness of the current auditor arrangements, such as whether California unclaimed property law requires life insurance companies to search the DMF.

4 *See* May 29, 2014 NAUPA Memorandum to Drafting Committee to Revise the Uniform Unclaimed Property Act, Uniform Law Commission, *available at* http://www.uniformlaws.org/Committee.aspx?title=Revise%20the%20Uniform%20Unclaimed%20Property%20Act.

3. NAUPA's Defenses Of Contingency Fee Arrangements Miss The Mark

NAUPA devotes much of its memorandum to purported defenses of the use of contingency fee arrangements that fail to address the concerns identified in the Best Practices Guide. For example:

- NAUPA argues that contingency fee arrangements are not illegal. This is a strawman. The Best Practices Guide does not argue that contingency fee arrangements are illegal (although, as NAUPA concedes, such arrangements have not yet been tested in court). More importantly, the question whether such arrangements are technically legal says nothing about whether their use by states is good public policy, nor does it erase the fundamental conflict of interest inherent in such relationships.

- NAUPA argues that private auditors operating on a contingency fee basis have collected substantial sums of money. But the end does not justify the means, nor does it excuse overly aggressive and extra-legal audits and collections. NAUPA does not acknowledge that substantial sums have been collected from life insurance companies based on audit practices that are contrary to state unclaimed property laws.

NAUPA articulates no reason why contingency fee arrangements in particular are necessary to collect unclaimed property or why robust collection could not be accomplished through a combination of hourly fee arrangements

and properly incentivized voluntary disclosure programs ("VDP").[5] NAUPA offers no meaningful discussion of VDPs such as that instituted by Delaware, which as of January 2014 had 466 companies enroll, with many more expected to enroll prior to the statutory deadline of June 30, 2014.[6]

Further, even accepting NAUPA's assertion that unclaimed property audits increase voluntary compliance, there is no evidence to suggest that an audit enacted under the reform measures proposed by the Best Practices Guide – including transparency in selecting an outside auditor (if required), fees paid on an hourly basis, and strong oversight of any auditor by state officials – would not similarly increase voluntary compliance while also stemming the potentials for abuse by private auditors existing under the present system.

4. NAUPA's Remaining Arguments Against The Best Practices Guide Lack Credibility

In its discussion of the Best Practices Guide, NAUPA takes issue with numerous statements that are self-evidently true. For example, NAUPA takes issue with the statement that the use of private audit firms to collect purported unclaimed property "inject[s] a private profit motive into the enforcement of state laws and thus carr[ies] a significant risk of abuse," which NAUPA claims is "unsubstantiated." NAUPA Memo. 10 (quoting Best Practices Guide). That a contingency fee arrangement injects a private profit motive into unclaimed

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5 NAUPA's argument that participation in VDPs is low is supported only by a citation to an article by PriceWaterhouse Coopers announcing that Wisconsin was about to *introduce* a voluntary compliance program for the first time. Patty Jo Sheets, "Abandoned & Unclaimed Property Alert," November 27, 2012, available at http://www.statetreasury.wisconsin.gov/news_doc_get.asp?onid=5651 ("The state is also in the process of formalizing a voluntary disclosure agreement ('VDA') and an amnesty program.") These figures obviously say nothing about compliance under a combination of a robust VDP combined with audits by private firms compensated on an hourly basis.

6 Delaware VDA Administration, LLC, January 31, 2014 Webinar, "Delaware's Voluntary Disclosure Program: - Secretary of State Jeffrey W. Bullock, http://www.delawarevda.com/.

property enforcement is a statement of fact that cannot be disputed: that is how contingency fee arrangements work. That such arrangements carry a significant risk of abuse has been borne out by the experience of the life insurance industry, as confirmed by the unanimous view of the state and federal courts that have examined the issue. It is not clear what further substantiation will be required before NAUPA concedes that reform is called for.

Similarly, NAUPA takes issue with "reckless statements" that contingency fee contracts present a "conflict of interest." NAUPA Memo. 14. Again, the Best Practices Guide demonstrates that incentivizing private auditors with a share of unclaimed property collections has led to rampant extra-legal collection of purportedly unclaimed property from life insurance companies. The only statement that can be characterized as "reckless" is NAUPA's insistence, in the face of clear evidence to the contrary, that such a conflict does not exist and is not an issue.

5. NAUPA's Resistance To Transparency Reforms Speaks Volumes

In its determination to criticize the Best Practices Guide, NAUPA even resists ILR's call for increased transparency regarding the process of selecting and contracting with private auditors by requiring unclaimed property administrators to post their contracts with private auditors on their website. NAUPA appears to take the position that members of the public should be satisfied with seeking access to private auditor contracts via cumbersome and time-consuming requests for public records under freedom of information laws. There is no defensible basis for opposing a cost-free measure that would facilitate public access to information about state unclaimed property administrators' arrangements with private auditors that purport to enforce state law on their behalf.

Thank you for your consideration of these responses, and please do not hesitate to contact me if you have any questions.

Sincerely,

Harold Kim