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No. 111 Original

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1991

STATE OF DELAWARE,

Plaintiff,

STATE OF TEXAS,

Plaintiff-Intervenor,

v.

STATE OF NEW YORK,

Defendant

REPORT OF THE SPECIAL MASTER

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January 28, 1992

REPORT OF THE SPECIAL MASTER

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State of Delaware v. State of New York

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REPORT OF THE SPECIAL MASTER

I. BACKGROUND

A. Introduction

This action was commenced in 1988 when the State of Delaware sought leave to file a complaint against the State of New York pursuant to the original jurisdiction of the Supreme Court of the United States. On May 31, 1988 the Court grant-

ed leave for the filing of this complaint, 486 U.S. 1030, and New York lodged its answer on July 27, 1988. The Court appointed the undersigned to serve as special master in an order dated December 12, 1988, 488 U.S. 990.

Delaware's complaint alleges that New York has wrongfully escheated and threatened to escheat certain unclaimed intangible personal property.[1] The unclaimed or abandoned property is alleged to arise from "distributions made with respect to securities," and the focus of the Delaware pleading is such property found in the hands of securities brokerage firms incorporated under the laws of Delaware. Delaware complaint, ¶ 3. The fundamental premise of the Delaware complaint is that the process by which dividends, interest, and other distributions are made gives rise to funds, securities, and other property in the hands of the brokerage firms, and that for some significant amounts of such property the holder has no identification or last known address of anyone claiming to be the beneficial owner of such property, *id.* The legal claim advanced by Delaware is that it is entitled, as the state of incorporation of the brokerage houses as to which its claim is directed, to escheat the unclaimed property.

On January 12, 1989 the State of Texas moved for leave to file a complaint as an intervening plaintiff in this case. The Court granted the Texas motion on February 21, 1989, permitting the filing of its complaint in intervention, 489 U.S. 1005. The Texas complaint avers that some of the unclaimed property

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1. Several of the parties have noted that these proceedings technically involve "custodial taking," not escheat, as a jurisdiction takes possession of the unclaimed funds subject to the right of a superior claimant (either another jurisdiction or a private party) that later asserts its rights. For most purposes, it is sufficient to describe these proceedings as involving "escheat" law, as the Court did in Texas v. New Jersey, 379 U.S. 674 (1965), understanding that term to encompass for purposes of this Report the theoretically interim (but oftentimes practically permanent) nature of custodial taking.

at issue is properly subject to custodial taking only by Texas. The legal grounds asserted for this claim rest on the argument that while the entities holding the unclaimed funds cannot identify or locate addresses for intended recipients or others beneficially interested in the distributed property, the issuing entity (e.g., a corporation which declares and pays a dividend on its common stock) is known, readily identifiable, and locatable. Texas advances the legal theory that the state of incorporation of the entity issuing the distribution has the superior right to take custodial possession of the unclaimed portions thereof. In addition, Texas emphasizes in its papers that the issuing entities include local governmental units of the State of Texas that have used bonds or other securities in funding projects and which issue distributions in respect of those securities. In an amended complaint lodged in October, 1989, Texas defined the abandoned property to include distributions held by other entities in the securities business, beyond the brokerage firms incorporated under the laws of Delaware.

Over the course of the period from 1989 through 1991 several additional states sought separately to intervene and lodged complaints either adopting the Texas form of complaint or setting forth substantially congruent averments. These jurisdictions are the States of Arizona, Colorado, Connecticut, Idaho, Minnesota, New Mexico, North Carolina, Oregon, South Carolina, Tennessee and Wisconsin, and the Commonwealth of Virginia.

On April 21, 1989 the State of Alabama, joined by the States of Hawaii, Illinois, Indiana, Kansas, Louisiana, Montana, Nevada, Oklahoma, South Dakota, Utah, Washington and the Commonwealths of Kentucky and Pennsylvania, moved the Court for leave to intervene. Like the Texas complaint, Alabama, et al., assert an interest in unclaimed property held by any entity in the securities industry to the extent that the entity issuing the distribution giving rise to the unclaimed property is incorporated or otherwise created under the laws of these plaintiff states. Later in 1989 and continuing through 1990 and

1991 several states sought and obtained leave to file complaints in intervention modelled on that of Alabama, et al. These jurisdictions are the States of Alaska, Arkansas, Florida, Georgia, Iowa, Maine, Mississippi, Missouri, New Hampshire, New Jersey, North Dakota, Vermont, West Virginia, and Wyoming.

On November 17, 1989 the State of California, joined by the States of Michigan, Nebraska, Ohio, and Rhode Island, moved for leave to intervene. These jurisdictions advance a claim for escheat of a portion of the unclaimed property at issue here on the legal theory that the states' entitlement to custodial possession and escheat of such intangibles should be in proportion to the "commercial activities" of each state. The District of Columbia, which has also sought to intervene, espouses essentially the same theory as do California, et al.

B. Intervention Motions

The action thus grew from the initial suit by Delaware against New York through the intervention of Texas with leave from the Court on February 21, 1989. In recognition of the several other jurisdictions that had lodged applications, on September 13, 1989, I filed a "Report of the Special Master on Motions to Intervene," recommending to the Court that it grant the motions to intervene that had been filed by a number of additional jurisdictions.[2] By order dated October 16, 1989, the Court ordered that Report filed, 110 S.Ct. 274 (1989).[3] In

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2. In addition to Texas (granted intervention by order of the Court), 22 jurisdictions had sought intervention by September of 1989. These jurisdictions were: Alabama, Arizona, Connecticut, District of Columbia, Hawaii, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Montana, Nevada, New Mexico, Oklahoma, Pennsylvania, South Dakota, Tennessee, Utah, Virginia, Washington, and Wisconsin.

3. As a matter of convenience, the "Report of the Special Master on Motions to Intervene" is attached as Appendix C to this Report.

Litigation Management Order No. 1, October 18, 1989, I encouraged all jurisdictions contemplating a motion to intervene to make prompt disposition of plans in order to facilitate participation in the preparations of this action. Since that time, as noted above, additional motions to intervene have been filed by another 25 states.[4] Each of the more recent motions has proffered a complaint in intervention adopting one (or more) of the positions that have been extensively briefed during this first-round of briefing, addressed to the applicable legal test. And, all of the jurisdictions have shown an admirable ability to coordinate through lead counsel for their respective positions, thus reducing to the vanishing point complexities that might otherwise be introduced by the comparatively "late" intervention by additional party states. In light of that, the reasons expressed in my September 13, 1989 Report for granting the various motions to intervene remain valid today. I accordingly recommend that the Court grant the applications of all jurisdictions that have, to this point, filed motions for leave to intervene.[5]

C. The Present Motions

Following a motion by defendant New York for judgment on the pleadings, and a conference attended by counsel for almost all of the then-participating jurisdictions, a limited program of discovery was authorized to permit the parties an adequate basis for presenting the dispositive legal issues. Pursuant

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4. Alaska, Arkansas, California, Colorado, Florida, Georgia, Iowa, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Hampshire, New Jersey, North Carolina, North Dakota, Ohio, Oregon, Rhode Island, South Carolina, Vermont, West Virginia, Wyoming.

5. This includes the motion of Texas for leave to file an amended complaint in intervention, referred to me by Court order of October 30, 1989, 110 S.Ct. 317.

to Litigation Management Order No. 1, the discovery was calculated to illuminate the structure of the flow of securities distributions giving rise to the unclaimed property at issue here. Discovery was permitted to seek identification of the principal entities involved in the securities distribution process, the levels, steps, or stages in the process, the relationships *inter se* of the organizations involved, and the variety of circumstances giving rise to the unclaimed intangible distributions in which the parties assert an interest.

Discovery undertaken pursuant to these instructions included documentary production and interrogatories (both factual and contention-related) exchanged by the parties, as well as discovery directed to non-parties with roles illustrative of the structure of the securities industry. The non-parties who participated in this discovery included two of the largest national securities brokerage firms and one smaller, regional brokerage firm. Documentary discovery and two depositions were also taken with respect to one of the largest commercial banks in the United States, through its custodial services and corporate trust account departments. Finally, substantial discovery (production of documents, a narrative statement, and deposition) was taken concerning the operations of the Depository Trust Company ("DTC"), a national repository for securities certificates and a key entity in the process of transmitting distributions in the securities field to their appropriate recipients.

At the outset of the discovery program and at several points during discovery, the parties were directed in written Discovery Orders to limit factual exploration to the general and structural matters bearing on the broader legal issues, and not to attempt to ascertain the status of any particular distribution, the exact amounts of unclaimed property held by any specific entity, or similar details. This was consistent with using discovery as a vehicle for allowing the parties to test each other's legal theories, but not as an attempt to actually determine which particular transactions gave rise to escheatable funds under the applicable legal tests.

Upon the expiration of the period authorized for discovery in this action, a schedule was established for briefing of motions directed at the parties' legal theories.[6] Each of the jurisdictions noted above participated in four rounds of briefing over a five-month period. The jurisdictions aligned themselves with one of three basic legal theories: (1) that reflected by the briefs filed by Delaware and by New York; (2) that reflected by the briefs filed by Texas and 12 other states aligned with Texas and by the group of states beginning alphabetically with Alabama (the "Texas, Alabama, et al." position); and (3) that reflected by the brief filed by the group of states beginning alphabetically with California (the "California, et al." position). In addition, New York raised a mixed factual/legal issue respecting whether the last known addresses of creditors could be found in a number of instances, and all parties focused on this set of contentions as well. In addition to papers setting forth its own position, each state or group filed briefs opposing alternative theories, followed by reply and rebuttal briefs.

Voluminous documents were submitted on the motions. These included transcripts of several depositions taken during the authorized discovery program, specimen contracts, and other instruments dealing with the relationships of various entities in the securities distribution process, and other documents located in discovery.

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6. As noted in Litigation Management Order No. 2, July 16, 1990, "it is important not to become mired in a semantic discussion as to what the contemplated motions should be designated. It is clear that the motions envisioned at this stage have never been considered to be full-blown summary judgment motions, disposing of all factual contentions and potentially ending this litigation in its entirety. . . . What has been permitted, and is the thrust of Litigation Management Order No. 1, is discovery into the basic mechanisms of the flow of securities, so that the parties could reasonably frame motions where factors such as who was the agent of whom might have some probative value."

Oral argument was held before me on February 14, 1991. All interested jurisdictions participated over several hours of argument and rebuttal. A draft report was circulated to the parties for comment on June 21, 1991. The draft report recommended a locational test that was somewhat distinct from those advanced by the parties, and comments on the draft report led to an August 28, 1991 scheduling order that invited reactions to the feasibility of the proposed locational test. The draft report had also raised a question of "retroactivity" (or "reachback") not theretofore briefed by the parties. Because of the importance of that issue and the fact that the parties had not yet briefed it, the draft report had recommended that the Court, should it otherwise agree with the recommendations of the Special Master, remand the retroactivity issue to the Special Master for further consideration, so that it ultimately could be presented to the Court in an orderly fashion. In light of the perceived wisdom of inviting further submissions by the parties, however, the August 28th scheduling order also requested that the parties brief the essentially legal general retroactivity issues, including laches, in the hopes of permitting those issues to be disposed of in the first general report and recommendation submitted to the Court as well. Two further rounds of submissions have been received responding to the dual request of the August 28th scheduling order.

II. FINDINGS OF FACT

As is more fully discussed in section III of this Report, there is remarkably little disagreement among the parties on factual issues about how the various aspects of the securities industry involved in this litigation actually operate. Set forth as Appendix B to this Report are facts that I find to be established for purposes of the matters now presented to the Court. Almost all of these are literally undisputed. As to only one proposition -- whether intermediaries who to date have concluded

that they cannot identify the proper recipient of excess funds received can in fact undertake further investigation and reconstruction of a transaction in order to identify a trading partner involved or the beneficial recipient intended for a particular distribution -- New York, alone among the 50 jurisdictions participating in this litigation to date, contends that there is factual controversy. The specifics of New York's contentions and its proffered demonstration of factual issues, are expressly dealt with in section III(E) of this Report, where I explain why the issues raised by New York, while creating a factual dispute in certain respects, do not create any material issues of fact as to the legal issues addressed in the present Report or as to the specific findings set forth in Appendix B.

III. DISCUSSION

A. Introduction

For purposes of the present round of motions, the legal issues may best be illuminated by reducing the myriad details of the securities transactions in question outlined in Appendix B to one paradigmatic factual pattern. There is an *issuer*, who makes a payment[7] that, if all things work as they should, will ultimately end up in the hands of a *beneficial owner*. Because of the complexities of the securities distribution system, the payments often work their way through a series of *intermediaries*, such as

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7. For purposes of the present motion the parties, and this Report, use the terms "payment" or "distribution" as generic descriptions. The unclaimed property that is the subject of this suit includes dividends, interest, stock distributions of various kinds, and other property issued in respect of an underlying security instrument. No party contends, nor does it appear to me, that the variations in the form of the property being distributed have any significance for the present issues.

depository trust institutions, banks, and brokers.[8] In a tribute to the efficiency of the distribution system, such payments indeed make their way through the system from the issuer to the beneficial owner without incident in the overwhelming percentage of instances. In a very small fraction of cases,[9] however, payments become "stuck" with one of the intermediaries because that intermediary is unable to determine to whom it should transmit the funds it is holding. (The person to whom the payment should be made may either be the beneficial owner or yet another intermediary in the chain of transmission. For present purposes, the essential point is that the payments do not

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8. These intermediaries consistently disclaim any ownership interest in the funds involved in this case. See, e.g., DTC Statement at D-18, Exhibit D to Arizona, et al. Brief in Support of Motion (Oct. 30, 1990) (with Texas as coordinating counsel, hereinafter briefs filed by Arizona, et al., will be referred to as "Texas" briefs); Principe Dep., p. 104; Scott Dep., p. 157. This is obviously true in a normal sense, since a rightful ownership claim by an intermediary would defeat the escheat rights of *any* jurisdiction. I take it, however, that the intermediaries are essentially stating a position that, but for possession (of the intangible) they have no rights whatsoever in the funds in question, only some correlative obligations (to turn the funds over to another further down the line). Whether this is literally true in all respects turns in part on who keeps the interest that accrues on these funds prior to escheat, a matter on which the record is not fully developed, and need not be for present purposes.

9. The percentage of funds that appears to become "lost" in the system has been estimated by some of the parties as approximately 0.02%, or two ten-thousandths, of the entire amount distributed. See Brief in Support of Motion of Texas, at p. 18 n.21 (Oct. 30, 1990). Although this percentage is very low, it nonetheless results in the accumulation of substantial funds, because of the extraordinary number of transactions that are completed. The parties estimate that, between 1985 and 1989 alone, approximately $360 million of such funds were turned over to New York under its claim of escheat. Ultimately, the total escheatable funds for that period almost certainly far exceeds this amount.

make it from the issuer to the beneficial owner; it is unimportant where in the process the payments get "stuck.") It should also be noted that in the circumstances giving rise to the presently contested property the intermediary that is left holding the payment has no claim to the payment as "owner" in its own right. (If it did, of course, there would be no escheat proceedings at all.[10]) Nor does any other yet-identified party in the distribution scheme claim the payments as "owner." Assuming that a private party with a cognizable ownership claim is not subsequently identified, these funds, after a period, are escheatable; the question is: To which jurisdiction?

The parties essentially offer three distinct *legal theories* to identify the appropriate jurisdiction to claim escheat rights in the first instance.[11] It is helpful to identify the basic contours of each party's position before analyzing those positions against applicable Supreme Court precedent in this area.

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10. Such a claim of entitlement could arise if the broker itself paid the intended beneficiary of the distribution, or where the broker held an ownership position for its house trading account as a principal or dealer, entitled to the benefit of any distributions made in respect of the security.

11. The position of New York, of which this Report will have more to say later, is not a distinct legal theory. Rather, its position involves a factual variant on the basic position of Delaware. New York's dispute with Delaware that originated this lawsuit is not over the appropriate legal theory; rather, it is over the factual question of whether the addresses of those further down the distribution line are ascertainable. But while conceived by the parties as a factual dispute, this Report will discuss why the general legal issues dramatically affect the relevance of New York's contentions. See *infra*, pp. 58-68.

1. Delaware's Position

Delaware's position is that it is entitled to a substantial share of the funds involved in this dispute because it is often the jurisdiction of incorporation of the brokers in whose hands the funds become "stuck." Delaware asserts that under the "primary" rule of Texas v. New Jersey, 379 U.S. 674 (1965), when intangible property (characterized as a "debt") is held by someone admittedly not its owner, the state of the last known address of the "creditor" is the appropriate jurisdiction to escheat the funds. But in the instant case, since the last known address of the "creditor" -- whether viewed as the next person or entity in the chain of distribution or the beneficial owner -- is (we may presume, for present purposes) unknown, the funds are to be distributed according to the "secondary," or "backup," rule of *Texas v. New Jersey*. This backup rule distributes the funds to the state where the "debtor" was "located," with location referring to the state of incorporation of the debtor.[12] Delaware asserts that a straightforward application of *Texas v. New Jersey* and Pennsylvania v. New York, 407 U.S. 206 (1972), should result in the funds in this case being distributed according to this backup rule, and that the term "debtor" in these two Supreme Court cases should be interpreted to refer, in this context, to any intermediaries holding the funds at the time intended beneficiaries or their addresses are found to be unknown. Delaware arrives at this conclusion by reasoning that the issuer can no longer literally be the "debtor" once it has paid the funds since, at that point, it no longer owes money to anyone nor has any right to the funds' return. This is stated succinctly in Delaware's opening brief:

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12. Thus, Delaware seems to concede that, for example, New York would have superior rights with respect to the funds left unclaimed in the hands of Depository Trust Company, which is incorporated in New York. Transcript of Oral Argument, at p. 35 (Feb. 14, 1991).

> The issuer, having fulfilled its obligation to pay the distributions to the record owners, has no further obligations and is no longer a "debtor," and the unknown beneficial owners are not "creditors" of the issuer. Rather, the undisputed evidence demonstrates that the brokers, banks and depositories who are holding the unclaimed distributions are the debtors to the unknown creditors. Under the settled Supreme Court rule, where, as here, no address of the creditor is contained on the books of the debtor, the right to escheat belongs to the State of incorporation of such debtors.

Brief in Support of Motion of Delaware, at p. 29 (Oct. 30, 1990).

2. Texas, Alabama, et al.'s Position

The position of the 42 jurisdictions that subscribe to the views identified as those of Texas, Alabama, et al., takes issue with Delaware's conclusion that the intermediary brokers are the appropriate "debtors" for purposes of applying the backup rule of the Supreme Court's precedents to this case. Boiled to its essence, the legal theory of Texas, Alabama, et al., is that the state of domicile[13] of the issuer of a security that initially put the distributions into the stream of commerce should have the right to take custody of unclaimed distributions when the intended beneficiary cannot be located, and no last known address for that person is known. These jurisdictions maintain that this position is the logical interpretation of the backup rule

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13. In their original papers, Texas, Alabama, et al., relied on the issuer's state of incorporation as the appropriate locational test. Their most recent submissions (commenting on the draft report) suggest substantial agreement with the analysis set forth later in the present Report, finding that looking to an issuer's principal executive offices is more appropriate as a locational test. These states do adhere, however, to the view that it is the location (however determined) of the *issuer* that should control for purposes of applying the Court's backup rule.

of *Texas v. New Jersey* and *Pennsylvania v. New York*. In their view of the distribution system, the role of intermediaries is to serve convenience only; the intermediaries are simply way-stations in a system that distributes funds from the debtor (the issuer) to the creditor (the beneficial owner), and the happenstance of where along this route a holder realizes that the intended payee cannot be located should not be determinative for purposes of escheat law's application. See, e.g., Brief in Support of Motion of Alabama, et al., at p. 66 (Oct. 30, 1990); Brief in Support of Motion of Texas, at pp. 48-50 (Oct. 30, 1990). These jurisdictions would simply interpret the backup rule to look to the location of the issuer in the first instance, rather than to the location of the intermediary holding the unclaimed funds.

3. California, et al.'s Position

California, et al., do not attempt to fit their legal theory within the backup rule of *Texas v. New Jersey*. The argument of the jurisdictions adhering to this position, rather, is premised on basic fairness, relying upon on the structure of the Supreme Court's argument in fashioning the primary rule in *Texas v. New Jersey*, by looking to a rule that would tend to distribute the funds, over time, to jurisdictions in proportion to their commercial activities. California, et al., suggest that the backup rule of the prior cases was a rule of convenience only, and that here the equities call for adopting a new and different backup rule: "nothing in controlling law would have precluded the Court from itself reaching a similar result in the exercise of its equitable power, and the fact that the majority in that very different case chose a different option does not preclude the Court from selecting what here would be a fairer course." Reply Brief of California, et al., at p. 14 (Jan. 17, 1991). While the position of California, et al., does not precisely identify what the components of this new equitable rule should be, in general contours, the funds remaining after application of the primary rule would tend to be distributed, under the proposed approach propound-

ed by these jurisdictions, based on an assessment of where all the nation's security-holders lived, or brokers were located, or some similar aggregate surrogate for proportional distribution based on where beneficial owners live or do business.

B. Applicable Supreme Court Precedent

To begin to assess these various positions, it is necessary to return to a close analysis of the two principal cases in this area, Texas v. New Jersey, 379 U.S. 674 (1965), and Pennsylvania v. New York, 407 U.S. 206 (1972).

1. Texas v. New Jersey

In this case, Sun Oil Company, a New Jersey corporation, owed some $26,500 to approximately 1,730 small creditors who had never appeared to collect the funds owed, mostly because they had never claimed or cashed checks. Sun Oil admitted it had no interest in these funds. From among four different legal theories being advanced by the various states involved, the Supreme Court fashioned a basic rule for the distribution of the funds (which I am referring to in this Report as the "primary" rule). Pursuant to this primary rule, when intangible property is held by someone admittedly not its owner, it will escheat to the state of the last-known address of the "creditor." In the Supreme Court's words, "[w]e 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 681-82. In reaching this result, the Court was driven by two policies: (a) the appropriate state to claim primary escheat rights "should be determined primarily on principles of fairness," *id.*, at 680, and (b) resolution of the question "should be settled once and for all by a clear rule which will govern all types of intangible obligations like these and to which all States may refer with confidence," *id.*, at 678. Thus, "fairness" and "certainty" were the Court's announced reasons for adopting the rule it selected. The Court

rejected a "contacts" test, for example, principally on the grounds that it would be too uncertain, *id.*, at 678-79. Further, the Court rejected the idea of turning the funds over to the jurisdiction where the principal offices of Sun Oil were located, even though that state "is probably foremost in giving the benefits of its economy and laws to the company whose business activities made the intangible property come into existence," *id.*, at 680, because it would have the oddity of converting a liability into an asset and because it would produce uncertainty. In the Court's view, the rule it chose, allocating the funds to the state of the last known address of the creditor, "is more certain and yet still fair," *id.* Adoption of such a primary rule had the virtue of clarity, in that it "involves a factual issue simple and easy to resolve," *id.*, at 681, particularly in light of the Court's determination that such addresses were to be determined, not by de novo factual hearings, but by looking to "the debtor's books and records." This rule was perceived as fair as well, in that it "will tend to distribute escheats among the States in the proportion of the commercial activities of their residents," *id.*

Having announced this primary rule, however, the Court confronted the fact that this principle would not apply to all of the funds before it, because, in some instances, the last known address of the creditor was unknown (or was in a jurisdiction that did not provide for escheat of these kinds of funds). To handle these circumstances, the Court adopted a backup rule -- admittedly a "cleanup" doctrine -- namely, that in these cases the remaining funds would escheat to the state of corporate domicile, which the decree made clear meant New Jersey, the state of incorporation of Sun Oil.[14] In providing for this back-

14. The concept of using, as a locational surrogate, the principal place of business or the location of principal executive offices, although discussed in the context of the primary rule, was never discussed in the context of the backup rule as a possible alternative. Presumably, the arguments for and against these locational presumptions that the Court

up rule, the Court noted that "[s]uch a solution for these problems, likely to arise with comparative infrequency, seems to us conducive to needed certainty and we therefore adopt it," *id.*, at 682.

Before turning to the gloss on these rules provided by Pennsylvania v. New York, 407 U.S. 206 (1972), three points concerning the opinion in *Texas v. New Jersey* itself bear noting. First, while the Court was obviously concerned with fairness (as well as certainty) in selecting the primary rule, the backup rule seems to have been arrived at primarily because, as a rule to be used with relative infrequency (most cases being handled by the primary rule), it allowed the circle to be closed in a manner that provided easily-followed guidance to future cases, 379 U.S., at 682. While the Court noted that the primary rule seemed fair in the sense that it would tend to allocate distributions proportionately among the states over time, *id.*, at 681, there was no indication that the Court thought that the backup rule would necessarily be fair in the same sense. (This is not to say that fairness would not be relevant to the backup rule, only that, for a rule that would apply only occasionally, certainty dominated.)

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used in discussing their potential utility in the primary rule were thought, on balance, to weigh against their use as a locational presumption in the backup rule. In favor of such a kind of rule, the Court noted that looking to the state where the principal offices were located was "more persuasive" than the "minor factor" of using the state "in which the debtor happened to incorporate itself," because the state where the principal offices were located was "probably foremost" in providing benefits to the company "whose business activities made the intangible property come into existence," 379 U.S., at 680. Counting against such a locational presumption, in the Court's view, was that it "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." Such as case-by-case rule, the Court suggested, "should not be adopted unless none is available which is more certain and yet still fair," *id.*, at 680.

Second, although the Court made explicit reference to the location of the "creditors," and while it used the term "debtor" several times in the course of discussing the various options proposed by the parties, the Court did not use the term "debtor" when announcing the backup rule to be applied, nor did the decree it entered use that term. Rather, the Court referred to "escheat by the State of corporate domicile," *id.*, at 682, which the Final Decree (but not the opinion itself) makes clear is a reference to the state of incorporation of Sun Oil, Texas v. New Jersey, 380 U.S. 518 (1965).

Third, while the opinion treated the unclaimed funds as if they were funds held by Sun Oil that simply had never been claimed by the appropriate creditor -- in other words, treating this case as if it involved a rather simple "debtor-creditor" relationship, with no intermediaries involved -- the underlying report of the Special Master indicated that at least some of the funds were held, not by Sun Oil, but by various other entities.[15] The status of these banks, and their relationship to Sun Oil (as paying agents or other types of intermediaries), was nowhere explored in any particular detail.[16] For these reasons, *Texas v.*

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15. With respect to cash dividends, the Special Master found that the funds had been deposited for payment "in a special dividend account" in a bank and, after a two-year waiting period, "moneys to cover unclaimed dividends were transferred from the special dividend account to a general account of the Company," Report of the Special Master, *Texas v. New Jersey*, No. 13 Original, at 11 (Dec. 2, 1963). As for stock dividends, the Special Master found that "[t]he Chase Manhattan Bank . . . [was] Transfer agent and Fidelity-Philadelphia Trust Company . . . [was] Co-Transfer Agent for the transfer of shares of stock of the Company. Bankers Trust Company . . . [was] co-Registrar of the stock of the Company," *id.*, at 5. The Special Master also found that "stock scrip certificates were issued by the Company's transfer agent, Chase Manhattan Bank," *id*, at 12-13.

16. When asked about this at oral argument in the instant case, counsel for New York indicated that he did not believe that anyone had referenced a "record holder"; that there had been "no transfer of legal title."

New Jersey provides us with no express holding that Sun Oil remained a "debtor" for purposes of either state law or federal common law necessary to decide this case.

2. Pennsylvania v. New York

Pennsylvania v. New York, 407 U.S. 206 (1972), provided the Court an occasion to test the appropriateness and application of the backup rule in the context of a set of transactions where, relative to the primary rule of *Texas v. New Jersey*, it was likely to be used with comparatively greater frequency (although still quite infrequently when compared to the overall number of transactions, including those that were completed without a hitch). In this case, the typical facts involved a sender who would go to a Western Union office and provide for the transmission of funds (by a device such as a money order) to be forwarded to a payee and claimed at another Western Union branch office. The sender would give money to Western Union. Western Union would then notify the payee and, when the payee presented himself, would provide the payee with a negotiable draft, which the payee could either cash at once or keep for future use. If the payee could not be located, or failed to call for the draft within a short period, Western Union would then notify the sender of this failure to deliver and would refund the monies to the sender through a negotiable draft. As described in an earlier Supreme Court case involving these facts:

> In the thousands of money order transactions carried on by the company, it sometimes happens that it can neither make payment to the payee nor make a refund to the sender. Similarly payees and senders who accept drafts as payment or refund sometimes fail to cash them.

Transcript of Oral Argument, at p. 9 (Feb. 14, 1991). Whether this is true or not, is a matter that was of apparently no concern to the decision in *Texas v. New Jersey*.

> For this reason large sums of money due from Western Union for undelivered money orders and unpaid drafts accumulate over the years in the company's offices and bank accounts throughout the country.

Western Union Telegraph Co. v. Pennsylvania, 368 U.S. 71, 73 (1961). The Supreme Court applied the primary rule of *Texas v. New Jersey* without controversy, although the facts of *Pennsylvania v. New York* actually involved one twist in its application. Under the primary rule, the unclaimed funds held by Western Union were subject to escheat "by the State in which the records of Western Union placed the address of the creditor, whether that creditor be the payee of an unpaid draft, the sender of a money order entitled to a refund, or an individual whose claim has been underpaid through error," 407 U.S., at 213 (quoting from the Report of the Special Master). This recognized that both the payee and the sender had, under applicable state law, a superior claim to the funds over Western Union. In a case where neither the payee nor the sender could actually be found, but last-known addresses were potentially available, it is clear that one turned to the jurisdictions of these last-known addresses. Given the primacy of the payee, presumably one would look, first, to see whether there was a last known address of the payee (although nothing for present purposes turns on which last-known address was considered first). If there was, that state was entitled to escheat the funds. If that address was unknown, then one would look to see if there was a last-known-address of the sender; again, if there was, then that state would be entitled to escheat the funds.[17]

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17. At least, this would be true in most cases. It is less clear what would have happened in the case where Western Union had indeed delivered the money order to the payee, but the payee never cashed it. In those cases, where Western Union has completed its delivery obligations, it is less clear that it would have any obligation to rebate monies to the sender or, if the sender could not be found, to the sender's jurisdiction

In both cases, the Court referred to the unknown payee *as well as the unknown sender* as a "creditor" of Western Union, as is apparent from the quotation earlier in this paragraph.

In the case where the address of neither the payee nor the sender was contained in the records of Western Union, the Court adopted the Special Master's recommendation, which was that "the right to escheat or take custody shall be in the domiciliary State of the debtor, in this case, New York," *id.* In this context, the phrase "debtor" clearly referred to Western Union. This was perceived, by majority and dissenters alike, to be a straightforward application of the backup rule of *Texas v. New Jersey*. The majority noted that, under the facts of *Pennsylvania v. New York*, a greater percentage of the unclaimed funds would fall into the backup category because the addresses of the creditors (whether senders or intended payees) were more often unknown. Adherence to the backup rule would, therefore, lead to an admittedly larger percentage of the unclaimed funds going to the state of incorporation of the debtor, Western Union, *id.*, at 214. The majority opinion noted that application of the backup rule to these facts provided "some inconsistency" with the refusal in *Texas v. New Jersey* "to make the debtor's domicile the primary recipient of unclaimed intangibles," *id.* But the majority went on to say that "the likelihood of a 'windfall' for New York" was not "a sufficient reason for carving out this exception to the *Texas* [backup] rule," *id.* It noted that "the only arguable basis for distinguishing money orders is that they involve a higher percentage of unknown addresses. But we are not told what percentage is high enough to justify an exception to the *Texas* rule," *id.*, at 214-15. Thus, the majority refused to alter the backup rule, thus preserving the concept of certainty and avoiding the need "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," *id.*, at 215 (quoting

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of incorporation.

from *Texas v. New Jersey*, 379 U.S., at 679). Having decided to apply the backup rule, the Court simply used the locational presumption used in the backup rule in *Texas v. New Jersey* -- to wit, the state of incorporation of the only party that could be located, Western Union.

It was on the continued appropriateness of the backup rule so formulated that three members of the Court dissented. Noting that the decisionmaking in these cases "is fundamentally a question of ease of administration and of equity," 407 U.S., at 217, the dissenters thought that application of the backup rule of *Texas v. New Jersey* to a situation where most of the unclaimed funds would be escheated according to the backup rule rather than the primary rule was inconsistent with the driving "principles of fairness" underlying *Texas v. New Jersey*, *id.* The dissenters, instead, would have used, as a backup rule applicable to the facts of *Pennsylvania v. New York*, a focus on the state where the debtor-creditor relationship was established, *id.*, at 219-20, which the dissent also believed was likely to be the state of the creditor's domicile, *id.*, at 220.[18]

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18. The dissenters argued:

> This modification is preferable, first, because it preserves the equitable foundation of the *Texas v. New Jersey* rule. The State of the Corporate debtor's domicile is denied a "windfall"; the fund is divided in a proportion approximating the volume of transactions occurring in each State; and the integrity of the notion that these amounts represent assets of the individual purchasers or recipients of money orders is maintained. Secondly, the relevant information would be more easily obtainable. The place of purchase and office of destination are reflected in Western Union's ledger books and it would, therefore, be unnecessary to examine the innumerable application forms themselves.

407 U.S., at 220.

C. Discussion of the Backup Rule

1. The Proper Interpretation of the Supreme Court's Backup Rule

The position of Delaware (and, indeed, for present purposes, New York) is derived from a particular interpretive reliance on these two cases. The thrust of Delaware's and New York's position involves the following syllogism. First, the backup rule of *Texas v. New Jersey* looks to the state of incorporation of the "debtor." Second, the Court in *Pennsylvania v. New York* rather clearly refused to deviate from this backup rule, even in a case in which its application would not tend to distribute escheatable funds among the states in some equitable proportion, choosing certainty and ease of administration, at least for application of the backup rule, over some global sense of a fair distribution. Third, identifying who is a "debtor" and who is a "creditor" are matters to be determined by reference to state law. Fourth, in the instant case, an issuer is no longer a "debtor" after it makes a payment to an intermediary, a point Delaware asserts is a consistent conclusion of state law,[19] and evidenced by Uniform Commercial Code §8-207(1).[20] Instead, as a matter of state law, each stage in the distribution

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19. See, e.g., Tex. Bus. Corp. Act §1.02A(15) (1991) (shareholder means "the person in whose name shares issued by a corporation are registered at the relevant time in the share transfer records maintained by the corporation"); *id.*, §2.26(1) (the corporation "may regard the person in whose name any shares issued by the corporation are registered . . . as the owner of those shares . . . for purposes of . . . receiving distributions thereon"). Other state statutes are to a similar effect. See generally Model Bus. Corp. Act §7.07, p. 568 (3d ed. 1984).

20. U.C.C. §8-207(1) provides: "Prior to due presentment for registration of transfer of a certificated security in registered form, the issuer or indenture trustee may treat the registered owner as the person exclusively entitled to vote, to receive notifications, and otherwise to exercise all the rights and powers of an owner."

process is handled as a discrete step, involving a debtor and a creditor. Before the issuer makes a payment to an intermediary, the issuer is a "debtor" and the intermediary a "creditor," but once the payment has been made, that transaction is over, and the issuer is now out of the equation. For the next stage in the distribution system, the intermediary now becomes a "debtor"[21] who owes the funds to another intermediary further down the distribution line (or to the beneficial owner) -- who then becomes the "creditor." See, e.g., Brief in Support of Motion of Delaware, at p. 24 (Oct. 30, 1990).

Texas, Alabama, et al., essentially focus their criticism on the position of Delaware and New York by turning to the final step in this syllogism and arguing, fundamentally, that the attempt to construe the securities distribution system as a series of discrete "debtor-creditor" transactions incorrectly identifies the nature of the property, rights, and transactions involved. Rather, these states argue, the securities distribution system is best conceived of as a system that, for convenience sake, has a number of intermediaries, but that these intermediaries have no real claim or status, at least for purposes of applying federal common law, such as the escheat (or custodial taking) rules applicable to claims of competing states. See, e.g., Brief in Support of Motion of Texas, et al., at p. 47 (Oct. 30, 1990); Brief in Support of Motion of Alabama, et al., at pp. 59-60 (Oct. 30, 1990). As the intermediaries perceive themselves, their principal role is to facilitate the flow of securities and funds, and thereby "preserve the [intermediary's] transparency as an element in the chain of communication between corporate issuers and the beneficial owners of their securities," DTC,

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21. While its argument posture requires Delaware to characterize the intermediary holding funds as a "debtor," there is no contention that there is any source of a "debt" other than the intermediary's holding of funds essentially as a bailee: The intermediary has no independent ownership claim to the funds in question.

SHAREHOLDER COMMUNICATIONS AND THE DEPOSITORY TRUST COMPANY 3, 6 (2d ed.) (DeCesare Dep. Ex. 17). Finally, according to these jurisdictions, U.C.C. §8-207(1) provides no more than an affirmative defense, not an indication that, for state law (much less federal common law) purposes, the flow of securities must be broken into a series of discrete transactions.

Approached on these terms alone, the position of Texas, Alabama, et al., raises some fundamental difficulties. Even though the distribution system's use of intermediaries may have originated as a matter of convenience, it may also make substantial sense for state law to seek to protect entities that have paid funds to record owners from the claims of beneficial owners that the funds were never received. As noted in the 1990 commentaries by the Permanent Editorial Board (PEB) to the Uniform Commercial Code, "[s]uch protection is clearly necessary, since, in the vast majority of cases, the issuer would have no knowledge that a transfer had been made or know the identity of the purchaser. Inherent in this scheme is that a distribution to the registered owner will relieve the issuer from any liability to the [subsequent] purchaser for the same distribution. Without that protection, no issuer could safely make any distribution without requiring the surrender, or exhibition, of the security by the distributee -- a patently impractical requirement." PEB Commentary No. 4 (discussing U.C.C. §8-207). Thus, there seem to be sensible reasons why, for many purposes of state law, the distribution system is broken down into a series of relatively discrete steps.

It does not, however, ineluctably follow, as Delaware and New York would have it, that, because practical realities require state law rules that protect issuers from claims that would require them to pay twice, rules governing competing custodial claims of states necessarily follow in the footsteps of those rules. While federal common law rules, such as the Supreme Court's rules governing the resolution of conflicting claims of escheat, cannot (and should not) operate in a vacuum, ignoring all state-

law rules, it does not follow that the federal law must track one particular manifestation of a state law rule. State law defines the *substance* of what is happening, and federal common law responds to the part of that substance *that is relevant to it.* See Connecticut v. Massachusetts, 282 U.S. 660, 670 (1931) ("The determination of the relative rights of contending States . . . does not depend upon the same considerations . . . that are applied in such States for the solution of similar questions of private right"); see also Mississippi Band of Choctaw Indians v. Holyfield, 490 U.S. 30, 43 (1989). But the effect of issuer protection provisions such as U.C.C. §8-207(1), whether conceived of as substantive rules or affirmative defenses, is not, even under state law, a declaration that *ownership* of the funds in issue shifts from issuer to intermediary to beneficial owner. Issuers are acquitted of a responsibility but the intermediaries do not necessarily acquire the rights of owners at that point; indeed, it is this understanding that sets in motion the very possibility of escheat. For whatever the characterization of U.C.C. §8-207(1) -- and as a matter of effect, its impact seems rather clear -- it is also rather clear that no one, least of all the intermediaries, considers the intermediary holding these funds as possessing an "asset" that would properly be reflected on a balance sheet in the sense of being a positive factor in establishing the intermediary's corporate worth.[22]

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22. Thus, "[a]ssets are financial representations of economic resources -- cash and future economic benefits -- the beneficial interest in which is legally or equitably secured to a particular enterprise as a result of a past transaction or event affecting the enterprise." FINANCIAL ACCOUNTING STANDARDS BOARD, OBJECTIVES OF FINANCIAL REPORTING AND ELEMENTS OF FINANCIAL STATEMENTS OF BUSINESS ENTERPRISES 20 (Exposure Draft 1977). (The wording, but not the effect, was revised in FINANCIAL ACCOUNTING STANDARDS BOARD, ELEMENTS OF FINANCIAL STATEMENTS OF BUSINESS ENTERPRISES 8 (Exposure Draft 1979).)

This suggests that, even if one believes that the Supreme Court's precedents require determination of an actor's status as "debtor" or "creditor," these terms may not be as obviously self-defining as Delaware and New York assume. Before making the payments, the issuer may in some contexts be seen as a debtor, in the classic sense that it owes the funds to someone (e.g., interest on bonds or dividends on some preferred stock), but it may be inappropriate to consider the intermediaries as creditors, in the ordinary sense of the concept. In applying these labels for the narrow purposes of escheat law, it is important that the particular context be considered.[23]

Such a focus on who is the beneficial owner is manifest in other areas of the law as well. For example, 11 U.S.C. §541(a)(1) includes as "property of the estate" for purposes of bankruptcy all the debtor's "legal or equitable interests" in property, while 11 U.S.C. §541(b)(1) excludes from the definition of property of the estate "any power that the debtor may exercise solely for the benefit of an entity other than the debtor." See also 124 CONG. REC. H. 11,114 (Sept. 28, 1978); S. 17,430 (Oct. 6, 1978): "Thus, where the debtor held only legal title to the property and the beneficial interest in that property belongs to another, such as exists in the case of property held in trust, the property of the estate includes the legal title, but not the beneficial interest in the property."

23. Mississippi Band of Choctaw Indians v. Holyfield, 490 U.S. 30, 43 (1989); Connecticut v. Massachusetts, 282 U.S. 660, 670 (1931); cf. Standard Oil Co. v. New Jersey, 341 U.S. 428, 441 (1951) ("The fact that New Jersey has adopted the Uniform Stock Transfer Act with its provisions for the transfer of shares and the replacement of lost certificates is, we think, without a bearing on the problem of the power to escheat"). Even in particular areas of state law, the terms "debtor" and "creditor" do not always mean the same thing or point to the same person or entity. See, e.g., U.C.C. §9-105(1)(d) ("Where the debtor and the owner of the collateral are not the same person, the term 'debtor' means the owner of the collateral in any provision of the Article dealing with the collateral, the obligor in any provision dealing with the obligation, and may include both where the context so requires").

There is no reason to believe that the Supreme Court was using these terms in any specific state-law sense in its prior escheat opinions. Rather, the words appear to be used as shorthand terms to identify (sometimes, but not always) readily the only potentially relevant parties for the issue -- application of escheat law among contesting states -- before the Court.

As this Report has already noted, the Court, in establishing the backup rule in *Texas v. New Jersey*, did not itself use the term "debtor." And while it did use the term "creditor," the Court used the term to refer to the only party further in the distributional chain that was identified at all -- the beneficial owner. Moreover, as also noted, several categories of distributions in that case were actually held by intermediary banks and paying agents rather than Sun Oil, but the Court did not on that account launch into an inquiry as to whether Sun Oil remained a "debtor" or not. Perhaps most persuasive as an indication that caution is required in using these labels, is the Court's use of the terms "debtor" and "creditor" in *Pennsylvania v. New York*. When a sender transmitted funds to Western Union, it is rather clear that Western Union did not thereby become the owner of the funds, in the sense of obtaining any beneficial right to them. Instead, Western Union may have borne nothing more than a contractual *obligation* with the sender to deliver the funds. In short, it would be possible to view Western Union as a bailee for hire -- an agent of the sender -- and not as a debtor in a transaction where the sender was the creditor.[24] If there was a debt underlying the transaction, the sender remained the payee's debtor until the obligation that was the subject of the

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24. When the liability of one arises from a fiduciary or in the nature of a trust, "the creditor has become, not the debtor of his debtor, but the trustee of a specific trust," Lehigh Valley Coal Sales Co. v. Maguire, 251 Fed. 581, 582 (7th Cir. 1918) (set-off case). A similar conclusion would follow in the case of principal-agent.

money order was satisfied.[25] Upon its failure to turn the funds over to the payee, Western Union then was required to return the funds to the sender, either on restitutionary grounds or on the basis of a principal-agent relationship. In either event, strict application of debtor-creditor terminology would not be appropriate.[26]

All this is by way of saying that the Court's use of the terms "debtor" and "creditor" in *Texas v. New Jersey* and *Pennsylvania v. New York*, seems to be more descriptive -- an attempt to identify the relevant parties -- than prescriptive legal commands, carrying the kind of definition one might find, for example, in the Uniform Fraudulent Transfer Act.[27] It seems to me that the Court's use of these terms was not intended to send courts (or Special Masters), in subsequent cases, in search of

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25. As noted by Texas, not all cases involving Western Union even had the sender as a "creditor" on account of an antecedent debt owed to the payee. Brief in Opposition of Texas, at p. 19 (Dec. 18, 1990). The sender could have been making a gift via Western Union in a transaction that did not give rise to nor respond to contractual liability of the sender to the payee. In these cases, admittedly the terms "debtor" and "creditor" could only be generically descriptive, not literal or legally significant.

26. I posed this question to counsel for Delaware at the time of the oral argument on these motions, and counsel essentially agreed there were limits on the ability to rely on a "literal" interpretation of the word "debtor" in this case. See Transcript of Oral Argument, at p. 27 (Feb. 14, 1991) ("I take your point and I think I would agree with you. The point I was trying to make is in the first instance of being literal, you have to understand what the Supreme Court was trying to say about *Texas v. New Jersey*. And it was using certain words certainly in some contexts in their literal way. It might have been better had they said rather than creditor, more precisely those persons who on any ground the holder owes the property to under some recognized legal theory. . . . That might have been a more complete analysis. I think they shorthanded it to that extent by calling them all creditors and all debtors.").

27. See, e.g., U.F.T.A. §1(4) ("creditor"); §1(6) ("debtor") (1984).

particular state-law definitions of "debtor" and "creditor" (which may, in any case, vary somewhat from state to state and context to context). Rather, it seems far more plausible that the Court intended by use of these terms to ask future courts (and Special Masters) to search for parties with relevant *attributes*, for purposes of escheat jurisprudence (not for other bodies of law, such as tax law or state debtor-creditor law), of the parties denominated "creditors" and "debtors" in these two opinions.[28] Cf.

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28. This is not to say that the issue is necessarily one to be resolved by federal common law, without reference to what state law has decided. In general, there are reasons for federal common law rules to track state law rules, absent a federal reason for a divergent rule. See *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 718 (1979) ("We conclude that the source of law is federal, but that a national rule is unnecessary to protect the federal interests. . . . Accordingly, we adopt state law as the appropriate federal rule. . . ."). But, unlike the case in *Kimbell Foods*, here the federal rule is not attempting to fit the federal government into a state debtor-creditor regime, where there are obvious advantages to having the rules by which the federal government's priority as creditor is determined parallel the rules by which private creditors' priorities are determined. Here, however, the question is one of escheat law, which has no private analogue; whatever rule the Court adopts will not interfere with the method by which securities are distributed. Resolution of this escheat-law question is to be determined principally on the equitable basis of fairness and ease of application. While an escheat rule that disregarded state law notions of beneficial ownership and the like would be troublesome, that is not the issue that is in dispute in this case. Instead, the issue is which state-law attributes are relevant for determining fairness and ease of application in the special context of escheat law rules. None of this requires federal law to supplant state law. Rather, it simply requires that the federal common law rule adopted by the Court be one that, on fairness and consistency terms, is defensible in terms of the attributes that state law gives to the property in question. Given that these attributes, at least in the present case, do not include beneficial ownership claims by the intermediaries, it is of no consequence whether state law refers to the relationships as those of "debtor-creditor," or "principal-agent," or, indeed, views the transactions, for state law purpos-

Mississippi Band of Choctaw Indians v. Holyfield, 490 U.S. 30, 43 (1989) (purpose of a federal statute considered in deciding what effect to give terms; the term "domicile" in that statute held not a reference to state law definitions).[29]

The question then becomes: "What are the relevant attributes?" One attribute seems to dominate both as a matter of logic and as a matter of the internal structure of the Court's prior cases. A legal right to the funds, as beneficial "owner," under whatever basis, makes one a "creditor." Thus, the beneficial owners in Sun Oil's case, having a legal right to the funds, were "creditors." So, too, were the payees in the Western Union case, whether the underlying transaction involved the *creation* of a debtor-creditor relationship, the *satisfaction* of a claim, or a *gratuitous transfer*.[30] Finally, so, too, were the senders in the Western Union case, in instances where the payees could not be found. Whether technically creditors under applicable state-law definitions, it is undisputed that the senders in those cases had a legal right to a return of the funds from Western Union for their beneficial use, and thus fit within the Court's descriptive use of that term.

Less clear, however, are the relevant attributes meant to be captured by these terms when there is no identifiable beneficial owner at that point in time. The term "debtor" could refer to an entity that, at a particular point in time, had a legal obli-

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es, as a series of discrete transactions or as parts of one larger transaction.

29. Indeed, in *Texas v. New Jersey* itself, the Court noted that it did not intend to use "technical legal concepts of residence and domicile," 379 U.S., at 674. It would be unusual to think the Court, simultaneously, intended to use technical, state law definitions of terms such as "creditor."

30. In the gift circumstance, the payee's rights to the payment may have been exclusively against Western Union, and subject to the sender canceling the money order before its delivery or negotiation.

gation to turn the funds over to the "creditor." This would point to the position of Delaware and New York in the present case, although I should note that it is not clear that such a concept would accurately have described the position of Sun Oil in every instance in *Texas v. New Jersey*, given that some of the funds were held by third parties or had not been claimed for decades (which may have relieved the issuer of any obligation to turn over funds to the original claimant).

But the Court's use of the term "debtor" could also descriptively refer, under these circumstances, to the last owner of the funds, in the sense of the last person who had a claim to the funds as an asset that would appropriately be reflected in the net worth of the entity in question. This would be Sun Oil in *Texas v. New Jersey* and it would be the issuer in the instant case. What about Western Union in *Pennsylvania v. New York*? It never had any claim to the funds as an owner, but it turned out to be the possessor of the funds in a world in which there is no "owner" of the funds, in the sense I am using it here, to be found, whether present or past. This interpretation would largely point to the position of Texas, Alabama, et al., in that it would fit rather tightly with their concept of the "originator" of the funds (in the sense that the originator would be considered to be the last locatable entity with an ownership claim to the funds). (Similarly, the term "creditor" could be analyzed in the same way.)

Neither interpretation seems to me to be deduced ineluctably from the prior Supreme Court cases, because the facts and issues presented did not require a choice between these two interpretations.[31] In *Texas v. New Jersey*, the Court in essence

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31. 12 U.S.C. §2503 rejected the use of the backup rule in *Pennsylvania v. New York* on its specific facts and, instead, substituted a rule that distributed the funds to the jurisdictions in which the Western Union office was located where the sender purchased the money order, by providing that, where the books and records of the organization reveal

where the money order, traveler's check, or similar written instrument was purchased, "that State shall be entitled exclusively to escheat or take custody of the sum payable on such instrument . . . ." Even if one were inclined to view this as a general expression of Congressional policy to which the Court, in its essentially equitable process, should give heed, see Moragne v. States Marine Lines, Inc., 398 U.S. 375, 392 (1970); United States v. Hutcheson, 312 U.S. 219, 235 (1941), it is less clear exactly what message the Court is supposed to extract out of this Congressional act. To be sure, that statute, picking up on the dissent in *Pennsylvania v. New York*, recognizes that the originator's state of domicile has a significant right to custody of the funds. Indeed, in the preamble to the statute, 12 U.S.C. §2501 provides that "Congress finds and declares that . . . (3) the States wherein the purchasers of money orders and traveler's checks reside should, as a matter of equity among the several states, be entitled to the proceeds of such instruments in the event of abandonment . . . ." See also S. Rep. No. 93-505, at 3 (1973) (letter from Federal Reserve Board Chairman Arthur Burns, stating that "[t]he bill focuses not upon the State of the last known address of the creditor, but upon the State where the debtor-creditor relationship was established").

In light of 12 U.S.C. §2503 and the Supreme Court's decisions in its two principal cases, one could attempt to extract the following general approach. The "primary rule" has the funds going to the custody of the state of the intended payee, where an address for the payee can be found. The "secondary rule," as expressed by Congress, could then provide that if there is an address for the originator but not the payee, the originator's state is entitled to custody of the funds. And, when there is no address for either the payee or the originator, the statute effects a presumption that, for money orders and traveller's checks, the state of the purchase is the originator's domicile, and that state is entitled to escheat the funds.

Having said that, however, it is questionable to adopt from one instance of legislative action, a general backup policy. For one thing, it is quite possible to read the effect of Congress' action as simply that of adopting a presumption for locating the domiciliary state of a "creditor" -- a presumption that is unnecessary in the instant case. Second, if one takes Congress' action as making appropriate a change in the backup rule, then the Court may also need to look at this Congressional action to see if it requires changing locational focus from jurisdiction of incorporation (used by the Court in its cases) to principal place of business

looked to the principal concerned parties and virtually treated the case as if there were no intermediaries; while the parties had briefed and the Special Master had reported on the various levels of intermediaries handling the payments, the case, for all intents and purposes, was decided as if it were a two-party case involving, simply, an issuer and a beneficial owner. And, in *Pennsylvania v. New York*, at least for purposes of applying the backup rule, while there was an intermediary in "possession" of the funds (Western Union), there was no prior owner (or originator) that could be located. Thus, in neither case was the Court faced with a need to choose between two distinctive uses of either the term "debtor" or the term "creditor."

This case, however, presents just such a need. The parties have focused their attention on the term "debtor" in the context of the backup rule, and this Report will start with that focus. As for a choice between Delaware's and New York's interpretation, on the one hand, and Texas, Alabama, et al.'s interpretation, on the other hand, neither interpretation seems to be preferable on grounds of certainty, which I think it is fair to say has been the Court's dominant policy in setting up and

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(used by Congress). More decisively, one can view Congress' intervention not as an expression that this solution is the "fairest" in the abstract, or in the context of other cases, but that it is the fairest in the context of the case Congress was considering. If one views Congress' primary concern as "being fair," one has no way of knowing, in this case, whether Congress would have sided with (among other possibilities) the position of Texas, Alabama, et al., or the position of California, et al. Indeed, California, et al., takes substantial comfort from the action of Congress in bolstering *their* position in this case, Reply Brief of California, et al., at pp. 13-14 (Jan. 17, 1991).

The point of this analysis is not to suggest that the Congressional action in response to the decision in *Pennsylvania v. New York* cannot be used to support the position of Texas, Alabama, et al. -- indeed, it seems to support that position more than the position of Delaware -- just that it is dangerous to read too much, for present purposes, into this Congressional action.

interpreting the backup rule. For this reason, it seems appropriate, and consistent with the spirit of both *Texas v. New Jersey* and *Pennsylvania v. New York*, to use fairness as the tie-breaker in deciding which interpretation to give to this backup rule. And, as a matter of fairness, I see the position of Texas, Alabama, et al., as having the greater claim.

The reason for this is not principally that adoption of the Texas, Alabama, et al., approach would necessarily tend to distribute the funds more "evenly" among states.[32] To be sure, assuming the parties are self-interested, their alignment in this case might permit one to assume that they believe this would be the result, but it seems inappropriate speculation at this point to try to base a decision as between two interpretations on an assumption that this necessarily will be so. A more durable consideration is the notion of rewarding the jurisdiction that has a claim to benefitting the "company whose business activities made the intangible property come into existence," *Pennsylvania v. New York*, 379 U.S., at 680. Returning the funds to the jurisdiction where the funds came "into existence" when the beneficial owner's jurisdiction cannot be determined, even with the assistance of the last known address presumption, makes sense in all cases, and is particularly appealing in the case of unclaimed payments on municipal obligations. A municipality will always be "incorporated" under the laws of its state, as well as otherwise be "located" there. And as to all issuers, municipal or not, it seems highly appropriate when funds unclaimed by beneficial owners (or their states) become subject to escheat, that they should be escheated by the state in which the issuer

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32. This approach may well lead to an equitable distribution of funds among states, under almost any view, if the Court were to reconsider, as this Report will recommend, how location is determined in the corporate context. See *infra*, pp. 40-50.

ran its business and generated the funds. Only a rule that looks to the "location" of the issuer will provide this result.[33]

This is not to denigrate the role played in the securities distribution system by the intermediaries, but only to note that it is largely happenstance where escheatable funds will get "stuck" at a particular brokerage house or similar entity. According determinative significance to the location of the intermediary seems inconsistent with the notion of making the intermediaries as "transparent" as possible. Indeed, such a rule would be prone to reward the state of incorporation of an intermediary whose records (or lack thereof) created the problem that resulted in the escheatable property in the first instance.

Nor does an interpretation of the backup rule that first looks to the location of the issuer seem inconsistent in any way with the decision in *Pennsylvania v. New York*, where the backup rule gave the funds to New York, the jurisdiction of incorporation of Western Union. This is not because "intermediaries such as Western Union have a far greater connection to the property than do securities industry intermediaries to unclaimed distributions," as Alabama, et al., argue, Reply Brief of Alabama, et al., at p. 10 n.11 (Jan. 17, 1991).[34] Rather, it is be-

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33. It is true that issuers today expend no effort to reclaim unpaid dividends from intermediaries (at least after the paying agent stage). Even if legally entitled to do so, however, there would be no financial incentives to make such efforts. Under longstanding case law such as Standard Oil Co. v. New Jersey, 341 U.S. 428 (1951), any funds reclaimed by the issuer would eventually escheat to the issuer's home state.

34. Indeed, I find this proposition dubious. It is true, as that brief notes, that "the very service that an entity such as Western Union sells is the transmission of funds," *id.* But this does not seem to distinguish Western Union's role very decisively from that of the brokers in the instant case. Indeed, the brokers may well perform other services as well, and it may be easier to say that the brokers have a greater, not lesser, connection to the transmission than did Western Union. The essential point, however,

cause, under the rather unique facts of the *Pennsylvania v. New York* case, there was no other entity that could be identified as having *any* claim to the funds, either presently *or* in the past. Short of creating another, "second generation," presumptive rule to identify the state of domicile of either the sender or the payee, Western Union's jurisdiction of incorporation had the best claim to the funds, simply because Western Union was in possession of the funds. That, however, is not the situation in the current case, where the prior owner of the funds -- the issuer -- can be identified.[35] In that respect, this case parallels *Texas v. New Jersey*. Adoption of the proposed interpretation here would mirror the (undiscussed) handling of the agents or intermediaries in *Texas v. New Jersey* -- they become (almost) transparent. The principal distinction between the present case and *Texas v. New Jersey* is that the percentage of funds in the backup rule category are significantly larger here. But that

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is that the brokers, like Western Union, are indeed intermediaries, without claims of their own to the funds.

35. It is for this reason that Delaware's attempt to use *Pennsylvania v. New York* to support its position is misleading at best. In its Brief in Support of Motion of Delaware, at pp. 22-23 (Oct. 30, 1990), it argues: "Certainly the purchasers of a money order in Pennsylvania for transmission 'created' it for the 'benefit of' the intended recipient of the money order and not for the intermediary, Western Union. But, the Supreme Court in *Pennsylvania v. New York* held that Pennsylvania could not escheat the money order, and that New York, as the State of incorporation of Western Union, could. So here, the State of incorporation of the issuer (*e.g.*, Texas) which 'created' the distributions for the 'benefit of' the beneficial owner is not entitled to escheat." But it is wrong to say that *Pennsylvania v. New York* held that Pennsylvania could not escheat funds. It appears to be recognized several times in the majority and dissenting opinions, and not contested by any of the parties in this case, that where the state of location of a purchaser of a money order is ascertainable, the unclaimed funds were appropriately claimed, under the primary rule of *Texas v. New Jersey*, by that state.

particular distinction *was* the one considered, and rejected, in *Pennsylvania v. New York.*

Thus, in interpreting the Court's precedent in shaping the backup rule, I extract two principles applicable to this case. First, debtor-creditor references should not be taken to refer to particular state-law regimes and their varying concrete definitions in different contexts. Such an interpretation of the use of this terminology is strained at best, and results in incongruous identification as debtors and creditors of entities who may have no ownership claims to the property in issue. A more coherent understanding of these terms requires a focus on the principals in a transaction, especially intended recipients and prior owners of the funds being distributed and the existence of a relationship between them. Second, it is more consistent with the precedent to support escheat (or custodial taking) by the jurisdiction that was connected with the entity that was the originator of the transaction (or the original owner of the funds) over the jurisdiction that was connected with the entity that simply holds the funds at the time no further distributions are possible.

The result proposed here is consistent with even earlier Supreme Court escheat law rules. In *Texas v. New Jersey*, Justice Stewart's dissent argued that the majority opinion overruled three prior Supreme Court cases, Standard Oil Co. v. New Jersey, 341 U.S. 428 (1951), Anderson Nat. Bank v. Luckett, 321 U.S. 233 (1944), and Security Savings Bank v. California, 263 U.S. 282 (1923). In each of those decisions, the Court had allowed the jurisdiction in which the issuer was incorporated to escheat unclaimed funds. These cases did so, however, in contexts where no other state (such as the jurisdiction where the beneficial owner was located) was claiming a superior right to escheat -- a matter pointedly noted by the Court in the *Standard Oil Co.* case ("[t]he claim of no other state to this property is before us . . . ," 341 U.S., at 443). See also *Texas v. New Jersey*, 379 U.S., at 682 n. 13 ("none of this Court's [prior] cases allowing States to escheat intangible property decided the possible effect of conflicting claims of other states"); Connecti-

cut Mut. Life Ins. Co. v. Moore, 333 U.S. 541, 548 (1948) ("[t]he problem of what another State than New York may do is not before us"). And while the Court in *Texas v. New Jersey* ultimately *preferred* the jurisdiction where the intended recipient was domiciled as the primary rule, enough to create a "last known address" presumption for that purpose, it is equally true that these prior cases suggest a *right* to escheat by the jurisdiction where the issuing corporation is located that is consistent with the position of Texas, Alabama, et al.

Finally, a focus on the location of the issuer is simple and inexpensive to implement, since the identity of the issuer is evident throughout. Indeed, the various banking and brokerage industry entities from whom discovery has been taken in these proceedings have indicated that they record distribution payments largely by issuer and attempt to reconcile their accounts on that basis. See, e.g., Wellener Dep., at 65, 68. The payments, moreover, are uniquely identified by a "CUSIP" identification number for the security involved. *Id.*; DeCeasre Dep., p. 64; Cerrito Dep., pp. 86, 90. Thus, there is already an identification of the security (and hence the issuer) as the securities distribution industry now operates. No substantial additional bookkeeping or computer activity would be required if the backup rule looked to the issuer's location.[36]

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36. The claims of California, et al., Response Brief in Opposition of California, et al., at pp. 26-27 (Dec. 18, 1990), about administrative burdens ring hollow in light of the existing databases from which the CUSIP numbers and other existing information about the payments could be "translated" into the identity of the issuer of the security, and then to appropriate references for purposes of identifying the state of incorporation for or state of the chief executive offices of that entity.

The primary rule looks to the location of beneficial owners. These beneficial owners, of course, may be in any of the 50 states or the District of Columbia. New York requested consideration at oral argument of an affidavit dated February 12, 1991 by Louis LaRocca, head of the "Dividend Division" of the Securities Industry Association. The

To this point, I have focused on the wisdom of interpreting the backup rule to look to the location of the issuer, instead of the location of the intermediary possessing the funds, at least in cases where the issuer can be located. It is also important to emphasize, however, that the backup rule actually has two

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apparent purpose for submission of this affidavit is to suggest that distribution of unclaimed property to all jurisdictions is more burdensome than turning it all over to one state, say New York. On the other hand, the affiant speculates that upon becoming familiar with the various jurisdiction's escheat procedures, it is "probably correct" that most securities firms could easily match records of entitled recipients to the specific states. The affidavit fails to recite the basis of any personal knowledge the declarant may have about the recordkeeping or perceived burdens of the security industry's members, and hence is entitled to little weight. More importantly, however, it is obvious that when *beneficial owners'* last known addresses are spread nationwide, the industry can and should be making remittances to those states. It appears that they are in fact doing so. See Shearer Deposition, July 20, 1990 at 357-58; Affidavit of John Happersett, January 28, 1991, at ¶ 4. Doing the same for *issuers* could entail no greater burden; indeed, it almost certainly will entail less of a burden, given that the number of issuers is far smaller than the number of beneficial owners. Moreover, New York's argument here is unusually close to the aggregation argument that New York and Delaware sharply criticize California, et al., for; to wit, that it is administratively difficult to track unclaimed funds issuer-by-issuer, thus, one should look for a yet-easier solution.

In any event, in an industry that depends on computerization for its numerous transactions, it is difficult to believe that the administrative differences between these two possible approaches to the backup rule should drive the selection of the appropriate rule. They are, at best, differences of minor degree, not of kind. And while ease of administration is a legitimate concern in fashioning a rule for these cases, it would be odd to deem any extra effort needed to coordinate turnovers to 51 jurisdictions to be a commensurate consideration with the goal of having the funds reach the correct locale. With respect to issuers, therefore, as is true with respect to identified beneficial owners with a last known state of location, New York's position reduces, in one sense, to the feckless view that it is easier to escheat all funds to a single state.

components. The first, which I am recommending as the appropriate construction of precedent, is a focus on the location of the *issuer* instead of a distributing intermediary in cases where the Court's proxy for location of the beneficial owner -- last known address as shown on the relevant party's books and records -- has failed to produce an appropriate jurisdiction for purposes of applying escheat law. The second part, the continued appropriateness of which seems to me dubious, is the use of the state of incorporation as the *proxy for location* of the issuer (or other relevant party).

In using the primary rule, location of the intended beneficiary is to be determined by looking to a last known address; in particular, the beneficiary's address as shown on the issuer's books and records. In applying the backup rule, location has been determined, in previous cases, by looking to the jurisdiction of incorporation. As a matter of logic, this surrogate is not compelled; it could as easily be the location of the principal executive offices or principal place of business. The Court, however, previously declined to adopt a principal office or place of business alternative, even though it viewed arguments for the approach "in some respects . . . more persuasive," on the ground that it "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," *Texas v. New Jersey*, 379 U.S., at 680. Thus the Court found that convenience indeed outweighed fairness concerns in this respect and used the jurisdiction of incorporation as a ready surrogate for purposes of applying this rule.[37]

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37. Congress, in responding to *Pennsylvania v. New York*, preferred to use the "principal place of business" rather than "state of incorporation" for purposes of applying its "backup" rule, 12 U.S.C. §2503(2). Inferentially, this was for the reasons (including greater fairness) expressed by Federal Reserve Board Chairman Arthur Burns in his letter to the Senate Committee chair, S. REP. NO. 93-505, at 4 (1973). No party has argued, however, that Congress' preference in that instance for a princi-

I do not believe this concern is warranted today in the context of the distribution on securities, however justified it was in 1965. Since 1965, we have had substantial experience with rules that look to the debtor's chief (or principal) executive offices as a locational test in matters involving intangibles, most notably in U.C.C. §9-103(3),[38] which governs filing rules for

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pal place of business rule should oblige the Court to reconsider the use of its state of incorporation rule; one that was adopted for reasons of judicial convenience. But it may be one reference point about a general change in the body of law and legislation since 1965 that the Court *may* want to consider. See *infra*, pp. 42-44; Moragne v. States Marine Lines, Inc., 398 U.S. 375, 392 (1970).

38. U.C.C. §9-103(3)(b) provides that "[t]he law . . . of the jurisdiction in which the debtor is located governs the perfection and the effect of perfection or non-perfection of the security interest." U.C.C. §9-103(d) then provides that "[a] debtor shall be deemed located at his place of business if he has one, at his chief executive office if he has more than one place of business, otherwise at his residence." In cases where the debtor has only one place of business, it is of course going to be the case that the jurisdiction of the place of business and the jurisdiction of the chief executive offices will be one and the same. Thus, for businesses, this test reduces to one that looks to the chief executive offices, Coogan, *The New UCC Article 9*, 86 HARV. L. REV. 477, 556 (1973). In 1978, the Uniform Commercial Code created a distinct test for "uncertificated securities," which looks to "the jurisdiction of organization of the issuer," U.C.C. §9-103(6). I point to the U.C.C.'s rule, however, not because its purpose is close to that governing escheat law -- indeed, it seems dubious to think it is -- but that the presence and durability of U.C.C. §9-103(3) indicate the relative ease of application of a test that looks to the chief executive office. See also 26 U.S.C. §6323(f) (1991) (tax liens are to be filed in the jurisdiction of a business' "principal executive office"; a choice made because this office is "the most readily identifiable of all the offices that a business may maintain," thus avoiding uncertainty, S. REP. NO. 1708, 89th Cong., 2d Sess. 11 (1966).)

security interests in accounts and intangibles.[39] In 1965, Article 9 was enacted in only a handful of jurisdictions; today, it is in place in every jurisdiction except Louisiana. And it has proved to be a rule relatively easy to apply, in a demanding domain of the law where precision and ease of determination are essential to the smooth operation of the filing system.[40] The durability of this rule suggests that the convenience of using the state of incorporation over a principal executive office test is marginal at best.[41]

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39. Indeed, this rule is, from time to time, offered as superior to the collateral's physical location for filing rules in tangible goods as well, Coogan, *supra* note 38, at 533-34, 557-58.

40. See *In re* J.A. Thompson & Son, Inc., 665 F.2d 941, 950 (9th Cir. 1982). There are, of course, exceptions. For one dealing with a "which county" rule in deciding where a debtor was located, see Uniroyal, Inc. v. Universal Tire & Auto Supply Co., 557 F.2d 22 (1st Cir. 1977). These cases, however, are relatively few, particularly at the statewide filing level; moreover, to the extent they are "to some extent subjective," S. D'Antoni, Inc. v. The Great Atlantic and Pacific Tea Co., 496 F.2d 1378 (5th Cir. 1974) (federal tax lien statute), the residual uncertainty can be substantially reduced by looking to standard sources, such as SEC filings, as the text discusses next.

41. CUSIP numbers will identify an issuer. Its principal executive offices should then be virtually as easy to determine as its jurisdiction of incorporation. As this Report suggests in text, it is sensible to use the information provided in filings with the Securities Exchange Commission ("SEC"), which will, for issuers subject to such filings, reduce to the vanishing point factual disputes over the location of principal executive offices. For the remainder of the (generally smaller) companies that do not make SEC filings, standard databases, for example, routinely provide headquarter location. See, e.g., Trinet Establishment Database; Dun's Market Identifiers; Standard & Poor's Register. (A sample from Standard & Poor's Corporate Description database is attached as Exhibit 19 to the Alabama, et al., Appendix, Oct. 30, 1990.) And while these may not have the ultimate precision of determining a state of incorporation, the degree of accuracy is surely going to be very high (as it needs to be

Moreover, the limited uncertainty that remains can largely be obviated by turning to a standard source to determine the location of the principal executive offices, just as the Court did in *Texas v. New Jersey* when it turned to the issuer's "books and records" as the source for determining the last-known addresses of beneficial owners. The Securities Exchange Act of 1934 (the "1934 Act") requires every company subject to its mandate to file quarterly and annual reports, known as Form 10-Q and 10-K, that list the "[a]ddress" of the company's "principal executive offices," 17 C.F.R. §§249.310, .308a. Looking to these reports to determine the location of the issuer's "principal executive offices" goes a long way towards satisfying the concerns expressed by the Court in 1965 -- that this concept of location, while "more persuasive" than the "minor factor" of using the state "in which the debtor happened to incorporate itself," was substantially uncertain in that it "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," *Texas v. New Jersey*, 379 U.S., at 680.

Three criticisms against looking to the issuer's principal executive offices, and using the SEC filings as the source of this information, are made, principally by Delaware. First, Delaware contends that a Court-created escheat rule that determines an issuer's principal place of business by looking to information contained in SEC filings would be unconstitutional, as "[d]esignating a particular filing or database . . . is a power that is uniquely legislative in character, and therefore, not included among the judicial powers of the Court." Brief of Delaware Commenting on Draft Report, at 21 (Nov. 5, 1991). As noted in *Texas v. New Jersey*, however, the Court, in this area, is essentially fashioning rules of convenience. Delaware nowhere ex-

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for Uniform Commercial Code purposes); the (very) little that is lost in accuracy seems to be more than made up by the (substantially) greater relevance of this locational test.

plains why the Court, in fashioning a locational rule, cannot also describe how it will give content to that rule, thus reducing ligitation and uncertainty. Indeed, the Court did precisely that in *Texas v. New Jersey*, by looking to the last-known addresses of beneficial owners that appeared on the issuer's books and records. If this method of determining location is sensible, nothing in the concept of separation of powers prohibits its adoption by the Court.[42]

Second, Delaware challenges the appropriateness of looking to the principal executive offices as a locational test. It suggests (correctly) that a company's executive offices are not *necessarily* where the principal business operations of the business are located, but it leaps from this premise to a conclusion that looking to the principal executive offices as a way of identifying "the jurisdiction where the benefits are created" is "not supported by any record facts." Brief of Delaware Commenting on Draft Report, at 9 (Nov. 5, 1991). Delaware also questions (for similar reasons) whether looking to the principal executive offices is any more "fair" than looking to the jurisdiction of incorporation, *id.*, at 13.

Delaware, however, overstates the reasons for using a firm's principal executive offices instead of its jurisdiction of incorporation as the appropriate way to "locate" the firm. Location (or principal location) may in fact turn on a number of factors; neither the state of incorporation nor the concept of the principal executive offices captures the full range of factors one would want to consider in the abstract. The idea, however, is to get a decent handle on location that is both "certain" and

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42. Delaware cites three decisions to suggest that the Court lacks the power to make this sort of judgment. Charitably put, none of these decisions so holds. See Vermont v. New York, 417 U.S. 270 (1974) (supervision of disputes without factual findings inappropriate); Missouri v. Illinois, 200 U.S. 496 (1906) (proof lacking); Rhode Island v. Massachusetts, 37 U.S. 657, 701 (1838) (Delaware cites to argument of counsel only).

"fair," *Texas v. New Jersey*, 379 U.S., at 680. Adoption of a simple way of determining location here attempts to restate the inquiry of *Texas v. New Jersey* (conducted, there, in the context of the primary rule, but equally applicable to a locational surrogate for the backup rule) of whether a *convenient*, *easy to apply*, and generally *fair* test can be envisioned. Here, the comparison is between the easily-determined, but "minor factor" of looking to the jurisdiction "in which the debtor happened to incorporate itself" and the principal executive office test. Looking to principal executive offices, particularly as determined by reference to SEC filings where they exist, provides certainty virtually equivalent to a focus on the jurisdiction of incorporation. Hence, the two tests provide roughly comparable convenience and ease of application. The principal executive office test, however, is much more fair. While the location of principal executive offices will not always be the same as the principal place of business or other "real world" relevant locational factors, that location will, in almost every case, involve substantial operations (in the sense of executive decisionmaking, which is of critical importance to the day-to-day life of a business). Moreover, principal executive offices usually, albeit not always, will be located at a firm's principal place of business, particularly as one focuses on relatively small companies and not just the "Fortune 500." This is more than can be said about the location of incorporation as compared to the location of a business' operations.

Delaware asserts that it is entitled to discovery before this locational test is adopted, presumably so as to test the comparative advantages of a principal executive office test relative to a jurisdiction of incorporation test. There has been no showing, however, of how the fruits of such discovery could assist the Court in making this essentially equitable judgment. Significantly, the Court did not invite discovery by the parties on the locational test it adopted at the time of *Texas v. New Jersey*; in resolving this essentially equitable matter, the material that has been provided to date seems ample to make the locational choice. Anecdotal examples -- which Delaware has already

submitted -- will not provide a basis for making a global comparison of the appropriateness of one test or another -- and it is the global comparison that is at issue.

It is clear, moreover, that looking to principal executive offices "will tend to distribute escheats among the States in the proportion of the commercial activities of their residents," *Texas v. New Jersey*, 379 U.S., at 680, much more closely than will a jurisdiction of incorporation test; additional discovery will not change that fact.[43] Indeed, since it is the larger, publicly-traded, enterprises that generate the lion's share of the securities distributions, and those entities are by any standard disproportionately incorporated in one state, it would be quite unfair to use the jurisdiction of incorporation as an easy answer to locational questions when the principal executive office test could provide a much superior allocation among the jurisdictions with roughly comparable ease and certainty.

Third, Delaware contends that using the SEC filings will not produce the requisite certainty, both because firms sometimes list dual offices on these filings and because not all issuers must make such filings. Delaware notes two instances where the relevant SEC filings had dual principal executive offices listed. Alabama, et al., suggest that a review of the most recent quarterly Forms 10-Q filed with the SEC by the approximately 1,700 New York Stock Exchange Companies show four companies -- approximately one-fourth of one percent -- with dual

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43. This is demonstrated by the research already conducted by the parties, reflected in their recent briefing. Delaware concedes that over 50 percent of the "Fortune 500" largest companies and over 40 percent of the companies listed on the New York Stock Exchange are incorporated in Delaware, while it is not contended that more than a small fraction of those entities have any business activity in Delaware whatsoever. Compare Delaware Brief, Nov. 5, 1991, at 14 with Supplemental Reply Brief of Alabama, et al., Nov. 21, 1991, at 7 n.6 (public databases report less than one percent of these companies are actually headquartered in Delaware).

principal executive offices listed (and three companies with incorporations in more than one state). Alabama, et al., Supplemental Reply Submission to Draft Report, at 12 (Nov. 21, 1991). The fact that there are, very occasionally, judgment calls that need to be made in using the SEC filings, however, does not mean that substantial certainty is not accomplished. Presumably in the very few cases in which principal executive offices are listed in two (or more) jurisdictions, one could allow the funds to go to either state, or perhaps more appropriately, to the states in equal portion. The need to resolve these cases does not undo the substantial certainty that would be acquired by using a principal executive offices test and by determining that by reference to SEC filings.

It is also true that the SEC filings are not all-encompassing. They are, however, a good start. Domestic companies subject to the 1934 Act will be covered, and this includes all companies either listed on a national securities exchange or having at least 300 shareholders, 15 U.S.C. §§78*l*(g)(4), 78o(d).[44] In addition, foreign issuers that make public offerings in the United States will also be covered, as they must file periodic reports under the 1934 Act in order for their securities to be listed on domestic exchanges or sold in the domestic over-the-counter market, 15 U.S.C. §§78*l* and 78m. These reports call for identification of the "principal executive office" in the United States, see, e.g., Form 20-F, 47 Fed. Reg. 54,781 (1982). States and municipal issuers will pose generally no problem, as their principal executive offices are rarely in doubt.

This leaves the question of what to do with a principal executive office locational test for issuers that are not required to file 1934 Act reports with the SEC, mostly small issuers. In

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44. Companies with fewer than 300 shareholders presumably will often have the last-known addresses of the beneficial owners on its books and records and, hence, the funds would be subject to escheat under the primary rule of *Texas v. New Jersey*.

point of fact, it is these small issuer cases that presumably are least likely to work their way through the national securities distribution system at issue here. To the extent funds derived from these issuers end up the subject of dispute as to which state has escheat rights, a general inquiry into where the principal executive office is located seems neither burdensome or complex, again as experience under Article 9 of the Uniform Commercial Code over the past two decades reveals.[45]

These factors lead me to recommend a minor change in the backup rule. While the rule should be confirmed as one that focuses on the issuer's location, the applicable locational test should be the jurisdiction of the entity's principal domestic executive offices[46] rather than the state of incorporation.

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45. There is also a question of federal issuers or federally-chartered issuers. In the case of federal issuers, use of either a jurisdiction of incorporation test or a principal executive office test seems strained. Presumably, the District of Columbia would be able to claim these funds under the proposed locational test offered in this Report. (Congress could perhaps deal with these cases by claiming federal escheat law rights, cf. United States v. Oregon, 366 U.S. 643 (1961), but there is no basis to think that the Court should enter this realm on its own.) In the case of federally-chartered issuers, such as federally-chartered banks and the like, a principal executive office test works considerably better than does a jurisdiction of incorporation test. Cf. New York Reply Brief, at p. 19 n.14 (Jan. 17, 1991) (suggesting principal place of business as the apporpriate test for federally-chartered entities).

46. I favor this test over a "principal place of business" test, believing that it is easier, and less prone to controversy, to determine in what jurisdiction the principal executive offices are. A focus on principal place of business will require one to have subsidiary rules (is this meant in terms of number of employees, business generated, property owned, or the like?), and room for disagreement, that is far less likely to be the case, as the test under Article 9 of the Uniform Commercial Code has revealed, with a chief executive office test. Moreover, as discussed in text, looking to principal executive offices allows the use, in a large majority of cases, of a convenient source of this information: SEC

This not only seems calculated to identify the jurisdiction where the benefits are created, but it also is more likely to distribute the funds, in this and other cases, fairly among the various jurisdictions. Indeed, with this minor change, it is doubtful that any rule, including that proposed by California, et al., discussed below, is likely to be more fair or certain, whether in the abstract or in practice. The recommendation does, however, change longstanding practice in one minor, but particular, respect, as can be seen not only from *Texas v. New Jersey*, but from the Court's prior one-state cases, such as Standard Oil Co. v. New Jersey, 341 U.S. 428 (1951).[47] Nonetheless, it is a change that, on balance, I recommend favorably for the Court's consideration.

2. The Appropriateness of the Basic Approach of the Backup Rule

To this point, I have stayed within the confines of the backup rule itself, attempting to tease out an ambiguity in its application and to decide between two plausible interpretations of prior precdent in this area. California, et al., urge that this entire approach is misguided. These states argue that the current backup rule is not appropriate (although they resist less strongly the use of a backup rule that contains a principal executive offices locational test), and that the Court should be guided more heavily by notions of fairness in deciding the appli-

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filings. There is reason to believe that not only will this source reduce controversy over "which state" to the vanishing point, but will soon be easy to access as well, via the SEC's proposed Electronic Data Gathering Analysis and Retrieval System.

47. These cases, however, as observed by the Court at that time, involved no claims of competing states, *id.*, at 443. The issue was whether the jurisdiction of incorporation had *any* right to escheat the funds, not how its right measured up against the rights of other potential jurisdictions, including one in which a firm's chief executive offices were located.

cation of the backup, or second level, rule. California, et al., in short, would have the Court now do what it refused to do under the circumstances of *Pennsylvania v. New York*. In the view of California, et al., a rough, aggregate concept of fairness could be attained through adoption of a gross formula that would, in some approximate fashion, reflect where the nation's beneficial owners lived or conducted commercial activities.

California, et al., are surely right that the rules previously adopted in this area of law by the Court are, as the Court itself has stated, less a matter of Constitutional command, or even logic, than of equity. However, the very argument made by California, et al., in this case was made to, and rejected by, the Court in *Pennsylvania v. New York*. There it was expressly contended that the relatively high percentage of instances falling under the backup rule warranted reexamination of that rule on grounds of fundamental fairness, rather than a mere clarification of its application. But this kind of argument was decisively rejected by the Court's majority in that case:

> *Texas v. New Jersey* was not grounded on the assumption that all creditors' addresses are known. . . . Thus, the only arguable basis for distinguishing money orders is that they involve a higher percentage of unknown addresses. But we are not told what percentage is high enough to justify an exception to the *Texas* rule, nor is it entirely clear that money orders constitute the only form of transaction where the percentage of unknown addresses may run high. In other words, 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."

Pennsylvania v. New York, 407 U.S., at 214-15. This case is, in reality, no different. While there is reason to believe that, as in

Pennsylvania v. New York, the proportion of unclaimed funds that will be allocated pursuant to the backup rule rather than the primary rule of the last known address of the beneficial owner is substantially greater than it was in *Texas v. New Jersey*, there is no reason to believe that the percentage of unclaimed funds relative to the total funds that pass through the securities distribution system is any greater here than in the Court's prior cases. While the aggregate dollar amount is, admittedly, almost certainly greater, the Court expressly considered and rejected in *Pennsylvania v. New York* a focus on dollar amounts, or relative shares between the primary and the backup rule.

California, et al.'s argument, in the face of this history, is essentially to reiterate its point: The sheer magnitude of the unclaimed funds involved in this case mandates a more equitable distribution criterion, one unencumbered by continued allegiance to vestiges of the existing backup rule. It may not have been appropriate in 1972, when *Pennsylvania v. New York* was decided, to reconsider the backup rule, according to California, et al., but this case reveals that now surely is the time and place to do so.

California, et al., assume their proposed distributional rule is fairer because of its intended geographic diversity and its tie to the demography of securities investors. However, the Texas, Alabama, et al., position also addresses distributional concerns without adding a further fiction to the concept of the beneficial owner's location. Particularly if the backup rule is construed to define the issuer's location for escheat purposes to be where its principal executive offices are, rather than where it is incorporated, that backup rule may have as much underlying fairness as the approach proposed by California, et al. And such a modification is a minor adjustment in the rule's application that is consistent with *Texas v. New Jersey* and *Pennsylvania v. New York*, while the allocational rule proposed by California, et al. totally recasts the law in a free-form effort to serve the fairness goal.

Even assuming, arguendo, that the proposed approach put forth by California, et al., is in any sense more equitable than others in handling this case, this does not ineluctably lead to the conclusion that the Court should jettison the current backup rule and create another doctrine for the purposes of this case. While the Court admittedly has the power to do just that, there may be institutional reasons why it should not. One, of course, is *stare decisis*. However forcefully made, the arguments of California, et al., are, ultimately, those considered and rejected by the Court in *Pennsylvania v. New York*. There is virtue in clear rules, and in discouraging parties from routinely challenging those rules as not quite right for their particular case. And whatever the virtues of *stare decisis* in Constitutional decision-making, there is much to be said for it in areas of equitable rulemaking, such as here, particularly where Congress can respond to perceived unfairness in a way that it cannot in the Constitutional arena.

There is also much to be said for an institutional competence focus in this case. Adherence to the Court's announced general rules leaves Congress as the arbiter of a particular rule's merit and continued viability in a given context. For example, Congress adopted a particular statutory solution in response to *Pennsylvania v. New York*. California, et al., seek a sweeping new rule, but offer only the broadest outline, with few details. This point is not insignificant. California, et al., elide the fact that their suggested approaches are gross aggregates only. Instead of looking at the distribution of (known) beneficial owners of a particular security, for example, these jurisdictions propose to make allocations under a formula cutting across *all* beneficial owners of *all* the nation's securities. (These jurisdictions would apparently use the same approach if the formula were predicated on broker office locations.) But this not only moves from an individual security to aggregates, it stops not far short of a *reductio ad absurdum* of this position: distribute the funds based on population. While none of these suggested approaches, including one that looks to relative population

levels, is necessarily inappropriate in the abstract -- they all, in a way, balance individual fairness with ease of administration -- this kind of global approach to fairness seems far removed from even equitable judicial decisionmaking. Yet that is, at bottom, what California, et al., would have the Court do.

In light of this, it may be preferable to acknowledge that Congress has the ability, should it be unsatisfied with the application of the Supreme Court's basic rules in this area to a particular type of transaction, to change the rule with respect to that kind of transaction. That is to say, the Court sets the general rule, and any specific application of the rule that is perceived to be unfair can be argued to Congress. Fashioning precise fairness rules to handle a relatively unique, complex, and significant (in terms of dollars) case (as this case is) -- and rules that will govern the future as much as (or more than) the past -- seems best addressed to Congress, which can decide which jurisdictions, in what proportion, should get the funds, as well as how approximate the proxy should appropriately be.

There are significant reasons to believe that Congress is better suited than the Court to weigh the merits of proposals such as that offered by California, et al. Given the intricate and financially significant nature of this case, any sweeping distribution plan encompassing every security holder or broker raises numerous complexities best addressed through the legislative process. Even if it is true that a fair allocation system could be devised, such as one distributing escheated funds according to each state's percentage of security holders, this approach will likely prove difficult to administer. Under *Texas v. New Jersey*, the plan of California, et al., serves merely as a backup plan. It takes effect only when the beneficial owner's last known address cannot be discovered.[48] Otherwise, the primary rule

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48. Note that, unless all jurisdictions have the same period for escheat, the funds might be partially escheated at any given time, with other funds continued to be held by the intermediary.

governs, and the undelivered funds would escheat to the beneficial owner's domiciliary state. While this distinction seems clear-cut, the reality may be quite different.

Assume, for example, that the beneficial owner's last known address cannot be found, and the undelivered funds escheat to the various states according to this security-holder formula. If that missing address is subsequently discovered, the escheat action may (at least after a period) cut off the beneficial owner's right to reclaim the funds, but the beneficial owner's domiciliary state may continue to have a superior right to escheat under the primary rule. However, asserting this right may prove difficult, since the funds have already been dispersed across the country. Difficult questions arise as to the precise location of these dispersed funds, and whether the domiciliary state would have to claim a fraction of the funds from each applicable state in order to recoup its claim. Moreover, under any of the California, et al., approaches, the percentage of security holders or brokers claimed by any one state will presumably change over time. This raises the issue of how often the allocation formula should be updated.

In discussing these concerns, I do not mean to suggest that they cut decisively against adoption of such a rule. My view is simply that the California, et al., proposal is more appropriately within the province of Congress. This is particularly so where the backup rule, as conceived of in this Report, carries with it substantial intuitive fairness as well. The claim of overwhelming comparative fairness for the proposed rule by California, et al., is, in fact, substantially overstated.

D. Summary of Recommendation Regarding the Applicable Legal Standard for the Backup Rule

In sum, the parties to this case have raised a genuine ambiguity in the application of the Court's precedents to this set of facts. Unlike the prior cases, there is a need to decide here, in application of the backup rule, whether the Court's use of

the term "debtor" implicated state law definitions or, rather, was a term of convenience best interpreted as a directive to look to the substance of the relationship between the principals of the transaction in issue. In addition, because of the large sums involved, this case tests the general appropriateness of the backup rule as severely as can be imagined, and California, et al., appropriately raise the issue of whether the convenience of that rule should be reconsidered in light of fairness concerns.

As set forth in earlier sections of this Report, there are three distinct parts to my recommendation. First, that the backup rule be retained. Second, that prior case law in this area be interpreted so as to resolve an ambiguity in its application by favoring the state where the issuer is located over the state where the intermediary is located, as both consistent with prior case law, as well as fairer and equally certain. Third, that the location for purposes of the backup rule be determined by looking to where the issuer's principal executive offices are located -- admittedly changing prior case law in this one, relatively minor, respect.

Although I have spoken throughout this Report of a "primary" rule and a "backup" rule, a full summary of the governing principles has several branches. At the outset, of course, where the entitled recipient is locatable, that person receives the distribution. No unclaimed property results. And that is true, as well, where the recipient cannot be located, but the originator of the transaction can be, and that originator is entitled to a return of the funds, as owner. The Court's sequence applies when there is no locatable individual (or entity) with an ownership claim to the property. In those cases, the distributional sequence would be as follows:

First, where the state of domicile of an unlocatable entitled recipient[49] is known, through finding a last known

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49. The nature of who the "entitled recipient" is, is addressed *infra*, pp. 61-68.

address, that state may take custody of the unclaimed distributions (the primary rule of *Texas v. New Jersey*).

Second, where the entitled recipient's domicile is undeterminable (no last known address), but the state of domicile of the originator of the distribution is known, then the state of domicile of the originator may take custody of the unclaimed distributions, whether or not the originator would have been entitled to receive the funds back in its own right (the present case, in light of the discussion in *Pennsylvania v. New York*).

Third, where the entitled recipient's domicile is undeterminable (no last known address), and the originator's domicile is likewise undeterminable, then (and only then) the state of domicile of the intermediary holding the funds may take custody of the unclaimed distributions (the backup rule, as applied to the particular facts of Western Union).

In each case, I propose that the applicable test for determining location be a last known address rule that, in the case of corporations, looks to its principal executive offices as determined by SEC filings, where applicable. This would be a modification of the current backup rule, but would seem to harmonize the last known address locational test in the primary and backup rules.

I recommend this to the Court as appropriate and consistent with both the letter and the spirit of *Texas v. New Jersey* and *Pennsylvania v. New York*. While this locational test would entail a small point of evolution in this area of federal "common" law equitable rulemaking, it would provide a backup rule that is generally both fair and convenient, as well as generally consistent with prior decisionmaking. Going further, by jettisoning the backup rule, may provide neither more fairness nor more certainty.

E. Recommended Application of this Legal Rule to the Position of New York; A Construction of the Primary Rule

New York, defendant in the action as originally filed, and an active participant in the preparations and briefing of these dispositive motions, has taken a position regarding the backup rule that is largely parallel to that of Delaware. Going beyond this position, however, New York has also presented views of certain aspects of the legal architecture and industry facts respecting the primary rule to which no other state subscribes, and which I find to be in significant respects erroneous. It asserts that its factual contentions regarding application of the primary rule itself require rejection of the dispositive motions of intervening states (while joining Delaware in arguing that judgment is appropriate against the intervening states). I will set forth briefly here (1) why the facts conceded by New York are sufficient to doom its arguments with respect to how the primary rule should cast a shadow across the backup rule in this case, and (2) why its factual contentions about the feasibility of determining identities or addresses of the proper recipients of distributions do not raise material fact questions affecting the ripeness of the present motions for decision on the fundamental issues. Finally, and perhaps most importantly, I note that if the Court's basic characterization of the participants in these distribution transactions is generally as set forth in earlier sections of this Report, the entire focus of New York's sui generis approach is beside the point.

1. Factual Claims Regarding Addresses Under the Primary Rule

The central thrust of New York's position is a claim under the *primary rule* under *Texas v. New Jersey* rather than the backup rule. It asserts that the identities and locations of the proper recipients of the funds the industry currently finds to be owner-unknown can, in fact, be ascertained, albeit with such

difficulty that, even New York seems to concede, it would not be worth the time and energy to accomplish; thus, New York contends that a presumption of location based on aggregate statistics is appropriate as a method of determining last known addresses.[50]

Regarding the motions directed at the backup rule, however, this position is all-but irrelevant. New York agrees with the other parties that unclaimed funds in the hands of DTC are in fact owner-unknown, and thus should pass to the appropriate jurisdiction under the backup rule.[51] It is obvious that New

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50. New York expresses its position as follows: "New York's right to escheat this property is based on the fact that it is feasible to determine the names and addresses of most of the creditor brokers from the debtor brokers' books and records, and that the addresses would be, for the most part, New York addresses. . . . However, since a significant number of the creditor brokers have New York trading addresses, neither the debtor brokers nor New York have considered it cost effective to reconstruct each and every transaction to establish that New York is entitled to escheat the property under the 'last known address' rule in *Texas v. New Jersey*." Brief in Support of Motion of New York, at pp. 51-52 (Oct. 30, 1990). Instead, New York proposes use of "a statistical sampling to establish that in the vast majority of cases, the unclaimed funds of New York debtor brokers are owed to creditor brokers with New York trading addresses," New York Brief in Opposition, at p. 61 n.26 (Dec. 18, 1990). I take this position as essentially asking for the adoption of a legal standard for presuming addresses that are in fact unknown. And, as such, the position is inconsistent with *Pennsylvania v. New York*, where the Court refused to allow an equally-apt presumption -- that the state in which the money orders were purchased was the state of the sender's domicile -- to govern. To the extent this is New York's position, judgment against it is entirely appropriate at this point.

51. New York asserts, and no one else contests, that, with respect to the property in DTC's Unclaimed Dividends Account, "the creditor cannot be determined from DTC's books and records," Brief in Support of Motion of New York, at p. 14 (Oct. 30, 1990). See also Brief in Support of Motion of Alabama, et al., at p. 6 n.4 (Oct. 30, 1990) ("Delaware's

York's concession about unclaimed funds in the hands of DTC is fully sufficient, without more, to require a decision spelling out the applicable doctrines that govern the backup rule.[52] The factual predicate for deeming the present motions ripe for fair determination is the undisputed circumstance that the central intermediary in the entire registration, transfer, and distribution process is left holding enormous amounts of unclaimed property after its dealings with issuers, transfer, and paying agents on one side, and its participant banks and brokers on the other. At this juncture it is not important what proportion, if any, of the funds now deemed owner-unknown by the banks or brokers could be resolved by the extraordinary efforts which New York conceives could be undertaken. Those determinations bear only on the allocation between transactions governed by the primary rule and those to be governed by the

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theory would leave for the State of New York the property held by those intermediaries (such as the Depository Trust Company and certain banks) that are domiciled in New York"). As it happens, DTC is incorporated under the banking laws of the State of New York (and presumably has its principal executive offices there as well), which under the contentions discussed earlier in this Report obviously bears on the selection of the jurisdiction entitled to take custodial possession and then escheat the unclaimed property.

52. As the record holder of a substantial proportion of all securities in this country and depository for over 600 banking and brokerage institutions, DTC processes a tremendous number of securities distributions annually and is left with substantial sums it finds to be owner-unknown. This fact alone demonstrates that the proper meaning and application of the backup rule must be determined in order to allocate those unclaimed funds appropriately. New York's contention that unclaimed funds in the hands of other enterprises in the securities industry can actually be associated with specific entitled recipients is thus irrelevant for purposes of framing decision on the backup rule, because even if every dollar resting in the unclaimed funds accounts of every bank and broker in the country could be resolved, disposition of the significant funds coming to rest with DTC would require operation of the backup rule.

backup rule, and New York has thus identified no triable issue of fact on the questions whether there should *be* a backup rule and whether there are large amounts of property to be distributed pursuant to that backup rule.

2. The Concept of "Creditor" in the Context of the Primary Rule

Even with respect to New York's assertions under the primary rule, and the ability to find addresses, however, New York's position is vulnerable under the analysis of this Report. New York has spent considerable time asserting that there is a triable issue of fact with respect to the ability to find creditor addresses, see, e.g., Robert Griffin affidavit (May 5, 1988), despite the unanimous conclusion of the industry entities and personnel from whom discovery was taken that the unclaimed funds at issue here are net of all successful efforts to identify appropriate recipients and are truly owner-unknown.[53]

New York has presented this position, and the other parties have challenged it, on the general issue of the feasibility of determining the appropriate next recipients of the funds in the chain of distribution, whom all parties seem to assume may

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53. The central inconsistency in New York's contentions, from which its analysis begins to unravel, is that it concedes that after internal efforts to identify proper recipients of unexpectedly large receipts, *unclaimed funds in the hands of DTC are in fact owner-unknown*, with no identification of the proper recipient, much less an address. There is no point in belaboring the intuitive inference that if this central entity (set up by the industry itself and reflecting its modern practices and recordkeeping facilities) is correct in declaring large sums arising from distributions to be owner-unknown, the unanimous and credible reports from banking and brokerage firms of a similar conclusion are probably also correct. (During the decades during which no contest was raised to New York's role in taking custody of the unclaimed funds, New York seems to have accepted without qualms the industry's inability to identify owners of these funds.)

be what New York calls the "creditor-brokers." It is tempting at first blush to conclude that rulings on various legal questions could await resolution of myriad questions of fact about the nature and condition of various intermediaries' records on particular distributions that will determine the nature and amount of sums open for custodial taking under the primary rule.

But while all the parties have focused their energies on the findability of creditor addresses, as contended by New York, none has focused on the more decisive legal issue: the appropriateness of looking to creditor-broker addresses under the primary rule in the first instance. The ambiguity in the Court's prior uses of the terms "debtor" and "creditor" necessarily affects a construction of the primary rule as well as of the backup rule.

Once one focuses on who the appropriate "creditor" is for purposes of applying the primary rule, the analysis in section III(C) of this Report suggests that New York's factual contentions are actually beside the point. Without restating the analysis set forth in that earlier discussion, it should be clear that a correct understanding of the Court's use of the debtor and creditor terminology bears not only on the issuer's status, but also on that of intermediaries. New York's central factual contention is that through rigorous, perhaps extraordinary, efforts to reconstruct thousands of transactions, it will be determined that the unclaimed funds from a particular distribution should have been forwarded to a broker tied to New York. Even if this is proven true in practice,[54] the result is not as

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54. A related factual assertion by New York is that brokers and banks always pay the beneficial owner the amounts due under a distribution. This proposition is meretricious, at best. I find, as set forth in Appendix B, that most if not all brokers and custodian banks establish semi-automatic payment systems to credit their customers with dividends and other distributions as of the payment date. Beyond that kernel of truth, however, the factual predicate for New York's reasoning is missing. New York implies that the intermediaries according such credits to customers

New York imagines it, for the records of that putative recipient broker would also need to be reconstructed to determine whether the funds in any sense belonged to it, or instead to a further broker or beneficial owner of securities.[55]

More importantly, the analysis earlier in this Report demonstrates that a focus on identifying the next intermediary entities through whom the funds should have been channeled is itself misplaced. I have already demonstrated that the term "creditor" is used in the Court's jurisprudence to signal a search for attributes of ownership rather than to invoke a state-law status determination as to the existence of a cognizable debt in

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become beneficially entitled to the distributions. However, the unclaimed funds at issue in the present litigation arise somewhat differently. Indeed, it is crystal clear that *none* of the payments actually made to customers of the banks and brokers gives rise to the unclaimed funds -- just the opposite. The owner-unknown funds at issue here arise because *the intermediaries give themselves full credit for every dollar of distribution they pass along to their customers*, and where that figure previously paid out is *more* than the distribution the intermediary receives, the intermediary routinely processes a claim to DTC or another intermediary for the shortfall. A broker or bank only ends up after the resolution of internal investigation (and any claims it may itself receive from others for part of the unclaimed excess in a distribution) with arguably escheatable funds where it has *not* advanced that value to a beneficial owner or another intermediary. And if it is the case that the intermediary is mistaken in thinking that it has paid all of its clients all of the funds to which they are entitled, that counts against, rather than in favor of, treating the intermediary as beneficially interested in the unpaid residue of a distribution.

55. Even if it is appropriate to look to the next intermediary for purposes of the primary rule -- which the text reveals is indeed suspect -- questions that arise about the appropriate jurisdiction to take custody and escheat with respect to any identifiable broker or other intermediary entity will need to be resolved by the location doctrine discussed in the text of this Report and the decision of the Court accepting, modifying, or supplanting that approach. See *infra*, n.59.

favor of a party.[56] In both of the central decisions by the Court, the threshold issue was the location of the intended recipient. In *Texas v. New Jersey* the location of Sun Oil's banks, transfer agents, and payment intermediaries was virtually ignored. For purposes of the primary rule, the ascertainability of the location of the intended payee was the focus. Similarly, in *Pennsylvania v. New York*, whether Western Union sent the funds to an intermediary branch in another state was not significant. The key issue was whether the intended payee or the sender of the funds could be located.

In applying the primary rule to the unclaimed funds arising out of distributions in the securities industry, the goal must be to identify the *ultimate intended beneficiary* of the payments, not the various intermediate points in the process of transmitting the funds. But this point, which derives from the same idea behind the Court's use of the terms debtor and creditor that has already been discussed, undoes New York's basic argument regarding the findability of addresses for purposes of applying the primary rule. New York's argument, at bottom, conflicts with the thrust of *Texas v. New Jersey* in setting forth the primary rule, as it would treat as an "asset" of the next broker-intermediary something that we would not conventionally consider an asset, see 379 U.S., at 680. It is clear, for primary and backup rules alike, that the Court's use of terms such as "creditor" was not that reliant on literal state-law legal definitions.

It would make no analytical sense, moreover, to view, for backup rule purposes, the appropriate party -- as between an intermediary holding "stuck" funds and an issuer -- as the issuer and yet hold that, for purposes of applying the primary rule, the term "creditor" was a reference to the next intermediary rather than to the beneficial owner. If intermediary A could find the next recipient, intermediary B, but intermediary B could not

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56. See *supra*, pp. 23-40.

locate anyone further down the distributional chain, the funds would ultimately escheat to the jurisdiction where the issuer were located, under the interpretation of the backup rule being recommended to the Court in this Report. It is not sensible, in light of this, to hold that, in cases where intermediary B could not be found, the state where intermediary B was located was entitled to escheat the funds. That state would then, quite perversely, have better rights when intermediary B's address could not be located than when it could. Instead, it is far more logical to consider the term creditor, as well as the term debtor, as descriptive -- terms describing the prior and next beneficial owner of the funds: the issuer and the beneficial shareholder. See *supra*, pp. 23-40. Under this logical corollary of the discussion of creditor and debtor in this context, New York's claimed ability to locate (or, more accurately, presume) the "trading addresses" of brokers such as intermediary B becomes irrelevant. The addresses it needs to be able to locate for application of the primary rule are those of the beneficial owners the funds were ultimately designated for.

This leads to the basic point regarding New York's address contentions. If the extended study of broker and bank records and reconstruction of transactions which New York envisages yields the identification of a beneficial owner, the funds attributable to that owner should be paid accordingly, or escheated to the state of the owner's last known address if the distribution cannot be consummated. But if the study of security industry records yields only the identity of another intermediary, the process falters -- both factually and as a matter of escheat doctrine under the Court's precedent. Only if it could be further determined that the identified bank or broker was trading for its own account as a principal, or was otherwise the beneficial owner of the distribution (such as might be the case if the identified bank or broker had paid the beneficial owner originally), would it be sensible to launch an effort to locate that bank or broker. The difficulty, however, is that there is no basis

to presume this conclusion.[57] Where the reconstruction of transactions by the holder of funds yields only the bare identification of a bank or broker involved in the distributions, it may also be that the entities identified were serving as they do in the great majority of instances -- as intermediaries for others and not as beneficial recipients and that the beneficial owner was, in fact, never paid. In that circumstance, the payee ultimately intended to receive the funds would still be unknown, and inquiry under the primary rule would be completed. The holder of the funds would not have been able to identify a "creditor" in the sense of a person with anything reasonably resembling ownership attributes. Thus the funds should be returned to the jurisdiction where the sender, here the issuer, is located, if that can be identified. Only where the issuer or its location cannot be determined would the funds escheat to the jurisdiction where the intermediary holder is located.[58] Without knowing more

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57. See note 54, *supra*. See also the undisputed factual findings set forth in Appendix B to this Report, which explain in detail how the unclaimed property at issue in this litigation arises, and why it is almost never the case that an intermediary acting other than for its own trading account will have a claim as a creditor.

58. Facts adduced on these motions demonstrate that each intermediary establishes records for securities distributions. These records identify the issuer through the name and class of the security involved and often through a "CUSIP" number unambiguously identifying the security to which the payments pertain. The jejune suggestion that some participants in the securities distribution network do not set up separate datafiles tracking the addresses of the corporations with publicly traded securities hardly leads to a reasonable fear that such companies would be unlocatable. There are multiple, redundant, and easily accessible publications, computer databases, and public information repositories where addresses, registered agents, and office locations are set forth for publicly traded corporations. See Alabama, et al., Appendix, Oct. 30, 1990, Exhibits 19 & 20; Principe deposition, pp. 69-72. I am perfectly comfortable with the thought that if there is ever a rare instance in which a

about an individual transaction, locating the creditor broker is not necessarily the same as locating the beneficial owner. Presuming one from the other, as New York desires, adds presumption on presumption with no legal or practical authority for either.

This leaves, perhaps, some room for New York's factual contentions, and it should have an opportunity to pursue them if it is so advised. It should be made clear at this juncture, however, that in applying the primary rule, the last-known-addresses of the beneficial owners, not other intermediaries, will control. Second, the addresses must be shown on a transaction-by-transaction basis, with the burden resting on the jurisdiction that contends that there is a last known address of an entitled recipient within its borders. There is nothing in the Court's jurisprudence to suggest that New York can prevail by making a statistical showing that "most" such addresses are in New York. (Indeed, assuming that the relevant addresses are those of beneficial owners, not "creditor-brokers," it is dubious that New York would, even for statistical purposes, be able to show that the addresses of "most" beneficial owners were in New York.[59]) Finally, the posture in which New York's contention

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publicly traded corporation places distributions into the payment channels in the industry and then disappears entirely, the records noted will provide a "last known address" -- and, if those records are for some incomprehensible reason lost, that particular distribution may be escheated to the state of the holder possessing the funds without altering the landscape of the law.

59. I see no reason for the Court to address, at this point, the appropriateness of "trading addresses," although I do note that this is not a concept used in securities law, the Uniform Commercial Code, debtor-creditor law, or the law of personal jurisdiction, venue, or subject matter jurisdiction of the courts. From all that I have been shown, this "trading address" approach seems to be a conception created out of whole cloth by New York, to favor itself in the instant case -- or, perhaps more accurately, to rationalize post-hoc what it has been doing for many years.

arises is one in which the intermediary in question has determined that it is unable to locate any "downstream" recipient of the funds it is holding. In light of that, it seems eminently appropriate to place the burden on New York, or indeed any other state that wishes to adopt the same position, to demonstrate, once an intermediary determines through review of the records it maintains that the addresses of beneficial owners are not locatable, and hence the property is escheatable, that the appropriate addresses can be found, and to bear the costs of making such an attempt (so that these costs do not fall on the intermediaries, who claim no interest in the funds and are not even parties to this lawsuit). If, under these conditions, New York (or any other jurisdiction) wishes to continue to press its arguments regarding the findability of the last-known-addresses of proper recipients of specific unclaimed distributions for purposes of applying the primary rule, it should be permitted to do so upon remand.

IV. OTHER ISSUES

A. Minimum Contacts

Delaware has raised a question of whether a backup rule that looked to the issuer's domicile would satisfy "minimum contacts" requirements set forth in cases such as Shaffer v. Heitner, 433 U.S. 186 (1977). Its argument is that the state of incorporation of the issuer (Texas, for instance) may not be able to sue, in Texas courts, a broker located in New York holding funds that Texas would be entitled to under the escheat rule, because Texas' courts would not have sufficient "contacts" with the transaction. This argument proves too much, even when applied to a locational presumption such as jurisdiction of incorporation (and, *a fortiori*, I would think, when applied to other presumptions, such as principal executive office or principal place of business). It would, for example, apply to the primary

rule of *Texas v. New Jersey*.[60] More decisively, this argument conflates two distinct issues. The first is what law should be applied to govern the transaction. The second is what courts may entertain the action. Only the second issue is governed by minimum contacts rules such as those set forth in *Shaffer v. Heitner*. See *id.*, 433 U.S., at 215 ("we have rejected the argument that if a State's law can properly be applied to a dispute, its courts necessarily have jurisdiction over the parties to that dispute"); Hanson v. Denckla, 357 U.S. 235, 254 (1958); *id.*, 357 U.S., at 258 (Black, J., dissenting). It may be that, because of minimum contacts requirements, the state of incorporation of an issuer (assuming that is the appropriate locational test) could not sue in its own courts to escheat funds held by an entity located in another state. But nothing in those rules would prohibit the state of incorporation from suing in the courts of the state where the unclaimed property was located.[61] And the law applied by the courts of the state would be the Supreme Court's escheat rules.[62] As noted by the Court in *Texas v. New Jersey*, "[t]he issue before us is not whether a defendant has had sufficient contact with a State to make him or his property

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60. For example, if California is the last known address of a beneficial shareholder with respect to funds "stuck" in a brokerage house that did all of its business out of New York, then although California would have first priority to escheat the unclaimed funds, under the first branch rule, Delaware's argument would make problematic California's ability to bring suit.

61. Indeed, statutes in a majority of jurisdictions authorize the chief legal officer to bring actions on behalf of, and in the name of, the unclaimed property administrators of other jurisdictions, and to request reciprocity in this respect. See, e.g., Cal. Civ. Pro. Code §§1574-1575 (1981).

62. Not state conflicts rules, which is why a "contacts" analysis is not relevant. *Texas v. New Jersey*, 379 U.S., at 678.

rights subject to the jurisdiction of its courts," 379 U.S., at 678. In sum, minimum contacts is a red-herring in this case.

B. Reachback Period

For the last several decades, New York has been gathering a significant portion of the unclaimed funds resulting from distributions made with respect to securities. Under this Report's recommendations, and indeed under almost any conceivable resolution of the legal issues governing this case, New York's right to many of these funds will be truncated. As holder of these escheated funds under a "custodial taking," New York may now be subject to superior escheat claims by other states. This raises the question whether there should be any limitations imposed as to a state's ability to "reach back" and reclaim portions of funds accumulated by New York under its custodial takings statute from prior years.[63] These rules might come from two distinct sources. The first involves the retroactivity of any Court decision itself. The second comes from potentially applicable doctrines that would protect a party notwithstanding full retroactivity.[64] See generally Fallon & Meltzer, *New Law, Non-Retroactivity, and Constitutional Remedies*, 104 HARV. L. REV. 1733 (1991).

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63. A separate but related issue is whether (and when) there is a limitation on the ability of private parties to claim funds once they have been taken by a state as unclaimed property. See Texas v. New Jersey, 379 U.S., at 682 (escheat "cut[s] off the claims of private persons only"); Anderson Nat. Bank v. Luckett, 321 U.S. 233, 238-39, 242 (1944); cf. Connecticut Mut. Life Ins. Co. v. Moore, 333 U.S. 541 (1948). This issue, however, is not directly involved in this case, and indeed New York's unclaimed property statute has no relevant limitations period.

64. The most obvious example is the doctrine of *res judicata*, see James B. Beam Distilling Co. v. Georgia, 111 S.Ct. 2439 (1991). Whether it extends much beyond this context when dealing with the rights of states, is in substantial doubt. See Illinois v. Kentucky, 111 S.Ct. 1877 (1991).

California, et al., have suggested that the issue of retroactivity need not be reached in this case, because New York's custodial takings statute has no limitations period.[65] I disagree with this suggested disposition, for two reasons. First, retroactivity analysis may (under some circumstances) apply to more than New York's rights of retention. Second, and directly focused on the case before us, if the Court's judgment is not retroactive, then it may be that (under a strained view of the status quo ante) no other state would have a superior claim, thereby making moot the fact that New York has no limitations period. I thus discuss retroactivity first.

The retroactivity of the Court's decision interpreting and applying escheat rules was at issue in *Pennsylvania v. New York*, where the Court adopted, over the express contention of New York that *Texas v. New Jersey* should not be applied retroactively, the Special Master's recommendation that "the *Texas* rule be applied to all the items involved in this case regardless of the date of the transactions out of which they arose," 407 U.S., at 212-13, including some that dated back to the 1950s, see Western Union Telegraph Co. v. Pennsylvania, 368 U.S. 71, 76 (1961) ("New York has already seized and escheated a part of the very funds here claimed by Pennsylvania"). Thus, there is

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65. See Memorandum of State Executive Department, Division of the Budget, entitled "Unclaimed Property -- Simplifying Administration," 1980 New York Laws 1709, 1710: "Unlike the laws of several other states, New York's Abandoned Property Law is a custodial statute rather than an escheat statute. Under New York law, the rightful owner of unclaimed property never loses title to such property and the claim is not subject to the statute of limitations. It merely remains in the custody of the State Comptroller until discovered by the rightful owner." See also *In re* Estate of Menschefrend, 283 A.D. 463, 466, 128 N.Y.S.2d 738 (1954), *aff'd*, 8 N.Y.2d 1093, 170 N.E.2d 902, 208 N.Y.S.2d 453 (1960), *cert. denied*, 365 U.S. 842 (1961) (the 1943 revision of New York's Abandoned Property Law was "to change the policy of the State from confiscation to custodial protection").

at least some reason to believe that the general issue of retroactivity in this area has already been addressed by the Court (which decided *Pennsylvania v. New York* only one year after its seminal retroactivity decision in Chevron Oil Co. v. Huson, 404 U.S. 97 (1971)).

Since that time, retroactivity has generated substantial controversy and uncertainty among members of the Court. See, e.g., James B. Beam Distilling Co. v. Georgia, 111 S.Ct. 2439 (1991); American Trucking Assns. v. Smith, 495 U.S. ___, 110 S.Ct. 2323 (1990). Some members of the Court view retroactivity as the wrong issue, believing that opinions are fully retroactive and that the real issue is one of remedy (such as statutes of limitations, *res judicata* and the like). Others seem to adhere to the analysis of Chevron Oil Co. v. Huson, 404 U.S. 97 (1971). It seems clear, however, that if any opinion emanating from this case is to be retroactive under the doctrine of *Chevron Oil*, then it would be viewed as "retroactive" under either view (subject to an analysis of remedial limitations). Thus, I turn to *Chevron Oil* first.

The first step of retroactivity analysis under *Chevron Oil* is that "the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed." *Id.*, at 106. Later opinions have reaffirmed that the exception for cases of first impression is restrictive indeed. See Ashland Oil, Inc. v. Caryl, 110 S.Ct. 3203, 3204-05 (1990) ("Because *Armco* did not overrule clear past precedent nor decide a wholly new issue of first impression, it does not meet the first prong of the *Chevron Oil* test"); see also James B. Beam Distilling Co. v. Georgia, 111 S.Ct. 2439, 2448 (1991) (White, J., concurring) (a "reasonably foreseeable" decision does not implicate nonretroactivity under *Chevron Oil*).

Putting aside for a moment the use of a principal executive office locational test, it is difficult to see how the recommended disposition in this case meets this stringent first prong.

As I have attempted to show, a holding that one returns funds to the jurisdiction where the issuer is located rather than the jursidiction where an intermediary holding funds (such as DTC) is located is a logical interpretation of prior precedents in this area. This recommendation teases out an ambiguity in the Court's use of a term such as "debtor," but doing so is quite different than "decid[ing] a wholly new issue of first impression."[66]

Changing the locational presumption from the jurisdiction of incorporation to the location of the principal executive offices does come closer to meeting the first prong of *Chevron Oil*, but it is hard to see how this change affects New York. New York's claim to the funds it holds was not based on a claim that it was the appropriate state under a test giving the funds to the jurisdiction of incorporation *of the issuer*. Rather, it was claiming the funds either under a claim of being the jurisdiction of incorporation of the intermediary (in the case of DTC) or under a claim that it was the appropriate state under the first branch of *Texas v. New Jersey*, namely, the last-known-address of the creditor. Thus, in the one area where there might be a colorable nonretroactivity claim, New York has no real basis for asserting surprise, reliance, or harm.

As I read *Chevron Oil* and its progeny, one does not get to the third prong -- a weighing of the equities so as to avoid injustice or unnecessary hardship, 404 U.S., at 107 -- if the first test is not satisfied. Thus, on retroactivity alone (putting aside remedial limitations), New York's claims of fiscal harm are not relevant.

Assuming the Court's judgment in this case is to be retroactive, as I believe its precedents indicate, the question turns to

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66. New York's claim that it "relied" on prior law in cases where it suggests it can "presume" addresses in New York of next-stage broker-intermediaries is, for the reasons discussed *supra* pp. 61-67, implausible in the extreme.

one of remedial limitations. *Res judicata* is not involved. Thus, the potentially relevant remedial limitations would seem to stem either from a statute of limitations or from an equitable doctrine such as laches. I will look at each in turn.

Before looking at whether a statute of limitations defense might be applicable to the claims of states, one needs to find an otherwise applicable statute of limitations. There does not appear to be a relevant state statute of limitations period here. As noted before, New York statutory authority to take custodial possession of these funds is not subject to a statute of limitations, even against private citizens, as a matter of New York law. Memorandum of State Executive Department, Division of the Budget, entitled "Unclaimed Property -- Simplifying Administration," 1980 New York Laws 1709, 1710; Office of Unclaimed Funds, State Comptroller, State of New York, HANDBOOK FOR REPORTERS OF UNCLAIMED FUNDS 35 (3d ed 1991). New York has had an opportunity to contest this interpretation of its own laws, and has not done so.[67]

Nor does there appear to be any other relevant source for a statute of limitations. The Court, in its precedents in this area, has had an opportunity to impose a statute of limitations and has declined that opportunity. In *Texas v. New Jersey*, the Court noted that the state of corporate domicile should "be allowed to cut off the claims of private persons only, retaining the property for itself only until some other State comes forward with proof that it has a superior right to escheat," *id.*, 379 U.S., at 682-83. Following this opinion, New Jersey asked the Court to delete paragraphs 2 and 3 of its Final Decree and

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67. At oral argument before the Special Master, counsel for New York, in responding to a question, stated that he was not aware of any basis for limiting retroactivity in this case. Transcript of Oral Argument, at p. 86 (Fed. 14, 1991). While I do not treat this statement as a binding concession, neither has New York subsequently pointed even to a statute of limitations rule that would apply to private parties.

impose a "reasonable period of limitations," Motion for Modification of the Final Decree in *Texas v. New Jersey*, at 4-5; the Court denied the motion, 381 U.S. 948 (1965).

Even if there was a relevant statute of limitations, the Court has indicated that defenses such as a statute of limitations do not apply to actions by states. See Weber v. Board of Harbor Comm'rs, 85 U.S. (18 Wall.) 57, 70 (1873) (statutes of limitations generally not applicable to states); Guaranty Trust Co. v. United States, 304 U.S. 126, 132-33 (1938); cf. Illinois v. Kentucky, 111 S.Ct. 1877 (1991) (a laches defense is generally not applicable against a state). This point was made by the Court in *Texas v. New Jersey* itself, where it noted, 379 U.S., at 682, that escheat "cut[s] off the claims of private persons only." Thus, there appears to be no reason to limit the reachback effect of any opinion the Court issues in this case vis-a-vis funds held by New York using a statute of limitations.

A limitation such as might arise from a defense such as laches might seem to be more to the point, except that the Court has consistently spoken of the fact that laches defenses are generally not applicable against states, Illinois v. Kentucky, 111 S.Ct. 1877 (1991); Costello v. United States, 365 U.S. 265, 281 (1961); cf. Block v. North Dakota, 461 U.S. 273, 296 (1983) (O'Connor, J., dissenting) ("time does not bar the sovereign in conflicts between sovereigns"). Nor, should I add, is there any reason to think that the other states sat on their rights in this case. It is true that it took the states some 16 years after *Pennsylvania v. New York* to bring this action, but that delay itself does not indicate that 50 other jurisdictions slept on their rights. In hindsight, the basis for the suit is clear, and the sums impressive enough, but that is quite different from asserting that this suit should have been obvious to the states in 1974. Indeed, the decision in *Pennsylvania v. New York*, which applied to all items in issue, followed by some 11 years the opinion in Western Union Telegraph Co. v. Pennsylvania, 368 U.S. 71 (1961), in which case the Court invited the competing claims of other states to be resolved in an original action, *id.*, at 77. See New

York's Supplemental Submission, Nov. 5, 1991, at 22 and n.7 (conceding that neither laches nor limitations statutes are generally applicable and that the New York statute has no period of limitations).

I admit to being troubled by the realization that New York, which may have been collecting funds such as these for decades (albeit under thin rationales), may, in principle, have to disgorge virtually all of these funds (other than those for which New York can show that it is the location of the issuer's principal executive offices). The magnitude of these funds is such that their disgorgement will impose some hardship on New York; a hardship that is not eliminated by the realization that funds held in a custodial capacity are all, in theory, subject to such disgorgement.[68] I suspect, however, that there are limitations on the reachback of the recommendations of this Report

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68. To a large degree, of course, this hardship represents a calculated risk New York has imposed on itself, and not an unjust surprise or unfair burden. While it assiduously pursued the regular pay-over of unclaimed property in the securities industry amounting to many millions of dollars annually, New York's unclaimed property procedure only preserved $750,000 in a custodial account. See N.Y. State Finance Law §95. Thus in any year New York appears to have simply absorbed and spent almost all of the funds it technically acknowledged it was holding as custodian awaiting the claims of others. While, under an ordinary scenerio, a factual assumption that most unclaimed funds would not subsequently be claimed might be statistically valid, a reserve sum of $750,000 under the factual and legal uncertainty surrounding *these* unclaimed funds seems meager indeed. Well-known precedent from the Supreme Court make it clear that custodial takings are subject to superior rights of other states. See, e.g., New York's Supplemental Submission, Nov. 5, 1991, at 23 (states take custodially "and then only until another State comes forward with proof that it has a superior right to the escheat, or the property is claimed by its owner"). In this context, the failure to maintain a custodial account that exceeded more than a tiny fraction of the payment obligation exposure New York faced is not so much an issue of hardship as it is one of indifference or calculated gamble.

-- limitations that stem from practical realities rather than legal norms. Although New York does not have, in my view, either to a limitations or a laches defense, it may well be that New York is protected by the fact that records may no longer exist that reveal who the issuers were of funds that became "stuck" in the 1970s or earlier. While New York imposes a ten year recordkeeping requirement on brokers and dealers, there is little reason to believe records beyond that point will be easy to reconstruct. It is thus likely that, as one passes backwards in time, it will no longer be possible to determine whether any other state has a superior claim to the funds than does New York, which holds the funds under its custodial taking statute. This practical reality may relieve the most urgent sense of hardship from a realization that applicable legal rules do not seem to limit the reachback effect of a decision in this area.

C. Implementational Considerations

Other significant issues of implementation should also be remanded to me for further proceedings, party comment, and, if appropriate, for a subsequent recommendation and proposed supplemental decree. These issues include (i) the extent of the burden resting on a jurisdiction asserting that an address or identification is in fact known (is the burden a preponderance of the evidence or, as is common in equity, proof of a clear and convincing nature) and (ii) whether a convenient mechanism can be established for resolution by the Special Master of batches of disputed items (such as whether addresses are unknown in particular cases) or whether submission of such disputes to trial courts in the various states as the issues arise would be preferable.

V. CONCLUSION

At bottom, the legal issues presented by the parties in this case raise an ambiguity in the Court's precedents, namely, the scope and effect of the terms "debtor" and "creditor." This case raises the question of whether these terms appropriately refer in the first instance to (prior and subsequent) "owners" of funds, such as the issuer and a beneficial shareholder, or whether they refer equally to intermediaries holding funds as well, without claim of ownership. The basic question permeates application of the primary and backup rules alike. The parties' positions in this case also invite the Court, again, to reconsider its prior analysis at a more fundamental level.

In this Report, I recommend that it is more logical and fair to construe the terms debtor and creditor, in both the primary and the backup rules, as referring to the originator and beneficial claimant of the funds, as long as the location of either can be determined. That construction, I further recommend, obviates any fundamental need to reconsider the basic equitable rules themselves. Particularly if the backup rule is modified in a minor respect so as to use a locational test of the issuer's principal executive offices, this construction provides, for the primary and the backup rules alike, a distribution that seems appropriately fair, while convenient and consistent in application. As such, it appears congruent, in both letter and spirit, with the Court's original goals in fashioning equitable rules in this area in *Texas v. New Jersey*.

A proposed Decree embodying these recommendations is attached as Appendix A.

Respectfully submitted,

THOMAS H. JACKSON
Special Master

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January 28, 1992

Appendix A

PROPOSED DECREE

DELAWARE V. NEW YORK, ET AL.

No. 111, Original.
Decided _____. -- Decree entered_____.

Decree carrying into effect this Court's opinion of _____, ____ U.S. ____ (199).

DECREE

This cause having come on to be heard on the Report of the Special Master heretofore appointed by the Court, and the exceptions filed thereto, and having been argued by counsel for the several parties, and this Court having stated its conclusions in its opinion announced on _____, ____U.S. ____, and having considered the positions of the respective parties as to the terms of the decree,

And the following definitions having been adopted for purposes of this Decree:

> "beneficial owner" -- the person or entity who actually owns a security, and is entitled to receive the economic benefits of ownership and to exercise any privileges it provides in voting on matters of corporate governance;

"distribution" -- a payment or other transfer of money, securities or value (such as dividends, or interest) made in respect of an equity or debt security;
"holder" -- a person or entity in possession of all or part of a distribution, and who disclaims any ownership of, or entitlement to, its economic benefits or corporate governance rights;
"issuer" -- a corporate or governmental entity, including federally-chartered and foreign entities, that issues equity or debt securities (such as a company that has issued common stock, or a municipality which has issued bonds);
"last-known address" -- an address within the United States or its Districts or Territories;
"ownership interest" -- an interest in property entitling the person or entity holding that interest to the beneficial enjoyment of the property in question.
"underlying security" -- the common stock, bond, or similar device as to which a distribution has been made;

IT IS ORDERED, ADJUDGED AND DECREED AS FOLLOWS:

Intervention

1. All applications for intervention by a State, District, or Territory in these proceedings that were filed prior to the date of this decree are granted. The motion of Texas for leave to file an amended complaint in intervention is likewise granted.

The Merits

2. Each distribution in question in this case as to which the holder's books and records contain a last-known address of

the underlying security's beneficial owner is subject to escheat or custodial taking only by the State, District, or Territory of that last-known address, to the extent of that jurisdiction's powers under its own laws to escheat or to take custodially.

3. Each distribution in question in this case as to which the holder's books and records do not contain a last-known address of the underlying security's beneficial owner or, the last-known address being known, as to which the laws of the State, District, or Territory of the beneficial owner's last-known address do not provide for the escheat or custodial taking of such property, is subject to escheat or custodial taking only by the jurisdiction where the issuer of the underlying security has its principal executive offices, to the extent of that jurisdiction's powers under its own laws to escheat or to take custodially, subject to the right of the jurisdiction of the beneficial owner's last-known address to recover the property if and when its law makes provision for the escheat or custodial taking of such property.

4. Each distribution in question in this case as to which the holder's books and records do not contain a last-known address of the underlying security's beneficial owner and do not identify the issuer of the underlying security in respect to which the distribution was made, or as to which neither the laws of the State, District, or Territory of the beneficial owner's last-known address, the last-known address being known, nor the laws of the jurisdiction of the principal executive offices of the issuer of the underlying security provides for the escheat or custodial takingof such property, is subject to escheat or custodial taking only by the jurisdiction where the holder of the unclaimed distribution has its principal executive offices, to the extent of that jurisdiction's powers under its own laws to escheat or to take custodially, subject to the right of the jurisdiction of the beneficial owner's last-known address or the jurisdiction of the principal executive offices of the issuer to recover the property if

and when its law makes provision for the escheat or custodial taking of such property.

5. As to any distribution unclaimed in the hands of a holder, which itself disclaims any ownership in the distribution, the holder's determination after normal commercial efforts in review of its books and records to identify and locate addresses for the beneficial owner, and the issuer of the underlying security, shall be prima facie evidence of the ascertainability of the identifying information called for in this Decree. The burden shall rest upon any State, District, or Territory contesting the holder's determination to demonstrate, at the cost of that State, District, or Territory, that the books and records of the holder, together with readily available public information sources, identify a party with a superior right to the distribution and permit the holder to ascertain the location or last known address of that party.

6. For an entity that files periodic reports under the Securities Exchange Act of 1934, the principal executive offices of that entity shall be the office identified on the last report filed in the twelve-month period immediately prior to the distribution in question. If no single principal executive office is thusly identified, the appropriate location of the principal executive office of the entity shall be determined as a factual matter.

7. This action is hereby remanded to the Special Master for continued supervision of the implementation of this Court's decision and this Decree, including, where appropriate, further Reports and administration. The Special Master shall make further Reports to this Court on such other substantive matters as may be raised before him or that he may direct the parties to address. In addition, the Special Master may establish appropriate mechanisms for the submission and resolution of disputed

claims concerning the allocation of specific distributions under the principles of this Court's decision and this Decree.

8. Any relief prayed for by any party to this action which is not hereby granted is denied.

Appendix B

FACTS NOT REASONABLY SUBJECT TO DISPUTE

A. Overview

(1) The unclaimed property involved in this action arises after an issuer of a security pays distributions (dividends, interest, stock distributions, or other transfers of value) to the record owners of the security.

(2) "Certificated" securities are those that are documented with an actual physical certificate. These are either registered through a listing of the named owner on the books of the issuer, or are bearer instruments, not registered in anyone's name.

(3) Certificateless or "book-entry" securities are recorded electronically and on other records, but are not evidenced by a formal certificate. At this stage of the evolution of the securities marketplace, equity securities are generally certificated, though an increasing proportion of debt securities are maintained in book-entry form only.

(4) The "registered owner" or "record owner" of a security is the person in whose name the security is recorded on the issuer's books (and perhaps on the face of a physical certificate). The individual or entity so reflected, however, may not be (and commonly is not) the "beneficial owner" of the security, i.e., the person entitled to receive the economic and other benefits of owning that security (such as the right to receive distributions and the right to vote in matters of corporate governance).

(5) The recordkeeping of ownership and transfer data for some corporations may be handled by the issuer itself, but most issuers hire professional transfer agents and registrars, such as a trust company or bank offering this specialized service. The obligations of the transfer agent are commonly specified in the terms of an express contract.

(6) Upon presentation of a certificate, the transfer agent will verify that the certificate is valid and outstanding and not subject to any claims of loss or theft. The agent will then physically punch and mark the certificate as superseded (canceled), and will cause a new certificate to be issued pursuant to appropriate instructions from the prior holder.

(7) Most securities are held by intermediaries (such as depository institutions, brokers, and banks) for the benefit of others and are registered in the "street name" or "nominee name" of an intermediary.

(8) One such intermediary, Depository Trust Company ("DTC"), by its own estimation, in 1989 held approximately 72% of the shares of companies represented in the Dow Jones Industrial Average, 65% of the shares of all U.S. companies listed on the New York Stock Exchange, and 85% of the principal amount of all municipal bonds. There are several other, much smaller, depository institutions serving the securities industry. A large proportion of the securities not registered in the name of these depositories (or their nominees) is held in street or nominee name for the brokerage houses and banks that act on behalf of clients with beneficial ownership interest in the securities.

(9) The pervasive use of street name and nominee registration does not, however, affect the entitlement of beneficial owners to enjoy the benefits of security ownership, including financial distributions and corporate voting rights. Interpolation

of several layers of intermediaries also does not impede the system in actually providing to investors the attributes of ownership in these securities. Intermediaries regularly and assiduously arrange for the transmission to beneficial owners of proxies and information needed to exercise ownership rights, and arrange for the crediting of economic distributions made in respect of the securities.

(10) Most securities are traded on a stock exchange or between brokerage firms in the "over-the-counter" market. After a sale has been achieved, formal "settlement" of the transaction must take place, normally by delivery of the securities physically (or by creation of the appropriate book-entry) and the exchange of payment. According to industry practice, trades in stocks and corporate and municipal bonds should be effectuated by settlement on the fifth business day after the trade date. This process, which entails several recordkeeping and verification steps, is daunting in light of the large volume of trades taking place daily.

(11) The settlement process was streamlined by the creation of clearing organizations and depositories. Clearing organizations (the largest of which is the National Securities Clearing Corporation ("NSCC")), obtain trade data by computer on a daily basis from both the buying and selling brokerage firms and attempt to reconcile the information.

(12) Management of the physical security certificates created enormous burdens in the settlement process by the 1960s. In response, the securities industry created certificate depositories. Since 1973, DTC, a special purpose trust company organized under the laws of New York, has served as the principal securities certificate depository. DTC's members (called participants) are brokerage firms, banks and clearing agencies. They number in excess of 600, located throughout the United States and Canada.

(13) Focusing on the distributions which give rise to the unclaimed property at issue in this action, intermediaries (which disclaim any ownership interest in these distributions) endeavor to re-transmit the benefits received to the credit of the intended beneficiary. If the record holder of the security is a depository, for example, it will pay over or credit the distribution to its participants (banks and brokerage firms) shown on its own ledgers as having positions in the security. The bank or brokerage firm, in turn, will pass the distribution on to its customers, normally the beneficial owners who were the intended recipients of the benefits all along.

(14) Intermediaries commonly attempt to monitor upcoming distributions based on announcements from issuers. With respect to the vast majority of issuers, intermediaries may opt to credit their participants or customers with the value of the distribution as of the announced "payable date," rather than awaiting actual receipt of the distribution from the issuer. However, even intermediaries who engage in this practice regularly withhold such credits if the issuer is deemed unreliable or perhaps incapable of making good on an expected distribution. Also, where the amount or rate of an announced distribution is not fixed in advance, customer or participant accounts may not be credited until the value is actually received by the intermediary.

(15) Payments forwarded or credited by intermediaries to their customers may be reversed on rare occasions if the distribution is not in fact received as anticipated, or if an error has been made.

(16) The vast majority of each distribution declared by an issuer reaches the intended beneficiaries. In light of the trillions of dollars worth of securities outstanding, however, even a tiny percentage of failed transactions yields many millions of dollars on an annual basis in unclaimed securities distributions.

(17) Portions of a distribution may become "stuck" when an intermediary cannot determine the identity or address of the intended payee, its nominee, or another intermediary to whom the payment should be routed. Along the chain of transmission of the economic distributions, therefore, some of the payments can (and do) become unpayable in the hands of all three levels of intermediaries: paying agents of the issuer, depository institutions, and banks or brokers holding securities for customer accounts.

B. Paying Agents

(18) Paying agents or dividend disbursing agents are usually banks or similar enterprises, acting under a contractual arrangement with an issuer. Paying agents are employed by many issuers to disseminate dividends, interest, or other distributions.

(19) In many instances, the same entity will serve as both transfer agent and paying agent for a particular security. However, many issuers retain separate entities to perform these functions.

(20) For registered securities, on the payable date the paying agent will disburse the distribution to the record holders, i.e., those persons to whom the securities were registered on the issuer's books as of the close of business on the record date for the distribution. Payment, as noted above, is made a few days later, on the payment date. For a bearer security, however, the paying agent must await the receipt of coupons and then disburse the distribution to the persons presenting the coupons. It is not uncommon in the case of bearer securities for fewer than all of the coupons to be presented to the paying agent for payment of a particular distribution, leaving the paying agent with an overage -- an excess and unclaimed balance remaining from the total distribution.

(21) The paying agent for an issuer will almost always rely exclusively on information from the transfer agent or the issuer itself in making payments, including a list of shareholders on the record date for the distribution.

(22) A paying agent will frequently calculate in advance the expected distribution amount to be received from the issuer, and attempt to resolve differences if the actual amount does not coincide with its calculated values based on the shareholder list and other information provided from the stock transfer ledger and other records of the issuer or the transfer agent. In general, changes in the amount of a security issue outstanding in the period around the record and payment dates for a distribution may result in an excess or shortfall in the amount of distribution made available to the paying agent.

(23) Even though such anomalies are typically investigated and resolved in advance of payment, it nevertheless happens that when a distribution is paid out to the record holders, sometimes checks are never negotiated or are returned in the mail to the paying agent.

(24) In some instances the contractual arrangements between the issuer and the paying agent may require the agent to return such unclaimed distributions to the issuer after a certain period of time. If not, it is the practice of some paying agents in some jurisdictions to remit such unclaimed owner-unknown distributions to the jurisdiction of incorporation of the issuer (or domicile of a government issuer) as unclaimed property. More generally, after the statutory periods of dormancy expire, the paying agent will either remit the funds to the issuer's credit, transfer them to the state of incorporation of the issuer (usually where that state requests the funds) or simply hold the funds as unclaimed property.

(25) With respect to bearer bonds, when the coupon for a bond is not presented, the paying agent is ordinarily unable to ascertain the identity or address of the current holder, and funds allocable to such unpresented coupons are either returned to the issuer at its request, held by the paying agent as unclaimed, or escheated to the state of incorporation of the issuer of the bonds.

C. Securities Depositories

(26) DTC is the largest of three securities depositories in the United States, the others being the Mid-West Securities Depository Trust Company and the Philadelphia Depository Trust Co. DTC holds a position in these depositories and they hold positions in DTC, enabling their respective participants to conduct transactions with each other through the depository network.

(27) In order to be depository eligible, an issue must satisfy the criteria set forth in DTC's Operational Arrangements. DTC requires, for example, that dividends and interest be announced through standard services and paid on time, and that transfers of securities be accomplished within a certain time. DTC deals with underwriters, and some issuers, to obtain the necessary agreements. Both equity and debt securities are eligible for deposit under such terms, and more recently municipal bonds have also been so treated.

(28) DTC was organized to serve the securities industry, and does not view itself as an agent of issuing corporations. Nevertheless, it does enter into agreements with issuers and underwriters working with issuers to bring a security to the marketplace, at least with respect to the qualification of those specific securities for deposit.

(29) DTC's "primary mission" is stated to be the reduction of costs for securities services offered to the public by its participants. To this general end it immobilizes certificates for securities in a central place and provides electronic recordation of changes in ownership positions on behalf of its bank and broker participants in preference to physical transmission of certificates. It also handles pledges of certificates in certain circumstances, and alternative procedures for physical withdrawal when requested by a participant. Settlement of transactions is handled in a substantial proportion of the instances without any manipulation of the physical certificate(s) representing the share interests involved.

(30) DTC's participants have accounts at the depository in which they maintain a "book-entry" position in their securities. When a participant deposits physical certificates with DTC or receives securities via book-entry, its account balance is promptly credited; when it withdraws physical certificates or requests that securities be "delivered out," its balance is debited. Certificates are endorsed over to DTC's own nominee, Cede & Co. ("Cede") and then may be deposited at the depository's offices in New York, or at any one of a number of regional locations.

(31) Despite the growing emphasis on paperless maneuvers, members of the security industry regularly process demands for physical transmission of certificates. DTC's participants may withdraw physical certificates from DTC either on a routine or an urgent basis. In the normal case, DTC locates a certificate in an appropriate denomination in its vault and forwards that certificate to the issuer or its transfer agent for "re-registration" in a specified name, which may be either a beneficial owner or a nominee of that person, a broker, or a nominee of the broker or other intermediary. More exigent requests for immediate presentation of a certificate are processed by DTC through its Certificate-on Demand ("COD") system. Under this procedure, DTC simply takes a certificate from its vault, endorses it in

Cede's name, and then delivers the certificate to the requesting participant institution. Unless and until the recipient arranges for re-registration, Cede remains the record holder of the security on the transfer agent's books. This potential for delayed or non re-registration is one source of unexpected receipts of funds at DTC, as paying agents for issuers make distributions premised on the continuing record ownership of Cede prior to advice of any new designation of record holder.

(32) In order to reduce the movement of certificates between transfer agents and the depository, DTC uses a system known as Fast Automated Securities Transfer ("FAST"), in which all securities registered in Cede's name are evidenced in a single FAST "balance" certificate held by a transfer agent acting as DTC's custodian under an agreement between the transfer agent and DTC. If the issuer's transfer agent has agreed to provide COD urgent withdrawals to DTC's participants, when a participant entity requests an urgent withdrawal under the Fast System, the agent will honor the request by reducing the balance registered in Cede's name and issuing certificates in the requested denominations in the participant's "street" or nominee name. Some transfer agents do not agree to this level of service commitment for some issues ("Full FAST" service) but do contract to allow DTC to hold an assortment of round-lot certificates in its own vault with which to honor urgent requests (this practice is aptly called "Half FAST").

(33) Another form of certificate withdrawal from DTC is known as the "withdrawal by transfer," wherein a certificate is removed from DTC's vault and delivered to the transfer agent for the security, re-registered in the name designated by the participant who requests this service, and then delivered directly from the transfer agent to the participant or its designee. This process may take as long as two weeks, depending on the location and workload of the transfer agent.

(34) In general, then, in effecting a distribution a paying agent normally either wires or delivers a check for the payment of that distribution to DTC, as the record owner of the issuer's securities, through Cede as nominee.

(35) DTC monitors upcoming distributions through a number of financial information services, so that it will know in advance of a payable date to expect to receive a distribution. Prior to the payable date, DTC calculates how much of the distribution it expects to receive by adding up its participants' positions in that security as of the close of business on the record date for that distribution. Then, on the payable date, DTC credits its participants who had a positive balance in the security on the record date with the amount of the distribution in accordance with the rate information previously received by DTC. If DTC actually receives *less* than the expected amount of distribution for a security, it will routinely investigate why it has an "under-age." The depository will attempt to identify and correct any errors in its calculations, and may adjust a participant's account. It may in an appropriate case make a claim to the issuer or its paying agent to recover the shortfall from the amounts due. When, as sometimes happens, DTC receives more of the distribution than it was expecting -- an overage -- there is very little beyond checking its own calculations and records that DTC can do to resolve this excess balance. If the internal records show that all participants with positions in the security were satisfied, DTC may not be able to identify any appropriate recipient of the excess funds received.

(36) Overpayment of distributions to DTC results on occasion from the structure of trading, settlement, deposit, and withdrawal procedures described above, which may result in "missed transfers" and "Cede float," as well as more prosaic errors or out-of-balance conditions between DTC's records and those of the issuer or its paying agent.

(37) Missed transfers may occur from a variety of scenarios, but perhaps most common is a situation where a participant institution requests a "routine" withdrawal -- one in which DTC's standard practice would be to send the certificate directly to the transfer agent to have the issuer's books updated and the certificate re-issued in the new name. If the transfer agent fails, for reasons of clerical error, shipment delay, or otherwise, to re-register the certificate on or prior to the record date, DTC (actually, Cede as its nominee) will be listed as the record owner and the issuer's paying agent would pay the distribution to it accordingly. The depository is not "expecting" the distribution because it has already shipped out the certificate and bases its calculations on normal re-registration cycles making the transfer likely to happen on or before the record date. DTC may well not recognize that this transfer missed the record date (hence the term "missed transfer") and caused the excess of payment over the expected amount of the distribution.

(38) "Cede float" is a term DTC uses to refer to certificates withdrawn in physical form from DTC's vault prior to record date while still registered to Cede on the transfer records of the issuer (or its agent). When the record date for a distribution is reached, the record holder of the security is to be paid the distribution. However, if the holders of such certificates as of the record date (who may or may not be the persons to whom DTC actually gave possession of the paper) have failed to re-register the certificate, the issuer's payment agent will pay DTC since Cede will remain the holder of record on the issuer's books. In one recent year, over one million certificates registered to Cede were withdrawn from DTC's vault under just one of the various procedures for taking physical possession of certificates, and in DTC's experience many of these "float" in the channels of the industry, changing hands numerous times, before being re-registered in another's name. Indeed, such a certificate in Cede's name may remain in this nominee name over several subsequent distribution record dates, further under-

mining any possibility of DTC's sorting out why it may receive excess distribution at some future payment date.

(39) When the certificate is withdrawn from DTC's vault and given to a participant, it enters the stream of commerce still registered in Cede's name. DTC has no control over when the certificate is submitted to the transfer agent for re-registration, and has no way of knowing how many hands the certificate passes through before it is re-registered. While DTC knows the participant who withdrew the Cede certificate, that participant is unlikely to be the owner if the certificate remains in Cede's name. DTC presumes that the participant withdrew the COD to make physical delivery to a party outside of the depository system and unknown to DTC. Therefore, DTC does not consider the participant's address to be the last known address of the proper recipient of the unclaimed distribution.

(40) Transfer agents are required to provide DTC with the date the transfer was actually completed and any other information needed to clear the transfer position. In general, DTC has no other way of knowing what occurred at the transfer agent level.

(41) More pedestrian kinds of errors also occur, albeit infrequently, not all of which are uncovered in DTC's efforts to resolve incongruities in the amount of distributions received. These include miscalculation of a participant's total position in the security, use of the wrong rate for the distribution in calculating the expected receipt, and failure to credit a participant with the full amount of a distribution that the participant should receive.

(42) Out-of-balance conditions may also develop from clerical or shipment problems. Thus, if the records of the issuer (or its transfer agent) and those of DTC do not reflect the same amount for the position of DTC, the amount paid and the

amount expected will diverge. Out-of-balance conditions also result, inter alia, when an issuer or its transfer agent fails to make timely posting of a transfer that has been made. Since the error occurs outside of DTC it is most unlikely that DTC will discover the exact cause of the overpayment.

(43) Another occasional reason for overages, according to DTC, is mishandling of bearer bonds. Such bonds have interest coupons attached to them which must be clipped and presented to a paying agent or issuer for payment. In rare instances at DTC, a bond will become separated or lost from its participant's deposit ticket, resulting in DTC possessing greater inventory -- bond interest payments or coupons -- than DTC's records of participant positions would support. In such an event the payment received as a result of DTC presenting a coupon from a certificate without a deposit ticket would be set aside and booked as an excess pending a possible claim from the proper recipient of the funds.

(44) The existence of physical certificates continues to cause a large proportion of all anomalies in the amount of distributions received. For example, in the case of fully certificated registered issues and half FAST issues, the total position of DTC's participants on its records does not usually match the number of securities registered in Cede's name on the issuer's books.

(45) Finally, overages on distributions also result from late changes in the rate of a distribution. DTC allocates distributions according to the information provided by financial reporting services. Approximately two days prior to the payment date, the expected payment amount is calculated based on then current rate per share information. In some instances, rate changes prior to the payment date result in overpayment to DTC.

(46) Duplicate payments also occur periodically, as when a transfer agent executes a transfer request from DTC, but fails to delete Cede from its records, resulting in an overpayment to DTC as well as a correct payment to the new registered holder. However, DTC does not experience overpayments on "book entry only" issues. This is because Cede is the only record owner, and its total position must equal the entire Cede position on the issuer's books, since there are no certificates available.

(47) The anomalous reality is that the depository is aware in the abstract of the causes of over-receipts, but it often cannot determine the cause of a particular distribution "overage." And, of course, there may be multiple causes of discrepancy, since virtually all of DTC's participants hold account positions on, for example, IBM common stock, and among the millions of shares of that one security there could be several different glitches at play over any one record and payment date cycle. While some errors cancel each other out, others accumulate, making identification of precise overages and recognition of the individual causes of the differences impossible.

(48) DTC records the overpayment balance on every distribution it receives from a paying agent in its "Unclaimed Dividends" account. It records each balance under a unique reference number, consisting of the issue's "CUSIP," record date, pay date, and a function code to differentiate between types of distributions. The CUSIP number is a nine-digit figure assigned by the Committee on Uniform Security Identification Procedures. The first six digits of the CUSIP number uniquely identify the issuer, the next two digits identify the security, and the final digit is used as a "check digit" that confirms the accuracy of the previous digits. CUSIP numbers are used throughout the securities industry to identify each different security. In addition, intermediaries identify each distribution received on a particular security by the CUSIP number for that security. Unclaimed

distributions, therefore, are identified by CUSIP number and, through the CUSIP number, by issuer.

(49) Just as the depository sometimes makes claims to issuers or paying agents, on occasion a broker or banking institution may make a claim to DTC for correction of an underpayment on a security distribution.

(50) Individual beneficial owners may not make claims of this nature against DTC, which instead requests that such claims be resolved between the owner and DTC's participant institution, usually the owner's broker or bank.

(51) The vast majority of claims that come into DTC from claimants holding Cede certificates over the record date materialize within three to six months following the payment date. However, some claims may be made years later, even after the property has been turned over to New York as unclaimed for the statutory period. When such a late claim appears valid, DTC may provide a claimant with an affidavit which allows the claimant to pursue recovery of the property directly from New York.

D. Brokerage Firms

(52) Brokerage house customers sign account agreements which often provide, among other things, for the custody of certificates. Most often, when securities that are not depository eligible are purchased, the brokerage firm will become the record holder, holding them "in street name," for the benefit of its customers. The customer most commonly elects not to hold the certificates and the broker will either hold them in a central depository, or in its vault, registered in the name of the brokerage or its nominee.

(53) Individual "retail" customers of the brokerages requesting certificates normally receive only those certificates registered in the individual's name. These customers do not usually receive endorsed certificates registered in the name of the brokerage or its nominee, and hence such arrangements do not normally result in distributions received erroneously by brokerage firms. Some large entities, such as institutional investors, have arrangements with some brokers to hold certificates in their own vaults, and may receive certificates reflecting the endorsement of the brokerage firm and or its nominee. If those certificates are not reregistered, unexpected payments to the broker may arise in connection with a distribution.

(54) Brokers obtain information about distributions from issuers, industry publications and services, and depositories such as DTC. The information is commonly stored in a computer file by issue, CUSIP, rate of payment, record date and payment date.

(55) At the close of business on record date, brokerage customers with physical possession of securities registered in their own names will receive dividend and interest distributions directly from the paying agent.

(56) Stock brokerage firms have designed systems for fairly automatic crediting of distributions to customer accounts on the payment date. Between the record date and payment date, the broker sets up a dividend pending file for adjustments to its customers' record date positions. The broker normally credits all of its customers' accounts that have long positions in the particular security, based upon the dividend or interest rate and the number of securities held.

(57) Potential error sources at the brokerage firm level vary as widely as at the depository level. "Float" errors occur here too, for example when a customer of one firm sells a security reflect-

ed on a physical certificate held in the broker's vault. Settlement of such a transaction entails manual delivery of the certificate, and the same syncopation in re-registration observed with DTC may also occur. The term "nominee float" has been used to describe this phenomenon, since most such certificates in the physical possession of brokers and banks are registered in nominee names. The nominee remains the payee on the issuer's books until the certificate is re-registered, and thus receives distributions, for as long as the holder(s) of the certificate fail to submit it to the transfer agent for re-registration.

(58) In addition to errors, miscalculations, and registration anomalies paralleling those experienced at the depository level, brokers may also fall prey to other, trading-related sources of discrepancy. One of these arising for trades on the cusp of a distribution's record or payable dates is the "fail to deliver" or "fail to receive," which comes about when securities held in physical certificate form by a broker are not delivered in timely fashion upon settlement of a trade. The intended recipient does not, in those instances, have an opportunity before the record date to re-register the certificate, and the distribution is paid to the record owner rather than the new holder. While in most such instances the recipient pays the distribution over to the new holder, sometimes the error is not recognized. As an example, the seller may transmit the certificate in ample time, but it may be mishandled in delivery or at the offices of the second broker.

(59) Discrepancies in the amount of distributions received at the broker level may also result from loans of share certificates. Ordinarily the lender is entitled to receive the distribution, but errors occasionally occur and may not be corrected.

(60) Brokers routinely make claims against other brokers (and banks) to recover distributions to which they or their customers were entitled on payable date. The brokerage industry has

created the "Dividend Settlement Service" to facilitate these claims.

(61) Even the attempt to resolve ownership interest is frequently defeated by inherent uncertainty. Some brokerage firms investigate overages when they occur, but others do not (unless they receive an inquiry or a claim for those funds). When the firm does receive a claim, usually from another brokerage house, it seeks evidence that the claimant held a certificate over the record date, and that the certificate was registered in the name of the claiming brokerage at some time prior to the record date for the payment of the distribution. Because the claimed-upon broker is often unable to ascertain with certainty that the entity claiming the overage actually was entitled to a portion of the excess distribution, industry practice is to honor the claim if the claimant provides an indemnification holding the brokerage harmless should another claimant subsequently seek to recover part or all of the same distribution.

(62) When a claim is made, numerous verification procedures are open to the brokerage firm. It may have recourse to its "overs" or "overage" account to determine whether it booked an overpayment in the particular security for the record and pay dates involved. The broker may also examine its daily stock record, which lists, by account number, all trades in that security on a particular day. This record may indicate whether a delivery was made to the claiming broker around the record date. In addition, the firm may inspect records to match the certificate numbers in the claim against those on its delivery tickets.

(63) Daily stock records generally provide only an identification of all customer accounts that traded in a security, or had shares in transfer for re-registration, on a given date. However, there is no particular date prior to a record date which gives rise to overpayments.

(64) Similarly, a broker rarely can relate an overpayment to a particular customer account based upon a check of the certificate numbers. Since customers hold a position in the securities they own, not in specifically numbered certificates, when they withdraw the security the transferring broker simply pulls a specific certificate from its vault. Its number might not be logged to the account.

(65) When a claim is presented by another brokerage house, that firm may have paid its customer and be seeking reimbursement. The firm holding the funds may never learn whether the claim is being advanced for the interest of the beneficial owner of the underlying security or for the brokerage firm with whom that owner has an investment account.

(66) If any portion of an overage remains unclaimed for the statutory period, and the holder does not know to whom it is appropriately payable, the funds are normally reported as unclaimed and subject to escheat or custodial taking. In practice this has often meant custodial taking by New York, where many of the firms have significant offices.

(67) As with DTC, brokers understand how discrepancies develop between expected and actual distribution receipts, but often cannot determine the cause of a particular overage.

E. Custodian Banks

(68) Many banks offer custodial accounts that allow their investor customers to buy and sell securities through their brokers and leave those beneficially owned securities in the bank's custody. Like brokerage firms, the bank either retains the physical certificates or maintains book-entry positions at a depository. A customer trading securities will instruct the bank to deliver or receive securities.

(69) If the security purchased for the bank's client is eligible for deposit with the central depositories, that security is ordinarily so deposited and the bank's account is credited. Accordingly, the depository's nominee is the record holder on the transfer ledger of the issuer and its transfer agent. If the security is not eligible for deposit, the bank will generally transfer the certificate registration to the name of the bank's nominee.

(70) On the payable date for a distribution on these securities, the bank will receive the distribution directly from the issuer or its paying agent. For those securities on deposit with a depository, the bank will receive distributions from the depository because the depository's own nominee is the record owner in such instances, and the bank is "long" on the books of the depository as a participant institution.

(71) Banks, like brokerage firms, regularly become aware of an upcoming distribution in advance of the payable date, and credit the accounts of beneficial owners of the securities, as of the record date, on the payable date. In most instances a bank or broker will credit its customers' accounts with the distribution whether the bank receives the payment or not. In the rare case where that accounting entry proves improvident, the credit may be reversed.

(72) Payments received by banks (and brokerage firms) as distributions on securities are ordinarily received as a lump sum credit reflecting the total amount of securities held of record by the firm or reflecting the firm's position with a depository.

(73) As a result of such custodial arrangements, occasional overages in the receipt of distributions occur at custodial banks for the same reasons they occur at brokerage firms ("float" difficulties, missed transfers, out-of-balance conditions, and other errors). The internal audit and correction process is also similar to that applicable at brokerage firms, as is the difficulty

in identifying the appropriate recipient of some portion of an excess distribution received. Escheatable proceeds are thus created.

(74) A "missed transfer" can also cause an excess distribution to a bank or brokerage house. In those circumstances -- similar to the situation described above -- the endorsed certificate in the name of the brokerage or its nominee is delivered to the purchaser or purchaser's broker who then forwards it to the issuer's transfer agent. Before the agent reregisters the certificate in the name of a new owner, a record date passes. Thereafter, on the payment date for a distribution, the brokerage rather than the purchaser is listed as the record owner, and unless a claim is received by the brokerage, it will not know that it received the distribution for that certificate.

(75) Excess distributions can also accrue to a bank or brokerage firm when a certificate registered in the name of that entity is deposited with a depository and that certificate is not reregistered in the depository's name before the record date. An overpayment would result since the brokerage would be receiving a distribution from both the depository and the paying agent.

(76) Overpayments to banks and brokers with respect to a distribution can also result from payment rate changes which occur prior to the payment date, out-of-balance conditions existing on the books between the paying agent and the bank or brokerage, or between the depository and the brokerage, and other errors.

(77) In a significant number of instances, the bank or brokerage house cannot determine after diligent review who the appropriate recipient of the excess receipts in a distribution would be. And in many instances, unless a claim to pay over those unclaimed distributions is made by the ultimate beneficial owner

of such securities, the holder will not know the name or address of the beneficial owner of the distribution.

METAFACTS: General Propositions Generally Beyond Dispute

A. The intermediaries in the process of effectuating securities distributions -- paying agents, depository institutions, brokers, and custodian banks -- do not claim any entitlement to the excess, unclaimed distributions at issue in this action.[1]

B. These intermediaries acknowledge and operate on the premise that the securities system's purpose and desired result as to distributions is to deliver the payment to the beneficial owner of the underlying security, not to a record owner or any intermediary through whose hands the distribution might be channeled that are not also beneficial owners.

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1. In part this is because the anomaly exceeds expectations. If the distribution is *less* than expected, and particularly if the intermediary has paid a customer, client, participant or trading partner based on the expected level, the intermediary is at risk to take a loss on the distribution, and discovery shows that intermediaries uniformly investigate such underpayments with full vigor and make claims for the "underage". Since the intermediary in this sort of situation can demonstrate that it represented a party "down the line" and passed the benefit along to that party, it appears that the claims for underpayment are largely successful. When, however, the anomaly is in the form of overpayment to the intermediary, the intermediary lacks that certitude about the error; all of its known constituents will receive the benefits and still there is part of the distribution left over. Since the intermediary is not "out" any funds in this situation (i.e., any advance payment it may have made based on the expected amount to be received in the distribution has been fully recompensed, with an excess to boot) it has no claim to the excess.

C. At every level of intermediary transmission of securities distributions, significant amounts of distributions (in absolute dollar, but not percentage, terms) are on occasion found by the intermediary holders of the distribution to be without a known appropriate recipient.

D. Unclaimed distributions held by intermediaries fall into several categories, including:

(i) distributions with no known intended recipient, customer or client account, where:

(a) no intermediary associated with the distribution is identified in any way,[2] or

(b) an intermediary from whom the distribution was received is identified on the holder's records,[3] or

(c) an intermediary who appears to have been acting for the beneficial owner of the securities is identified.[4]

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2. A paradigm might be loose bearer bonds found in the vault of an intermediary, separated from any records attributing ownership or sources of the bonds.

3. For example, a depository knows that the distribution of which the unclaimed funds are a part came from a paying agent; a broker knows that the funds came from a depository or another broker.

4. For example, efforts to reconstruct all trades around the record date involving a particular issue may lead to the identification of a missed transfer in which an identified broker was to have been the recipient of

(ii) the holder may have distributions known to be payable to a beneficial owner who cannot be located but for whom the holder has a "last known address."

(iii) the holder may have distributions thought to be payable to a beneficial owner for whom no last known address is on record.

E. In all of the above circumstances, the intermediary will know the identity of the issuer, as this is the means by which records are organized.

F. The state of incorporation of any issuer or corporate intermediary is readily ascertainable from standard sources, governmental filings, computer databases, and the like.

G. The location of the principal executive offices of an issuer is, in almost all cases, ascertainable from standard sources.

H. Routine filings with the Securities Exchange Commission under the Securities Exchange Act of 1934 require defined issuers, domestic and foreign, to list their principal executive offices.

I. State and local governmental securities issuers have their principal executive offices in the state where they are chartered.

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a security expected to be re-registered prior to the record date for a distribution and, it appears, the beneficial owner for whom the would-be recipient broker acted was entitled to receive the distribution.

J. The unclaimed property at issue in this litigation arises from securities distributions by publicly-traded companies, and especially larger companies listed on securities exchanges. For the companies whose distributions are at issue in this litigation, the principal executive office location is more likely to reflect a jurisdiction in which significant commercial activity takes place than is the jurisdiction of incorporation, which for these companies as a group is disproportionately concentrated in one state (Delaware) in which, for many such companies, no significant business center is maintained.

APPENDIX C

No. 111 Original

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1989

STATE OF DELAWARE,

Plaintiff

against

STATE OF NEW YORK,

Defendant

REPORT OF THE SPECIAL MASTER ON MOTIONS TO INTERVENE

This case commenced as a suit by the State of Delaware ("Delaware") against the State of New York ("New York), in which Delaware asserts a right to unclaimed property, mainly dividend and interest payments by corporations of various locations, held or formerly held by brokers located in New

York and incorporated in Delaware. Involved, in the main, is the appropriateness and application of two cases on the issue of escheating of unclaimed property, Texas v. New Jersey, 379 U.S. 674 (1965), and Pennsylvania v. New York, 407 U.S. 206 (1972). The Court granted Delaware's motion for leave to file a complaint on May 31, 1988 and appointed the undersigned Special Master on December 12, 1988.

Shortly after this, other jurisdictions began to take more than a passing interest in this case. The State of Texas ("Texas") was the first to file a motion for leave to file a complaint in intervention, and its motion was granted by the Court on February 21, 1989. Numerous other states (plus the District of Columbia) have since then filed motions (variously labeled) to intervene, and, by order dated June 12, 1989, all of these motions filed as of that date were referred to the Special Master. These jurisdictions assert that portions of the monies at issue, attributable in the first instance to issuers incorporated in those jurisdictions, should escheat to them under their unclaimed property laws and under what they assert to be the correct interpretation of applicable precedents in this area.

New York has moved for judgment on the pleadings against Texas, and has opposed further motions to intervene by subsequent jurisdictions on the ground that "[t]he state applicants for intervention are not entitled to intervene as of right unless the Court decides to overrule *Texas v. New Jersey* and subsequently determines that Texas would not adequately represent them in establishing the amount of their claims." State of New York, Brief in Opposition to Motions for Leave to Intervene 6 (May 18, 1989). Furthermore, New York has requested that the Court should defer deciding the motions to intervene by the various jurisdictions until it decides the motion for judgment on the pleadings against Texas. *Id.* New York's motion for judgment on the pleadings was also referred to the Special Master by order dated June 12, 1989.

Although the number of jurisdictions seeking intervention is indeed large, I am convinced that New York's request to defer ruling on the motions to intervene should be denied.

Among other things, those jurisdictions seeking to intervene should be entitled to present their own defenses to a motion for judgment on the pleadings that is likely to affect their posture in this case as well. For, whether their stake in this lawsuit depends on the overruling of *Texas v. New Jersey* and *Pennsylvania v. New York* is, at bottom, an issue to be resolved, at the earliest, at the time of deciding the motion for judgment on the pleadings. It is enough for now to note that the jurisdictions seeking intervention purport to rely on these cases. Given that, they should be entitled to be heard on the motion for judgment on the pleadings, and that requires intervention before rather than after deciding such motion. Moreover, even in terms of judicial economy, the savings occasioned by proceeding the way suggested by New York are problematic. Should New York's motion against Texas on the pleadings be granted, it is at least conceivable that other states would then seek intervention, asserting that their basis for intervention differed substantively from Texas'. And, if New York's motion is not granted, the principal basis to reject intervention by other jurisdictions would then be that "applicant's interest is adequately represented by existing parties," FRCP 24(a), or "the intervention will unduly delay or prejudice the adjudication of the rights of the original parties," FRCP 24(b).

These issues are ripe for determination now. Intervention at this point will not unduly delay this case. And, while adequate representation of all the jurisdictions by a limited number of states seems possible, given that this is an original action and that states are sovereign entities, a generous intervention standard should be used, as the Court has appeared to use in the past. *See* Maryland v. Louisiana, 451 U.S. 725, 745 n. 21 (1981); United States v. Louisiana, 354 U.S. 515, 515-16 (1957). That way, such states have maximum latitude in presenting their own case. In saying this, I fully expect and hope that the various jurisdictions seeking
intervention can agree on methods for coordinating their positions. I view such agreed-upon coordination preferable, however, to a refusal to permit intervention. Accordingly, I recommend that the Court grant the various motions to intervene

by the jurisdictions that have, to this point, filed such motions. A proposed order is attached.

Respectfully submitted,

THOMAS H. JACKSON
Special Master

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September 13, 1989