American Bar Association
321 North Clark Street
Chicago, IL 60654

September 18, 2015

Ms. Katie Robinson
Staff Liaison
Uniform Law Commission
11 N. Wabash Ave., Suite 1010
Chicago, Illinois 60602

Re: Project to Revise the Uniform Unclaimed Property Act - *Connecticut Mutual* Does Not Permit States to Disregard Substantive Contract Conditions

Dear Ms. Robinson:

I am writing on behalf of the American Bar Association ("ABA") to (1) provide additional recommendations to the Uniform Law Commission's Drafting Committee to Revise the Uniform Unclaimed Property Act (the "UUPA") regarding the latest draft of the UUPA; and (2) provide clarification to the Drafting Committee regarding the U.S. Supreme Court's decision in *Connecticut Mutual Life Ins. Co. v. Moore*.[1] With respect to the first issue, we have attached a revised version of the UUPA that includes our recommended edits to the text of the UUPA. For ease of review, our recommended changes are highlighted as "tracked changes" and we have also included additional explanatory comments for most changes. Most of our changes are technical fixes, but we have also included some substantive comments.

With respect to the second issue, we believe it is important to provide clarification regarding the Court's decision in *Connecticut Mutual Life Ins. Co. v. Moore* because we have noted that this decision has been repeatedly cited during Drafting Committee meetings and in submissions to the Drafting Committee for propositions for which it does not stand. Specifically, the National Association of Unclaimed Property Administrators ("NAUPA") has cited the Court's decision as somehow inconsistent with the derivative rights principle. That reliance is misplaced. *Connecticut Mutual* involved the narrow issue of whether New York's escheat statute applicable to life insurance proceeds violated the Contract Clause of the U.S. Constitution. It did not address the derivative rights principle, other than to suggest that a state *cannot* constitutionally alter substantive contract conditions existing between the parties.

[1] 333 U.S. 541 (1948).

The U.S. Supreme Court recognized the derivative rights principle in a *subsequent* line of cases culminating in *Delaware v. New York*.[2] In that case, the Court reconfirmed 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."[3] 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."[4] 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 principle that the states' rights are derived from the rights of the owner.[5]

Connecticut Mutual did not involve the application of the derivative rights principle, but rather involved the limited question of whether a New York law requiring the escheat of unpaid life insurance proceeds violated the Contract Clause of the U.S. Constitution. The law at issue in *Connecticut Mutual* permitted escheat of unpaid life insurance proceeds owed under preexisting policies even without satisfying the insurance policy conditions requiring proof of death and surrender of the policy. The insurance companies argued that these contract conditions served a substantive purpose—they were intended to provide information from which the companies could establish defenses to their obligation to pay. Consequently, the companies argued that New York's attempt to require them to pay the policy proceeds to the state without satisfaction of these conditions specified in the policies materially changed the terms of its contracts with policyholders and therefore substantially impaired the contracts, in violation of the Contract Clause. In rejecting this argument, the Court stated that the "enforced variations from the policy provisions" were not unconstitutional because otherwise "the insurance companies would retain moneys contracted to be paid on condition and which normally they would have been required to pay."[6] In explaining its holding, the Court stated:

> When the state undertakes the protection of abandoned property claims, it would be beyond a reasonable requirement to compel the state to comply with

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[2] 507 U.S. 490, 503 (1993).
[3] *Id.* at 499.
[4] *Id.* at 501.
[5] *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."); *Blue Cross of N. California v. Cory*, 120 Cal. App. 3d 723, 737 (1981) ("[T]he Controller's rights under the UPL are 'derivative' and [ ] he accordingly succeeds to whatever rights the owner of the unclaimed property may have had and no more.").
[6] *Id.* at 546.

> conditions that may be proper as between the contracting parties. The state is acting as a conservator, not as a party to a contract.[7]

Nevertheless, 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 as property an amount 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."[8]

Strikingly, none of the potential defenses cited by the Court or the insurers was that the insured had not actually died. Thus, all of the parties and the Court assumed that the insurers would have had actual knowledge of death before escheating—the standard later adopted in the 1981 Uniform Act. Given that the Court did not place on the insurers any obligation to affirmatively determine whether insureds had died, and given that in 1948 neither the Social Security Death Master File nor the Internet existed, such an assumption would have been quite reasonable. Therefore, the "proof of death" in question was the merely formalistic substantiation required by the policies. Indeed, given the highly restricted ability at that time to affirmatively determine deaths, insurers would have had no ability to escheat without having actual knowledge of death, which in most cases could arise only by having been provided with some reliable notice of the death, even if not in the exact form required by the policy and the insurance laws of the state.

In other words, 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."[9] The Court specifically recognized that non-formalistic conditions may be raised as defenses to escheat, if those conditions have not been satisfied.[10]

Connecticut Mutual 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 Supreme Court 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."[11] Furthermore, a number of courts have subsequently denied state claims to

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[7] *Id.* at 547.
[8] *Id.* at 545.
[9] *Id.* at 546.
[10] *Connecticut Mutual* thus did not hold that states can disregard the contractual "due proof of death" requirement in all circumstances. It held only that requiring the reporting of life insurance benefits at the limiting age, or when the insurer has received some notice of death (presumably from, for example, a beneficiary or funeral home), does not impair the contracts in a constitutionally problematic way. In contrast, legislation that eliminates any requirement of notice and requires insurers to affirmatively seek out deaths substantially impairs preexisting contracts—it shifts the burden of establishing death entirely from the beneficiary to the insurer, and thus fundamentally alters the parties' bargain, a result the Court in Connecticut Mutual never contemplated.
[11] *Kane v. Insurance Co. of North America*, Ct. of Common Pleas, Opinion at 21, Jan. 20, 1976.

property where the purported owner of the property had not satisfied certain conditions to claim the property.[12]

Even if a state could adopt escheat laws that would override other, more substantive, conditions without violating the Contract 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. Indeed, the Court in *Delaware v. New York*, citing *Connecticut Mutual*, stated:

> Unless we define the terms "creditor" and "debtor" according to positive law, we might "permit intangible property rights to be cut off or adversely affected by state action … in a forum having no continuing relationship to any of the parties to the proceedings." *Pennsylvania* at 213.[13] Cf. *Connecticut Mut. Life Ins. Co. v. Moore*, 333 U.S. 541, 549–550, 92 L. Ed. 863, 68 S. Ct. 682 (1948) (upholding New York's escheat of unclaimed insurance benefits only "as to policies issued for delivery in New York upon the lives of persons then resident therein where the insured continues to be a resident and the beneficiary is a resident at … maturity"). *Texas*[14] and *Pennsylvania* avoided this conundrum by resolving escheat disputes according to the law that creates debtor creditor relationships; only a state with a clear connection to the creditor or the debtor may escheat. (Ellipses in original; footnotes supplied.)

Given the Court's emphatic requirement in *Delaware v. New York* that a debtor-creditor relationship exist under the positive law of the state, it simply could not have cited *Connecticut Mutual* if that case stood for the broad proposition NAUPA espouses that states are not bound by contractual contingencies. *Delaware v. New York* does not allow the state to create a debtor-creditor relationship where none exists, and neither does *Connecticut Mutual*.[15]

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[12] *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).

[13] *Pennsylvania v. New York*, 407 U.S. 206, 213 (1972).

[14] *Texas v. New Jersey*, 379 U.S. 674 (1965).

[15] Permitting the state to use its escheat laws to override substantive contract conditions also creates significant problems under the Full Faith and Credit Clause. For example, consider a contract that is entered into between two parties, and which is expressly agreed to be governed by the laws of a particular state. This state may be completely different than the state that has the right and jurisdiction to escheat any unclaimed property arising out of that contract. Thus, if the laws of the state governing the contract permit the parties to impose certain conditions between themselves, then any escheat laws of another state that do not respect such conditions will not be giving full faith and credit to the laws of the governing state. This effectively allows states to use their escheat laws to "trump" the debtor-creditor laws of other states, which is not permitted by the Full Faith and

Finally, even if states *could* constitutionally disregard substantive contract conditions as between the parties, such actions would still not constitute sound public policy, and thus should not be permitted or endorsed by the UUPA. To the contrary, the intended purpose of escheat laws is to return missing property to rightful owners; thus, such laws should not be used to alter the contractual relationships among debtors and creditors, directly or indirectly, including contractual relationships established under other laws. All states have adopted substantive laws governing debtor-creditor relationships, including the types of contract conditions that may be permissible or impermissible among the parties. These laws generally provide parties with wide latitude, consistent with fundamental principles of freedom of contract, to agree to various contract conditions that may restrict their ownership rights under certain conditions. Furthermore, a substantial body of common law has also developed over the years in construing the validity of certain types of contract conditions, including the use of expiration dates and other terms that may divest a party of its interest in certain property for failure to take certain actions. State escheat laws should not be used to override contract conditions which have been agreed by the parties and which are enforceable under the laws governing the terms of those contracts. Otherwise, the escheat laws would effectively trump not just the contracts themselves, but the laws governing those contracts—which the Supreme Court expressly held provide the basis for the state's escheat in the first place.

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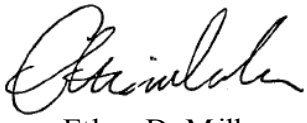
If the Drafting Committee has any questions or needs any additional information or clarification regarding any of our recommended changes to the UUPA or the *Connecticut Mutual* decision, please contact me at (213) 293-7258 or ethan.millar@alston.com. We very much appreciate the Drafting Committee's consideration of our comments and recommendations.

Sincerely,



Ethan D. Millar
ABA Advisor to ULC Drafting Committee to
Revise UUPA

Credit Clause because the state whose laws govern the debtor-creditor relationship has a substantially greater connection than the state whose unclaimed property laws apply to the property at issue. *Allstate v. Hague*, 449 U.S. 302, 308 (1981) (where there is a conflict between the laws of different states, the Full Faith and Credit Clause requires deference to the state with the most significant contacts to the controversy); *Nevada v. Hall*, 440 U.S. 410 (1979); *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930); *John Hancock Mutual Life Insurance Co. v. Yates*, 299 U.S. 178 (1936). Furthermore, if the state that governs the contract is the same as the escheat state, another constitutional problem is created, as the state's escheat laws then may effectively "amend" the state's debtor-creditor laws in violation of the single-subject provision of the state's own constitution. *See, e.g., Planned Parenthood Affiliates v. Swoap*, 173 Cal. App. 3d 1187, 1196 (1985) (invalidating a budget bill that would have imposed new substantive rules in the Family Planning Act that did not exist under such law); *Cal. Labor Fed'n v. Occupational Safety & Health Stds. Bd.*, 5 Cal. App. 4th 985, 994-95 (1992) (invalidating a budget bill that would have effectively amended the attorney fee provisions under CCP § 1021.5, creating "substantive conditions that nowhere appear in existing law.").

cc: Michael Houghton, Co-Chair, ULC Drafting Committee to Revise UUPA
Rex Blackburn, Co-Chair, ULC Drafting Committee to Revise UUPA
Charles Trost, Reporter, ULC Drafting Committee to Revise UUPA
Harriet Lansing, President, ULC
Robin K. Roy, ABA-ULC Liaison
Scott Heyman, ABA Business Law Section Advisor
Charolette Noel, ABA Business Law Section Advisor
Alexandra Darraby, ABA Forum on Entertainment and Sports Industries Advisor
Michelle Andre, ABA Business Law Section, Unclaimed Property Subcommittee
Dean Bunton, ABA Business Law Section, Unclaimed Property Subcommittee
Mike Rato, ABA Business Law Section, Unclaimed Property Subcommittee
Jamie Ryan, ABA Business Law Section, Unclaimed Property Subcommittee
Tami Salmon, ABA Business Law Section, Unclaimed Property Subcommittee
Sam Schaunaman, ABA Business Law Section, Unclaimed Property Subcommittee
Mary Jane Wilson-Bilik, ABA Business Law Section, Unclaimed Property Subcommittee
Michael Kliegman, Chair, ABA Business Law Section, Taxation Committee
John Biek, ABA Taxation Section, Unclaimed Property Subcommittee Co-Chair
Matthew Hedstrom, ABA Taxation Section, Unclaimed Property Subcommittee Co-Chair