

California Amends Escheat Statute in Response to Federal Court Injunction Prohibiting the State from Accepting Delivery of Unclaimed Property

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The authors explain a recent injunction prohibiting the California State Controller's Office from accepting or taking possession of unclaimed property, and subsequent changes to the California Unclaimed Property Law.

On June 1, 2007, in *Taylor v. Chiang*,¹ the United States District Court for the Eastern District of California entered a preliminary injunction prohibiting the California State Controller's Office from accepting or taking possession of "any property . . . pursuant to the California Unclaimed Property Law." The injunction will remain in effect until the Controller's Office promulgates regulations that require the Controller to give constitutionally adequate notice to the owners of unclaimed property prior to the state's taking custody of such items. While the injunction may turn out to be temporary, it could significantly affect the remittance of unclaimed property by corporations, banks, insurance companies, financial institutions, and other entities that engage in

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business in the State of California or are otherwise required to comply with the California Unclaimed Property Law.

BACKGROUND

The *Taylor* case was initiated by two plaintiffs (one a California resident, the other a resident of England) who alleged that the Controller of the State of California took possession of, and liquidated, their “abandoned” securities without notice, thereby causing financial damage.² The plaintiffs alleged that, in violation of the U.S. Constitution and the California Unclaimed Property Law (“UPL”), the Controller failed to give owners of abandoned property notice that the state was taking custody of their funds. In addition, the plaintiffs claimed that the Controller’s practice of liquidating securities escheated to the state was improper and sought an injunction requiring the Controller to return the plaintiffs’ securities. In 2005, after the District Court dismissed the action on Eleventh Amendment grounds, the United States Court of Appeals for the Ninth Circuit vacated and remanded the case to the District Court.³ In so doing, the Ninth Circuit emphasized the custodial nature of the UPL (i.e., that the Controller’s Office merely holds the property on behalf of the owner):

The State of California’s sovereign immunity applies to the state’s money. Money that the state holds in custody for the benefit of private individuals is not the state’s money, any more than towed cars are the state’s cars. Thus, where a permanent escheat determination has not yet been made, the state’s Eleventh Amendment immunity from suit against it for damages payable from its treasury has no application to escheated property and sales proceeds from escheated property, whether held by the Controller or the Treasurer.⁴

On remand, the plaintiffs moved for a preliminary injunction to require generally that the Controller comply with the UPL, and specifically to prevent the sale of any unclaimed property received by the state pursuant to the UPL unless constitutionally adequate notice is given to the owner.⁵ The District Court denied the motion for an injunction, finding that the plaintiffs did not have standing to request injunctive relief. Specifically, the court held that plaintiffs were requesting only an injunction relating to the Controller's future conduct, and found that the plaintiffs were no more at risk of harm by having their property escheated to the state in the future than any other person who owned property located in California.

THE NINTH CIRCUIT'S DECISION

Plaintiffs again appealed to the Ninth Circuit, and again, the Ninth Circuit reversed.⁶ Holding that the plaintiffs had standing to request an injunction, the Ninth Circuit rejected the notion that the potential harm to owners of escheated property who had not received notice of the escheat was limited to the effect on their control over the disposition of their property:

Rather, the injuries suffered by plaintiffs include not only those attendant to having their property escheated without notice, but also include (1) the cost of having to constantly monitor their property to avoid escheat, either by devoting significant time to search the internet themselves, by paying a service to do the same, or by "churning" their property so that it stays active and avoids escheat; and (2) the permanent deprivation of their property subsequent to California's sale of that property, which—pursuant to California's policy of *immediately* selling property after escheat—would frequently occur even if plaintiffs were diligent about monitoring their property.⁷

The Ninth Circuit also found that the plaintiffs had established the requirements for obtaining an injunction—including a showing of likelihood of success on the merits. Due process, the court held, “requires the government to provide notice reasonably calculated, under all the circumstances” to afford an individual the opportunity to object to the taking of his or her property.⁸ In so holding, the court rejected the Controller’s argument that the notice requirement was satisfied by general newspaper advertisements advising people to check the state’s Web site, written notice to some (but not all) owners whose property was to be escheated, and the UPL’s requirement that the holders of unclaimed property provide written notice to the owner. As to the newspaper advertisements and notices mailed by the state, the court concluded that these actions were insufficient because due process requires “that notice be given *before* an individual’s control of his property is disturbed.”⁹ With regard to a holder’s statutory obligation to provide written notice to the owner under the UPL, the court held that the state could not rely upon a third party to fulfill the state’s due process obligation to provide notice. The Ninth Circuit remanded the case to the District Court with instructions to enter a preliminary injunction and to “consider whether some sort of supervision, such as requirement of court approval of new regulations, is necessary.”¹⁰

THE INJUNCTION

Thereafter, the District Court held a hearing regarding the scope of the proposed preliminary injunction.¹¹ Both the plaintiffs and the Controller agreed that the injunction would cover “the sale, or conversion to cash, or destruction of any property received pursuant to the UPL.” However, the plaintiffs requested a broader injunction that would also prohibit the Controller from “taking title to or possession of any private property pursuant to the UPL without adequate notice.”¹² Ultimately, the District Court agreed, noting that

“[w]hen the Controller takes custody or property pursuant to the UPL, even temporarily, certain rights associated with ownership are lost which are not compensable in money damages.”¹³ The District Court declined to revise the provisions of the UPL itself, but determined that “until constitutionally adequate notice is provided,” the injunction would remain in force.¹⁴ The text of the injunction is as follows:

IT IS THEREFORE ORDERED THAT:

- 1) defendant John Chiang, Controller of the State of California, and his agents and employees, shall not accept, take title to, or possession of any property, nor sell, convert to cash, or destroy any property, including, but not limited to, securities and the contents of safe deposit boxes, pursuant to the California Unclaimed Property Law (California Code of Civil Procedure §§ 1500 et seq.) until the Controller has first promulgated regulations providing for fair notice to the owner and public, satisfactory to and approved by this court;
- 2) this preliminary injunction shall take effect immediately and shall remain in effect until otherwise ordered by this court, or until final judgment is entered in this case;
- 3) the Controller shall submit any proposed new regulations to this court together with a motion, with notice to plaintiffs, in accordance with and pursuant to the briefing schedule of Local Rule 78-230; and
- 4) the bond provisions of Federal Rule of Civil Procedure 65(c) are hereby waived.¹⁵

This injunction, which will remain in effect until such time as the Controller's Office adopts new notice regulations that are approved by the District Court, effectively prohibits the Controller from accepting unclaimed property from any holder (whether or not the holder is a California entity). In addition, the injunction applies not only to the Controller's Office, but to the Controller's "agents and employees." As a result, it is likely that a court would conclude that the injunction bars third-party forced audit firms from accepting unclaimed property on behalf of California.

It should be noted, however, that the action deals with the obligation of the Controller's Office to provide notice to the owners of unclaimed property prior to taking possession thereof; it did not repeal or modify the UPL in any other way. Accordingly, other than the remittance requirements, all other provisions of the UPL that pertain to holders of unclaimed property (e.g., due diligence requirements, reporting requirements, restrictions on dormancy fees) would appear to remain in force. On July 2, 2007, the State Controller's Office published a notice providing information to holders regarding the impact of the injunction on holder requirements.¹⁶ According to this notice, while unclaimed property may not be remitted to the state while the injunction is in effect, a holder's due diligence requirements and reporting obligations remain in force.¹⁷ In addition, the notice makes clear that no interest will be assessed against holders for failing to remit property while the injunction is in effect.¹⁸ It is recommended that holders monitor the Controller's Web site (<http://www.sco.ca.gov>), to track subsequent developments as they occur.

UPDATE ON CALIFORNIA INJUNCTION

The California state legislature moved swiftly to respond to the *Taylor* injunction. On August 24, 2007, the Governor signed Senate Bill 86 into law. The new legislation was intended to provide for

“a more expansive notification program” that includes: State-initiated notification to owners of unclaimed property *prior* to escheat; post-escheat investigation by the State to “identify . . . owners of unclaimed property”; and a “waiting period” of 18 months from the delivery of property to the State before any subsequent sale or disposal.¹⁹ Senate Bill 86 also delinked the previously simultaneous reporting and remittance requirements. In many states,²⁰ and under prior California law,²¹ holders were required to remit all due unclaimed property at the time of filing the annual report. Under the revised legislation, a holder is required to pay or deliver unclaimed property to the Controller’s Office “no sooner than seven months and no later than seven months and 15 days after the final date for filing the report.”²²

As noted above, the *Taylor* court indicated that the injunction would remain in effect until such time as the California Unclaimed Property Law provided for “constitutionally adequate notice” to the owners of unclaimed property prior to the escheat of their funds.²³ The new law seeks to accomplish this goal by requiring the State to contact the owner of unclaimed property prior to escheat, using the address listed on the holder’s report or an address supplied by the Franchise Tax Board.²⁴ This notice is required to be sent by the Controller’s Office between 45 and 60 days before the holder’s deadline for remitting property to the State.²⁵ The revised legislation also requires the Controller’s Office to publish a notice, “in a newspaper of general circulation,” designed to inform owners that the State may have custody of unclaimed funds belonging to them and that further information can be obtained from the Controller’s Office.²⁶

Shortly after the passage of the new law, on September 5, 2007, the State moved the District Court to lift the injunction.²⁷ Upon reviewing Senate Bill 86, the District Court found that the pre-transfer notice required by the new law, the newspaper publication requirement, and the searchable internet database maintained by the Con-

troller's Office "satisfie[d] constitutional due process."²⁸ Accordingly, the District Court dissolved the injunction.¹¹

With the passage of Senate Bill 86, California arguably has the most stringent pre-escheat owner notification requirements of any state. For owners, it signals a potentially increased likelihood that they will recover their property from the state, or even prevent their property from being escheated in the first instance. For holders, as noted above, the new law extends the remittance deadline to approximately seven months after filing the report. It remains to be seen whether other states will follow California's lead in this area, either on their own initiative or in response to litigation raising claims similar to those asserted in *Taylor*.

NOTES

- 1 *Taylor v. Chiang*, No. Civ. S-01-2407 WBS GGH (E.D. Cal. June 1, 2007).
- 2 *Taylor v. Connell*, No. Civ. S-01-2407 FCD GGH, 2002 WL 34204694 (E.D. Cal. June 26, 2002), rev'd sub nom. *Taylor v. Westly*, 402 F.3d 924 (9th Cir. 2005).
- 3 *Taylor v. Westly*, 402 F.3d 924, 936 (9th Cir. 2005).
- 4 *Id.* at 932.
- 5 *Taylor v. Westly*, No. Civ. S-01-2407 WBS GGH, 2005 WL 5480286 (E.D. Cal. Aug. 16, 2005), rev'd __ F.3d __, No. 05-16763, Slip. Op. at 6611-21 (9th Cir. May 31, 2007).
- 6 *Taylor v. Westly*, __ F.3d __, No. 05-16763, Slip. Op. at 6611-21 (9th Cir. May 31, 2007).
- 7 *Id.* at 6616 (emphasis in original).
- 8 *Id.* at 6618-19 (internal quotations and citation omitted).
- 9 *Id.* at 6619 (emphasis in original).
- 10 *Id.* at 6620-21.
- 11 *Taylor v. Chiang*, No. Civ. S-01-2407 WBS GGH (E.D. Cal. June 1, 2007) (order granting preliminary injunction).
- 12 *Id.* at p. 3 (internal quotations omitted).
- 13 *Id.* at p. 4.

- 14 *Id.* at p. 6.
- 15 *Id.* at p. 11-12.
- 16 John Chiang, Notice to Holders of Unclaimed Property—California Unclaimed Property Update (July 2, 2007), <http://www.sco.ca.gov/col/ucp/lawregs/index.shtml> (last visited July 16, 2007).
- 17 *Id.*
- 18 *Id.*
- 19 Cal. Senate Bill 86, § 1 (amendments to Cal. Civ. Proc. Code § 1501.5).
- 20 *See e.g.*, N.J. Stat. Ann. § 46:30B-57 (holder shall pay or deliver property “[a]t the time of the filing of the report”).
- 21 *See* Cal. Civ. Proc. Code § 1532(a) (West 2007).
- 22 Cal. Senate Bill 86, § 4 (amendments to Cal. Civ. Proc. Code § 1532).
- 23 *Taylor v. Chiang*, No. Civ. S-01-2407 WBS GGH at p. 6 (E.D. Cal. June 1, 2007) (order granting preliminary injunction).
- 24 Cal. Senate Bill 86, § 2 (amendments to Cal. Civ. Proc. Code § 1531).
- 25 Cal. Senate Bill 86, §§ 2, 4 (amendments to Cal. Civ. Proc. Code §§ 1531, 1532).
- 26 Cal. Senate Bill 86, § 2 (amendments to Cal. Civ. Proc. Code §§ 1531).
- 27 *Taylor v. Chiang*, No. Civ. S-01-2407 WBS GGH at p. 3 (E.D. Cal. Oct. 17, 2007) (order dissolving preliminary injunction).
- 28 *Id.* at p. 7.
- 29 *Id.* at p. 8.