US Supreme Court Asked to Address Rights of Unclaimed Account Holders

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What do the Queen of England, US President Barack Obama and Russia's President Vladimir Putin have in common?

Besides being prominent world leaders, they are also listed on the records of the Office of the Controller of California as being lost or unknown investors whose accounts are now held by the state and could be liquidated. So are over 26 million other investors, who are at risk for losing the market value of their accounts.

A petition now pending before the US Supreme Court seeks to remedy the growing problem of securities accounts classified as unclaimed answering two critical questions: just how much responsibility does a US state treasurer or controller have to track down the holders of unclaimed securities accounts and verify that they are indeed lost before seizing them. And what responsibility does the state official then have to give the holders the proper notice and fair value following the liquidation of their holdings in the escheated accounts?

The case involves a class action lawsuit filed by private investor plaintiffs against California's State Controller Betty Yee for illegally seizing securities accounts and not paying the plaintiffs the full value of their holdings. The suit has been pursued for years through the California court system, and the petitioners hope that the Supreme Court will finally settle it in favor of the plaintiffs.

Last month, the Shareholder Services Association and Securities Transfer Association, filed an amicus brief in the case, asking the Supreme Court to question the practices not only of California, but all US states. The SSA is the trade group representing over one hundred of the US' largest corporations while the STA represents over 100 transfer agents, or recordkeepers, paid by corporations to administer the accounts of registered shareholders. The Court's decision could ultimately affect millions of investors, the corporations whose shares they buy and sell, and transfer agents.

"We're just looking out for the rights of investors who are incorrectly being classified as lost and who are not receiving fair market value for their holdings when liquidated by states," says Patrick Burke in his role as president of the SSA. Burke, who is also director of operations and assistant corporate secretary for insurance giant AIG in New York can speak from personal experience. Had Burke not opened the mail at home addressed to his son living away at college, his son would never have discovered that his securities account was in danger of being escheated to a state because of "inactivity."

Companies have far more at stake than just protecting their shareholders. They are worried they might be hit with lawsuits from disgruntled shareholders who feel their accounts were unjustly transferred to state coffers. Such litigation is a real possibility now that states are paying auditors to review the books and records of corporations and financial firms to determine whether they have escheated as many accounts as they should. Paid commission or contingency fees, these auditors have a vested interest in classifying as many shareholders as possible "lost" even if they aren't, argue unclaimed property experts.

What's at Stake

The petitioners in the case before the Supreme Court are shareholders in different corporations whose accounts were escheated and liquidated by the State of California. They want the US' highest court to overturn a decision made by the Ninth Circuit Court of Appeals in California in March 2015 and to declare California's unclaimed property statutes as unconstitutional.

The California state appeals court ruled that the petitioners were not entitled to "just compensation" from the seizure and liquidation of their investments. What's more, California's State Controller did not have any obligation to track down "lost" investors by searching through publicly available databases either before or after the accounts were escheated even though it does so when it comes to collecting taxes. Such a requirement would exceed the rights of investors to due process, said the appeals court. Its recent decision appears to contradict a previous ruling it made in 2007 ordering a federal injunction to shut down California's unclaimed property program. That closure forced California's legislature to rewrite the state's statutes on unclaimed property that same year.

"California's unclaimed property statutes violate the constitutional rights of shareholders to due process and just compensation for the seizure of their property," asserts William Palmer, the Sacramento and Los Angeles-based attorney for the plaintiffs, who are also represented by Harvard Law School Professor Laurence Tribe and Jonathan Massey, a partner with the law firm of Massey & Gail. "The purpose of its unclaimed property program is to locate and and return private property to investors who are truly unknown. It is not to arbitrarily declare known investors to be unknown simply for the purpose of seizing property to use as revenue for state coffers."

The petitioners before the Supreme Court argue that California makes no attempt to find the supposedly lost shareholders through publicly available databases and rarely sends them a notice through the mail that it will liquidate their accounts. Instead, the state simply places generic ads in local newspapers across the state directing any "lost" shareholders to search through a website operated by the California Controller's office.

"That website does nothing more than tell investors whether or not their properties have been liquidated and doesn't help investors who live in other states or foreign countries. They must go through the onerous process of filing the paperwork to claim their accounts or monies, with the grim hope they will be successful," says Palmer. "Sometimes they are and sometimes they aren't, depending on just how helpful the person is on the other end of the line when they contact at the Controller's Office." There are no state-approved regulations to ensure the best results for investors or to regulate the conduct of unclaimed auditors.

California has no business taking unclaimed accounts if it cannot pay "just compensation" to investors and do the right job in tracking down lost investors, according to Palmer, who calls California's unclaimed property rules a "recipe for disaster." California's coffers and the commissioned auditors hired by the state are the only ones who benefit from its policies to the detriment of millions of unwitting investors, he argues.

Palmer' petition before the Supreme Court isn't the first time he has called the State of California to the carpet. In 2001, he filed the same class action lawsuit representing lead plaintiff Chris Lusby Taylor and several dozen other investors in a lower district court in Sacramento. Taylor, a UK citizen and resident who has never set foot in California, asserts he was not paid the correct value of his 52,224 shares in Intel by the California Controller when the state seized his employee benefit account and liquidated its holdings in 1990.

When Taylor discovered in 2001 that his account had been escheated, the state of California had already sold the shares for US$300,000. Taylor first sued Intel in 2001 and won a partial victory — he received about US$750,000 worth of restricted stock reflecting the US$300,000 Intel recovered from the Controller's office and an additional US$450,000 from Intel. Palmer insists that the state of California should have paid Taylor about US$3.8 million, the value of his shares in 2001 when he tried to claim his account.

Palmer lost that class action suit against the California Controller in 2001, but after several appeals finally succeeded in convincing the Ninth Circuit Court of Appeals in 2007 to require California to "remedy the constitutional problem with its escheat statute." Although California did pass new unclaimed property rules that year, the legislation was ineffective, as evidenced by the growing number of number of accounts and value of accounts it has seized since then, says Palmer. When his final plea to the California appeals court in 2012 to force California to make good on its promise to improve the way it tracks down lost shareholders and not liquidate the assets of escheated accounts failed in March 2015 he opted to take the case to the Supreme Court.

Although the case before the Supreme Court targets California's practices, many states follow similar ones. As a rule of thumb, states require unclaimed accounts to be escheated or transferred to the last state in which the shareholder resides three to five years after the owner of the account is considered "lost." As a last resort, if the address of the investor isn't known, the accounts will be given over to the state of incorporation of the issuer of the shares. New York and Delaware are the two most popular states for

incorporation. State treasurers or controllers, running unclaimed property programs, are free to quickly liquidate the assets in the accounts they hold on behalf of the "lost" investors.

What's in a Name

Just what triggers the designation "lost" is a matter of each state's interpretation. It could be as simple as an uncashed check or letter returned to a company's transfer agent as undeliverable. Some states, such as California and Delaware, also consider any "inactivity," that is the lack of any communication between the shareholder or the company, to qualify as "lost." However, this doesn't prove that the shareholder is lost, in any real sense.

That is exactly what happened with Taylor's employee benefit account. Taylor, a former Intel employee, had failed to cash dividend checks or vote proxies for more than three years. So the state of California presumed he had abandoned the account and seized it even though he had held onto stock certificates evidencing ownership in his safe deposit box at an English bank.

Once the so-called dormancy period ends — the time between when an account is termed unclaimed and when it is transferred to a state — the state is then free to quickly liquidate any of the assets in the account and use the money to replenish state budgets. The owner of the account, who might eventually show up to claim it, could end up losing out on the benefit of a higher payout, due to a market upturn, stock split, dividend or income payments or a corporate spin-off.

States do make some attempt to notify investors that they are holding onto their accounts through websites or public notices in local newspapers. However, those printed alerts can often go unnoticed because they are located in the back of the newspaper and published in small print.

"The owner of the account has the right to its property and should liquidate the account when he or she wants to, not when the state decides," says Jennifer Borden, an attorney specializing in unclaimed property who represents the SSA and STA. "Ideally, the Supreme Court should rule that California should not liquidate a securities account, but if the court says that it has the right to do so, the state should wait for at least three years." Doing so, according to Borden could potentially reduce the number of accounts which are liquidated should more investors come forward to claim their assets.

Although the crux of the petition before the Supreme Court involves the responsibility states have to find "lost shareholders" before they liquidate their assets, Borden hopes that the Supreme Court will also makes a decision about when an account should be escheated. The reason: there are **too many** accounts which are being escheated to state treasurers or controllers, simply because there was no activity on the accounts. Such inactivity could easily be the case for a retirement fund or a dividend reinvestment plan.

Borden wants the Supreme Court to come up with a narrower guidelines for determining when an account should be escheated, such as uncashed checks or mail returned to a transfer agent at least twice. Such a restrictive definition would stop accounts being escheated on the basis of inactivity, and reduce the potential lawsuits by investors that feel that their accounts have been unfairly escheated.

What makes Palmer think the Supreme Court will even consider his clients' case amidst the hundreds of

petitions it receives every year? Legal precedent is on his side, he says. Numerous US state appeals courts have upheld the rights of property owners and in June 2015, the Supreme Court overturned the Ninth Circuit Court of California's ruling in a similar case. Palmer's clients hope that the US' highest court applies the same reasoning when it comes to deciding whether or not California's Unclaimed Property Program is constitutional.

The June ruling involved property owners affected by a a Depression-era federal program designed to maintain a stable market for several agricultural products, including grapes. That program requires grape owners to give a percentage of their crops to the federal government, which doesn't pay them a red cent. When a farmer in California refused to do so, he was fined US$500,000.

California's Ninth Circuit Court ruled in favor of the US Department of Agriculture, but the Supreme Court reversed that decision, saying that the state appeals court erred in considering the seizure of raisins as a restriction on the use of personal property. The physical appropriation of property or a regulatory limit on production of grapes practically speaking has the same economic impact on a grower. The Fifth Amendment to the Constitution doesn't allow the government to take the grapes without paying farmers fair compensation, countered the Supreme Court, adding that farmers could be paid from proceeds from the sale of any confiscated grapes.

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