NATIONAL ASSOCIATION OF UNCLAIMED PROPERTY ADMINISTRATORS ®

MEMORANDUM

TO: **Drafting Committee to Revise the Uniform Unclaimed Property Act, Uniform Law Commission**

FROM: **Uniform Unclaimed Property Act Revision Committee, National Association of Unclaimed Property Administrators**

RE: **The Derivative Rights Doctrine Under Unclaimed Property Law, The Holder Advocates' Notion of that Doctrine, and Implications for Unclaimed Property Administration**

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The Derivative Rights Doctrine Under Unclaimed Property Law,
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Implications for Unclaimed Property Administration

I. Summary

The derivative rights doctrine as it has been understood during the past 60 years means that under the unclaimed property law, the State succeeds to the rights of the missing owner. By operation of State abandoned and unclaimed property laws, "the State has any and all rights of the owners to the property it claims as abandoned property."[1] The concept is captured in the metaphor that the State "steps into the shoes of the owner." Hence, the State rights are characterized as being derivative. But while the State's rights are derivative, they are not identical. The unclaimed property law provides citizen protection safeguards to ensure that the rights of the owner—whether a right to payment or delivery of property—is not forfeited or confiscated by a holder, which has possession, but no moral or legal right to retain the property. And they provide for the public interest by ensuring that property presumed abandoned is used for the common good rather than the chance enrichment of the holder.[2] Two of the most prominent safeguards are the non-presentment and anti-limitations provisions in the 1954, 1981, and 1995 Uniform Unclaimed Property Acts. In accord with long-standing jurisprudence, these safeguards undermine holder attempts to use conditions or practices that would result in the forfeiture of indisputable obligations to pay and affect an impermissible private escheat.

Holder advocates, however, have recently seized the doctrine and redefined it so that it becomes a limitation upon the rights of the State and its ability to safeguard the interests of the owner. Their notion would permit a holder to unilaterally impose conditions, restrictions, time limitations, or any other scheme to terminate its obligations to pay or deliver property. To avoid the specter of a private escheat scheme, the holder's actions are supposedly grounded in a valid and lawful business purpose—an ambiguous, amorphous, problematic standard. There is no authority in the law for this manipulation of the long-understood derivate rights of the State.

[1] *Travelers Express Co., Inc. v. Regan*, 498 N.Y.S.2d 569, 572 (App. Div. 1986).

[2] As the US Supreme Court stated, by such laws, unclaimed "property thus escapes seizure by would-be possessors and is used for the general good rather than the chance enrichment of particular individuals or organizations." *Standard Oil Co. v. New Jersey*, 341 U.S. 428, 436 (1951).

Other than their transparent dislike for unclaimed property laws and their clients' inability to keep the property of others, the advocates have presented no rationale that justifies overturning the established understanding of the State's derivative rights. They have made no demonstration how their notion of derivative rights safeguards the interests of the citizenry and enhances compliance with the law. And they have made no demonstration how compliance with the unclaimed property is so unfair and burdensome that the law should be changed, notwithstanding that the end result would condone forfeitures, a result that the law abhors. The irony in such criticisms of unclaimed property law is that holders have it within their control to overcome these criticisms by timely, complete, and truthful reporting, which is all that has ever been required.

Enactment of the holder advocates' notion of derivative rights would probably result in emasculation of State unclaimed property programs. Because a holder can easily invent some business purpose for any restriction on its obligation to the owners, surely all would do so. Any holder issuing a payment instrument or credit of any form—check, rebate, refund, traveler check, money order, stored value card, credit balance—would require that the instrument or credit be cashed or used within a time period fixed so that the holder can confiscate the funds. Insurance companies would do the same in requiring the presentation of documents before any claim could be made—documents that no State could have. In equity or debt securities transactions, the holder could insist that the owner take certain actions and within a certain time before the owner can receive any security. And financial institutions could impose document requirements or fees to undermine their obligations on accounts that they have. Attached as an Appendix to this discussion (*infra* at 16-17) is a compilation of schemes that a holder could utilize to avoid and frustrate any effective unclaimed property program. In actual operation, the holder advocates' notion of derivative rights would well serve the interest of their clients—holders. It would not serve the public interest in any manner and would undermine the salutary and remedial purposes that unclaimed property laws have achieved.

II. The Doctrine According to Holder Advocates

As enunciated by holder advocates, the derivative rights doctrine essentially imposes restrictions or limitations upon the State's right to take possession of fixed and certain obligations that are presumed abandoned by their owners. It sanctions the use contractual

conditions that holders impose to extinguish the holder's obligation to the missing owner as a barrier to the State's custody right under unclaimed property laws. The prevailing holder advocate view is reflected in the attached article from Alston & Bird, criticizing provisions of unclaimed property laws that monetize the holder's obligation or allow the collection of property where the owner could not do so because of contract restrictions that allegedly have some "valid and lawful business purpose."

This notion of the derivative rights doctrine is an invention of holder advocates. It is a misnomer for, and a misinterpretation of, the well-established concept that the State's rights are derived from, but are not identical to, those of the owner. That notion of the doctrine is not mentioned in any proceedings of the Uniform Law Commission in its deliberations about what became the 1954, 1981, or 1995 Uniform Acts, nor in any provision or comment in those Acts. Its contours are not discussed or analyzed in any court decision or law review article. Its provisions are not codified in any legislation. At best, the notion appears to be a mutation of the metaphor that in the unclaimed property situation, the State "steps into the shoes" of the missing owner. Its genesis appears to be from an article published in 2007 by Deloitte & Touche's Unclaimed Property Services practice (a copy of which is attached), that asserted:

> The Derivative Rights Doctrine provided a foundation for confirming the rights of the lost owner. There are a number of relevant cases where companies have tried to create a bylaw or exception so that if the individual does not come forward after a certain period of time, they are barred from receiving their property. Under the Derivative Rights Doctrine concept, once the property has been deemed presumed abandoned, the rights of the owner transfer to the state. This concept is commonly referred to as the "state stands in the shoes of the owner. [3]

Note that this explication of the doctrine makes no mention of any restrictions on the State's entitlement to custody when property is presumed abandoned. Holder advocates, however, have seized upon the doctrine, but ignored the real point being made. They have turned it into something very different—something designed solely to serve purposes of the holder community.

Another authority for the holder advocates' notion appears in an article in *State Tax Today*, a publication of Tax Analysts, based on a study for the Council on State Taxation. The

[3] Valerie Jundt, *Unclaimed Property Compliance for Financial Services Companies*, Financial Foresight (Deloitte Financial Services June 2007) (attached).

authors assert that the doctrine, "recognized by the U.S. Supreme Court in its unclaimed property decisions," is that "the states should have no greater property rights than the true owners of unclaimed property."[4] They cite the US Supreme Court decision in the *Standard Oil*[5] case. But that decision makes no mention of, and contains no discussion about, the State's derivative rights. Affirming the escheat judgment of the New Jersey courts, it solely addressed and rejected the holders' arguments concerning federal constitutional issues such as the adequacy of the notice of the escheat proceedings; the impairment of the owner's contract right to dividends and stock; the situs of the property and the holder's Due Process Clause rights; and the full faith and credit to be accorded to the State's escheat judgment.[6] Otherwise, no other supporting decisions of the US Supreme Court are cited. None there are.

III. State's Derivative Rights According to the Courts

The holder advocates' embellishment of the principle of derivate rights ignores two long-standing principles of unclaimed property jurisprudence. First, while the State's rights to unclaimed property derive from those of the absent owner, the State's rights and those of the owner are not identical. The State may assert its right to custody of unclaimed property even though it has not and cannot fulfill all of the contractual conditions that would be required of the owner, such as presenting a check for payment or a stock transfer form. In 1948, the US Supreme Court found that in taking custody of unclaimed property, the State is not bound to comply with contract conditions that the missing owner would have to: "[w]hen the state undertakes the protection of abandoned claims, it would be beyond a reasonable requirement to compel the state to comply with conditions that may be quite proper as between the contracting parties. The state is acting as a conservator, not as a party to a contract."[7] Based upon this principle and the Supreme Court's decision, the Wisconsin court concluded that while the States' rights are derivative, they are not identical:

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[4] *Reforming State Unclaimed Property Laws: Goals and Potential Forums*, 2009 Sate Tax Today 223-1, at 9 (Tax Analysts Nov. 23, 2009).

[5] *See* n. 2 *supra*.

[6] *Id*., 341 U.S. at 433, 435, 437, and 442.

[7] *Connecticut Mut. Life Ins. Co. v. Moore*, 333 U.S. 541, 547 (1948).

> [I]t would be accurate to say, for example, that the state's claim would not exist were it not for the owners'. But that is not to say that the two claims are identical. While they arise from the same source, they are not, in all respect [*sic*], the same. The owners' rights are based on the contractual obligation of the [holder] to pay valid and timely claims, which obligation has been acknowledged and reduced to a check or draft in payment. The owner has a right to the check or draft. However[,] the state's right, as a conservator of the owner's property, is based upon the statute.[8]

That Wisconsin court also observed that through the operation of unclaimed property laws, "owners may, in fact, have property returned through the state, which owners … could not obtain directly."[9] In accord, in a case involving expiration dates on gift certificates, the Illinois Appellate Court concluded that the State may take custody of unredeemed gift certificates although the owner's claim may have been barred for failure to redeem within the time specified on the certificate. The Court concluded that "the failure of an owner to make a timely claim will not prevent the State from taking the property from the holder as custodian."[10]

Second, the provisions of State unclaimed property law are binding upon private citizens and business organizations; they can make no disposition of such property other than as specified in that law.[11] As the US Supreme Court has ruled, "the laws which subsist at the time and place of the making of a contract, and where it is to be performed, enter into and form a part of it, as if they were expressly referred to or incorporated in its terms."[12] Existing State laws are part of the "law that creates property and binds persons [*sic*] to honor property rights."[13] The law that creates property—such as State law— necessarily defines "the legal relationship under which

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[8] *Employers Ins. of Wausau v. Smith*, No. 86 CV 2283, 1987 Wisc. App. [*sic*] LEXIS 4443, at *5-6 (Wisc. Cir. Ct. Jan. 15, 1987), *aff'd in part* and *rev'd in part* (issues-application of unclaimed property law to benefit checks in uncontested cases and prospective application of statutory change), 453 N.W.2d 856 (Wisc. 1990). There is no additional case law on the scope of the derivative rights doctrine. This understanding of the doctrine is so much a part of the jurisprudence and fundamentals of unclaimed property law that holders have had no basis to challenge it in court any further.

[9] *Id.*, 1987 Wisc. App. [*sic*] LEXIS 4443, at *21.

[10] *People ex rel. Callaghan v. Marshall Field & Co.*, 404 N.E.2d 368, 373 (Ill. App. Ct. 1980).

[11] *Pennsylvania v. York Water Co*. 36 Pa. D. & C. 603, 610 (C.P. 1939) (The unclaimed property law "rises above, supersedes, and sets aside any rule or regulation adopted or promulgated with the approval and consent" of private parties.").

[12] *Von Hoffman v. City of Quincy*, 71 U.S. 535, 550 (1867).

[13] *Delaware v. New York,* 507 U.S. 490, 501 (1993).

certain parties ('debtors') must discharge obligations to others ('creditors')."[14] In an unclaimed property case, the New Jersey Supreme Court explained that unclaimed property law is a part of the general law of the State and is a "continuing constituent part" of any contract or agreement entered into by parties that are subject to the State's laws.[15] At the same time, any private agreement that is "obnoxious to," "conflicts with a general law enacted by the Legislature for the common weal," or "is clearly opposed to the spirit and essence of the public custodial escheat law and to the broad public policy represented thereby" cannot "survive."[16] This concept has been applied so as to negate "private escheat," whereby the unclaimed property reverts to the

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[14] *Id*., at 502.

[15] *New Jersey v. Jefferson Lake Sulphur Co.*, 178 A.2d 329, 335 (N.J.), *cert. denied* and *appeal dismissed*, 370 U.S. 158 (1962).

[16] *Id*., at 338-39. *Accord*, *Blue Cross of Northern California v. Cory*, 174 Cal. Rptr. 901, 912 (Ct. App. 1981); *People v. Marshall Field & Co., supra* n. 10, at 374; and *Riggs Nat'l Bank v. District of Columbia*, 581 A.2d 1229, 1241 (D.C. 1990).

In the attached article from Alston and Bird, the authors attempt to undercut the authoritativeness of these cases and their underlying principles by asserting that those principles are limited to situations where the sole purpose of the corporate action is directed to circumventing the State's unclaimed property laws. These Courts' discussion of the principles, however, and their underlying rationale are applicable to any conflict between a private agreement seeking a forfeiture and the public policy in favor of the custodial taking of unclaimed property. There is no "legitimate business purposes" exception to the private escheat prohibition. Moreover, the principles of these cases have been applied in situations not involving anti-escheat motivations. For example, *Clymer v. Summit Bancorp*. involved trust indentures for government debt securities, a contractual arrangement not entered into for the sole purpose of avoiding the State's unclaimed property law. But those indenture contracts provided for reversion of unpaid funds to the issuer. Relying on *Jefferson Lake Sulphur (supra* n.18 and accompanying text), the New Jersey trial court noted that "[o]f course to the extent these contractual escheat provisions violate the [Unclaimed Property] Act, by establishing an ultimate repository for the unclaimed funds other than the sovereign, they are void." 726 A.2d 983, 992 n. 8 (N.J.Super. Ct. Ch. Div. 1998), *rev'd on other grounds*, 758 A.2d 652 (N.J. Super. Ct. App. Div. 2000), *rev'd,* 792 A.2d 396 (N.J. 2002). Thus, the principle of law is that it is not the intent of the parties to evade State unclaimed property laws that is significant. What is significant is whether the private agreement in any way disposes of unclaimed funds other than by delivery into the protective custody of the State. If it does, it is void.

obligor/issuer/holder or is diverted to some other use.[17] It has also been applied so as to negate limitations periods or expiration dates.[18]

These two principles of unclaimed property jurisprudence mean that (1) the State's rights are indeed greater than those of the owner in certain aspects and (2) those laws circumscribe a holder's imposition of terms or conditions that would undermine those State rights. This understanding of the notion of derivative rights is in no way undercut by the discussion of that notion by the New JerseySupreme Court in the *Standard Oil* case,[19] which was the first case to discuss derivative rights. In its discussion, the Court relied upon English law authorities from 1818 and 1825. Its discussion was limited in scope to absolute escheat actions and the State's statute of limitations; it did not consider contract conditions that evade unclaimed property laws. It reviewed a judgment absolutely escheating[20] certain intangible property (unpaid dividends, shares of common stock, unpaid wages, and unpresented corporate checks)[21]; an interim custodial escheat or modern unclaimed property action was not involved. The issue was whether the expiration of the statute of limitations applicable to this property before the expiration of the abandonment period for an escheat bars the State's action for escheat.[22] The Court reasoned that under New Jerseylaw concerning the statute of limitations, the expiration of the limitations period bars any action on the underlying obligation. The determinative principle was that "the right to interpose the bar of the statute of limitations to actions in contract … is a vested property

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[17] For example, where an entity issues checks that are uncashed, the Kentucky Supreme Court concluded that the obligations that those checks represent are subject to the state's custody and cannot be claimed by the entity as a "private escheat." *Revenue Cabinet v. Blue Cross,* 702 S.W.2d 433, 436 (Ky. 1986). And where an actors' guild bylaw provided for assignment to the guild of the proceeds of residual payments that had gone unclaimed, the California Court of Appeal concluded that the "bylaw on the disposition of unclaimed residuals is void as a private escheat law obviously designed to frustrate operation of [California's unclaimed property law]." *Screen Actors Guild, Inc. v. Cory*, 154 Cal. Rptr. 77, 80 (Ct. App. 1979).

[18] For example, the New Jersey appellate court concluded that "a corporation's adoption of a private 'statute of limitations' to circumvent an escheat statute is invalid." *In re Matter of Nov. 8, 1996, Determination, etc.,* 706 A.2d 1177, 1180 (N.J. Super. Ct. App. Div. 1998), *aff'd per curiam,* 722 A.2d 536 (N.J. 1999).

[19] *State by Parsons v. Standard Oil Co.*, 74 A.2d 565 (N.J. 1950).

[20] *Id*., at 568.

[21] *Id*., at 569.

[22] *Id*., at 570.

right which the law-making body may not abrogate or impair."[23] Applying this principle to the State's action to escheat after the bar of limitations vested, the Court concluded that "where the defense [of the bar of limitations] is sufficient in law, there is no property subject to escheat."[24] This conclusion was premised on the State's derivative rights:

> [W]here all remedy upon the intangibles has been barred by the statute of limitations, there is no property to escheat under the [absolute escheat] act now before us. The State's right is purely derivative; it takes only the interest of the unknown or absentee owner. If the remedy has been extinguished by the statute of limitations, the State is under like incapacity. The State takes only the creditor's right; it cannot create or revive an obligation that had no existence or had become extinct.[25]

As pointed out in the Uniform Law Commissioners' Comment to the anti-limitations provision in § 16 of the 1954/66 Uniform Act,[26] approximately one year after that decision, the New Jersey Legislature enacted a custodial escheat statute that allowed the State to take custody of subsequently escheatable property after five years. "[T]he lawmakers intended to provide a means whereby the State might assert its right in timely fashion to overcome the obstacle imposed by limitations."[27] Thereafter, the New Jersey Supreme Court considered the circumstance where the State's right to custody accrues before the expiration of the limitations period on the underlying obligations, but the custodial escheat action was not commenced until after the expiration of the limitations period. The Court ruled that the plea of the limitations statute does constitute a good defense to the State's action for custody after the limitations period expired.[28] "If, by virtue of limitations, the owner can obtain nothing, the State is under like

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[23] *Id*., at 572.

[24] *Id*., at 573.

[25] *Id*.

[26] Appendix II, *infra,* at 24; Unif. Disposition of Unclaimed Property Act (1954), cmt. to §16, 8A U.L.A. 295 (1993).

[27] *State by Parsons v. U.S. Steel Corp.*, 126 A.2d 168, 175 (N.J. 1956).

[28] *Id*., at 174. With the evolution of modern unclaimed property acts—where the State takes custody but never escheats the property, the circumstance where a custodial escheat action is commenced after the running of the statute of limitations no longer arises. The State's right to custody vests upon expiration of the abandonment period, long before the holder obtains any vested interest arising from expiration of the limitations period. "At the time the property is deemed abandoned, the States becomes entitled to custody of the property." *In re Continental Airlines, Inc.*, 161 B.R. 101, 105 (Bankr. D.Del. 1993). The State acquires "an accrued right of

disability."[29] But it also concluded that while "the defense of limitations may be pleaded by the defendant in the custodial action, … the failure to report property subject to custodial escheat … within a reasonable time so as to seasonably permit the Attorney-General to institute action therefor will undermine the defense."[30] The Court emphasized the holder's duty to report the existence of the property subject to the State's custody.[31] It explained that "[w]here … the bar is used primarily as a sword rather than a shield and by one who has been responsible to disclose the actionable essentials in the face of a duty to speak, factors of vicarious enrichment become a dominant consideration which we are prone to remedy in equity and good conscience."[32] The anti-limitations provision in the unclaimed property acts like those that the Uniform Law Commission has drafted now codify the law abnegating the use of limitations periods as a sword to evade reporting and delivery of property presumed abandoned.

IV. State's Custody Rights Under the Uniform Unclaimed Property Acts

The Uniform Law Commission and the States that have enacted their Uniform Acts have followed and codified the principles from the judicial decisions issued over many years. The inefficacy of contract conditions via-á-vis the State underlies § 2(b) of the Uniform Unclaimed Property Act (1981) and § 2(e) of the Uniform Unclaimed Property Act (1995).[33] Both sections expressly provide that property is subject to the State's protective custody "notwithstanding the owner's failure to … present an instrument …otherwise required to obtain payment." The Uniform Law Commissioners' Comment to both sections explains that that provision was "intended to make clear that property is reportable notwithstanding that the owner, who has lost

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possession of the moneys representing the unpaid and unclaimed debts" of the holder, which right has "the characteristics of an equitable lien." *New Jersey v. Union Bag-Camp Paper Corp*., 173 A.2d 290, 294, 295 (N.J. 1961). The State also succeeds to the "substantive rights afforded" the missing owner. *Bank of America, etc., v. Cory*, 210 Cal. Rptr. 351, 356 (Ct. App. 1985).

[29] *Id*., at 173. "The right of action to escheat or to obtain custody of unclaimed property is not derivative; but what may be obtained by exercise of the right is dependent upon the integrity of the underlying obligation." *Id.*

[30] *Id*., at 178

[31] *Id*.

[32] *Id*.

[33] Appendix II, *infra,* at 25, 29; Unif. Unclaimed Property Act (1981), § 2(b), 8C U.L.A. 186 (2001); Unif. Unclaimed Property Act (1995), §2(e), 8C U.L.A. 106 (2001).

or otherwise forgotten [the] entitlement to property, fails to present to the holder evidence of … ownership or to make a demand for payment." The principal authority that the Commission cites is the US Supreme Court decision in the *Connecticut Mutual Life* case,[34] along with the *Marshall Field & Co.* decision.[35]

The inefficacy of limitations periods on the owner's claim was first codified in the 1954 Uniform Act. Section 16 provides that the "expiration of any period of time specified by statute or court order, during which an action or proceeding may be commenced or enforced to obtain payment of a claim for money or recovery of property, shall not prevent the money or property from being presumed abandoned, nor affect any duty to file a report required by this act or to pay or deliver abandoned property to the [State]."[36] That provision continued in § 29(a) of the 1981 Uniform Act and § 19(a) of the 1995 Uniform Act, but was expanded to expressly include a limitation specified by contract.[37] The Commission's Comment to those sections expressly states that the provision was "written to insure that although the owner's claim against the holder may be barred by [a limitations period] prior to the effective date of the Act, the holder is not relieved of [the] obligation to pay abandoned property to the [State]." As authority for the provision, the Commission cited the *Marshall Field*,[38] *Screen Actors Guild*,[39] and J*efferson Lake Sulphur*[40] decisions. It concluded that "[s]ince the Unclaimed Property Act is based on a theory of truthful self-reporting, a holder which conceals property, willfully or otherwise, cannot expect the protection of the stated limitations period." The Commission's provision accords with the rationale underlying anti-limitations provisions. In 1983, the Supreme Judicial Court of Massachusetts concluded that "the concept of a statute of limitations is antithetical to the purpose of the [unclaimed] property act" because it "would permit every entity to make a self-serving

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[34] *See supra* n. 7 and accompanying text.

[35] *See supra* n. 10 and accompanying text.

[36] Appendix II, *infra,* at 23;Unif. Disposition of Unclaimed Property Act (1954), § 16, 8A U.L.A. 295 (1993).

[37] Appendix II, *infra,* at 26, 31; Unif. Unclaimed Property Act (1981), §29(a), 8C U.L.A. 256 (2001); Unif. Unclaimed Property Act (1995), § 19(a), 8C U.L.A. 135 (2001).

[38] *See supra* n. 10 and accompanying text.

[39] *See supra* n. 17.

[40] *See supra* n. 15 and accompanying text.

interpretation of the … law[], and to use that interpretation to its benefit by failing to report such property and barring any later enforcement action by a statute of limitations." The Court found a limitations period "would render the [unclaimed property law] difficult, if not impossible, to enforce," and "would create a situation in which the purpose of the … act, to reunite the property with its owners and to employ the property for public purposes in the interim, could not be achieved."[41]

The use of contract conditions to limit and extinguish a holder's obligation misapplies the concept of statute of limitations. Rather than allowing a party to avoid obligations, the concept of limitations primarily seeks to avoid burdening the courts with litigation of stale claims where memories have faded and documents have been lost.[42] Its focus then is on disputable claims. But unclaimed property law is focused on the disposition of fixed and certain—undisputable—claims. Such laws effectuate the public policy and uphold the moral principle that undisputed obligations should be satisfied, either by payment to the apparent owner or to the State when the right to payment is presumed abandoned. Because private contracts are always subject to the State's public policy and statutes, private parties cannot claim to have a right to structure their affairs in a manner that would dispose of unclaimed property in any manner other than as required by the unclaimed property law. "Parties have the right to contract as they see fit as long as their agreement does not violate the law or public policy."[43]

Nonetheless, there may be circumstances where certain property should not be subject to the State's unclaimed property law. For example, a holder may offer purchasers a "reward" on the purchases made; the purchaser would not pay anything additional; the reward would be redeemable in merchandise only; and the accumulated reward must be exercised within a relatively short period of time. Rather than carve-out an exception to the anti-limitations provision to accommodate such property, the better approach would be to exempt that property from the definition of "property" at the beginning of the unclaimed property law. As the New

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[41] *Treasurer & Receiver Gen. v. John Hancock Mut. Life Ins. Co.,* 446 N.E.2d 1376, 1381-82, 1380 (Mass. 1983).

[42] Statutes of limitations "are practical and pragmatic devices to spare the courts from litigation of stale claims, and the citizen from being put to his defense after memories have faded, witnesses have died or disappeared, and evidence has been lost." *Chase Securities Corp. v. Donaldson*, 325 U.S. 304, 314 (1945).

[43] *In re Lyon Financial Servs., Inc.*, 257 S.W.3d 228, 233 (Tex. 2008).

Jersey Supreme Court explained in the *Standard Oil*[44] case about the statute of limitations and escheat actions, "where that defense is sufficient in law, there is no property subject to escheat."[45] That being the case, then it is appropriate to expressly identify the type or class of property that is not subject to custodial taking. Doing so maintains the integrity of the anti-limitations provision, effectuates the public policy underlying unclaimed property laws, and safeguards the public interest in ensuring that fixed and certain obligations are properly discharged. It provides more guidance to the holder community about what property is or is not subject to custodial taking, thereby providing certainty. It removes a potential loop-hole that would foster mischief—the purposeful evasion of unclaimed property laws—and the quibbling about the efficacy of contract conditions in various machinations. And it avoids potential disputes and litigation concerning whether the underlying contractual relationship that the holder structures is an unconscionable adhesion contract that denies to the apparent owner the benefits of the contract—payment or delivery—and produces a forfeiture of undisputed obligations.[46]

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[44] *See supra* n. 19 and accompanying text.

[45] *Id*., at 573.

[46] An adhesion contract is a form or standardized contract that is imposed or drafted by a party with superior bargaining power and that gives the subscribing party the opportunity only to accept the contract as a whole or reject it—take–it-or-leave-it. Sierra David Sterlkin, *Challenging Adhesion Contracts in California: A Consumer's Guide,* 34 Golden Gate U.L.Rev. 285, 289-90 (2004). "The mere fact that a contract is one of adhesion does not render it unconscionable and unenforceable as a matter of law"; rather "the adhesive nature of a contract is generally noted to support other contract formation defenses such as unconscionability." 1 Martin Domke, *et al.*, *Domke on Commercial Arbitration*, §8:8 (2013). To be unconscionable, an adhesion contract must be shown to have unfair or oppressive terms or to be unfair in the particular circumstances of the case. 35 Mass. Prac. *Consumer Law* § 5:27 (3d ed. 2013). Unfairness is the primary concern:

> Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party. Whether a meaningful choice is present in a particular case can only be determined by consideration of all the circumstances surrounding the transaction. In many cases the meaningfulness of the choice is negated by a gross inequality of bargaining power. The manner in which the contract was entered is also relevant to this consideration. Did each party to the contract, considering [a party's] obvious education or lack of it, have a reasonable opportunity to understand the terms of the contract, or were the important terms hidden in a maze of fine print and minimized by deceptive sales practices? Ordinarily, one who signs an agreement without full knowledge of its terms might be held to assume the risk that he has entered a one-sided bargain. But when a party of little bargaining power, and hence little real choice, signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that [the party's] consent, or even an objective manifestation of [that] consent, was ever given to all of the terms. In such a case the usual rule that the terms of the agreement are

V. Ramifications of Holder Advocates' Concept of Derivative Rights: The Emasculation of Unclaimed Property Programs

The holder advocates' notion of derivative rights would subject the State to whatever conditions or limitations that the holder imposes—probably unilaterally—upon the owner. An evaluation of the propriety of doing so should be made with the following basic tenets of unclaimed property jurisprudence in mind:

A. The owner of the property presumed abandoned is the person or entity shown on the records of the property's holder as the one entitled to payment or delivery of the property. That owner has a legal right to payment or delivery. It is that right to which the State succeeds by application of the unclaimed property law.

B. The property holder has mere possession of the property presumed abandoned, but "no moral or legal right"[47] to retention or use of the proceeds of that property. Possession, without more, "is not equivalent to ownership of, or to having legal or rightful title to, the

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> not to be questioned should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld.

Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449-450 (D.C. Cir. 1965)(footnotes omitted). The Uniform Law Commission's Comment to the unconscionability provision in the Sales Article of the Uniform Commercial Code also looks to unfairness in the unconscionability determination:

> The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. … The principle is one of the prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power.

U.C.C. § 2-302 cmt. 1 (2003)(This provision is cited in the Commissioners' Comment to § 5 of the 1995 Uniform Unclaimed Property Act addressing the unconscionable dormancy fees. Appendix II, *infra,* at 25; 8C U.L.A. 115 (2001) .)

Separate from unconscionabililty, an adhesion contract may also be unenforceable on grounds of public policy. "A promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms." Restatement (Second) of Contracts § 178(1). One of the factors in making the determination about enforceability is whether a forfeiture would occur. *Id.*, § 178(2)(b). "[A] decision as to enforceability is reached only after a careful balancing, in the light of all the circumstances, of the interest in the enforcement of the particular promise against the policy against the enforcement of such terms. ... Enforcement will be denied only if the factors that argue against enforcement clearly outweigh the law's traditional interest in protecting the expectations of the parties, its abhorrence of any unjust enrichment, and any public interest in the enforcement of the particular term." *Id.,* cmt. b.

[47] *New Jersey v. American Sugar Refining Co*., 119 A.2d 767, 773 (N.J. 1956).

unclaimed [property]."[48] The US Supreme Court has ruled that a holder has no ownership interest in unclaimed property. In the unclaimed property context, a holder is a debtor and as such its debts "are not property to it, but rather a liability, and it would be strange to convert a liability into an asset when the State decides to escheat."[49] And as the Utah Supreme Court has explained, "[t]he very nature of the presumption of abandonment indicates that the holder is not the rightful owner of the property."[50]

C. The property itself is "a fixed and certain interest,"[51] meaning that the owner has an established right to payment or delivery of the property, and the holder has an indisputable obligation to pay or deliver.

D. Unclaimed property laws prevent forfeiture of the property to its fortuitous holder. The law abhors a forfeiture. As a New Jersey court has stated the principal, "forfeiture … [is] an event contrary to the purpose of the Uniform Unclaimed Property Act and, generally undesirable."[52]

E. An unclaimed property law is "consumer protection and public interest legislation, protecting the interests of the true owner of property against confiscation by the holder while giving the State the benefit of its use until the owner claims it."[53] And as the Maryland appeals court has stated, the "Uniform [Unclaimed Property Act] is remedial legislation 'designed to put an end to the unearned and fortuitous enrichment of the holders of abandoned property and to provide instead for the interests of the citizens … and ensure that any such escheat would be for public benefit rather than for private gain.'"[54]

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[48] *A. Gallo & Co. v. Comm'r of Envtl. Prot.*, 73 A.3d 693, 703 (Conn. 2013) (Beverage distributors have no property interest in the refund values that are to be paid to consumers upon return of the empty containers).

[49] *Texas v. New Jersey*, 379 U.S. 674, 680 (1965).

[50] *Div. of Unclaimed Property v. McKay Dee Credit Union*, 958 P.2d 234, 239 (Utah 1998).

[51] Appendix II, *infra,* at 28; Unif. Unclaimed Property Act (1995), § 1(13), 8C U.L.A. 98 (2001).

[52] *In re Estate of Peterson*, 720 A.2d 676, 678 (N.J.Super. Ct. Ch. Div. 1998).

[53] *Clymer v. Summit Bancorp.*, *supra* n. 16, 726 A.2d at 993.

[54] *Comptroller of the Treasury v. PHH Corp.*, 717 A.2d 950, 952 (Md. Ct. Spec App. 1998) (quoting *Riggs Nat'l Bank of Washington v. Dist. Of Columbia*, *supra* n. 16, at 1233-34.

Applying these basic tenets, it is probable that implementation of the holder advocates' notion of derivative rights will emasculate the efficacy of unclaimed property law and cripple the State's ability to safeguard the property rights of missing owners and to return property to those owners. Substantial sums are involved, as shown by the billions of dollars now in the States' custody. State audits show that without unclaimed property laws, holders would take these substantial amounts into income. It can be anticipated that holders would impose contract conditions of all sorts to extinguish the rights of the missing owners and derivatively, any entitlements of the State.[55] For example, in the context of consumer rebates, issuers and their fulfillment providers purposely imposed a time period (90 days) to cash a rebate check in order to escape any possible unclaimed property obligations. If such a machination is effective, surely other issuers of payment instruments would do the same. And so would other holders, such as securities and insurance companies and financial institutions, impose document presentation requirements that no State could ever satisfy because no State would have access to such documents.

Any proposal that the anti-limitations provision should be removed or restricted would overturn long-established law and return the uncertainty that prevailed before the anti-limitations provision settled the matter in the 1954 Uniform Unclaimed Property Act. On the one hand, the absence of an express anti-limitations provision may permit a holder to plead limitations against the State's claim for custody.[56] On the other hand, the absence of anti-limitations provision may have no significance on the enforceability of the State's custody claim.[57] Furthermore, the anti-limitations provision put to an end any argument whether a limitations period created a vested right or was but a procedural remedy that does not affect the State's exercise of its "separate and

[55] *See* Appendix I*, infra,* at 21-22. *See also* the attached Bryan Cave Benefits Blog, *Do Your Plan a Favor: Eschew Escheating*, Jan 6. 2014, recommending that non-ERISA employee benefit plans "sidestep unclaimed property statutes" by imposing a forfeiture of lost participant benefits that would occur before the shortest applicable escheat period runs.

[56] *See*, for example, *South Pacific Transp. Co. v. Texas*, 380 S.W.2d 123, 127 (Tex. Civ. App. 1964) ("There is no express provision in the laws of Texas which abrogates [the holder's] right to plead limitations against enforcement of claims which are barred before escheated, nor is there any implied exception of which we are aware.").

[57] *See*, for example*, Travelers Express Co., Inc., v. Utah*, 732 P.2d 121, 122 (Utah 1987).

distinct right to escheat."[58] Additionally, it is probable that elimination of the anti-limitations provision may lead to proposals to change long-standing limitations periods, reducing them to a time less than the abandonment period. Doing so not only allows the holder to escape its liability on its obligations to the State, but also jeopardizes the citizen's right to enforce the holder's payment obligation to the citizen. It would resurrect limitations as an obstacle to the State right to custody, a result contrary to the prevailing legislative intention.[59]

Similarly, allowing holders to escape their unclaimed property obligations by imposing a short limitations period for the reach-back period for unreported or under-reported property only rewards delinquency or purposeful evasion of the law. Holder advocates have essentially argued that where a holder has failed to timely and fully report and has destroyed its records, it should keep the unclaimed funds because the missing owner can no longer be identified and the State cannot possibly reunite that owner with the property. This will foster holder non-compliance. The Uniform Law Commission has noted that "many holders find the economic incentive for noncompliance so great that violations of the law are frequent and extensive" because the "holder who neglects to report or pay has the use of property which is extremely valuable to it."[60] In the 1995 Uniform Act, the Commission noted that "voluntary compliance with the Act continued to be a problem."[61] It still is. Enactment of a short reach-back period would be a disincentive to compliance. While the lack of owner information frustrates the State's efforts to reunite owners with their property, equitably a holder ought not to benefit by its own delinquency or intransigence. And the public ought not to be denied the use and benefit of the unclaimed funds, another objective of unclaimed property legislation.[62] Allowing a holder to fail to timely report and remit, then destroy its records, and keep the unclaimed funds would

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[58] *Sennett v. Ins. Co. of N. Am.*, 247 A.2d 774, 778 (Pa. 1968). *See also In re Barber*, 78 N.Y.S.2d 798, 806 (Sup. Ct. 1948), *aff'd*, 87 N.Y.S.2d 623 (App. Div. 1949) ("[T]he Statute of Limitations only precludes the remedy to enforce payment of the debt, it does not extinguish it.").

[59] *New Jersey v. U.S. Steel Corp*, *supra* n. 27, at 175 (N.J. 1956) ("We have no doubt that the lawmakers intended to provide a means whereby the State might assert its right in timely fashion to overcome the obstacle imposed by limitations.")

[60] Appendix II, *infra,* at 28; Unif. Unclaimed Property Act (1981), Comment to § 34, 8C U.L.A. 269 (2001).

[61] Appendix II, *infra,* at 33; Unif. Unclaimed Property Act (1995), Comment to § 24, 8C U.L.A. 143 (2001).

[62] "The objectives of the act are to protect unknown owners by locating them and restoring their property to them and to give the state rather than the holders of unclaimed property the benefit of the use of it . . . ." *Douglas Aircraft Co. v. Cranston,* 374 P.2d 819, 821 (Cal. 1962).

effectively immunize the holder from its unclaimed property obligations. And it "would frustrate the purpose of the Unclaimed Property Act."[63] As the District of Columbia appellate court said of a bank's efforts to escape unclaimed property reporting, "[t]o put a belated end to a multi-million dollar windfall [to the holder] is not an act of oppression, and [the holder] suffer[s] no hardship" because "[i]t's had the use of money that wasn't its money for some period of time, and it's been able to do whatever it wanted to do with that money."[64]

VI. Other Related Issues

This discussion has covered the present unclaimed property jurisprudence concerning the State's derivative rights and the holder advocates' notion of this doctrine. Beyond this broad discussion of derivative rights, there are some "sub-issues" that require additional discussion.

A. Can the State liquidate an owner's claim where the underlying transaction was limited to merchandise or services? Yes. When the unclaimed property law governs the disposition of certain property, either in an express provision or the miscellaneous intangible provision, that provision controls and becomes an integral part of any subsequent contract between the holder and the apparent owner.[65] For example, where a State has an unclaimed gift certificate provision, a certificate issued after enactment of that provision would have been issued with the understanding that under State law, any unredeemed merchandise-only certificate would be presumed abandoned and that an amount of money equaling the purchase price would be delivered into the State's protective custody.[66] As a New York trial court explained, a gift certificate is issued in accordance with existing law and precludes an issuer from having any property interest in the unredeemed certificate:

> [F]rom the time [the gift certificate issuer] sold its first gift certificate[,] it was the public policy of [New York] State … that the unclaimed amount of gift certificates not redeemed within five years must be paid over to the Comptroller to be used for the benefit of the public. And, inasmuch as the

[63] *Div. of Unclaimed Property v. McKay Dee Credit Union*, *supra* n. 50.

[64] *Riggs Nat'l Bank, supra* n.16, 581 A.2d at 1241-42.

[65] *See supra* text accompanying notes 11-18.

[66] 1 David J. Epstein, *Unclaimed Property Law & Reporting Forms* § 9.04[3], at 9-33 (Lexis/Matthew Bender & Co., Inc., 2002).

> Contract Clause applies only to the impairment of existing contracts[,] [the New York law] did not impair [the issuer]'s contract rights because those rights are subject to the previously enacted statute. Moreover, the [issuer]'s claim that it had a property interest in unredeemed gift certificates is frustrated by a statute in existence at the time of the sale which declares that the value of those certificates escheat to the State. Because the statute deprived [the issuer] of any property interest in the unredeemed gift certificates, there could not be a taking and no process was due.[67]

In accord, the Georgia Supreme Court concluded that "[i]n light of the purpose of [the unclaimed property] statute to utilize unclaimed gift certificates for the benefit of all the people of the state, … an amount equal to the price paid for an unclaimed gift certificate must be paid to the state after five years, regardless of whether the certificate previously expired or otherwise lost value pursuant to contractual terms."[68]

B. How can a State monetize the unclaimed amount where the property is denominated in goods or services? The value of such property may be specified in the unclaimed property law. For example, in the case of gift certificates and credit memos, the 1981 Uniform Act specifies that the amount for a gift certificate presumed abandoned is the amount paid by the purchaser and that for a credit memo is the amount credited to the recipient.[69] In other circumstances, the underlying transaction or common sense can provide the monetization. For example, rebates or refunds will usually have a stated value shown on the rebate offer, as occurred in the Young America Corp. rebate litigation, and a refund may be the same as a credit memo that states a fixed amount.[70] If a service is pre-paid, the pre-payment would be in a fixed amount. Even where a holder disguises a transaction as involving "points," there may be information in the underlying documents where those "points" are the equivalent of some amount of dollars. For

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[67] *In re Kimberley's A Day Spa, Ltd. v. Hevesi*, 810 N.Y.S.2d 616, 618-19 (Sup. Ct. 2006).

[68] *Benson v. Simon Prop. Group, Inc.,* 642 S.E.2d 687, 691 (Ga. 2007).

[69] Appendix II, *infra,* at 61; Unif. Unclaimed Property Act (1981), § 14(b), 8C U.L.A. 216 (2001). Under the 1995 Uniform Act, the proceeds of an unclaimed gift certificate may be a stated percentage of the certificate's face value. Appendix II, *infra,* at 29; Unif. Unclaimed Property Act (1995), § 2(a)(7), 8C U.L.A. 103 (2001).

[70] *See*, for example, *A. Gallo & Co. v. Comm'r of Envtl. Prot.*, *supra* n. 48, where the unclaimed bottle refunds were represented by "the refund value … to be paid to consumers upon return of the empty containers."

example, the documents about the AmEx/InteliSpend Incentive Cards, state that the card is a "$10 value American Express branded" card; "10 points = $10 value"; "[o]ne point equals one U.S. dollar in purchasing power"; purchases made with the card are "similar to those made with cash"; "Available Balance: 10.00"; and "[a]ll unused value may be forfeited." In applying the unclaimed property law, the State, as would a court, can lay aside semantics and look to the substance of the transaction, not simply its form.[71]

C. Was there consideration? Here again, the substance of the underlying transaction must be examined. It is probable that in most cases, the apparent owner has given consideration—paid over money, such as for a money order or gift card, or purchased a product or service offering a rebate, or rendered a service for which compensation is paid. But consideration does not necessarily need to run from the apparent owner to the holder. For example, the payee of an official check or money order may be the apparent owner, even though someone else was the remitter who gave the funds for the issuance of the instrument. In the AmEx/InteliSpend Incentive Cards scheme, a sponsor paid the card issuer to issue the incentive card to the recipient—the apparent owner. The recipient then becomes the intended beneficiary of the contract between the sponsor and issuer. As such, the recipient "may sue for a breach of the contract in his or her own name, even though the [recipient] is a stranger to the contract and [its] consideration."[72] Moreover, nowhere in unclaimed property jurisprudence has property initially received by gift been automatically exempted. Stock owned as the result of a gift from relatives, life insurance benefits owed to a beneficiary, or proceeds of a bank account in trust or payable on death to another all may have their genesis in a donative context, but all are subject to custodial taking when the presumption of abandonment arises.

D. When property is reportable, must a holder waive its fees where it does so for the apparent owner? Yes. The rule derived from the cases is now codified in § 5 of the 1995 Uniform Act: fees may be deducted from property reported "only if … the holder

[71] The equitable concept of substance rather than form "is one of great practical importance, [which] pervades and affects to a greater or less degree the entire system of equity jurisprudence.... Equity always attempts to get at the substance of things, and to ascertain, uphold, and enforce rights and duties which spring from the *real* relations of parties. It will never suffer the mere appearance and external form to conceal the true purposes, objects, and consequences of a transaction." 2 J. Pomeroy, *Equity Jurisprudence* (5th Ed.1941) § 378, pp. 40-41 (emphasis in original.).

[72] Olson v. Etheridge, 686 N.E.2d 563, 566 (Ill. 1997).

regularly imposes the charge, which is not reversed or otherwise canceled."[73] In a case involving service charges on money orders, the Rhode Island Supreme Court found that because the State's rights are derivative, the issuer could not enforce against the State contract rights that it did not enforce against the apparent owner:

> As custodian of unclaimed property, the rights of the state's general treasurer are derivative. The treasurer acquires all rights of the rightful owner. Travelers, having waived its contractual rights as to individual purchasers of money orders, may not now enforce those same rights against the state.[74]

Courts in other jurisdictions have found waiver on "similar rationales" based upon the State's derivative rights.[75]

E. If a business records property as a liability on its financial records, does the burden shift to the holder to establish that the property is not unclaimed property? A debtor-creditor relationship underlies most unclaimed property transactions. As the US Supreme Court has explained, the holder is the debtor and the property is a liability to it.[76] Evidence of that liability and of the passage of the abandonment period would make out a prima facie case of unclaimed property subject to the State's custody. For example, where the unclaimed property is represented by any form of payment instrument—check, money order, gift certificate, or stored value card, the State's burden is to present facts supporting a prima facie case of the missing owner's right to payment. The State would make out such a case by showing the issuance of the payment instrument, its non-negotiation or non-use, and the passage of the requisite period of abandonment. As now codified in § 6 of the 1995 Uniform Unclaimed Property Act, "[a] record of the issuance of a check, draft, or similar instrument is prima facie evidence of an obligation."[77] The State having made a prima facie case, the Unclaimed Property "Act does not require the State to rebut every possible scenario that favors [the holder's] position" that the property

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[73] Appendix II, *infra,* at 30; Unif. Unclaimed Property Act (1995), § 5, 8C U.L.A. 114 (2001).

[74] *Violet v. Travelers Express Co.*, 502 A.2d 347, 349-50 (R.I. 1985).

[75] *Borges v. Westport Bank & Trust Co.,* 651 A.2d 1358, 1360 (Conn. Super. Ct. 1993).

[76] *See supra* n. 29 and accompanying text.

[77] Appendix II, *infra,* at 30; Unif. Unclaimed Property Act (1995), § 6, 8C U.L.A. 115 (2001).

could not be presumed abandoned.[78] After presenting such a prima facie case, the burden would shift to the holder to go forward with evidence to counter the prima facie case, such as proving that the property is not covered by the unclaimed property law or that the presumption of abandonment has been rebutted.

VII. Conclusion

The notion of the derivative rights doctrine that holder advocates have invented and promoted is not based on any credible authorities or precedents. It runs contrary to the unclaimed property jurisprudence that has emerged in the past sixty-some years. It runs contrary to the codification of unclaimed property law principles in the successive Uniform Acts of the Uniform Law Commission since the first uniform act in 1954. The holder advocates to date have presented no credible bases for overturning these established principles and supplanting them with their notions of derivate rights, and no court has embraced this revisionist concept. Other that their transparent dislike for unclaimed property laws, they articulate no facts and cite no experiences demonstrating some legitimate problems justifying reversal or departure from the principles discussed here. They offer no demonstration that their notions will safeguard an owner's right to payment or delivery, or enhance the reporting and delivery of unclaimed property to the State, or ensure that unclaimed property escapes forfeiture and is used for the public good.

The holder advocates' criticisms arise because in the past 30 years, States have actively enforced the reporting obligations of holders, increasing personnel and using effective auditing techniques. In the past, holders have ignored unclaimed property laws with impunity, keeping for themselves property that should have been paid to the owners or delivered to the State when presumed abandoned. Because of effective State enforcement of the law, holders can no longer keep what is not theirs. In reaction, holder advocates propose a notion of derivative rights that would effectually emasculate unclaimed property administration by leaving it crippled by contract conditions and limitations that the State could never satisfy or overcome. True it is that doing so will serve the interest of holders. But also true it is that their notions undermine and do not serve the public interest in any manner.

[78] *Div. Of Unclaimed Property v. McKay Dee Credit Union*, *supra* n. 50, at 238.

The Derivative Rights Doctrine Under Unclaimed Property Law,
The Holder Advocates' Notion of that Doctrine, and
Implications for Unclaimed Property Administration

Appendix I

If the State's Claim is Circumscribed by the Underlying Claim of the Owner, the Following Representative Schemes Could be Used to Eliminate the State's Claim

A. Gift card, refund, credit memorandum, or other similar entitlement that is payable only in merchandise and not cash.

B. Rebate, refund, settlement, or other disbursement, the underlying terms of which state that untimely presentment for payment will result in the liability becoming void.

C. Any dormancy, minimum balance, and other "service charge" that is disclosed to an owner, or is instituted through amendment in a manner consistent with account terms and conditions.

D. Imposition of a contractually-based "escheat fee" or other charge for the owner becoming lost, and any associated assets or accounts being transferred to the custody of the state.

E. Duly-adopted by-laws of a corporation, that provide if a shareholder becomes lost, the shareholder forfeits the right to receive future dividend checks.

F. Duly adopted by-laws of a partnership, agreement of trust, or other governance documents of a business entity that provide a owner's failure to claim a distribution or other entitlement will result in the reallocation of the entitlement to other partners or beneficiaries.

G. Limiting the terms and conditions of the acceptance of a refund, rebate, or other offer to the owner's actual presentation of the check for payment.

H. A term or condition of an account arrangement where the holder would only be required to issue a refund, make a distribution, or make other payment where the amount involved was above a certain threshold (e.g., $10); otherwise no amounts would be payable or distributable.

I. A term or condition allowing the holder to delegate or transfer its payment liability to a third party without notice to or consent of the owner (i.e., engaging an unaffiliated check disbursement entity in a foreign country).

J. A term or condition of an account arrangement where the holder has the owner's consent to transfer any unclaimed balance or distribution to a charitable organization.

K. A term or condition which provides that if the owner fails to maintain contact with the holder, and the holder cannot ascertain the whereabouts of the owner, the holder's obligations (i.e., payment) are suspended until such time as the owner can be located.

L. A condition that for an owner to receive property, a specific condition precedent (providing authorization code, surrender of certificates, production of documentation) must be met.

In addition to these scenarios effectively eliminating (or greatly reducing) any unclaimed property, repeal of the anti-limitations provision would legally incapacitate a state from claiming any property where the statute of limitations had run prior to reaching a full period of dormancy. In the absence of an anti-limitation provision, a reduction in the statute of limitations period for contract actions to make it shorter than the abandonment periods in the unclaimed property law would prevent the state from making claim to virtually all unclaimed property, other than property held in trust (in most instances, a fiduciary could not assert a statute of limitations defense to defeat a claim of ownership or escheat).

The Derivative Rights Doctrine Under Unclaimed Property Law,
The Holder Advocates' Notion of that Doctrine, and
Implications for Unclaimed Property Administration

Appendix II

Pertinent Uniform Unclaimed Property Act and Comments Cited

A. Uniform Disposition of Unclaimed Property Act (1954 & 1966)

Section 16. Periods of Limitations Not a Bar.

The expiration of any period of time specified by statute or court order, during which an action or proceeding may be commenced or enforced to obtain payment of a claim for money or to recover property, shall not prevent the money or property from being presumed abandoned property, nor affect any duty to file a report required by this Act or to pay or deliver abandoned property to the [State Treasurer].

Commissioners' Comment

Section 16 treats unclaimed property as subject to the Act even though the period of limitations has run prior to date of presumed abandonment. A special problem is presented that warrants careful consideration in relation to the local law in each state adopting the Uniform Act. The following brief statement of the authorities will be of service.

The Supreme Court has held that, where, under the local law as interpreted by the courts, title to real or personal property has not "vested." The 14th Amendment is not violated by legislation revising a cause of action already barred by the running of the statute of limitations. *Campbell v. Holt*, 115 U.S. 620, 29 L. Ed 483 (1885); *Chase Sec. Corp. v. Donaldson*, 325 U.S. 304, 89 L. Ed. 1628 (1944). However, there are a number of courts which have held that the defense of the statute of limitations creates a vested right and in that case it cannot be taken away by statute. See cases collected in notes entitled Power of Legislature to Revive a Right of Action Barred by Limitations, 36 A.L.R. 1316 (1924); 133 A.L.R. (1940). Comment, Developments in the Law, Statutes of Limitations, 63 Harv. L. Rev. 1177, 1178-1190 (1950).

Illustrative of the problem is *Standard Oil Co. v. New Jersey*, 5 N.J. 281 (1950), in which case the defendant raised the defense of the bar of limitations against an action of escheat brought by the state under it general unclaimed property law. The property involved consisted of unpaid stock dividends, shares of stock,

unpaid wages, money withheld from wages toward purchase of liberty bonds, money held to pay checks issued by the corporation, and money owing on unclaimed bond coupons. The court stated that:

> "The principle is imbedded in our jurisprudence that where a right of action has become barred under existing law, the statutory defense constitutes a vested right which is proof against legislative impairment."

Under the doctrine of escheat, the court said, the state merely succeeds to the rights of the owner. If such rights have been barred by the statute of limitations, the state has no derivative right because the owner has no right. Thus, the court concluded the state has no right to unpaid wages, money owing on checks, and the money payable on bond coupons. However, the court decided otherwise as to dividends on stock and money withheld from wages for purchase of bonds, for these, the court said, were in the nature of a trust against which the statute of limitations did not run. Thus the state was enabled to escheat these items.

The New Jersey Legislature has taken action to avoid this decision be revising its escheat law to provide that case, dividends, interest, and wages owed by a corporation shall be presumed abandoned and delivered to the custody of the state after being unclaimed for five years instead of the previous period of fourteen years. The new period is shorter than the period of limitations. N.J.Stat., Sec. 2A:37-29 (1951). After two years of custody, the property is escheated to the state. Thus, the statute of limitations with a period exceeding five years will be no defense to an action against a corporation to escheat these items of property.

Each state, in considering the adoption of the Uniform Act, must investigate its own law on the subject to determine whether the bar of the statute of limitations can be lifted. Oklahoma, for instance, appears to have a constitutional prohibition against reviving a cause of action barred by the statute of limitations. *Mines v. Hogan*, 79 Okla. 233, 192 Pac. 811 (1920). If the law of vesting is in accord with that of New Jersey, the solution used by that state may well be desired. Of course, in determining the question of policy, any state may conclude to permit the statute of limitations to serve as a defense. Kentucky so decided. Ky. Rev. Stat. (1949), Sec. 393.110. In such case, the problem is eliminated by the holder becoming entitled to the property.

Finally, it should be noted that, in connection with many types of property, the statute does not run during the period of inactivity which gives rise to the presumption of abandonment. Thus where the claim is against a fiduciary, as with some of the items involved in *Standard Oil Co. v. New Jersey*, *supra*, or if

"demand" is a condition of the owners' right to sue, as in the case of utility deposits and certificates of deposit in banks (see the Uniform Commercial Code, Sec. 3-108(2): "A cause of action on a certificate of deposit does not accrue until demand …"), the problem of removing the bar of the statute will not arise. (See also Comment, Developments in the Law, Statute of Limitations, *supra*, pp. 1200 et seq., for general discussion of when the statute begins to run). In case of insurance policies, the obligation of the company is generally conditioned upon the submission of proof of death or other contingency. Thus it would seem the statute would not begin to run until such proof was submitted. Bank deposits fall into a similar category. Thus it may well be that the bulk of abandoned property falls outside the scope of the statute of limitations problem.

Finally, in connection with the removal of the bar of the statute of limitations, attention must be given to the fact that in connection with certain classes of business transactions, for example, so-called "nominee dividends" in brokers' accounts, reliance may have been placed upon the bar of the statute of limitations and the holder of unclaimed property may have made distribution or otherwise utilized it in some manner which would result in severe prejudice if the bar of the statute were later removed for the purposes of the unclaimed property law. In such instances, it may prove necessary to include an exception, either in this section or elsewhere in the Act avoiding hardship by precluding the arising of presumption of abandonment in such cases.

B. Uniform Unclaimed Property Act (1981)

1. Section 2(b). Property Presumed Abandoned; General Rule.

Property is payable or distributable for the purpose of this Act notwithstanding the owner's failure to make demand or to present any instrument or document required to receive payment.

Commissioners' Comment

Subsection (b) is intended to make clear that property is reportable notwithstanding that the owner, who has lost or otherwise forgotten his entitlement to property, fails to present to the holder evidence of his ownership or to make a demand for payment. See *Connecticut Mutual Life Insurance Co. v. Moore*, 333 U.S. 541 (1948), in which the Court stated: "When the state undertakes the protection of abandoned claims, it would be beyond a reasonable requirement to compel the state to comply with

conditions that may be quite proper as between the contracting parties." See *also Provident Institution for Savings v. Malone*, 221 U.S. 660 (1911), involving savings accounts; *Insurance Co. of North America v. Knight*, 8 Ill.App.3d 871, 291 N.E.2d 40 (1972), involving ne- gotiable instruments, and *People v. Marshall Field & Co*., 83 Ill.App.3d 811, 404 N.E.2d 368 (1980), involving gift certificates.

Section 2(b) obviates the result reached in *Oregon Racing Comm. v. Multonamah Kennel Club*, 242 Or. 572, 411 P.2d 63 (1963), involving unpresented winning parimutuel tickets.

Since the holder is indemnified against any loss resulting from the delivery of the property to the administrator, no possible harm can result in requiring that holders turn over property, even though the owner has not presented proof of death or surrendered the insurance policy, savings account passbook, the gift certificate, winning racing ticket, or other memorandum of ownership.

2. **Section 14. Gift Certificates and Credit Memos.**

(a) A gift certificate or a credit memo issued in the ordinary course of an issuer's business which remains un-claimed by the owner for more than 5 years after becoming payable or distributable is presumed abandoned.

(b) In the case of a gift certificate, the amount presumed abandoned is the price paid by the purchaser for the gift certificate. In the case of a credit memo, the amount presumed abandoned is the amount credited to the recipient of the memo.

Commissioners' Comment

Section 14 should be read in conjunction with Section 2. The comment to Section 2 is particularly pertinent to this section. Holders did not routinely report gift certificates and credit memos under the 1966 Act, but it has been held that both kinds of property are within the coverage of Section 9 of that Act. See, for instance, *People v. Marshall Field & Co*., 83 Ill.App.3d 811, 404 N.E.2d 368 (1980).

Subsection (b) is intended to clarify the amount reportable which is represented by gift certificates and credit memos. In the case of a gift certificate, it is the price paid by the purchaser. In the case of a credit

memo, it is the amount credited to the recipient's account.

3. **Section 29. Periods of Limitation.**

(a) The expiration, before or after the effective date of this Act, of any period of time specified by contract, statute, or court order, during which a claim for money or property can be made or during which an action or proceeding may be commenced or enforced to obtain payment of a claim for money or to recover property, does not prevent the money or property from being presumed abandoned or affect any duty to file a report or to pay or deliver abandoned property to the administrator as required by this Act.

(b) No action or proceeding may be commenced by the administrator with respect to any duty of a holder under this Act more than 10 years after the duty arose.

Commissioners' Comment

Section 29 has an added provision that the expiration of time periods set forth in contracts will not prevent the property from becoming reportable. See *People v. Marshall Field & Co*., 83 Ill.App.3d 811, 404 N.E.2d 368 (1980); *Screen Actors Guild, Inc. v. Cory*, 91 Cal.App.3d 111, 154 Cal. Rptr. 77 (1979); *State v. Jefferson Lake Sulphur Co*., 36 N.J. 577, 178 A.2d 329 (1962). Section 2 abrogates another contractual condition often asserted as a defense to reporting property otherwise presumed abandoned, the failure to present the evidence of indebtedness.

Subsection (a) is written to insure that although the owner's claim against the holder may be barred by the statute of limitations prior to the effective date of the Act, the holder is not relieved of his obligation to pay abandoned property to the administrator. The comment to Section 16 of the 1966 Act noted that local law must be consulted in order to ascertain whether legislation constitutionally may be enacted reviving a cause of action barred by the statute of limitations. This issue has been litigated in several states, e.g., *Country Mutual Insurance Co. v. Knight*, 40 Ill.2d 523, 240 N.E.2d 612 (1968); *Douglas Aircraft Co. v. Cranston*, 24 Cal. Rptr. 851, 374 P.2d 819 (1962); *cf. Standard Oil v. New Jersey*, 5 N.J. 281, 74 A.2d 565 (1950). Even though the statute of limitations has run before the effective date of the Act, the holder must report and deliver the property to the state if the holder does not regularly enforce the statute. See *South Carolina Tax Commission v. Metropolitan Life Insurance Co*., 266 S.C. 34, 221 S.E.2d 522 (1975).

Subsection (b) provides that an administrator must commence an action against a holder within 10 years after the time the property was first reportable. Under existing law it is not clear that statutes of limitations apply to the state in compelling a holder to report or deliver unclaimed property. A holder may under the 1966 Act be subject to suit for an indeterminate period. Certain states have argued that Section 16 of the 1966 Act applies to states and thus there is no statute of limitations. The 10-year limitation period will provide a holder with a cut- off date on which it can rely.

4. **Section 34. Interest and Penalties.**

Commissioners' Comment

A major weakness of the 1966 Act was its ineffective penalty provision. Primary reliance on the criminal law as a compliance mechanism is misplaced. Often the reason for withholding property is economic, and economic sanctions in those cases are generally more effective in assuring compliance.

The experience of several states is that many holders find the economic incentive for noncompliance so great that violations of the law are frequent and extensive. The holder who neglects to report or pay has the use of property which is extremely valuable to it. The provision for civil penalties in subsection (a) is designed to give a holder sufficient incentive to report and pay over abandoned property. It is also designed to ensure that the true owners or their representatives, the states, receive the income from the property while it is wrongfully withheld.

C. **Uniform Unclaimed Property Act (1995)**

1. **Section 1. Definitions**

In this [Act]:

* * *

(13) "Property" means … a fixed and certain interest in intangible property that is held, issued, or owed in the course of a holder's business, or by a government, governmental subdivision, agency, or instrumentality, and all income or

increments therefrom. The term includes property that is referred to as or evidenced by:

(i) money, a check, draft, deposit, interest, or dividend;

(ii) credit balance, customer's overpayment, gift certificate, security deposit, refund, credit memorandum, unpaid wage, unused ticket, mineral proceeds, or unidentified remittance;

(iii) stock or other evidence of ownership of an interest in a business association or financial organization;

(iv) a bond, debenture, note, or other evidence of indebtedness;

(v) money deposited to redeem stocks, bonds, coupons, or other securities or to make distributions;

(vi) an amount due and payable under the terms of an annuity or insurance policy, including policies providing life insurance, property and casualty insurance, workers' compensation insurance, or health and disability insurance; and

(vii) an amount distributable from a trust or custodial fund established under a plan to provide health, welfare, pension, vacation, severance, retirement, death, stock purchase, profit sharing, employee savings, supplemental unemployment insurance, or similar benefits.

Commissioners' Comment

The Act provides exclusively for the disposition of unclaimed intangible property and does not apply to tangible property, with one exception: Section 3 applies to tangible property contained in safe deposit boxes. Paragraph (1[3]), defining property, is not intended as a substantive addition to the coverage of the 1981 Act. It is, however, intended to be all-inclusive; the descriptions of property interests that are set forth as examples are not limiting, but are stated to help holders identify kinds of property interests which otherwise may be overlooked. Thus, "property" is not the check, note, certificate or other document that evidences the property interest, but the underlying right or obligation. See *Blue Cross of Northern California v. Cory*, 120 Cal. App. 3d 723, 174 Cal. Rptr. 901 (1981) ("right to be paid" is the " 'intangible personal property' (or 'chose in action') ... which is recognized in the UPL"). The requirement that the right be "fixed and certain" excludes unliquidated claims from the coverage of the Act, such as disputed tort claims.

2. **Section (2)(a)(7). Presumption 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:

* * *

(7) gift certificate, three years after December 31 of the year in which the

certificate was sold, but if redeem- able in merchandise only, the amount abandoned is deemed to be [60] percent of the certificate's face value;

3. **Section 2(e)**

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.

Commissioners' Comment

Subsection (e) is intended to make clear that property is reportable notwithstanding that the owner, who has lost or otherwise forgotten his or her entitlement to property, fails to present to the holder evidence of ownership or to make a demand for payment. See *Connecticut Mutual Life Insurance Co. v. Moore*, 333 U.S. 541 (1948), in which the Court stated: "When the state undertakes the protection of abandoned claims, it would be beyond a reasonable requirement to compel the state to comply with conditions that may be quite proper as between the contracting parties." See also *Provident Institution for Savings v. Malone*, 221 U.S. 660 (1911), involving savings account; *Insurance Co. of North America v. Knight*, 8 Ill.App.3d 871, 291 N.E.2d 40 (1972), involving negotiable instruments, and *People v. Marshall Field & Co.*, 83 Ill.App.3d 811, 404 N.E.2d 368 (1980), involving gift certificates. With respect to gift certificates, see also Section 19(a), which invalidates private periods of limitation. Thus, gift certificates will be reportable notwithstanding language on the certificate purporting to avoid escheat by creating an expiration date prior to the time of presumed abandonment. Section (c) also obviates the result reached in *Oregon Racing Comm. v. Multnomah Kennel Club*, 242 Or. 572, 411 P.2d 63 (1963), involving unpresented winning parimutuel tickets.

Since the holder is indemnified against any loss resulting from the delivery of the property to the administrator, no possible harm can result in requiring that holders turn over the property, even though the owner has not presented proof of death or surrendered the insurance policy, savings account passbook, the gift certificate, winning racing ticket, or other memorandum of ownership.

4. **Section 5. Dormancy Charge**

A holder may deduct from property presumed abandoned a charge imposed by reason of the owner's failure to claim the property within a specified time only if there is a valid and enforceable written contract between the holder and the owner under which the holder may impose the charge and the holder

regularly imposes the charge, which is not regularly reversed or otherwise canceled. The amount of the deduction is limited to an amount that is not unconscionable.

Commissioners' Comment

This section is consistent with those cases which have ruled on the issue of service charges under the 1966 Act and the 1981 Act. Section 5 is a limitation on the deduction of charges based solely on dormancy and is applicable to all intangible property presumed abandoned. This section, which applies to all unclaimed property, re- places similar limitations that were specifically focused on various types of property in the 1981 Act. The limitation of a service charge to an amount that is not unconscionable is new and is drawn from Article 2, Section 302, of the Uniform Commercial Code.

5. **Section 6. Burden of Proof as to Property Evidenced by Record of Check or Draft.**

A record of the issuance of a check, draft, or similar instrument is prima facie evidence of an obligation. In claiming property from a holder who is also the issuer, the administrator's burden of proof as to the existence and amount of the property and its abandonment is satisfied by showing issuance of the instrument and passage of the requisite period of abandonment. Defenses of payment, satisfaction, discharge, and want of consideration are affirmative defenses that must be established by the holder.

Commissioners' Comment

This provision clarifies the burden of proof in situations where the obligation evidenced by a negotiable instrument is disputed by the holder, and is consistent with cases which have ruled on the matter. See *Insurance Co. of North America v. Knight*, 8 Ill. App. 3d 871, 291 N.E.2d 40 (1972), *app. dismissed* 414 U.S. 804, 38 L. Ed. 2d 40, 94 S.Ct. 165 (1973), *Blue Cross of Northern Cal. v. Cory*, 120 Cal. App. 3d 723, 174 Cal. Rptr. 901 (1981), and *Revenue Cabinet v. Blue Cross & Blue Shield*, 702 S.W.2d 433, 435 (Ky. 1986). See also *Riggs Nat'l Bank v. District of Columbia*, 581 A.2d 1229 (D.C.App. 1990). It is also consistent with the cases holding that when claiming abandoned property the State steps into the shoes of the owner (see Epstein, McThenia and Forslund, "Unclaimed Property and Reporting Forms," sec. 3.02 (Matt. Bend. 1984), and Article 3-308 of the Uniform Commercial Code. Under U.C.C. Section 3-308(2), "When signatures are admitted or established, production of the instrument entitles a holder to recover on it

unless the defendant establishes a defense." The reason for requiring a plaintiff to produce the instrument is "to show that the plaintiff is in fact the holder, and in order to protect the defendant from double liability." 6 Anderson, Uniform Commercial Code, sec. 3-307:4, p. 158 (3rd ed., 1993). The administrator, by proving issuance of the instrument, succeeds to all rights of the payee. Because the issuer is relieved of all liability on the instrument by paying the obligation to the State as unclaimed property, and is indemnified by the State, there is no chance that the issuer would be held liable twice, and therefore the administrator is not required to produce the instrument in order to possess the same rights as a holder in due course.

6. **Section 19. Periods of Limitation.**

(a) The expiration, before or after the effective date of this [Act], of a period of limitation on the owner's right to receive or recover property, whether specified by contract, statute, or court order, does not preclude the property from being presumed abandoned or affect a duty to file a report or to pay or deliver or transfer property to the administrator as required by this [Act].

(b) An action or proceeding may not be maintained by the administrator to enforce this [Act] in regard to the reporting, delivery, or payment of property more than 10 years 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. In the absence of such a report or other express notice, the period of limitation is tolled. The period of limitation is also tolled by the filing of a report that is fraudulent.

Commissioners' Comment

Subsection (a) is consistent with cases such as *People v. Marshall Field & Co.*, 83 Ill. App. 3d 811, 404 N.E.2d 368 (1980), *Screen Actors Guild, Inc. v. Cory*, 91 Cal. App. 3d 111, 154 Cal. Rptr. 77 (1979), and *State v. Jefferson Lake Sulphur Co.*, 36 N.J. 577, 178 A.2d 329 (1962). It also abrogates another contractual condition often asserted as a defense to reporting property otherwise presumed abandoned, the failure to present the evidence of indebtedness.

Subsection (a) is written to insure also that although the owner's claim against the holder may be barred by the statute of limitations prior to the effective date of the Act, the holder is not relieved of his obligation to pay abandoned property to the administrator. The Comment to Section 16 of the 1966 Act

noted that local law must be consulted in order to ascertain whether legislation constitutionally may be enacted reviving a cause of action barred by the statute of limitations. This issue has been litigated in several States, *e.g.*, *Country Mutual Insurance Co. v. Knight*, 40 Ill. 2d 523, 240 N.E.2d 612 (1968); *Douglas Aircraft Co. v. Cranston*, 24 Cal. Rptr. 851, 374 P.2d 819 (1962); *cf. Standard Oil v. New Jersey*, 5 N.J. 281, 74 A.2d 565 (1950). Even though the statute of limitations has run before the effective date of the Act, the holder may be required to report and deliver the property to the State if the holder does not regularly enforce the statute. *See South Carolina Tax Commission v. Metropolitan Life Insurance Co.*, 266 S.C. 34, 221 S.E.2d 522 (1975). *But see State of Washington v. Puget Sound Power & Light Co.*, 103 Wash. 2d 501, 694 P.2d 7, 10 (1985).

Subsection (b) provides that an administrator must commence an action against a holder within 10 years after the time the property was first reported or specifically placed in issue. The 1995 amendment clarifies existing law and codifies the holdings of abandoned property cases that have ruled on issues of limitations. See *Blue Cross of Northern California v. Cory*, 174 Cal. Rptr. 901, 913, 120 Cal. App. 3d 743 (App., 1981) (no statute of limitations will commence to run against the State until after the holder duly reports in compliance with the unclaimed property act); *Travelers Express Co., Inc. v. Cory*, 664 F.2d 763 (9th Cir.1981) (statute of limitations commences to run only after filing of report which contains written explanation of why property is not subject to the act); *Employers Insurance of Wausau v. Smith*, 453 N.W.2d 856 (Wis.1990) (filing of report essential to running of statute of limitations, since unclaimed property act depends on self-reporting); *Sennet v. Insurance Co. of North America*, 432 Pa. 525, 247 A.2d 774, 777-78 (1968) (same; "INA simply has to take its stand: if it reports the holding [of funds in issue] (as a precautionary measure), the statute will run; if it does not, the Commonwealth is not precluded..."); *State of New Jersey v. U.S. Steel Corporation*, 22 N.J. 341, 126 A.2d 168 (1956) (same); *Treasurer and Rec. Gen. v. John Hancock Mut. Life Ins. Co.*, 388 Mass. 410, 446 N.E.2d 1376 (1983) (same). The provision also parallels the Internal Revenue Code, 26 U.S.C. sec. 6501(c). Since the Unclaimed Property Act is based on a theory of truthful self-reporting, a holder which conceals property, willfully or otherwise, cannot expect the protection of the stated limitations period.

7. **Section 24. Interest and Penalties.**

Commissioners' Comment

A major weakness of the 1966 Act was its ineffective penalty provision. Although the 1981 Act increased penalties for non-compliance, voluntary compliance with the Act continued to be a problem. In this Act, compliance failures not accompanied by willfulness are dealt with by moderate increases in the applicable penalties, and the administrator simultaneously is given authority to waive both interest and penalties where the holder has attempted in good faith to comply, or where the failure has been due to excusable neglect. Where the holder's failure is willful or fraudulent, and not in good faith, penalties are increased more substantially.

Deloitte.

June 2007

Financial Services

Financial Foresight

A look at the latest topics affecting banking, insurance, investment management and securities

Unclaimed Property Compliance for Financial Services Companies

Unclaimed property is often overlooked as an area of risk for many financial services companies. According to industry estimates, states are holding more than $22 billion in unclaimed intangible assets and fewer than 20 percent of all companies are estimated to be in compliance with state unclaimed property laws.

"Lack of compliance can have serious regulatory consequences for banks, asset managers, insurance companies, and securities firms," says Kevin M. McGovern, National Partner-in-Charge of Financial Services Regulatory Consulting for Deloitte & Touche LLP ("Deloitte & Touche"). "With limited exception, there is no statute of limitations on an unclaimed property liability, and non-compliance can have Sarbanes-Oxley implications as well."

To mitigate potential areas of risk, financial services companies need to develop and implement effective policies and procedures for identifying unclaimed property and taking appropriate steps to return such property to its rightful owners and/or report it to the appropriate state.

What is Unclaimed Property?

Many different classes of financial assets can become unclaimed property:

- **Mutual funds:** Shareholder accounts, uncashed dividends, redemption checks, commission checks, and portfolio dividends.
- **Financial institutions:** Savings and demand deposit accounts; uncashed official checks, money orders and travelers checks; individual retirement accounts, the contents of safe deposit boxes and trust department property.
- **Securities industry:** Customer account cash and securities balances; overpayments in dividend and interest receivable suspense accounts; over-deliveries in stock receivable suspense accounts; account redemptions, class action payments, and dividend and escrow payments; and broker and account executive commissions.
- **Life insurers:** Death claims and matured endowments; annuities and dividends; accident and health payments; agent balances; demutualization proceeds due policyholders; and, in some situations, employee benefit plans.
- **Property and casualty insurers:** Agent balances; premium refunds; unpresented drafts; and amounts held in suspense.

The 50 U.S. states, the District of Columbia, Guam, Puerto Rico, and the U.S. Virgin Islands all have their own custodial statutes governing the treatment of unclaimed property. These regulations trace their origins to the concepts of "escheat" in English common law. Escheat means title to a citizen's property has actually passed from an individual to the government.

Financial services companies and other "holders" of unclaimed property are required to report and remit unclaimed property to the appropriate jurisdiction when there has been no owner-generated activity for a specified period of time. In many states, financial accounts are declared "dormant" after there has been no activity by the owner for a specified period of time. In many cases, where there the owner hasn't made a deposit or withdrawal to their account and/or when mail has been returned as undeliverable to the owner's last known address the property is deemed "presumed abandoned" and is reportable to the appropriate jurisdiction.

"Under state law, all companies, including financial services companies, have an obligation to report unclaimed property to the owner's last known address on the books and records of the company," says Mark A. Paolillo, National Managing Director of Unclaimed Property Services for Deloitte & Touche. "If there is no address sufficient for the mailing of a letter, financial services companies should report the unclaimed property to the owner's state of last known address. Where there is no address, the unclaimed property should be reported to the holder's state of incorporation or for an unincorporated entity, to its state of legal domicile."

Most financial services companies report unclaimed property as a matter of course. According to recent informal online poll of some 375 financial services executives conducted by Deloitte & Touche, 85% stated that their organizations have filed unclaimed property reports in the past.

U.S. Supreme Court Cases

Two U.S. Supreme Court cases have established the legal foundation for the reporting of unclaimed property:

- Texas v. New Jersey (379 U.S. 674, 85 S.Ct. 626, 13 L. Ed. 2d 596). This 1965 U.S. Supreme Court decision said that unclaimed property is reportable to the owner's state of last known address as shown on the holder's records. If there is no last known address, or the state does not provide for the escheatment of the funds, unclaimed property is reportable to the holder's state of incorporation.
- Delaware v. New York (507 U.S. 490). Most of the funds at issue in this 1993 decision were unclaimed dividends, interest, and other securities distributions held by intermediary banks, brokers, and depositories in their own names for beneficial owners who could not be identified or located. The U.S. Supreme Court first held that the debtor (or holder), for purposes of the Texas v. New Jersey analysis, was the intermediary and not the issuer of the securities. In addition, the Court reaffirmed the Texas v. New Jersey holding and in doing so rejected New York's argument to adopt a principal place of business test, reasoning that the state of incorporation was found to be "the most efficient way to locate a corporate debtor."

Delaware v. New York also found that issuers of securities cannot be considered "debtors" once they make distributions to intermediaries that are record owners. This is because payment to a record owner discharges all of an issuer's obligations to the beneficial owner under Article 8 of the Uniform Commercial Code.

As a result, an intermediary serving as the record owner is the "debtor" insofar as it has a contractual duty to transmit distributions to the beneficial owner. Unlike an issuer, it remains liable should a "lost" beneficial owner reappear to collect distributions due under such a contract.

After the Delaware v. New York decision, many states amended their laws to clarify that an original obligor may be able to satisfy its obligation to report and remit unclaimed property by transmitting payment to an intermediary. As a result, issuers may be able to contract away unclaimed property liability and intermediaries must be aware of their potential liability.

Unclaimed Property: Rules and Regulations

Unclaimed property is often viewed as a tax, but it is not.

One of the fundamental concepts governing unclaimed property is the Derivative Rights Doctrine which says that whatever rights the property's owner had, once the dormancy period has been met, those same rights transfer to the state.

"The Derivative Rights Doctrine provided a foundation for confirming the rights of the lost owner. There are a number of relevant cases where companies have tried to create a bylaw or exception so that if the individual does not come forward after a certain period of time, they are barred from receiving their property. Under the Derivative Rights Doctrine concept, once the property has been deemed presumed abandoned, the rights of the owner transfer to the state. This concept is commonly referred to as the "state stands in the shoes of the owner," says Valerie M. Jundt, a Senior Manager with Deloitte & Touche's Unclaimed Property Services practice.

There are no nexus requirements for unclaimed property, so a company does not have to have a business presence or employees in a state in order to have an unclaimed property reporting obligation to that state. In the field of unclaimed property, what is commonly referred to the tax world as nexus, can be considered the state of the owner's last-known address. Thus, large corporations that hold funds for owners with addresses in every state have an obligation to file unclaimed property reports in all 50 states.

With limited exception, there is no statute of limitations for unclaimed property. Simply filing an unclaimed property report does not trigger a statute of limitations. Unclaimed property reports represent someone's assets, and the courts are very protective of those assets. Should a company be selected for an audit, states often go back to the date that they enacted their law or the date a company incorporated.

Administrative remedies for unclaimed property are not readily available. Only a few states have a formal appeals process, so companies that resist audits or disagree with audit findings have few options to pursue.

Sarbanes-Oxley Implications

Unclaimed property can also have implications for Sarbanes-Oxley compliance.

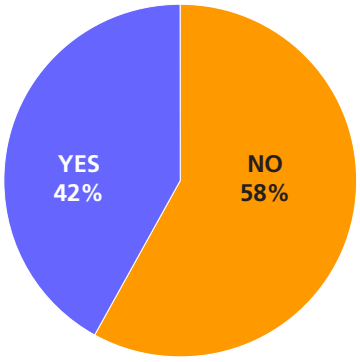
Section 302 of the Sarbanes-Oxley Act requires chief executive officers ("CEO") and chief financial officers ("CFO") of public companies to certify quarterly and annually that they are responsible for their companies' internal controls; that they have designed controls to ensure that material information is known to them; that they have evaluated the effectiveness of the controls; and that they have presented their conclusions in the Securities and Exchange Commission filing.

Many times, companies don't have adequate controls and procedures in place to track unclaimed property. If these controls and procedures are deficient, how can management be able to confirm the accuracy of their company's financial statements?

In addition, Section 404 of the Sarbanes-Oxley Act requires CEOs and CFOs to annually state their responsibility for establishing and maintaining an adequate internal control structure and procedures to certify financial statements as well. How many companies extend this certification to their unclaimed-property liabilities?

"When auditors look at these two sections of the Sarbanes-Oxley Act, a lot of questions can arise concerning the appropriate accrual of unclaimed property liabilities," says Richard E. Goggin, a Senior Manager with Deloitte & Touche's Unclaimed Property Services practice.

Has your company ever undergone an unclaimed property audit?



Unclaimed Property Audits

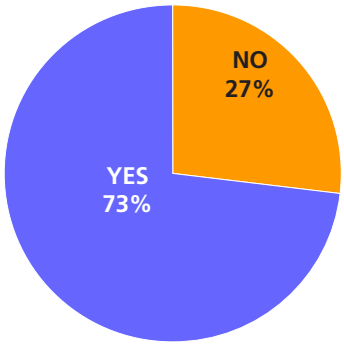
According to Deloitte & Touche's recent online poll, nearly half (42%) of the financial services executives surveyed said that their companies had gone through an unclaimed property audit. An unclaimed property audit may take one of several forms:

- Audit by a single state;
- Multi-state audits, where three or four states jointly examine unclaimed property compliance; or
- Audits conducted by third-party auditors (where states contract with outside parties to serve as their agents and where the third-party auditor is typically paid a percentage of the unclaimed property assessment).

Some states monitor merger and acquisition activity in order to identify unclaimed property audit opportunities, believing that acquirers' targets may not be in compliance. Reports showing little or no unclaimed property can also trigger state audits.

All states have the ability to assess penalties and interest for unclaimed property reporting violations. While the penalties can vary by state, may have the ability to assess a 25% penalty, 12% interest and a fee of $100 to $200 per day per auditor. At the same time, many states offer unclaimed property amnesty programs and voluntary disclosure agreements ("VDA"). Under their amnesty programs, states allow companies that have not filed unclaimed property reports to come forward and submit reports and related property without penalty. VDAs also allow companies the opportunity to reduce the number of years they must include with their original submission in exchange for a reduced probability of an audit.

Has your company developed and implemented written policies and procedures relating to unclaimed property compliance?



Policies and Procedures

According to Deloitte & Touche's recent online poll, 73% of the financial services executives surveyed said that their companies have developed and implemented written policies and procedures relating to unclaimed property compliance. Such policies and procedures enable organizations to manage their unclaimed property responsibilities by providing guidance related to:

- Determining potential unclaimed property liability;
- Complying with all applicable states in a timely fashion;
- Tracking and reporting unclaimed property to the appropriate jurisdiction;

- Conducting internal audits of unclaimed property processes and procedures;
- Identifying what part of the organization will assume responsibility for tracking the unclaimed property laws as well as preparing and signing reports;
- Enhancing internal controls through a periodic review of states' due diligence requirements;
- Recovering unclaimed property funds from states; and
- Forming an Unclaimed Property Committee – including, but not limited to, representatives from the organization's Tax, Legal, Accounting, Internal Audit, Treasury, and MIS departments – to assist with compliance.

Further information about unclaimed property may be found on the following Web sites:

The National Association of Unclaimed Property Administrators

http://www.unclaimed.org

Unclaimed Property Professionals Organization

http://www.uppo.org

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Note: Answers reflect views of more than 375 financial services executives participating in a webcast poll conducted on May 1, 2007.

This article was based on a recent Financial Services Dbriefs webcast, a bi-weekly webcast series addressing regulatory, governance and business issues. These hour-long webcasts allow viewers to listen to, and interact with, our subject matter specialists anyplace internet access is available. To subscribe to Dbriefs visit www.deloitte.com. To listen to one of our previous webcasts please visit our online archive.

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Unclaimed Property ADVISORY

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Alston & Bird to Form Coalition to Participate in Unclaimed Property Law Reform Efforts by the Uniform Law Commission and American Bar Association

In January 2013, the Uniform Law Commission (ULC)[1] authorized the appointment of a new Study Committee on Revision of or Amendments to the Uniform Unclaimed Property Act (the "Study Committee") to explore revising or amending the Uniform Unclaimed Property Act (the "Uniform Act"). The ULC originally promulgated the Uniform Act in 1981 to replace the Uniform Disposition of Unclaimed Property Act (1954/1966). The 1981 Uniform Act was substantially updated in 1995, and most states have adopted one of the two versions of the Uniform Act. In addition, courts, unclaimed property administrators and holders alike have relied extensively on the Official Comments to both versions of the Uniform Act in interpreting their statutory provisions. Since the 1995 update, however, the ULC has not made any revisions to the Uniform Acts or the accompanying comments.

Unfortunately, in recent years, the Uniform Acts (and the specific state unclaimed property laws that are based on them) have become increasingly burdensome to holders of unclaimed property, while at the same time straying from the original purposes and principles of custodial escheat laws. In particular, the Uniform Acts lack crucial aspects of due process, such as meaningful statutes of limitations, clear procedures for appealing decisions of administrators and reasonable burdens of proof in favor of holders. The Uniform Acts also depart from the consumer protection purpose underlying unclaimed property laws by requiring the escheat of property potentially owed by one business association to another in the course of their commercial dealings, for example. Moreover, the Uniform Acts currently depart from the derivative rights doctrine—which is the principle underpinning all custodial unclaimed property laws that treats the state, through the operation of its unclaimed property law, as "standing in the shoes" of the missing owner of the property—in several important respects. For example, the Uniform Acts require the escheat in cash of unredeemed balances on gift certificates that are by their terms redeemable solely for merchandise or services. The Uniform Acts are also sometimes applied by state administrators to attempt to reach merchandise return credits that are redeemable solely for merchandise or services, nonrefundable unused tickets or other admissions and other nonrefundable prepayments for goods and services for which owners have no right to demand and receive any payment of cash, despite the fact that no amounts are "due and payable" to the owner with respect to such property types.

[1] The ULC, previously known as the National Conference of Commissioners on Uniform State Laws, was formed in 1892 "to promote uniformity in the law among the several States on subjects as to which uniformity is desirable and practicable."

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In addition, the Uniform Acts contain anti-limitations provisions requiring property to be reported to a state, notwithstanding the fact that the owner's right to claim such property has expired pursuant to a binding contract. The Official Commentary accompanying the 1981 and 1995 Uniform Acts indicates that such provisions were intended to avoid situations in which holders unilaterally seek to impose contractual provisions limiting owners' rights to claim property with the specific purpose and intent of avoiding the appropriate application of unclaimed property laws (i.e., "private escheat"), which is contrary to the public policies underlying such laws. However, because these anti-limitations provisions of the Uniform Acts are not expressly limited to "private escheat" situations, states have frequently sought to apply them to override contractual provisions entered into by businesses for valid and entirely lawful business reasons. The application of such anti-limitations provisions to permit states to assert claims for property in circumstances where the actual owners of the property could not is again contrary to the derivative rights doctrine. Instead, the application of these provisions should be limited to situations in which the contractual limitations on owners' rights to claim property are imposed for the specific purpose of avoiding the application of unclaimed property laws, thereby effecting a private escheat.

In addition, as the ULC has acknowledged, numerous technological developments, changes in business practices and new property types have arisen in the 18 years since the 1995 Uniform Act was promulgated—yet more states have adopted the 1981 Uniform Act, which is now more than 30 years old. It is clear that a revision to or rewrite of the Uniform Acts is long overdue.

The specific task of the Study Committee, according to the ULC, is to "gather information and viewpoints from a broad assemblage of interested persons and organizations, to evaluate the input, and to report to the [ULC's] Executive Committee its recommendations as to whether drafting should be undertaken and, if so, the outlines of a desirable uniform or model act." Accordingly, participation in the proceedings of the Study Committee presents a unique opportunity for members of the business community to influence and shape the next iteration of the Uniform Act, whether it takes the form of an update to the 1995 version of the Uniform Act or a complete rewrite.

The Study Committee has scheduled a meeting for stakeholders (i.e., interested observers to whom the Study Committee has extended an invitation to participate) on April 24, 2013, in Washington, D.C. to help it further "evaluate the desirability and feasibility of a uniform law revising the current provisions of UUPA."[2] The Study Committee is interested in stakeholders' "views on the prospects for enactment of such a law." In particular, the Study Committee has developed a list of topics to be discussed, including the following:

- the aspects of the Uniform Acts that need to be revised consistent with recent federal and state legislation and judicial decisions;
- ways to make the reporting requirements in the Uniform Acts more efficient;
- whether the abandonment periods should be reviewed and revised;
- whether there are categories of property that can be better or more clearly addressed;
- the impact of technological advancements or industry practices on the Uniform Acts; and
- other potential improvements to the Uniform Acts.

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[2] Notably, the National Association of Unclaimed Property Administrators (NAUPA) has resolved to participate with the ULC in the process of amending or revising the Uniform Acts.

Following this meeting, the Study Committee will develop a final recommendation to the ULC Scope and Program Committee concerning whether to move forward to form a drafting committee and, if so, the topics that should be included in the drafting project. According to the Study Committee, such a recommendation would be considered by the Scope and Program Committee (as well as the ULC Executive Committee) in July 2013. The goal would be to have a draft ready for initial consideration at the ULC's 2014 annual meeting and a draft for final adoption at the 2015 annual meeting.

The ULC is undertaking this effort at least in part in response to a parallel project to update state unclaimed property laws that has been initiated by the Unclaimed Property Subcommittee of the Business Law Section of the American Bar Association (the "ABA Unclaimed Property Subcommittee"). Chaired by Ethan Millar of the Alston & Bird Unclaimed Property Team, the ABA Unclaimed Property Subcommittee is in the process of developing a Model Unclaimed Property Act, the provisions of which would ultimately be recommended to state legislatures to modernize and improve existing state unclaimed property laws.

Recognizing the importance of this opportunity for holders to provide input to two major organizational efforts to rewrite state unclaimed and abandoned property laws, Alston & Bird's Unclaimed Property Team is forming a coalition to participate in the ULC Study Committee's proceedings and provide holder input to the ABA Unclaimed Property Subcommittee's Model Act initiative. It is envisioned that the coalition's role in such proceedings would entail not only advocating for, but also actively drafting, specific amendments or revisions to the Uniform Acts and proposed Model Unclaimed Property Act. The Alston & Bird Unclaimed Property Team is currently in the process of drafting a formal mission statement and proposed strategic goals—stay tuned for further developments. In the meantime, please contact any member of our team for more details regarding the ULC's Uniform Act update project, the ABA Unclaimed Property Subcommittee Model Act project or the Alston & Bird coalition.

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Do your plan a favor: eschew escheating

Bryan Cave LLP
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January 6 2014

Given the migratory nature of society these days, it is not uncommon for an employee benefit plan to accumulate significant sums of money attributable to the accounts of lost participants. For a number of States, the assets attributable to lost participants are an attractive revenue source. Utilizing their unclaimed property statutes, many States attempt to seize these funds so they can add them to the State's coffers.

Most employee benefit plans subject to ERISA can sidestep this potential leakage of plan assets through the use of clear plan language that expressly provides for the forfeiture of amounts from the accounts of participants who are determined to be lost after some predetermined period. The language should also provide that those forfeited funds will be utilized either through a reduction of the sponsor's contribution obligation or their application to reduce plan expenses. The Department of Labor has unequivocally concluded that such plan provisions are to be honored irrespective of unclaimed property statutes that might otherwise dictate a contrary result. Most plans that provide for the forfeiture of the accounts of lost participants further provide that those accounts will be restored if the lost participants are later found.

Employee benefit plans that are not subject to ERISA and, therefore, do not benefit from ERISA preemption, can be designed to sidestep unclaimed property statutes with plan provisions that provide for forfeitures before the shortest applicable escheat period runs.

An exception to this approach, however, applies to employee benefit plans that are funded with insurance (even if subject to ERISA). Both the Department of Labor and courts have sided with the States regarding the application of their unclaimed property statutes based on the insurance exception to preemption under ERISA's statutory scheme. Further, the provisions of ERISA do not appear to preclude an employee benefit plan from voluntarily turning over assets attributable to lost participants to a State's unclaimed property department. We believe the better use of such plan assets provide for their utilization to reduce plan expenses or to reduce the sponsor's contribution obligation rather than letting them escheat.

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