A Tale of Two Questions: May States Escheat or Sell Foreign-Address Unclaimed Property?

As the importance of unclaimed property compliance to the holder community has increased, two questions have surfaced that are of importance to the holder community.

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In recent years, many businesses and organizations responsible for unclaimed property reporting to the various states (collectively referred to herein as "holders"), have seen an increase in state unclaimed property enforcement activity, in part due to state budget constraints and the states' need for revenues,¹ and in part due to the proliferation of the third party, contract auditor industry. As the importance of unclaimed property compliance to the holder community has increased, two questions have surfaced that are of importance to the holder community.

First, should the holder's state of domicile, or any other U.S. state, be entitled to escheat foreign-address property?

Second, many states that receive from holders or their agents shares or certificates representing shares registered to foreign-address owners, as part of the unclaimed property reporting process, sell the securities from time to time. Is it desirable for the states to sell such property? If not, what authority is there to support the argument that states should not sell such property?

In this article, the authors examine the constitutional and other authorities pertinent to a resolution of these questions.
The authors submit that neither the holder's state of domicile, nor any other U.S. state or territory, is entitled to escheat foreign-address property under the U.S. Constitution. The authors further submit that, even if such escheat were permissible, the liquidation by states of foreign-owned securities raises perhaps even more serious constitutional concerns by divesting the owners of their property rights without due process, particularly as the state liquidating the property typically has no connection whatsoever to the owner of the shares.

**Should a Holder's State of Domicile, or Any Other U.S. State, Be Entitled to Escheat Foreign-Address Property?**

The willingness of the states to seek to escheat foreign-address property can perhaps be attributed in large part to language found in the 1981 and 1995 versions of the Uniform Unclaimed Property Act ("UUPA"). Thus, the Official Commentary to both the 1981 and 1995 UUPA states that the Uniform Law Commission ("ULC") considered allowing the state of domicile to claim custody of foreign-owned property to be "a rational extension of [the U.S. Supreme Court's] ruling" in *Texas v. New Jersey*, in which the Court established federal common law rules setting forth when states have the jurisdiction to escheat unclaimed property.

We respectfully disagree with the statements made in the 1981 and 1995 versions of the UUPA that allowing the state of domicile to claim custody of foreign-address property is a "rational extension" of the U.S. Supreme Court's ruling in *Texas v. New Jersey*. In that case, the Court never gave any indication that states had the right to escheat unclaimed property owned by persons residing in foreign countries.

To the contrary, the Court clearly indicated that it intended the rules it articulated to be *exclusive* of all other possible rules. The Court stated that it was announcing rules "to settle a controversy as to which State has jurisdiction to take title to certain abandoned intangible personal property through escheat." Subsequently, in *Delaware v. New York*, the Court stated that "[i]n *Texas v. New Jersey* . . . we adopted *two rules* intended to 'settle the question of which State will be allowed to escheat [abandoned] intangible property.'" The Court has repeatedly rejected attempts by states to "extend" the two rules articulated by the Court in *Texas v. New Jersey*.

Indeed, we note that the ULC is currently in the process of revising the last version of the UUPA, i.e., the 1995 UUPA, and has clearly indicated that the question of whether foreign-address property may be escheated is under review. Furthermore, the initial draft of the Revised UUPA produced by the Drafting Committee of the ULC responsible for the revision provides that "This [Act] does not apply to property held,
due, and owing to a person whose last known address is in a foreign country or to property arising out of a foreign transaction where the property is held in a foreign country or location outside the United States, unless the property has been voluntarily turned over to the State pursuant to Section 5(4)."

The draft similarly provides that the term "property" does not mean "property owed to a person whose last known address shown on the records of the holder is in a foreign country or location outside the jurisdiction of the United States (or an army, air or Fleet Post Office), unless the holder voluntarily remits such property to the custody of the State pursuant to Section 5(4).”

We believe it would be advisable to provide in the revised final version of the UUPA that foreign-address property is not subject to claim by any State as unclaimed or abandoned property for several reasons.

First, as already discussed above, the escheat of foreign-owned property is contrary to federal common law, as set forth in Texas v. New Jersey and subsequent cases involving a state's jurisdiction to escheat. Thus, any such escheat should be precluded by the Supremacy Clause of the U.S. Constitution. 9

Second, the underlying key principle behind unclaimed property laws is that they were meant to help reunite missing owners with their property. A foreign-address owner is not likely to be reunited with his or her property via delivery of custody of such property to any U.S. state. Rather, as a matter of logic, missing owners, or their heirs, would be more likely to seek to claim the property from the entity or holder which originally was associated with the property interest.

Third, there is insufficient nexus or connection between foreign-address property and the holder's state of domicile to justify, on an equitable basis or as a constitutional matter, the state of domicile asserting a right to custody of such property. Both the 1981 and 1995 Uniform Acts expressly recognize such a limitation by prohibiting claims by any state to property "held, due and owing in a foreign country and arising out of a foreign transaction." 10 However, neither of those Acts provides any guidance about when property is deemed to be "held, due and owing" in a foreign country or to "arise out of" a "foreign" transaction. This is precisely the kind of fact-based rule that would have to be applied on a case-by-case basis that the U.S. Supreme Court has repeatedly rejected. 11

Although the Supreme Court gave the right to claim custody of property where the owner is unknown or the holder has no record of any address for the owner to the holder's state of domicile, the authors submit that it is in fact not a "rational extension" of that rule to conclude that the holder's state of domicile should
similarly be allowed to claim custody of property where the owner is known and the owner's last known address is in a foreign jurisdiction.

The "disposition of abandoned property is a function of the state,' a sovereign 'exercise of regulatory power' over property and the private legal obligations inherent in property."\(^{12}\) Even if it is deemed justifiable to allow the holder's state of domicile to take custody of such property from the holder when the owner of the property is unknown or the owner's state of last known address is unknown, where the owner of the property is known, and is last known to have resided in a foreign country, there is no "sovereign" relationship between the holder's state of domicile and the owner that would justify allowing the holder's state of domicile to claim custody of the property of the foreign owner.

Fourth, application of state unclaimed property laws to foreign-address property is likely to subject holders to multiple conflicting claims for the same property in violation of the U.S. Constitution. In the past several decades, a number of foreign countries have implemented unclaimed property laws, many others are currently considering doing so, and it is likely that this trend will continue for the foreseeable future. The Supreme Court long ago held that the Due Process Clause protects a holder against multiple escheat claims for the same property.\(^{13}\) In *Western Union Tel. & Tel. Co. v. Pennsylvania*, the Supreme Court rejected Pennsylvania's claim to property as violating the due process rights of the holder under circumstances where the state asserting the claim to escheat was unable to provide protection to the holder against conflicting claims by other states.

Since neither the courts of any state asserting a claim for foreign-owned property, nor even the U.S. Supreme Court, could protect a holder against a subsequent claim that might be asserted for the property by the country of residence of the owner, or the country of citizenship of the owner, or some other foreign jurisdiction that might have a basis to assert such a claim, the authors submit that due process precludes any U. S. state, including the holder's state of domicile, from claiming such property.

Finally, under the most recent Supreme Court precedent involving state taxation of foreign-owned property, a demand for custody of foreign-owned property by any state, including the holder's state of domicile, would violate the Foreign Commerce Clause of the U.S. Constitution. The Commerce Clause of the Constitution provides that Congress shall have the power to regulate commerce "with foreign Nations, and among the several States, and with the Indian Tribes."\(^{14}\)
In *Japan Line, Ltd. v. County of Los Angeles*, the Supreme Court recognized that special considerations beyond those that govern the taxation of property owned by U.S. citizens come into play when states seek to tax property owned by foreign citizens, even when that property is physically used in the U.S. and is subject to the state's due process jurisdiction to tax. In *Japan Line*, at issue was an attempt by Los Angeles County to impose a fairly apportioned property tax on shipping containers physically located at the port of Los Angeles on tax day.

Although the Court found that such taxation would have been permitted if the containers were owned by U.S. persons, the fact that they were instead owned by foreign companies precluded their taxation by any U.S. jurisdiction, the Court concluded. The analysis by which the Court reached that conclusion is equally applicable to a state's attempt to take custody of foreign-owned property under its unclaimed or abandoned property laws.

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

As their second reason, the Court in *Japan Line* noted that the imposition by a state of any tax on a foreign-owned instrumentality of commerce would "impair federal uniformity in an area where federal uniformity is essential." In *Michelin Tire Corp. v. Wages*, the Court noted the "overriding concern" of the Framers of the Constitution that "the Federal Government must speak with one voice when regulating commercial relations with foreign governments."

In *Japan Line*, the Court said that "a state tax on instrumentalities of foreign commerce may frustrate the achievement of federal uniformity in several ways. If a novel state tax creates an asymmetry in the international tax structure, foreign nations disadvantaged by the levy may retaliate against American-owned [property] present in their jurisdictions. Such retaliation, of necessity, would be directed at American [property] in general, not just that of the taxing State, so that the Nation as a whole would suffer. If other States followed the taxing State's example, various instrumentalities of foreign commerce could be
subjected to varying degrees of multiple taxation, a result that would plainly prevent this Nation from 'speaking with one voice' in regulating foreign commerce."\(^{18}\)

The Court continued that, for both these reasons—because the tax claim asserted by Los Angeles subjected foreign-owned property to a risk of multiple taxation not borne by property owned by a U.S. person, and because the tax as applied to foreign-owned property "prevents the Federal Government from 'speaking with one voice' in international trade . . . [w]e hold the tax, as applied [to foreign-owned property], unconstitutional under the Commerce Clause."\(^{19}\)

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

Accordingly, the authors submit that neither the state of domicile, nor indeed any other U.S. state, can constitutionally demand custody of foreign-address property.

**May States Sell Foreign-Address Unclaimed Property for Which They Have Custody?**

Generally, when a state takes custody of unclaimed property, it holds such property for the benefit of the owner until the owner comes forward to claim it. The state takes no action that affects the rights of the owner. If the owner ultimately does come forward to claim the property, the owner will receive the full value of the property back from the state having custody of the property in the interim.

An important exception to this general rule, however, is the treatment by states of stock and other securities. States taking custody of stock or other securities frequently liquidate, or sell, such stock or securities, and merely hold the proceeds of such sale (less the expenses incurred by the state in selling the property) to be returned to the owner of the property if the owner ever comes forward to claim it. For example, Section 1143 of the Delaware Escheats Law, Title 12, Delaware Code Annotated, provides in pertinent part as follows:
"(a) All abandoned property, other than money, delivered to the State Escheator pursuant to this subchapter, may be sold or disposed of at public auction to the highest bidder or in such manner and at such times as the State Escheator, in the Escheator's discretion, shall determine to be in the best interests of the State. In the case of stocks, bonds, or other securities, disposition may be made by sale through a registered broker on a recognized securities exchange or over the counter market or, if there is no ready market for such security, by negotiation or public auction.

(b) The proceeds from the sale of any such abandoned property, less all costs incurred in connection with such sale, shall be held in the place of such property and any claimant for abandoned property shall be entitled only to the money so received, less lawful service charges."

Under the Delaware Escheats Law, assuming it applies to foreign-owned stock in the first place (which we contend it does not), a foreign owner of shares of stock of a Delaware corporation would receive only a single due diligence letter, sent by regular mail—not certified or registered mail—and written in English, notifying the owners that if they do not take affirmative steps to assert their ownership interests, their shares will be turned over to the Delaware State Escheator.

Furthermore, such notice, under the form prescribed by the Delaware State Escheator, does not give the foreign owners any notice that the State Escheator will (or even may) sell their shares and divest them of their ownership of the shares and the right to any future appreciation in value. Instead, foreign owners who do not receive the notice, or do not understand its import, may not find out that they no longer own their shares until such time as they attempt to sell them, which may be years later at a time when the shares may have substantially increased in value.

The rightful owners who come forward at that time to claim their "property" from Delaware will be disappointed to learn that Delaware will only return to them the net proceeds of Delaware's sale of the shares years earlier. Not only will the owners not receive any appreciation in value of the shares after their escheat to and sale by Delaware, Delaware will not even pay them interest on their funds that Delaware had use of during the interim.

It is worthy of note that the Delaware State Escheator is not obligated by the Delaware statute to exercise his/her discretion in the best interests of the rightful owner of the property, but rather to do whatever he/she shall determine "to be in the best interests of the State." This, too, is contrary to the underlying function of unclaimed property laws as being for the protection of the interests of owners. As a result, however, it is the
practice in Delaware, as in many other states, to sell stock or other securities escheated to the state as soon as practicable, making it less likely that the rightful owner will learn of the escheat of his/her shares and claim them back from the state prior to their being liquidated.

This is in contrast to the 1995 UUPA, which at least would require states to hold securities that are delivered into their custody for three years prior to selling them, or to make the owner who claims the shares within such three-year period "whole"—i.e., give an owner claiming the securities within such three-year period the full value of the securities as of the date of the owner's claim—not the date when the state may have chosen in its own interests to sell the securities-plus any dividends, interest, or other increments thereon up to the time of the owner's claim. Instead, a foreign shareholder of a Delaware corporation whose shares are escheated to Delaware is highly likely to be deprived of any increase in the value of such shares after they escheat to the state.

As indicated above, the authors believe that states may not constitutionally demand custody of foreign-address property. However, when the property type being claimed is stock or equity-related property, and it is determined that foreign-address shares are required to be escheated to the state of domicile of a holder, then the authors further submit that the state of domicile should not be allowed to sell the shares. This is based on the fact that the state of domicile's right of escheat is not grounded in any relationship with the owner of the shares, but rather is based on the state of domicile's relationship as sovereign of the issuer/holder.

We do not believe that gives the state of domicile of the issuer/holder sufficient relationship with the owner of the shares to empower the issuer/holder's state of domicile to take affirmative action to divest the owner of his/her ownership of the shares. In such situations, the holder's state of domicile is not just stepping into the shoes of the holder to take custody of property until the rightful owner comes forward to claim the property. Rather, the state is presuming to exercise rights of ownership of the shares, including divesting the true owners of their ownership right, even though the holder's state of domicile has no relationship whatsoever with the owners of the shares, who were last known to have resided in a foreign country.

At most, if the state of domicile of a holder is permitted to step into the shoes of the holder and take custody of a foreign owner's property, the state should be required to continue to hold such property until the rightful owners or their heirs make claim to the property. If the state of domicile is unwilling or unable to hold shares indefinitely (or at least for an extended period of time), then it should decline to accept escheat of the shares and leave them with the issuer/holder.
The shares are not the property of the issuer/holder, over whom the state is sovereign and, as such, may perhaps be empowered to exercise rights over the issuer/holder's property. Rather, the shares belong to the foreign shareholder, with whom the issuer/holder's state of domicile has no relationship whatsoever. Surely it violates the due process rights of such foreign shareholders for a U.S. state with whom the shareholders have no relationship to be allowed to take custody of their property, sell it, and use the proceeds for the state's purposes, thereby depriving the rightful owners of the benefits of ownership of their property.

1 Unclaimed property laws are primarily consumer protection statutes designed to protect the interests of owners of property, not to raise revenues for states. States take custody of unclaimed property which is presumed abandoned when it has not been claimed by the rightful owner for a statutorily prescribed "dormancy period" and hold it until the rightful owner comes forward to claim it. However, the fact is that typically less than 50% of funds escheated to any state are ultimately claimed by owners, and in some states-for example, Delaware-that figure is under 10%. As a result, unclaimed property has become a significant source of revenue for states-revenue that can be raised without politicians having to touch the political "third rail" of "raising taxes." In Delaware, unclaimed property has over the past 15 years become the third largest revenue source for the state, contributing as much as $600 million per year to the state's coffers.

2 See 1981 UUPA Sec. 3(5); 1995 UUPA Sec. 4(5). Each of those provisions permits a state to claim custody of property where the last known address of the apparent owner, as shown on the records of the holder, is in a foreign country and the holder is domiciled in the state. Note: The Uniform Acts, as drafted by the Uniform Law Commission ("ULC"), are normative in nature, i.e., they are not the law in any one state or jurisdiction unless and until adopted under the laws of the particular state or jurisdiction. More information on the role of the ULC can be obtained from www.uniformlaws.org.

3 379 U.S. 674, 13 L. Ed. 2d 596 (1965).

4 The second priority rule, as articulated by the Supreme Court in Texas v. New Jersey, 379 U.S. 674 (1965), applies only where the holder's books and records contain "no address at all" or contain an address "in a State which does not provide for escheat of property . . . ." However, Section 4 of the 1995 UUPA provides that when the last known address of the apparent owner is in a foreign nation the state in which the holder is domiciled may claim the property. The Official Comment to Section 4 of the 1995 UUPA
acknowledges that the escheat of foreign address property "was not dealt with by the Supreme Court in Texas v. New Jersey." The Comment refers to the provision allowing foreign-address property to be claimed by the state of domicile as "a rational extension of that ruling."


8 See initial draft of Revised UUPA ("RUUPA") released in February 2015-specifically the additional language added to the end of Section 1(19)(viii). The Reporter's Comment immediately following Section 1(19)(viii) notes that the ULC Drafting Committee was asked whether a revision should "retain the provision in the 1995 Act that allows the State of the holder's domicile or residence to take custody of foreign-addressed unclaimed property. NAUPA recommends leaving it as is, UPPO recommends that it be amended. The consensus of the committee was to accept UPPO's recommendation." Note: Section 5(4) of the RUUPA allows a holder, at its option, to voluntarily remit property for which the last known address of the apparent owner is in a foreign country. The Reporter's Comment thereto states that this change presumes that the Act will not require remission of property when an owner's address is in a foreign country. Note: As the initial draft of the RUUPA released in February 2015 is likely to undergo additional revisions, the reader is cautioned to carefully review the final version of the revised uniform act.

9 U.S. Const. art. VI.

10 1981 UUPA Sec. 36; 1995 UUPA Sec. 26. Note: The initial draft of the RUUPA released in February 2015, states in Section 26 that "This [Act] does not apply to property held, due and owing to a person whose last known address is in a foreign country or to property arising out of a foreign transaction where the property is held in a foreign country or location outside the United States, unless the property has been voluntarily turned over to the State pursuant to Section 5(4)." However, the Reporter's Comment following such Section states that "This provision is related to a decision on whether property held for the benefit of an owner whose address is outside of the United States." Note: As the initial draft of the RUUPA released in February 2015 is likely to undergo additional revisions, the reader is cautioned to carefully review the final version of the revised uniform act.

11 In its original decision establishing the rules for states' claims to abandoned intangible property, Texas v. New Jersey, the Supreme Court rejected a rule proposed by Illinois which would have allowed the state of the holder's "main office" or principal place of business to claim abandoned property, saying that such a rule
"would raise in every case the sometimes difficult question of where a company's 'main office' or 'principal place of business' or whatever it might be designated is located. Similar uncertainties would result if we were to attempt in each case to determine the State in which the debt was created and allow it to escheat. Any rule leaving so much for decision on a case-by-case basis should not be adopted unless none is available which is more certain and yet still fair. We think the rule proposed by the Master, based on the one suggested by Florida, is . . . . We therefore hold that each item of property in question in this case is subject to escheat only by the State of the last known address of the creditor, as shown by the debtor's books and records." 379 U.S. at 680, 681.

In its subsequent decision in Pennsylvania v. New York, 407 U.S. 206 (1972), the Court rejected a variation on the Texas v. New Jersey priority rules proposed by Pennsylvania that would have created a "presumption" that the creditor's residence is in the state in which the transaction giving rise to the property in question occurred, and to allow that state to assert the first priority claim, at least where the records of the holder do not contain any last known address for the owner. Although agreeing that "Pennsylvania's proposal has some surface appeal," the Court rejected it and reaffirmed the second priority rule giving the right to escheat owner-unknown property to the holder's state of domicile, saying "to vary the application of the Texas rule according to the adequacy of the debtor's records would require this Court to do precisely what we said should be avoided-that is, 'to decide each escheat case on the basis of its particular facts or to devise new rules of law to apply to ever developing new categories of facts.'"


13 See Western Union Tel. & Tel. Co. v. Pennsylvania, 368 U.S. 71, 7 L. Ed. 2d 139 (1961).

14 U. S. Const. art. I, § 8, cl. 3.


16 441 U.S. at 448.


18 441 U.S. at 450 (citations omitted).

19 441 U.S. at 453-454.
Delaware takes the position that foreign-address property, held by a Delaware corporation that is presumed abandoned under the Delaware statute is required to be reported and remitted to Delaware. However, unlike the UUPA, which expressly provides for claims by a holder's state of domicile of abandoned foreign-address property, the Delaware Escheats Law contains no such provision. Accordingly, the authors contend that, even if the escheat of foreign-owned stock was constitutional (which, as discussed above, we believe it is not), Delaware lacks the statutory authority to escheat such property.

See 15 DE Reg. 965.