CARLTON FIELDS

Court Invalidates California Unclaimed Property Law Regulations

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A California state court recently enjoined the state from enforcing two rules adopted by the Office of the State Controller without compliance with the California Administrative Procedure Act (APA) concerning the state's Unclaimed Property Law (UPL). The court concluded that the rules were regulations that were improperly promulgated under the APA, and barred their application.

The Office of the State Controller promulgated the regulations under a provision of California's Unclaimed Property Law that provides that life insurance or annuity proceeds become state property if they are unclaimed three years after they become due. The first regulation, the External Database Regulation, required insurers to search the Social Security Administration's Death Master File or a similar database to determine whether any insureds were deceased. The second regulation, the Dormancy Trigger Regulation, required insurers to report policy proceeds as unclaimed no later than three years after the insurer had reason to know that the insured had passed away, regardless of whether the insurer's own records showed that the insured had died. The state controller had been actively enforcing the regulations in UPL compliance audits and had imposed substantial fines for noncompliance.

Thrivent Financial for Lutherans brought suit seeking an injunction barring the enforcement of the regulations and a declaration that they were improperly promulgated. Both Thrivent and the Office of the State Controller moved for summary judgment. The court granted Thrivent's motion. It explained that there was no dispute that the regulations were being enforced and that they had not been adopted in conformity with the APA. The court also rejected the state's argument that its "regulations" were not in fact "regulations," as well as the state's contention that the Controller's interpretation of the governing statute was the only reasonable one. The court explained that the language of the UPL was "reasonably susceptible" to an "interpretation that the triggering event for the reporting of a policy is the disclosure by an insurer's own records that its insured is deceased." The court therefore barred California from enforcing the regulations or imposing financial penalties on insurers for failing to comply with them. The relief included an order that the controller remove all references to the regulations in materials disseminated to life insurers unless the references were accompanied by conspicuous disclaimers.

The court's decision is a win for insurers who will — at least for the time being —not be subject to the regulations' costly requirements and the threat of substantial penalties for noncompliance.

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