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.

REPLY BRIEF OF THE PLAINTIFF-INTERVENOR STATES OF TEXAS, ARIZONA, COLORADO, CONNECTICUT, IDAHO, MINNESOTA, NEW MEXICO, NORTH CAROLINA, OREGON, SOUTH CAROLINA, TENNESSEE AND WISCONSIN AND THE COMMONWEALTH OF VIRGINIA TO THE EXCEPTIONS OF THE STATES OF DELAWARE AND NEW YORK

DAN MORALES
Attorney General of Texas
WILL PRYOR
First Assistant Attorney General
MARY F. KELLER
Deputy Attorney General
for Litigation, *Counsel of Record*
JAMES A. THOMASSEN
Assistant Attorney General
JEFFREY A. CORYELL
Assistant Attorney General
P. O. Box 12548
Austin, Texas 78711
(512) 463-2018

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Attorneys For The State Of Texas

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STATEMENT OF THE CASE

1. *Introduction*

This case involves a vast pool of unclaimed property, amounting to hundreds of millions of dollars, consisting of dividends and interest held (or previously held) by securities depositories, brokers and banks with operations in New York City. Much of this property has been seized by New York under its abandoned property laws, based on little more than the fortuitous location of Wall Street. Delaware commenced this litigation to assert that it should receive a major portion of these funds, based solely on the happenstance that most of the brokers in question are incorporated in Delaware.

Texas intervened to urge that the federal common law rule of *Texas v. New Jersey,* 379 U.S. 674 (1965), properly applied to the facts of this case, should cause the unclaimed property to be distributed to all of the States, based upon the fact that the corporate and municipal issuers of the underlying securities (who paid out the dividends and interest that became unclaimed) are domiciled in such States. All of the remaining States and the District of Columbia have also sought leave to intervene, most in support of the Texas position.

The Special Master appointed by this Court has now filed his Report, which Texas and the other States joining in this Reply Brief ("Texas, *et al.*") support in all respects. The Special Master's conclusions reflect a detailed and careful analysis of the voluminous record and the contentions of all States participating in this case. His recognition that issuers are the debtors of securities distributions for purposes of the federal common law rule of *Texas v. New Jersey* will preserve that time-honored rule while applying it fairly to the factual setting of this case. In addition, the Special Master's recommended modification of the locational test under that rule, from state of incorporation to principal executive office, is an appropriate adjustment to preserve the rule's essential purpose of fairness among the States.

The objections of Delaware and New York to the Special Master's Report, on the other hand, would convert *Texas v. New Jersey's* rule of fairness into an engine of inequity. Delaware and New York each would bind the federal common law rule of that case to the technicality of nominee registration of securities, an arrangement created under state law for wholly unrelated purposes. New York further asserts that it is entitled to retain the enormous sums it has wrongfully taken, based in part upon a newly-devised (and wholly invalid) presumption as to the identity of the unknown owners of unclaimed securities distributions held by brokers. None of the other forty-eight States or the District of Columbia has objected to the Special Master's Report.[1]

The contentions of Delaware and New York proceed from an erroneous view of both the conceptual underpinnings of *Texas v. New Jersey* and the purpose of the federal common law rule established therein. These two States further rely upon mistaken assertions about the nature of the unclaimed property in this case. A brief review of the history of the rule of *Texas v. New Jersey*, and of the nature of the unclaimed property at issue, is necessary before addressing the arguments advanced by Delaware and New York in their Exceptions to the Special Master's Report.

2. *The Rule of* Texas v. New Jersey

The occasion, although not the result, of the rule of *Texas v. New Jersey* was foreshadowed by a line of cases dealing with due process challenges to state escheat or unclaimed property laws. In these cases the various States' claims to escheat, based on different kinds of contacts between the escheating State and the escheated property, were upheld. *See, e.g., Standard Oil Co. v. State of New Jersey*, 341 U.S. 428, 437 (1951) (New Jersey was the state of incorporation of Standard Oil, the issuer and holder of the unclaimed property); *Connecticut Mutual Life Ins. Co. v. Moore*, 333 U.S. 541, 542 (1948) (New York was the state in which the underlying insurance policies had been issued for delivery,

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[1] The States of Michigan, Maryland and Nebraska, and the District of Columbia, all endorse the Report of the Special Master, Exceptions of Michigan, *et al.*, 2, although they have filed Exceptions in order to continue to suggest that the unclaimed securities distributions should be spread among the States pursuant to an allocation formula specific to this case.

and in which the persons whose lives were insured by such policies had lived); *Security Savings Bank v. California*, 263 U.S. 282, 285 (1923) (California was the state in which contracts of deposit were made and to be performed, and in which the bank was incorporated and had its place of business). In *Western Union Telegraph Co. v. Pennsylvania*, 368 U.S. 71, 72-79 (1961), the Court recognized that these possible premises for escheat of intangibles were conflicting, and indicated that it would be appropriate for the Court to establish a rule of priority to govern conflicting claims. However, as this Court later cautioned, "none of this Court's cases allowing States to escheat intangible property decided the possible effect of conflicting claims of other States." *Texas v. New Jersey*, 379 U.S. at 681 n. 13. In none of those cases was the issue of the priority of different States' laws squarely before the Court, and none of those cases now serves to limit or define the rule eventually adopted to establish such priority.

In *Texas v. New Jersey*, the priority issue was presented to the Court, which adopted the now well-known two-part rule of priority. The first, or "primary," rule provides that the power of escheat falls to the State of the last known address of the "creditor" of each item of property. 379 U.S. at 682. The Court explained that this rule is "require[d]" by "fairness among the States," because it: (1) "involves a factual issue simple and easy to resolve, and leaves no legal issue to be decided;" (2) "recognizes that the debt was an asset of the creditor;" and (3) "will tend to distribute escheats among the States in the proportion of the commercial activities of their residents." 379 U.S. at 680-81.

Under the second, or "back-up," rule, however, when such "creditor" or address is unknown, or when such State has no applicable unclaimed property law, the unclaimed property is "subject to escheat by the State of corporate domicile" of the debtor, subject to the right of another State to recover the property "upon proof that the last known address of the creditor was within its borders," or "if and when its law made provisions for escheat of such property." 379 U.S. at 682. Thus, under this back-up rule, a State "retain[s] the property for itself only until some other State comes forward with proof that it has a superior right to escheat." *Id.*

The unclaimed property at issue in *Texas v. New Jersey* included dividends on shares of common stock. In that case the debtor of these unclaimed securities distributions was held to be the issuing corporation, Sun Oil, despite the fact that some part of the unclaimed property in question was held not by Sun Oil but by various banks and paying agents. 379 U.S. at 675 n. 4. The unclaimed property in this case again includes dividends on corporate stock, as well as interest on corporate and government bonds. Texas, *et al.*, submit that, like the dividends at issue in *Texas v. New Jersey*, the unclaimed distributions in this case fundamentally represent payments of debts flowing from the issuers to the investors.

The rule of *Texas v. New Jersey* was revisited seven years later in *Pennsylvania v. New York*, 407 U.S. 206 (1972). The unclaimed property in the *Pennsylvania* case arose out of the purchase of money orders from Western Union. Pennsylvania argued that because Western Union's money order records frequently do not include an address for either the sender or the payee, the state in which the money orders were purchased should be presumed to be the State of the sender's residence and therefore entitled to take custody of the funds. 407 U.S. at 211-12. The Court declined to incorporate this presumption into the rule of *Texas v. New Jersey*. In response to the complaint that this would cause most of the funds to be remitted to the Western Union's state of incorporation, the Court noted that although the percentage of unknown addresses was apparently high, "a substantial number of creditors' addresses may in fact be available," and nothing "prohibits States from requiring Western Union to keep adequate address records" in the future. 407 U.S. at 215.

Like the present case, the factual setting in *Pennsylvania v. New York* involved a multi-phase transaction. However, the transaction there was fundamentally different because the party originating the property (in that case, the sender of the money order) was unknown. In the present case, the issuer of the underlying security is always a known and locatable entity. Also, in the money order setting, the sender did not necessarily generate the money order in fulfillment of a debt. In the present case, whether the underlying security is a bond or a share of stock, the distribution is always transmitted by the corporate or municipal issuer in fulfillment of a contractual obligation undertaken by that issuer.

Texas, *et al.*, believe that the rule of *Texas v. New Jersey* has proven to be fair and practicable and has been applied to good effect to many kinds of unclaimed intangible property. Thus, these States submit that the rule should be preserved, and should be interpreted so as to produce a fair result when applied to the unclaimed securities distributions at issue in this case. The proposed modification of the back-up rule, which serves to refine and improve that rule in light of recent developments in law and technology, should be adopted.

3. The Unclaimed Property In This Case

The complexities of the securities industry, including the identity and role of various intermediaries involved in distributing dividends and interest from issuers of securities to their investors, and the various reasons that some of these payments become "stuck" in the hands of intermediaries rather than being passed on to the investors, are comprehensively described in Appendix B to the Special Master's Report. Texas, *et al.*, adopt the Special Master's findings in lieu of a detailed recitation of facts in this Statement of the Case. In order to respond to certain assertions by Delaware and New York in their Exceptions, however, it is necessary to briefly highlight the following factual background.

While the fundamental economic relationship between the issuers of securities and their investors has not changed since *Texas v. New Jersey* was decided in 1965, the system for distributing dividends and interest from issuers to their investors has changed dramatically. Today securities are generally registered in nominee name and immobilized in a central depository. The depository holds the securities for the account of brokers and banks, whose books and records in turn show the holdings of their customers (or the holdings of other brokers or banks, who in turn hold those securities for their customers). Thus, securities distributions must pass through a chain of intermediaries such as depositories, brokers and banks before reaching the investors entitled to them.

The unclaimed property in this case comprises distributions whose progress from the issuer to the investor through the chain of intermediaries has been interrupted by processing delays, bookkeeping errors and other mishaps. In other words, the unclaimed property at issue is the amount by which the distributions received by the intermediaries exceed what the intermediaries must pay out to beneficial owners (or to other intermediaries to be further transmitted to beneficial owners) according to their own books and records, reduced by any amounts subsequently paid out by the intermediaries in response to valid claims of ownership. Although large in amount, these unclaimed distributions constitute only a minuscule portion of the billions of dollars of securities distributions that corporations and governments regularly transmit to intermediaries, with the intention and expectation that such distributions will be passed along to the beneficial owners of the securities.

Distributions must be paid to intermediaries, rather than directly to the investors, because the securities are registered in the nominee names of the intermediaries.[2] Under a nominee arrangement, the investor retains ownership of and control over the securities, but does not appear as the record holder in the books of the issuer. This practice developed primarily to facilitate the settlement of securities trades, and the role of intermediaries in receiving and transmitting distributions is merely an "ancillary outgrowth" of nominee registration. Statement of the Depository Trust Company ("DTC") p. 2 (reproduced at Appendix ("App.") pp. 7a-8a).

Issuers have not always been required to transmit the bulk of the distributions on their securities through a chain of intermediaries. Until fairly recently, investors usually held physical security certificates registered in their own name.[3] However, in the late 1960s and early 1970s, the rapidly increasing volume of paper transactions processed through brokerage firms and transfer agents created a crisis in the industry. DTC Statement pp. 1-3 (App. pp. 7a-9a). This crisis led to the development of central depositories such as DTC, as well as a great increase in the percentage of

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[2] For a discussion of nominee registration, *see* SEC, Final Report of the SEC on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other Than the Name of the Beneficial Owner of Such Securities, House Committee on Interstate and Foreign Commerce, 94th Cong., 2d Sess. (1976).

[3] *See* Loss, *Securities Regulation* 529 n. 226 (1951) (only about 10% of corporate stock held in nominee name as of 1937); SEC Legislation, Hearings Before the Subcommittee on Securities of the Senate Committee on Banking and Currency, 85th Cong., 1st Sess. 34 (1957) (testimony of Philip A. Loomis, Jr., Director, Division of Trading and Exchanges, SEC) (about 20% of corporate stock held in nominee name by 1957).

securities held in nominee name.[4] A large majority of outstanding securities issues are now eligible for deposit into central depositories, and vast numbers of securities have actually been deposited. Brokers generally belong to the depositories and utilize their facilities. Shearer Dep. 362, 365; Principe Dep. 56-57; Cirrito Dep. 37.

Intermediaries such as brokers and banks are not entitled to retain the distributions they receive due to nominee registration. While the vast majority of such distributions are routinely passed along to investors, the unclaimed distributions in this case represent that tiny fraction of the total which inevitably goes awry in a complex system of such magnitude.[5] One of the brokers from whom discovery was taken estimated that "far, far less than one percent" of distributions handled by the brokerage firm become unclaimed property. Shearer Dep. 516.

Securities distributions are received by the intermediaries

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[4] This evolution in the securities industry was spurred by a number of related developments. Congress passed the Securities Investor Protection Act of 1970, Pub. L. 91-598, 84 Stat. 1636 (1970) (codified at 15 U.S.C. §§ 78o, 78aaa-78lll (1988)), which permits investors to accept bookkeeping entries rather than physical certificates without risking the loss of their capital. The Uniform Commercial Code was amended to provide that legal delivery of a security occurs when an appropriate book entry has been made on the books of a depository. U.C.C. § 8-320(1) (promulgated in 1977) (App. pp. 4a-5a). Central depositories, initially created by the major exchanges, became subject to SEC regulation in 1975, and Congress specifically directed the SEC to encourage nominee registration. Pub. L. 94-29, 89 Stat. 141 (1975) (codified at 15 U.S.C. § 78q-1(e) (1988 & Supp. II 1990)).

[5] For example, in 1989 alone DTC processed $ 207.7 billion of cash dividend and interest payments. DTC, *1989 Report of the Depository Trust Company* 3 (Exhibit E to Brief of Ariz. [Tex.], *et al.* (Oct. 30, 1990)). Prudential Bache services over 300,000 different securities issues in over 2 million accounts. Cirrito Dep. 18-19.

from various sources including issuers, paying agents and depositories.[6] These payments are not identified to particular certificates within a security issue, but rather are received and held as one undifferentiated amount. Shearer Dep. 131. An intermediary discovers that it has received an overpayment only when the total amount it has received on a particular distribution for a particular security issue proves to be different from (and to exceed) the total amount that it has paid out to its customers or to other intermediaries. Principe Dep. 86; Shearer Dep. 181.

There are many acknowledged causes of unclaimed distributions, although as to particular items of property the specific cause (or causes) cannot be identified. Thus, for example, such unclaimed property may be caused by out-of-balance conditions between issuers and intermediaries;[7] "missed transfers" (i.e., when physical securities are sent to a transfer agent for reregistration, but the transfer agent fails to post the reregistration prior to the pertinent record date),[8] and various kinds of errors resulting in out-of-balance conditions between a depository and one of its participants, between brokers, or between brokers or banks and their

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[6] DeCesare Dep. 26-27, 37-38; Cirrito Dep. 22, 40, 48, 71-78, 82-83; Principe Dep. 75, 79-80, 100-101, 104; Shearer Dep. 94, 129-35, 206-07, 225; Scott Dep. 15-16.

[7] DTC Statement p. 15 (App. pp. 11a-12a); Shearer Dep. 194; Cirrito 224; Scott Dep. 166-67.

[8] DeCesare Dep. 87-91, 120 ("it's always possible that [a transfer agent] could fail to post something on a transfer and have a bad record as to what is actually outstanding by registration") and 123 (missed transfers can result in excess payments to the depository that are still unresolved after three years and are therefore turned over to New York as unclaimed property); Principe Dep. 98; Shearer Dep. 242-43.

customers.[9] In the words of a vice president of Prudential Bache, "[t]here are any number of reasons why you would wind up receiving monies that you really wouldn't know what to do with." Cirrito Dep. 224.

Thus, the causes of this kind of unclaimed property are known to be numerous. However, by the time the unclaimed securities distributions become abandoned property (i.e, after the passage of the applicable dormancy period), both the actual owners of the property and the specific reasons that the property became unclaimed are not known. As explained by a senior vice president of Prudential Bache, "the problem with overages is that you don't have -- you don't agree or don't know to whom the monies are due. If you did, you would pay them." Cirrito Dep. 128.

Because nominee registration does not alter the economic rights of the beneficial owners of the securities, the intermediaries acknowledge that they do not own the unclaimed distributions. DTC Statement p. 18 (App. p. 14a) ("These funds and property do not belong to DTC"); DeCesare Dep. 36-37, 118-119, 131; Cirrito Dep. 73-75; Shearer Dep. 349, 352; Principe Dep. 104; Scott Dep. 157.

The intermediaries all account for unclaimed distributions on their own books and records by use of CUSIP numbers, or by internal codes that may be converted to CUSIP numbers. Cirrito Dep. 86, 90; Shearer Dep. 199, 203-04; Principe Dep. 91-92; Scott Dep. 176. CUSIP numbers uniquely identify the issuer as well as the particular issue of the underlying security. Thus, with respect to each and every item of unclaimed securities distributions in this case, the identity of the issuer is always a known factor.

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[9] Shearer Dep. 194; Scott Dep. 166-67.

SUMMARY OF ARGUMENT

The Special Master correctly interpreted and applied the federal common law of interstate escheat priority to the factual setting in this case by recognizing that issuers rather than mere intermediaries are the debtors of unclaimed securities distributions for purposes of the rule of *Texas v. New Jersey*. This result grounds the federal common law in the fundamental economic relationship between issuers and their investors, not the mere shadow play of nominee ownership, an arrangement devised under state law merely to facilitate securities trading.

Contrary to Delaware's argument, the federal common law rule is not constricted by "substantive due process" considerations in the form of archaic notions of the "situs" of intangibles, nor is the federal common law controlled by technical state law definitions of "debtor." The essential federal purposes of fairness among the States and ease of administration require that the issuers of securities be recognized as the debtors under *Texas v. New Jersey*, without regard to whether the issuers are technically liable to their investors under state laws governing private rights for other purposes.

As an equitable rule, the rule of *Texas v. New Jersey* must be interpreted on the basis of the substance rather than the form of the underlying transaction. As state and federal laws recognize, nominee registration in the name of intermediaries is a matter of form, not determinative of substantive economic rights. The substance of the underlying transaction is that issuers generate securities distributions solely for the benefit of the beneficial owners of the securities. Distributions must pass through the hands of various intermediaries solely as the incidental result of the trading convenience of nominee registration. The priority of conflicting state escheat laws should not be determined by the mere happenstance of which intermediary happens to be holding the distributions when they become "stuck."

Delaware's procedural due process and *stare decisis* objections to recognizing issuers as debtors are also flawed. The issue in this case is not which state has sufficient contacts with the unclaimed property to initiate unclaimed property proceedings in its own courts, but the very different issue of which State's law should have priority. The possibility that a State may be compelled to enforce its unclaimed property law in the courts of another State is inherent in the rule of *Texas v. New Jersey* and therefore constitutes no valid objection to the Special Master's proposed decree. The doctrine of *stare decisis* is not implicated by the Special Master's recognition of issuers as debtors because this is merely a logical interpretation of an existing judicial rule, not a reversal of, or departure from, prior precedent.

New York's newly created "trading address of creditor brokers" theory, by which it seeks to treat brokers differently than banks or DTC for purposes of *Texas v. New Jersey*, is meritless. This theory rests upon a series of presumptions, all of them unwarranted. In any event, New York's presumption-based theory is fatally inconsistent with *Texas v. New Jersey*.

The Special Master's recommendation that the locational test for issuers should be principal executive offices, rather than state of incorporation, should be adopted. The principal executive offices test is fairer than state of incorporation, and would be simple and efficient to implement due to the availability of SEC filings as an authoritative source for this information. This improvement of a judicially-created doctrine is neither barred by *stare decisis* nor inconsistent with judicial deference to the legislature.

The decree in this case should apply to all unclaimed property wrongfully taken by New York from securities intermediaries. New York's obligation to disgorge these funds is inherent in the nature of custodial taking of unclaimed property, and is compelled by this Court's disposition of the same issue in *Texas v. New Jersey* and *Pennsylvania v. New York*. Even if the retroactivity analysis set forth in *Chevron Oil v. Huson* is applied, moreover, that analysis confirms that New York must yield up the unclaimed property it has wrongfully taken.

ARGUMENT

POINT I.

THE ISSUERS ARE THE DEBTORS OF THE UNCLAIMED SECURITIES DISTRIBUTIONS IN THIS CASE UNDER THE RULE OF *TEXAS V. NEW JERSEY*

By recognizing issuers rather than mere intermediaries as the debtors of unclaimed securities distributions, the Special Master has correctly interpreted and applied the rule of *Texas v. New Jersey* in conformity with its essential federal purposes of fairness and clarity. As a rule of fairness, fashioned by this Court out of considerations of equity, the rule must take account of the economic reality of the underlying transaction and the fundamental relationships between the parties, not the mere technical status of intermediaries as nominee holders of securities.

The fundamental relationship out of which the unclaimed securities distributions arise is the relationship between the issuer of the security and its investors, who are the beneficial owners of the securities. It is undisputable that the system of nominee registration, with its attendant necessity of passing distributions along a chain of ownership from the issuer to the investor, was created merely as a trading convenience. The issuer transmits distributions to intermediaries with the expectation that they will be passed along to the beneficial owners of the securities, and the intermediaries have no entitlement to retain the distributions. Thus, the intermediaries function merely as a conduit from issuer to investor, whose presence should be disregarded in applying a rule based on fairness and equity.[10]

Regardless of where securities distributions may get "stuck" along the chain of intermediaries between issuer and investor, the issuer retains its continuing status as the entity which issued the underlying security, caused the debt to the investor to come into being, and actually created the funds or property which has been inserted into the distribution system. Likewise, the beneficial owners retain their status as the parties with the exclusive right to the economic benefit of the distributions. It is the fundamental and continuing economic relationship between the issuer and its investors, not the mere happenstance that distributions may be received by an intermediary who is unable to further pass them along, that should guide the application of the rule of *Texas v. New Jersey*.

A. Delaware's Objections To The Special Master's Report Are Unfounded

The criticisms by Delaware of the Special Master's Report would wink away the economic reality of the unclaimed property, its nature and how it came into existence, in favor of a formalistic adherence to archaic

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[10] This is entirely consistent with the intermediaries' own perception of their role as "preserv[ing]" their "transparency" in the chain of communication between issuers and beneficial owners. DeCesare Dep. Exh. 6 (DTC, *Shareholder Communications and the Depository Trust Company* 3, 6 (2d ed., undated) (cited at Report 24-25).

notions of the territorial "situs" of intangibles, and to a rule of state law governing the rights of private persons for other purposes.[11] As the Special Master correctly recognized, however, rules of state law do not control the federal common law rule expressed in *Texas v. New Jersey*, and must not be followed in this case. To do so would thwart the distinctly federal purposes of the rule of *Texas v. New Jersey* by exalting form over substance, elevating technicality over reality, and turning a rule premised upon fairness into a conundrum of inequity and internal contradictions.

1. Interpretation Of *Texas v. New Jersey* Is Not Controlled By Formalistic Notions Of The "Situs" Of Intangible Property Discussed In This Court's Prior Escheat Cases

Delaware argues that the rule of *Texas v. New Jersey* is limited by formalistic notions of the "situs" of intangibles discussed in this Court's prior escheat cases. Del. Br. 33-36. Thus, Delaware suggests that *Texas v. New Jersey* was the "culmination" of a line of cases "defining the limits of a state's power to escheat," Del. Br. 33, and that the Special Master's Report "goes beyond the traditional limits of substantive due process taught by those earlier decisions," Del. Br. 24. Specifically, Delaware argues that the primary rule of *Texas v. New Jersey* is defined by the notion that a State "step[s] into the creditor's shoes" (i.e., *mobilia sequuntur personam*), and likewise that the back-up rule is

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[11] New York parrots Delaware's legal theory with respect to New York banks and DTC, since these entities are incorporated in New York. As to brokers, however, New York advances the different (and fatally inconsistent) theory that unclaimed distributions should be presumed "owed" to "creditor brokers" with "trading addresses" in New York. Delaware and New York's shared "intermediary debtors" theory is addressed jointly in this Section A of Point I. New York's further "creditor brokers" theory is separately addressed in Section B of Point I.

defined by the competing notion of "constructive dominion over the debt" based upon "power to seize funds from a person subject to its jurisdiction." Del. Br. 34. Delaware thus portrays the Report as raising "serious substantive due process concerns," Del. Br. 35, such that the term "debtor" must be equated with a state-law obligor rather than the known originator of the debt and the unclaimed property.

Delaware's reading of *Texas v. New Jersey* is untenable for at least three reasons. First, this Court's prior escheat cases did *not* define the "substantive due process" boundaries of a State's power to escheat, much less limit that power to two specific notions of the "situs" of an intangible. Second, Delaware's theory is contradicted by the reasoning of *Texas v. New Jersey*, which subordinated "substantive due process" considerations of "situs" to equitable considerations of fairness. Finally, the Court explicitly declared in *Texas v. New Jersey* that it had written a fundamentally new rule, on a clean slate, not controlled by Constitutional provisions or past precedents.

1. Nothing in the escheat cases preceding *Texas v. New Jersey* suggests that a State's power to escheat is constitutionally confined to the two notions of "situs" (*mobilia sequuntur personam* and the location of an obligor) that Delaware now contends define the permissible boundaries of the rule of *Texas v. New Jersey*. In the case upon which Delaware principally relies, *Connecticut Mutual Life Insurance Co. v. Moore*, 333 U.S. 541 (1948), the Court actually sustained a State's power to take custody of unclaimed proceeds on life insurance policies on the basis that (1) the policies were delivered within the State, and (2) the policies were issued on the lives of persons residing within the State. Thus, the contacts between the escheating state and the escheated property did not conform to either of the two notions of "situs" described by Delaware as "limiting" a State's power to escheat (i.e., in that case, the location of the beneficiary of the policy or the domicile of the insurer), and yet the taking was upheld against the insurer's due process challenge. *See also Western Union Telephone Co. v. Pennsylvania*, 368 U.S. 71, 76 (1961) (noting that state claims to escheat the proceeds on unclaimed money orders could potentially be based on numerous contacts, including the residence of the payee, the location of the sender, the place where the money order was delivered, and the location of the fiscal agent on which the money orders were drawn); *Security Savings Bank v. California*, 263 U.S. 282, 285 (1923) (relevant contacts included principal place of business and place where contracts were made, as well as corporate domicile of debtor).

2. The reasoning employed by this Court in *Texas v. New Jersey* itself indicates most dramatically that traditional notions of the "situs" of intangibles as delimiting state escheat power in a substantive due process sense are alien to the rule adopted in that case. For example, the primary rule is in fact a significant deviation from the ancient doctrine of *mobilia sequuntur personam*. That doctrine, which had been followed (albeit with skepticism) in some Supreme Court cases but avoided in others,[12] traditionally requires that the creditor or his technical domicile be *actually* present within the State, not that the creditor merely have left behind a last known address. *Cf. Baldwin v. Missouri*, 281 U.S. 586, 592-93 (1930). By shifting the focus from technical domicile to last known address, *Texas v. New Jersey*, 379 U.S. at 681

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[12] For example, the doctrine was adhered to in one succession tax case as "settled" law, "whether it approve itself to legal philosophic test or not." *Blodgett v. Silberman*, 277 U.S. 1, 10 (1928). However, in another succession tax case, *mobilia sequuntur personam* was characterized as a "legal fiction" and not followed. *Safe Deposit & Trust Co. v. Virginia*, 280 U.S. 83, 91-92 (1929). It is absurd to suggest that this embattled ancient doctrine commands such allegiance today as to "define" the "limits" of the primary rule under *Texas v. New Jersey*.

n.11, the Court detached the rule from the traditional due process notion of territorial dominion over the person. 379 U.S. at 678-79.[13] Hence, the primary rule may in a limited sense be "in line with" this ancient doctrine, 379 U.S. at 681, but it is also a significant departure from (and certainly not "controlled" by) that doctrine.

Similarly, in formulating the back-up rule, the Court revealed that it was concerned with considerations of fairness, not with the notion of "situs" as determined by the physical location of a state-law obligor. In evaluating Pennsylvania's proposed rule that the property should go to the State of the principal place of business of Sun Oil, the Court acknowledged that this claim was "in some respects ... more persuasive" because "this 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." 379 U.S. at 680. The characteristic of Sun Oil as owing the unclaimed property, however, was described by this Court as a factor counseling *against* use of a debtor-based rule to afford priority of taking, not a factor *in favor* of such priority. *Id.* (it would be "strange" to assign priority based upon a "liability"). Delaware's interpretation of the term "debtor" in the back-up rule thus focuses on the one attribute (merely having a liability) that this Court identified as rendering the use of the debtor's location *less acceptable*, and ignores the attribute (having created the unclaimed property) that gave the "principal place of business" test (and, inferentially, the other proposed proxy for the location of the corporation) its relative

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[13] Justice Stewart highlighted this departure in his dissenting opinion by noting that "in a case such as this the domicile of the debtor is by hypothesis unknown," so that the rule may well "giv[e] the property to the one State within which we know the creditor is not." 379 U.S. at 683. Thus, the doctrine of *mobilia sequuntur personam* may have been a springboard for the primary rule, but the primary rule plainly moves far beyond it.

persuasiveness.

Significantly, the Court did not reject the "most significant contacts" test or the "place where the indebtedness was created" test (each proposed in *Texas v. New Jersey*, 379 U.S. at 677-78 & n. 6, 680) as insufficient to support a State's power to apply its unclaimed property laws in a "substantive due process" sense, even though these tests do not track the location of a creditor or of an obligor. Instead, the Court was concerned with whether these tests would provide a fair and clear rule of priority. Thus, the Court explained that the issue was not "whether a defendant has had sufficient contact with a State to make him or his property rights subject to the jurisdiction of its courts," but the "very different problem of deciding which State's claim to escheat is superior to all others," 379 U.S. at 678-79, a "question which should be determined primarily on principles of fairness," 379 U.S. at 680. Therefore, the reasoning employed in *Texas v. New Jersey* reveals that the conceptual underpinnings of the rule are not substantive due process notions of territorial "situs," but equitable considerations of fairness.[14]

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[14] This conclusion is further compelled by the Court's statement that the proposed "corporate domicile" rule had "the obvious virtues of clarity and ease of administration," but would "too greatly exalt a minor factor" by "permit[ting] escheat of obligations incurred all over the country by the State in which the debtor happened to incorporate itself." 379 U.S. at 679-81. In at least three prior opinions, the Court had endorsed corporate domicile as a permissible basis for escheating or taking custody of property. *Standard Oil Co. v. State of New Jersey*, 341 U.S. 428 (1951); *Anderson Nat'l Bank v. Luckett*, 321 U.S. 233 (1944); *Security Savings Bank v. California*, 263 U.S. 282 (1923). None of these cases is even mentioned in the context of New Jersey's claim, despite the view of Justice Stewart that these precedents were effectively overruled by the Court's selection of creditor's last known address as the primary rule. 379 U.S. at 683 (dissenting opinion). Thus, it is clear that the rule announced in *Texas v. New Jersey* has no connection to the formalistic notions of the "situs" of intangibles that Delaware contends "defines" a state's power to escheat.

3. Finally, the Court in *Texas v. New Jersey* took care to explain, in plain terms, that it wrote upon a clean slate. The Court stated that its ruling "could have been resolved otherwise" because the issue of the priority of unclaimed property claims among States "is not controlled by statutory or constitutional provisions or by past decisions, nor is it entirely one of logic," but is "fundamentally a question of ease of administration and of equity." 379 U.S. at 683. The Court's choice was thus "require[d]" by "fairness among the States." 379 U.S. at 680. The rule ultimately adopted was thus not compelled by "substantive due process" notions of the "situs" of intangibles, but because it is "the fairest, is easy to apply, and in the long run will be the most generally acceptable to all the States." 379 U.S. at 683. Delaware's contention that the back-up rule of *Texas v. New Jersey* must be construed in conformity with the notion of the territorial "situs" of an intangible as following the location of a state-law obligor must therefore be rejected.

2. The Federal Common Law Rule Of *Texas v. New Jersey* Must Conform To The Federal Purpose Of Fairness Among The States, Not A Rule Of State Law Governing Private Rights For Other Purposes

Delaware contends that this Court must slavishly adhere to state law in fashioning the federal common law governing conflicting state claims to escheat of intangibles. Del. Br. 45-48. The Special Master correctly recognized, however, that the federal common law rule of *Texas v. New Jersey* is not controlled by rules of state law defining private rights and obligations. Report 25-26. Where state law is inconsistent with the federal purpose to be achieved by a rule of federal law, this Court has not hesitated to fashion federal law in accordance with that purpose. Here, the federal purposes of fairness among the States and clarity in defining the priority of State claims to escheat or custodial taking require that the debtors of unclaimed securities distributions be the issuers of the securities, not the intermediaries who happen to end up holding such distributions when they become unclaimed.

Interstate controversies are recognized as one of the few areas of the law governed entirely by federal common law. *Texas Industries v. Radcliff Materials*, 451 U.S. 630, 641 (1981); *Northwest Airlines, Inc. v. Transport Workers Union*, 451 U.S. 77, 95 & n. 33 (1981); *Hinderlider v. La Plata River & Cherry Creek Ditch Co.*, 304 U.S. 92, 110 (1938). In such cases, "state law is not controlling." *Colorado v. New Mexico*, 459 U.S. 176, 184 (1982). This Court will draw upon settled principles of state law in fashioning federal common law only to the extent that such principles are *consistent* with the federal purpose to be achieved.

In *Connecticut v. Massachusetts*, 282 U.S. 660 (1931), for example, the Court refused to consider itself bound by the rule of riparian rights, even though that rule prevailed in each of the States before it:

> The determination of the relative rights of contending States ... does not depend upon the same considerations and is not governed by the same rules of law that are applied in such States for the solution of similar questions of private right.

282 U.S. at 670. *See also Colorado v. New Mexico*, 459 U.S. at 184-187 & n. 12; *New Jersey v. New York*, 283

U.S. 336, 342-343 (1931).[15]

In fashioning federal common law, this Court has not hesitated to depart from state law in order to further the uniquely federal purposes to be served. For example, in *Mississippi Band of Choctaw Indians v. Holyfield*, 490 U.S. 30 (1989), this Court held that the word "domiciled" as used in the Indian Child Welfare Act of 1978, 25 U.S.C. §§1901-1963 (1988), is defined by federal common law rather than local state law. The Court then ruled that the children in the case were "domiciled" in a reservation as a matter of federal common law, even though the Supreme Court of Mississippi had found them not "domiciled" therein as a matter of state law. *See also United States v. Pelzer*, 312 U.S. 399, 402-03 (1941) (gifts held to be future interests for federal tax purposes despite treatment as present interests under state law); *Burnet v. Harmel*, 287 U.S. 103, 109-110 (1932) (state law treatment of oil and gas transaction as "sale" is immaterial in deciding whether "sale of corporate assets" occurs under federal tax law).

Contrary to Delaware's assertion, there is no lack of a federal reason for recognizing that issuers are debtors with respect to the unclaimed property at issue in this case. The overriding federal purposes to be served in this case are fairness among the states and clarity in operation of the rule of priority among the states. As discussed in the following subsection, equating mere intermediary holders with debtors under the rule of *Texas v. New Jersey* would produce only

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[15] Delaware errs in arguing that the Court must follow state law in this case in order to avoid "disruption of the underlying state law." Del. Br. 45. The rule of *Texas v. New Jersey* is neither derived from state law defining property rights, nor does it have the effect of defining property rights under state law. The only effect of *Texas v. New Jersey*, and of the decree in this case, is to determine which State's unclaimed property law has priority over all others.

inequitable results and confusion in this area of the law.

Delaware argues that this Court should defer to a rule of state law providing an affirmative defense to issuers (i.e., U.C.C. § 8-207) on the ground that this rule is "uniform" among the States. Del. Br. 49. This argument misses the point. Whatever the universality or utility of this rule in the state-law context for which it was created (i.e., streamlining the processing of rights in securities by shielding issuers from the threat of multiple liability), the rule is simply inapplicable to the very different question of determining which State as a matter of fairness should have priority to escheat unclaimed securities distributions. Putting aside for the moment that fundamental error, however, Delaware's argument also fails for another reason. Regardless of how "uniform" § 8-207 may be among the various States, that uniformity is unavailing because § 8-207 does not uniformly apply to the unclaimed property in this case.

Section 8-207 provides that the issuer of a security may only "treat" the record holder as exclusively entitled to exercise the rights of ownership "prior to due presentment" of a certificated security for reregistration to a new record holder. U.C.C. § 8-207(1). This provision therefore does not apply to all of the unclaimed property at issue in this case, because some unknown portion of the unclaimed securities distributions at issue were paid by the issuers *after* "due presentment" of the underlying securities for reregistration, through errors or delays in reregistration ("missed transfers") on the part of the issuer or its paying agent.[16]

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[16] "If, because of a delay in registration, DTC receives the payment instead of the new owner, DTC will experience an overpayment. ... Discrepancies in information received from the transfer agents could give rise to abandoned property." DTC Statement at 12 n. * (App. p. 11a n. 5).

(continued...)

Due to the nature of the unclaimed distributions at issue in this case, there can be no direct proof of the reason why any particular item of property became unclaimed. (If those facts were known, the item would be turned over to its rightful owner.) However, the record dramatically confirms that post-presentment distribution payments can become abandoned property. A document produced by New York in discovery shows that a transfer agent neglected to record the transfer of 100 shares of Borden, Inc. stock for fifteen years. This resulted in the payment of $ 3,500 in cash and 200 additional shares of stock to DTC, all after due presentment of the underlying 100 shares for reregistration, which DTC later remitted to New York. DeCesare Dep. 127-38 and Exhibit 6 (N.Y. Doc. N4949-4952). The quantity of funds and property that similarly have been paid out in error after presentment of securities for reregistration, and which lie undetected among the undifferentiated mass of unclaimed securities distributions held by intermediaries or by New York, cannot be told. What is apparent, however, is that § 8-207, even if it were pertinent to the issue in this case, does not uniformly apply to the unclaimed property in this case.

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[16](...continued)

See also DeCesare Dep. at 87-91 (description of missed transfer as a cause of overages), 103-06 (missed transfers can occur in the direct mail withdrawal process), 119-20 (DTC cannot differentiate overages caused by Cede float from overages caused by undetected missed transfer). The brokers and custodial bank also confirmed that "missed transfers" cause overpayments of distributions to intermediaries. Shearer Dep. 194, 242-42; Principe Dep. 98; Cirrito Dep. 224; Scott Dep. 166-67, 169, 182-83 and Exhibit 9. The paying agent acknowledged that such erroneous post-presentment payments occur. Wellener Dep. 90-92, 124-25.

3. Recognizing Issuers As The Debtors Grounds The Equitable Rule Of *Texas v. New Jersey* In The Substance Of The Underlying Transaction, Not The Mere Shadow Play Of Street Name Registration

As a case in equity,[17] this proceeding is governed by the equitable principle that "[e]quity will penetrate beyond the covering of form and look at the substance of a transaction, and treat it as it really and in essence is, however it may seem." *Gay v. Parpart*, 106 U.S. 679, 699 (1883). *See First National City Bank v. Banco Para El Commercio*, 462 U.S. 611, 629-30 (1983) (Equity will disregard corporate entity to avoid fraud or injustice.); *Bangor Punta Operations v. Bangor & Aroostock Railroad Co.*, 417 U.S. 703, 713 (1974) (Courts of equity, "piercing all fictions and disguises," will deal with "substance" and not "blindly adhere" to form.); *Young v. Higbee Co.*, 324 U.S. 204, 209 (1945) ("Equity looks to the substance and not merely to the form.").

The present case must therefore be decided on the basis of the substance rather than the superficial appearance of the transactions involved. The essence of the distribution system is that the beneficial owners have invested their money in the issuers' securities and are exclusively entitled to receive the economic benefits of their investment, including distributions. Issuers generate distributions for the benefit of the beneficial owners, not of intermediaries. Distributions must pass through the hands of various intermediaries in the distribution system solely as an incidental result of the trading convenience of nominee registration. Issuers transmit distributions to the intermediaries solely for the purpose of

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[17] "[P]roceedings under this Court's original jurisdiction are basically equitable in nature." *Ohio v. Kentucky*, 410 U.S. 641, 648 (1973).

further transmitting the distributions to the beneficial owners.

Significantly, the courts have long recognized that the status of intermediaries as record holders is a mere matter of administrative convenience, which should not be taken to define substantive ownership rights. In *Keech v. Zenith Radio Corp.*, 276 A.2d 270 (Del. Ch. 1971), successors in interest to a brokerage firm sought to establish their entitlement to certain securities, the certificates for which had been lost, based upon the fact that the brokerage was the record holder. Due to the common practice of street name registration by brokers, the court ruled that there is no presumption of ownership arising out of record ownership by a broker. Although there was no notice to the issuer of any transfer of the shares by the broker, the mere fact of nominee registration in the name of a securities broker put the actual ownership of the securities in issue, and the persons claiming through the record holder were not entitled to claim the benefits of ownership without further proof of their entitlement. *See also Merrill Lynch Pierce Fenner & Smith v. North European Oil Royalty Trust*, 490 A.2d 558, 561 (Del. 1985); *Davis v. Fraser*, 307 N.Y. 433, 121 N.E.2d 406, 411-412 (1954); *In re Metropolitan Royalty Corp.*, 62 A.2d 857 (Del. Super. Ct. 1948). These cases explicitly recognize that the technical status of intermediaries as record holders is merely an administrative convenience, not reflective of the substantive ownership rights arising out of the securities.

Federal and state law both recognize the primacy of the economic relationship between issuers and their investors over the technicality of street name registration in matters of substantive right. Under state law, beneficial owners may bring stockholder's derivative actions in their own names, without regard to the nominee registration of the underlying securities. *Pearce v. Superior Court*, 149 Cal. App. 3d 1058, 197 Cal. Rptr. 238 (5th Dist. 1983); *Karfunkel v.*

USLIFE Corp., 116 Misc. 2d 841, 455 N.Y.S.2d 937 (Sup. Ct. 1982), *aff'd*, 98 A.D. 628, 469 N.Y.S.2d 1020 (1st Dept. 1983); *Gamble-Skogmo, Inc. v. Saks*, 35 Del. Ch. 503, 122 A.2d 120 (1956). Courts reviewing corporate elections may intervene to protect unregistered beneficial owners from fraud or injustice. *Tracy v. Brentwood Village Corp.*, 30 Del. Ch. 296, 59 A.2d 708, 709 (1948); *Italo Petroleum Corp. v. Producers' Oil Corp.*, 20 Del. Ch. 283, 174 A.2d 276, 278 (1934).[18]

Also recognizing the fundamental relationship between issuers and beneficial owners, book entry delivery of securities registered in the nominee name of a depository is deemed valid delivery of title to the beneficial owner. U.C.C. § 8-320(1) (App. pp. 4a-5a). Transfer agents and registrars owe a duty of good faith and due diligence to the beneficial owners of securities. U.C.C. § 8-406(1)(b) (App. p. 6a). Thus, the substantive rights of beneficial owners are not merely a matter of contract between them and their brokers or custodial banks, but are recognized and protected by state law.

Federal law likewise recognizes the fundamental economic relationship between issuers and beneficial owners. In 1975 Congress directed the Securities and Exchange Commission ("SEC") to develop a national depository system and to end the exchange of physical certificates among

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[18] Many state corporation laws now permit corporations to adopt procedures to deal directly with the beneficial owners of their stock. *See* Model Business Corporations Act § 7.23. The significance of this is not, as Delaware asserts, Del. Br. 41-42, whether this provision has been utilized by a significant number of corporations. The significance for this case is that state law recognizes, as Delaware would have this Court ignore, that the fundamental investment relationship flows not between the issuer and the record owner on the one hand, or between the an intermediary and its customer on the other, but from the issuer to the beneficial owners who hold the economic rights to the underlying securities.

brokers. 15 U.S.C. § 78q-1(e) (1988) (enacted by Pub. L. 94-29, § 15, 89 Stat. 97, 141-46 (1975)). However, Congress also recognized that the consequent expansion of nominee registration could potentially affect the fundamental relationship between issuers and their investors. Therefore, Congress directed the SEC to:

> make a study and investigation of the practice of recording the ownership of securities in the records of the issuer in other than the name of the beneficial owner of such securities and to determine (1) whether such practice is consistent with the purposes of this chapter, ... and (2) whether steps can be taken to facilitate communications between issuers and the beneficial owners of their securities while at the same time retaining the benefits of such practice.

15 U.S.C. § 78*l*(m) (1988).

The SEC has promulgated a series of comprehensive regulations designed to facilitate interaction between issuers and their non-record beneficial owners. First, regulations require banks and brokers who hold securities on behalf of their customers to transmit to issuers upon request lists of beneficial owners who do not object to disclosure of their holdings. 17 C.F.R. §§ 240.14b-1 and 240.14b-2 (1992). This procedure facilitates communications between issuer and beneficial owner directly, without going through the intermediaries at all. Cirrito Dep. 52-55, 183-85. Second, the SEC has promulgated regulations that require intermediaries to transmit shareholder communications such as proxy solicitations promptly to beneficial owners. 17 C.F.R. §§ 240.14a-1, 240.14a-13, 240.14c-1 and 240.14c-7 (1992). The significance of these regulations is not whether they directly affect the payment of distributions; concededly, they do not. However, these regulations plainly recognize that in substance, the relevant economic relationship flows from the issuer to its investors, not to the mere intermediaries reflected as nominee owners on the issuer's books and records.[19] In light of the recognition under state and federal law that the economic relationship, in substance, flows from the issuer to its beneficial owners, Texas, *et al.*, submit that the equitable rule of *Texas v. New Jersey* should be interpreted and applied to that relationship, not to the mere formality of nominee registration.

The analysis used by this Court in *Texas v. New Jersey* itself confirms that the substance rather than the form of the transaction should control. In adopting the primary rule, the Court looked to the fundamental nature of the unclaimed property as an asset of the creditor. The Court explicated this concept by noting that if the creditor, instead of perhaps leaving behind an uncashed check, had negotiated the check and left behind the cash, then the State in which the cash was physically located would have the only right to escheat. 379 U.S. at 681. Thus, in fashioning the rule, the Court was guided not by technical form of the transaction (e.g., whether the creditor had received a check), but instead by the equitable substance of the situation.

The application of the rule of *Texas v. New Jersey* recommended by the Special Master likewise responds to the equitable substance of the present multi-party transaction. Recognizing the issuer as the debtor takes account of the fact

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[19] Disclosure requirements under the federal securities laws also show that the substantive economic relationship flows from issuers to beneficial owners, not to mere nominee holders. 15 U.S.C. §§ 78m(d) and 78p(a) (1988) (App. pp. 2a-4a) (reporting requirements for beneficial owners of 5% and 10% of certain classes of equity security). *See Calvary Holdings, Inc. v. Chandler*, 948 F.2d 59 (1st Cir. 1991) (mere nominee holder not required to file Schedule 13D); *Depository Trust Co.*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) para. 82,192, at p. 82,243 (SEC No Action Letter, Feb. 23, 1979)(depository-nominee exempt from reporting requirements).

that if the issuer, instead of transmitting the distribution to the wrong intermediary, had instead held on to the distribution pending a claim by the actual owner, then the issuer would be the entity holding and obliged to pay over the property as well as the entity that caused the property to come into existence. Thus, the equitable substance of the situation dictates that the state of the issuer should have the right to take custody of the intangible property at issue in this case.

Accepting the interpretation advanced by Delaware would affirmatively disrupt the federal purpose of fairness and clarity that this Court sought to achieve by adopting the rule of *Texas v. New Jersey*. First, if the location of a mere intermediary determines the State with priority to take custody of unclaimed securities distributions, vast amounts of unclaimed property would be turned over to one or two States on the basis of a party who neither has nor had any substantial or meaningful connection to the property, except that they have mistakenly received money owed to someone else.

Second, to the extent that the unclaimed distributions at issue represent proceeds of state and municipal obligations, it is patently unfair to adopt an interpretation that would cause those proceeds to inure to the benefit of a State other than the one whose taxpayers paid out the money. By recognizing the issuer as the debtor with respect to distributions on state and municipal obligations, this Court will insure that such distributions are returned to the State whose public expenditures caused the property to come into being, and whose taxpayers ought to be benefitted by the use and custody of any unclaimed property arising out of the underlying municipal obligations.

Third, the position argued by Delaware would cause paying agents to be treated differently than other intermediaries when it comes to the escheat of owner-unknown securities distributions. Under the rule recommended by the Special Master, the mere business expediency of nominee registration is correctly deemed insignificant for determining priority to escheat, as are the business expediencies of paying agents and bank accounts. *Cf. Standard Oil Co. v. New Jersey*, 341 U.S. 428, 437 n. 8 (1951). Depositories, brokers and banks, like paying agents under present practice, would remit unclaimed property to the state in which the issuer is located.

Fourth, Delaware's interpretation would cause particular payments from the exact same distribution to be sent to different States depending solely upon which intermediary happened to be holding the distributions when they became unclaimed. This would require claimants of distributions that have been remitted to a State to unwind the often complicated trail of the distribution in order to determine where to claim the funds. Because distributions may pass through the hands of many intermediaries before they become "stuck", and because the transactions giving rise to the unclaimed distributions may involve multiple intermediaries, the unknown beneficial owner may have no knowledge regarding which intermediary was left holding his or her property. Thus, that beneficial owner would face the difficult, if not impossible, task of unwinding the transactions that precipitated the unclaimed distributions before he or she could know what State took custody of the funds. Under the Special Master's proposed decree, on the other hand, the investor could determine the state from which to claim distributions from the identity of the issuer of his security. The issuer is always a known quantity, no matter how many intermediaries may have come into contact with the unclaimed funds, and the identity of the issuer may always be ascertained from the CUSIP numbers that are universally employed to keep track of securities and distributions.

4. Delaware's Procedural Due Process And Stare Decisis Arguments Are Unfounded

Delaware contends that procedural due process concerns (i.e., that the state in which the issuer of securities is located may lack "minimum contacts" with the holder of the unclaimed distributions to initiate judicial proceedings in its own courts) counsel against adopting the Special Master's Report. Del. Br. 35.[20] This argument is without substance. The Special Master correctly rejected Delaware's procedural due process objection as a red-herring in this case. Report 68-70.

The possibility that a State with no continuing connection to the unclaimed property or its holder may have prior right to apply its unclaimed property laws is inherent in the primary rule under *Texas v. New Jersey*. The State in which the creditor's last known address is located (and in which the creditor herself may not be) may have no continuing connection at all to the unclaimed property or the holder thereof. This did not constitute any barrier to adoption of the primary rule, because the issue is which State's law has priority, not whether the State can sue in its own courts. Thus, the possibility that a State may be compelled to enforce its laws in the courts of another State (a practice which has been endorsed by the courts, *see, e.g., State v. Amsted*

[20] Delaware's citation to *Ohio v. Wyandotte Chemicals Corp.*, 401 U.S. 493, 500 (1971), to suggest that it is inappropriate for States to resort to the courts of sister States, Del. Br. 36, is misleading, to say the least. The quoted language is not a pronouncement by this Court, but merely part of a recitation of the policies supposed to underlie the grant of original jurisdiction under Article III of the Constitution. In fact, in the *Wyandotte* case, this Court declined to exercise its original jurisdiction, with the result that the plaintiff State may subsequently be compelled to enforce a judgment in the courts of a sister State. 401 U.S. at 499-500. Thus, *Wyandotte* is hardly authority for the proposition that States should never be exposed to the possibility of bringing suit in the courts of a sister State.

Industries, 48 N.J. 544, 226 A.2d 715, 718 (1967)), is inherent in the rule of *Texas v. New Jersey* already, and constitutes no barrier to recognizing the issuer as the debtor of unclaimed distributions on securities.

In any event, in many cases the intermediary holders of owner-unknown unclaimed securities distributions are national brokerage firms or other entities doing business in many States, so that minimum contacts for purposes of custodial taking will exist in the State entitled to take the property. For example, discovery taken in this case confirms that the brokerage firms Merrill Lynch and Prudential Bache have offices in all fifty States. Shearer Dep. 17; Cirrito Dep. Ex. 4. In those rare instances in which a State may find it necessary to enforce its unclaimed property laws against an intermediary not doing business within the State, any practical difficulties may be alleviated by interstate cooperative arrangements. *See* Unif. Unclaimed Prop. Act (1981) § 33, 8A U.L.A. 617, 672 (1983) (providing for interstate cooperation and agreements regarding unclaimed property claims).

Delaware also errs in arguing that the Special Master's recognition of issuers as debtors of unclaimed securities distributions under *Texas v. New Jersey* and *Pennsylvania v. New York* implicates the doctrine of stare decisis. Del. Br. 70-76. Neither of those cases addressed the different factual situation now before the Court. The present case involves only a judicial interpretation of the rule so that it may be equitably applied to a new factual situation.

It is perfectly appropriate and to be expected that this Court will develop and refine federal common law rules of its own making, especially in light of new factual situations not previously considered. "It has been said so often as to become axiomatic that the common law is not immutable but flexible and by its own principles adapts itself to varying conditions." *Funk v. United States*, 290 U.S. 371, 383 (1933). To accept Delaware's conception of stare decisis would petrify the federal common law into a lifeless fossil, which surely it is not.

In this case, the Special Master has accomplished a clarification, not an "unacknowledged change," Del. Br. 28, 70, to the rule of *Texas v. New Jersey*. The conclusion that issuers are debtors of this property is merely a logical application of a federal common law rule in light of this Court's concerns for fairness and clarity as expressed in that decision. This part of the Special Master's Report therefore merely represents a judicial interpretation of the federal common law as applied to a new factual setting, not a reversal or amendment of the rule.

Contrary to Delaware's argument, the substance of the rule of *Texas v. New Jersey* is not defined or controlled by the Uniform Unclaimed Property Act or state unclaimed property laws. The rule of *Texas v. New Jersey* is a rule of *federal* common law. *Cf. Texas Industries v. Radcliff Materials*, 451 U.S. 630, 641 (1981) (original jurisdiction cases involving interstate controversies generate federal common law). To the extent that such state laws are inconsistent with this Court's interpretation of federal common law, they must yield to the latter under the Supremacy Clause. *Pennsylvania v. New York*, 407 U.S. at 215 n. 8. Thus, state laws such as these are simply irrelevant to the doctrine of stare decisis.[21]

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[21] To the extent that the Uniform Unclaimed Property Act of 1981, and state laws fashioned after it, have conflated the terms "holder" and "debtor," this simply reflects that fact that the holder and the debtor are often the same. Texas, *et al.*, submit that such laws were not drafted in contemplation of the kind of multiparty, multiphase transaction now before this Court. As has occurred in the past, it is to be expected that the model unclaimed

(continued...)

B. New York's "Trading Addresses of Creditor Brokers" Theory Is Meritless

In addition to asserting that the intermediary brokers and banks who hold unclaimed securities distributions should be deemed the debtors of those distributions, an erroneous view that New York shares with Delaware, New York also contends that unclaimed distributions held by brokers (but not banks) are "owner-known" rather than "owner-unknown." Specifically, New York contends that these unclaimed distributions are in fact owed to other brokers or banks with "trading addresses" in New York, whose identities and "trading addresses" are identifiable through a meticulous reconstruction of the holding brokers' records. N.Y. Br. 77-81.[22] This contention is contradicted by: (1) the testimony of all three brokers from whom discovery was taken, who agree that their records do not identify the owners of the unclaimed property or their addresses, Shearer Dep. 193, 195, 198; Principe Dep. 104-05; Cirrito Dep. 73, 93-94; (2) New York's own litigation posture with respect to DTC and New York banks, as to whom New York concedes that the unclaimed securities distributions at issue in this case are owner-unknown, N.Y Br. 28, 81; and (3) New York's own prior statements, in litigation and official publications, that the books and records of brokers do not reveal the identity or last known addresses of the owners of this kind of unclaimed

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[21](...continued)
property act will be amended as necessary to conform to this Court's statement of the federal common law in this area.

[22] New York concedes that the heroic effort that would be required to engage in this reconstruction renders it too costly for New York or the brokers themselves to actually perform on anything more than a random sample basis. N.Y. Br. 80.

property.[23]

New York's theory in this case is actually an after-the-fact rationalization for having taken millions of dollars of unclaimed distributions on the basis of statutes that have nothing to do with the rules of priority established in *Texas v. New Jersey*. The New York abandoned property law purports to cover all unclaimed distributions "received in this state" or "held in this state" by a broker or its nominee, without regard to whether or not the broker's records contain last known addresses of creditors. N.Y. Aband. Prop. Law §§ 511(1), 511(1-a) and 511(3) (McKinney 1991).[24] Thus, New York has in fact taken millions of dollars of unclaimed property from brokers doing business in New York, based on nothing more than the proximity of Wall Street.

New York's newly-minted "creditor broker" theory, invented in this litigation to justify its past conduct, rests upon a series of four presumptions, none of which is warranted as a matter of fact or relevant as a matter of law. These presumptions, and the reasons why they are unavailing, are as follows:

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[23] Stipulation of Agreed Facts, *In The Matter of the Application of the Office of the Comptroller For a Certification that Certain Property Held by Paine Webber Jackson & Curtis Be Deemed Abandoned Property* para. 7 (Jan. 4, 1982) (App. p. 15a) (Exhibit 8 to Brief of Ala., *et al.* (Oct. 30, 1990)); New York Office of Unclaimed Funds, *Handbook for Reporters of Unclaimed Funds* 40 (2d ed. 1988) (App. pp. 16a-17a) (Exhibit 10 to Brief of Ala., *et al.* (Oct. 30, 1990)); New York Office of the State Comptroller, *Abandoned Property Law Handbook for Brokers and Dealers* para. 1 at p. 71, para. 4 at p. 73 (1983) (App. pp. 17a) (Exhibit C to Complaint of Delaware (Feb. 9, 1988)).

[24] Similarly, New York's statute applicable to banks covers unclaimed property "held or owing" by banking organizations, regardless of whether or not the holder's records contain last known address of creditors. N.Y. Aband. Prop. Law § 300(1)(e) (McKinney 1991).

1. New York presumes at the outset that all (or virtually all) of the unclaimed distributions held by brokers and eventually remitted to New York as abandoned property result from one single cause, "nominee float," which New York describes as "aris[ing] when brokers and banks buy and sell securities in certificated format and are unable to timely re-register the securities." N.Y. Br. 29-34, 77. In fact, as discussed *ante* at p. 10-11, unclaimed distributions may be attributable to variety of mishaps (e.g., delays, miscalculations, out-of-balance conditions) and transactions (e.g., fails-to-deliver, stock borrows) not involving "nominee float" at all.[25] Thus, there is no basis for New York's presumption that unclaimed distributions arise solely from nominee float.

Even if all unclaimed distributions could be attributed to "nominee float," which they cannot, not all "nominee float" can be attributed to deliveries of endorsed physical certificates to brokers or banks. Physical certificates may be endorsed and delivered directly to customers, in which case there is no broker or bank on the scene to play the part of a "creditor broker."[26]

New York disingenuously claims that brokers "attribute" their unclaimed distributions to "nominee float." N.Y. Br. 30 (citing Cirrito Dep. 128-29). In fact, while one of the

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[25] DTC Statement pp. 12 n. *, 15 (App. pp. 11a-12a n. 5); DeCesare Dep. 87-91, 120-21, 123, 133, 138, and Exhibit 6; Shearer Dep. 131, 193-94, 242-43; Cirrito Dep. 75, 193-94; Principe Dep. 98.

[26] Direct deliveries of physical securities in endorsed physical form are common to institutional customers, who account for a large volume of business. Shearer Dep. 31-35; Principe Dep. 64; Cirrito Dep. 129, 212-13. Such deliveries are rare to retail customers, but do sometimes occur. Shearer Dep. 34; Cirrito Dep. 128-29; Affidavit of Edward Corman (Exhibit 6 to Brief of Ala., *et al.* (Oct. 30, 1990)).

brokers "guess[ed]" that nominee float is "probably the biggest cause" (or at least the "most clearly understood" cause) of unclaimed distributions, Cirrito Dep. 128, 224, all of the brokers agreed that "[t]here's many reasons why we could receive more money than we anticipated receiving," Shearer Dep. 192,[27] and all of the brokers further agreed that they cannot identify the actual reason (or reasons) for any specific unclaimed distribution that remains unclaimed, Shearer Dep. 192, 195; Principe Dep. 96, 101; Cirrito Dep. 223.

New York also attempts to shore up its presumption as to the cause of escheatable unclaimed distributions by asserting that brokers "routinely" pursue claims against overpayments resulting from causes other than "nominee float," thus negating those other causes as contributing to unclaimed distributions turned over to New York. N.Y. Br. 29, 33 n. 35. There is absolutely no support in logic or fact for this distinction. Brokers are just as likely, if not more, to pursue claims arising out of the "most clearly understood" phenomenon of nominee float than out of errors, out-of-balance conditions, failures to deliver, failures to credit customers' accounts, or other miscellaneous mishaps that may never come to the brokers' attention.[28]

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[27] *See also* Cirrito Dep. 224 ("it could result from a number of different reasons") and Principe Dep. 97 ("any number of circumstances").

[28] New York produced representative claims, submitted by individuals to recover unclaimed distributions since remitted to New York as abandoned property, which confirm the variety of errors and mishaps that can result in escheatable unclaimed distributions. N.Y. Docs. N5016-27, N5404-26, N5427-37 (Exhibits 13-15 to Brief of Ala., *et al.* (Oct. 30, 1990)). As one of the brokerage officers said, "I caution you not to infer from [the industry practice of pursuing claims resulting from stock borrows] that everybody makes 100 percent of their claims on time and consequently everything is a wash, because in reality it doesn't happen that way." Cirrito Dep. 219.

2. New York's second presumption is that brokers' trade records, through an elaborate process of reconstruction, can generally yield up the specific delivery of a physical security certificate in endorsed negotiable form that later caused an overpayment of distributions to the broker. N.Y. Br. 80. Thus, as set out in the self-serving affidavit of New York's own Unclaimed Property Director, Robert Griffin (Exhibit A to New York Brief in Opposition to Filing of Complaint (May 9, 1988)), an unclaimed distribution in the amount of $ 1,100 on a dividend of $ 0.22 per share of Houghton Mifflin stock could be deduced to arise from a sale of 5,000 shares of such stock. The trade records of the broker could then be searched to find the prior trade of 5,000 shares of Houghton Mifflin that caused the overpayment.

Apart from the fact that overpayments do not necessarily result from deliveries of certificates to brokers or banks, New York's insistence that particular overpayments can be linked to particular trades is patently absurd. In the given hypothetical, the overpayment of $ 1,100 could represent the combination of two $ 550 overpayments, or the net result of an overpayment of $ 3,100 and an underpayment of $ 2,000. Even if the $ 1,100 amount represented only one overpayment caused by only one delivery, the so-called "creditor broker" could have engaged in hundreds (if not thousands) of prior trades of Houghton Mifflin stock. Any given trade of 5,000 shares, or two trades of 2,500, could be the cause, no matter how recent or how long ago.[29] The simple and indisputable fact is that nobody, broker or State auditor, can look at a brokers' trade records and, without additional information, link specific overpayments to specific trades. Shearer Dep. 192-93; Principe Dep. 102; Cirrito

[29] Of course, a physical certificate can remain outstanding in endorsed negotiable form for an indefinite time, resulting in overpayments on many successive distribution dates.

Dep. 73, 218-219, 222-24.

3. Even if all unclaimed distributions were caused by deliveries of certificates from brokers to other brokers or to banks (which they are not), and even if all overpayments could be linked to specific deliveries recorded in brokers' records (which they cannot), New York's "creditor broker" theory would nonetheless fail because of the specious nature of both parts of its third presumption: that all brokers or banks to whom physical certificates are delivered ("recipient brokers") both (a) *retain* the certificates in their possession until they are reregistered into the recipient brokers' names at some later date, and, until then, (b) *credit* their customers' accounts with the intervening periodic distributions that the brokers themselves fail to receive (because the underlying certificates are not registered in the recipient brokers' names).

First, recipient brokers do not necessarily retain physical certificates in endorsed negotiable form. They frequently endorse the certificates and pass them along. If purchased for an institutional customer, for example, the certificate is commonly endorsed and delivered to the customer. Shearer Dep. 33; Cirrito Dep. 36; Principe 64-65. In fact, deliveries to institutions or other brokers can be accomplished by sending along a certificate registered in any name at all, so long the necessary endorsements have been supplied. Principe Dep. 65 ("It could be any name ... If I have a certificate in the name of Merrill Lynch that's properly endorsed sitting in my box, I'll in fact deliver that certificate."); Shearer Dep. 33 ("It could be delivered in anybody's name").

Second, while it is an industry practice to credit customers' accounts on payment in general, this does not necessarily mean that the actual beneficial owners of unclaimed securities distributions were in each case credited by their brokers. The portion of a distribution that may eventually become unclaimed property represents only a fraction of a percent of the entire distribution. Thus, this infinitesimal quantum that becomes "stuck" in the hands of an intermediary does not logically correspond to what "normally" or "usually" occurs. There is no basis to presume that just because customers' accounts are "usually" or "routinely" credited, the unknown beneficial owner corresponding to the unusual situation of an unclaimed distribution has in fact been paid that amount.

4. Finally, New York's theory also hinges on the unwarranted presumption that all of the so-called "creditor brokers" have "trading addresses" located in New York. New York admits, however, that not all, but only "almost all," N.Y. Br. 19, or "virtually all," N.Y. Br. 45, 80, of such "creditor brokers" are located in New York. As the Special Master concluded, Report 59 n. 50, there is no basis in logic or precedent for adopting a legal standard for presuming the addresses for a hypothetical class of creditors (or "virtually all" of such class) in lieu of actual last known addresses.

As shown above in detail, each of the four levels of presumptions upon which New York rests its claim in this litigation is unfounded. Moreover, as the Special Master correctly determined, New York's reliance upon "creditor brokers" is legally as well as factually insupportable. Report 61-68. New York's quest to prove that the addresses of recipient brokers and banks can be derived from the records of brokers holding unclaimed distributions is simply irrelevant, since such recipient brokers legally do not qualify as creditors or owners (or even "apparent owners") of the unclaimed property. When this Court referred to the last known addresses of creditors in *Texas v. New Jersey* and *Pennsylvania v. New York*, it referred to parties with some claim of ownership to the unclaimed property, not to mere intermediaries. Thus, in *Texas v. New Jersey* the existence of paying agents and banks as holders of the unclaimed property was ignored, and in *Pennsylvania v. New York* the possibility that Western Union might pay the money orders through branch offices, banks or fiscal agents was not of concern. The essence of a "creditor" under the rule of *Texas v. New Jersey* is therefore that the unclaimed property is "property" or an "asset" as to the creditor. 379 U.S. at 680-681. There is nothing about the fact that a broker or bank at one time received the underlying security, without more, that establishes that such broker or bank is later entitled to receive distributions on the security. Thus, New York's factual contentions about identifying "creditor brokers" are legally irrelevant.

POINT II.

THIS COURT SHOULD IMPLEMENT THE SPECIAL MASTER'S RECOMMENDATION THAT THE LOCATION OF ISSUERS BE DETERMINED BY PRINCIPAL EXECUTIVE OFFICE RATHER THAN BY STATE OF INCORPORATION

In addition to recognizing issuers as the debtors of the unclaimed property in this case, a matter of judicial interpretation of the term "debtor" in the back-up rule of *Texas v. New Jersey*, the Special Master also recommends that this court implement a minor modification to a separate component of the back-up rule. Specifically, the Special Master recommends that the proxy for location of the issuer be changed from state of incorporation to principal executive office. Report 40-50. This recommendation does not discard but rather improves the back-up rule. Texas, *et al.*, endorse the Special Master's recommendation. Modifying the locational test as recommended produces a fair and easily implemented standard.

As the Special Master correctly noted, Report 41, in *Texas v. New Jersey* this Court recognized the manifest fairness of using a principal office or place of business test as a locator for purposes of applying the back-up rule, since that would send the property to a State "probably foremost in giving the benefits of its economy and laws to the company whose business activities made the intangible property come into existence." 379 U.S. at 680. However, perceiving determination of principal place of business to be "sometimes difficult," *id.*, the Court elected to use the ready surrogate of jurisdiction of incorporation as a location factor for purposes of applying the back-up rule.

The Special Master did not find (as Delaware suggests, Del. Br. 53) that this perception was "arbitrary" in 1965. Rather, the Special Master found that, however appropriate the Court's perception of relative convenience had been in 1965, changes in law and technology have now made clear that the principal executive office test is easy and simple to implement. Relative convenience having been equalized, manifest fairness tips the scales to principal executive office.

A. Principal Executive Office Is Fairer Than State Of Incorporation As A Proxy For The Location Of Issuers

As the Special Master correctly recognizes, Report 50, the principal executive office test is manifestly fairer than the state of incorporation test because it is much more likely to identify the jurisdiction which gave the benefits of its economy and laws to the company whose business activities made the intangible property come into existence, and also to distribute unclaimed property fairly among the States. Report 50.

As to the first criterion, it is indisputable that some, if not most, of the essential business activities of a company will be carried out where a company has its principal executive office. Delaware's assertion that in some instances executive and manufacturing activities may occur in different places, Del. Br. 65-68, proves nothing to the contrary. At the very least, the principal executive office is the place where key business decisions are made. With respect to the vast majority of companies, moreover, much if not all of the company's other activities will also occur there or in the same state. Delaware's fanciful description of corporate executives relocating their offices to golf resorts notwithstanding, Del. Br. 67, the principal executive office test is an effective means to locate, in an precise and simple manner, the key business activities of a company.

On the other hand, there is no necessary connection at all between the business activities of a company and the State in which it happens to incorporate itself. Delaware nowhere disputes this. Instead, Delaware launches into an extensive, and entirely irrelevant, catalog of supposed benefits of Delaware corporation law to the stockholders of Delaware corporations. Del. Br. 62-64. This is an outright misreading of *Texas v. New Jersey*. The Court there identified the benefits a State gives to a company, not to its shareholders, as the relevant fairness criterion.[30]

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[30] Even on its own terms, Delaware's argument is mistaken. Delaware says "penetrating academic analysis" and "comprehensive empirical study" have recently shown that Delaware corporation law provides benefits to shareholders of Delaware corporations, contradicting contrary views expressed "until about 20 years ago." Del. Br. 62-63. In fact, this academic debate continues to this day, with many eminent scholars opining that Delaware corporation law, through permissive measures, favors management to the *detriment* of shareholders. Hazen, *Corporate Directors' Accountability: The Race to the Bottom - The Second Lap*, 66 N.C. L. Rev. 171 (1987); Brudney, *Corporate Governance, Agency Costs and the Rhetoric of Contract*, 85 Col. L. Rev. 1403 (1985); Schwartz, *Federalism and Corporate Governance*, 45 Ohio St. L.J. 545 (1984); Chirrelstein,

(continued...)

Delaware also makes the erroneous argument that it would be fair to give the vast amounts of unclaimed property at issue in this case to Delaware because of the time and effort that its judiciary puts into deciding corporate law cases. Del. Br. 69. Even if there were any sense to the notion that Delaware deserves a reward for the efforts of its public sector, it already receives more than ample compensation from its steep corporation fees and franchise taxes, among the highest in the nation. Macey & Miller, *Toward An Interest Group Theory of Delaware Corporation Law*, 65 Tex. L. Rev. 469, 492 n. 86 (citing Del. Code Ann. tit. 8, §§ 391 and 503). Corporation franchise tax revenue averaged 15.8% of Delaware's total revenues during the period 1960 to 1980. Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. L. Econ. & Org. 225, 240-42 (1985). Plainly, any additional money coming Delaware's way as a result of the proliferation of Delaware corporations is sheer windfall.

Regarding the second criterion of fairness, distributing unclaimed property fairly among the States, nothing shows the superior fairness of principal place of business over state of incorporation better than the fact that over 50% of the

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[30](...continued)
Towards a Federal Fiduciary Standards Act, 30 Clev. St. L. Rev. 203 (1981). Indeed, even the commentators upon which Delaware relies are not so uniformly laudatory as Delaware suggests. Professors Macey and Miller, for example, see Delaware corporation law as benefitting shareholders in some respects, but also as the "least restrictive ... in second-guessing the amount of manager's compensation, rejecting insider contracts on grounds of self-dealing, or permitting corporations to indemnify officers and directors," all favoring managers at the expense of shareholders, and further view Delaware's prominence as a state of incorporation in part as an effort to maximize revenues for "an elite cadre of Wilmington lawyers who practice corporation law" in Delaware. Macey & Miller, *Toward an Interest Group Theory of Delaware Corporation Law*, 65 Tex. L. Rev. 469, 472, 485 (1987).

Fortune 500 companies are incorporated in Delaware, but fewer than 1% of those companies have their headquarters there.[31] Delaware thus seeks to obtain an unconscionable windfall profit, fantastically out of proportion to the business activities that actually occur in Delaware, all based on the "minor factor" of where companies elected to incorporate themselves.

B. The Principal Executive Office Test Is Simple And Efficient To Implement

The principal executive office test would be simple and efficient to implement because the necessary data with respect to virtually all public issuers is contained in public filings with the SEC, and this information is publicly available though computerized databases.

Most private issuers of publicly traded securities are required to identify their principal executive office in filings with the SEC under the Securities Act of 1933, 15 U.S.C. §§ 77a *et seq.* (1988 & Supp. II 1990) ("1933 Act"), and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.* (1988, Supp. I 1989 & Supp. II 1990) ("1934 Act").[32]

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[31] Del. Suppl. Br. 14 (Nov. 5, 1991) (citing Alva, *Delaware and the Market for Corporate Charters: History and Agency,* 15 Del. J. Corp. L. 885, 887-90 (1990)); Ala., *et al.* Suppl. Reply Br. 7 n. 6 (Nov. 21, 1991) (citing Disclosure Database and Standard & Poor's Corporate Descriptions).

[32] The 1933 Act requires the filing of a registration statement with the SEC with respect to non-government securities sold in interstate commerce. 1933 Act §§ 5 and 6, 15 U.S.C. §§ 77e and 77f (1988). Registration is accomplished by filing a comprehensive registration statement. 1933 Act § 7 and Schedule A, 15 U.S.C. § 77g and Schedule A (1988). The official SEC forms for the registration statement require that the "[a]ddress, including zip code, and telephone number, including area code, of registrant's principal executive office" be disclosed. *See, e.g.,* Form S-1,

(continued...)

These filings are well-suited to the back-up rule of *Texas v. New Jersey* because they are authoritative, regularly updated, and easily accessible to the public.

SEC filings are authoritative and regularly updated because the very purpose of such filings is complete and accurate disclosure, and because civil and criminal penalties are imposed for material misstatements contained therein.[33] Significantly, the 1934 Act itself invokes reliance upon the "principal executive office" disclosed by issuers.[34]

The data contained in SEC filings of issuers is widely available to the public through computerized data bases. *See, e.g., LEXIS-NEXIS Library Contents and Alphabetical List, Issue 1, 1991*, pp. 67-68 (Mead Data Central 1990); *Database List, Spring 1991*, p. 72 (West 1991). The SEC is

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[32](...continued)
47 Fed. Reg. 11,449 (1982). The registration statement is available to the public, 1933 Act § 6(d), 15 U.S.C. § 77f(d) (1988).

The 1934 Act requires even more comprehensive filings by issuers of securities. Securities sold on national exchanges or quoted in the national over-the-counter market must be registered under the 1934 Act, and issuers of such securities must file periodic reports. 1934 Act §§ 12 and 13, 15 U.S.C. §§ 78*l* and 78m (1988, Supp. I 1989 & Supp. II 1990). The official forms promulgated by the SEC for these reports require disclosure of the issuer's "principal executive office." *See* Form 10, 47 Fed. Reg. 34,934 (1982) (registration of securities); Form 8-K, 42 Fed. Reg. 4,429 (1977) (current reports by issuers); Form 10-Q, 46 Fed. Reg. 12,486 (1981) (quarterly reports by issuers); and Form 10-C, 47 Fed. Reg. 33,589 (1982) (NASDAQ securities).

[33] 1933 Act §§ 11 and 24, 15 U.S.C. §§ 77k and 77x (1988); 1934 Act §§ 18 and 32, 15 U.S.C. §§ 78r and 78ff (1988).

[34] The 1934 Act requires persons acquiring more than 5% of any class of equity security to file with the SEC and send to the issuer "at its principal executive office" a statement containing specified information. 1934 Act § 13(d)(1), 15 U.S.C. § 78m(d)(1) (1988) (App. pp. 2a-3a).

planning a system called Electronic Data gathering Analysis and Retrieval System ("EDGAR") that will further facilitate electronic access. *See* 56 Fed. Reg. 54,420 (1991); 51 Fed. Reg. 24,155 (1986).

Delaware's complaint that the public databases reflect some conflicting headquarters data for a few companies is inapposite because those difficulties can generally be resolved short of litigation by referring to the original SEC filing. Those rare instances where companies report more than one principal executive office (apparently about as rare as companies with multiple incorporation) are so *de minimis* as to constitute no legitimate objection to the general utility of the rule.

C. Modification Of The Back-Up Rule Is Not Barred By The Doctrine Of Stare Decisis

Delaware errs in arguing that the minor change recommended by the Special Master is barred by the doctrine of stare decisis. That equitable doctrine has little force in the unique circumstances of this case because (1) the substantive rights of holders and claimants are not affected by the change, (2) all of the States potentially affected by this modification are presently before the Court, and (3) it would be inappropriate to defer to Congressional action with respect to a generally applicable change in the federal common law of interstate controversies created by this Court. Even if the doctrine of stare decisis had some force in this case, however, the minor modification here proposed is amply justified by changes in the law and in technology since 1965.

"*Stare decisis* is not an inexorable command; rather, it 'is a principle of policy and not a mechanistic formula of adherence to the latest decision.'" *Payne v. Tennessee*, 111 S. Ct. 2597, 2609-10 (1991) (quoting from *Helvering v. Hallock*, 309 U.S. 106, 119 (1940)). In the present case, the principles underlying the policy of stare decisis are largely inapplicable.

Contrary to Delaware's assertion, this case does not directly implicate the reliance interests of private persons with respect to property. The federal common law of interstate escheat claims does not determine *whether* private persons holding unclaimed property must remit such property to a State, but only *which* State has the prior claim to hold such property in custody. The holders, who have no ownership claim to the unclaimed property, do not have any property interest to be substantively affected by the federal common law, since they must turn the property over to one State or another in any event.

The only private persons with substantive rights regarding unclaimed property are the missing beneficial owners. As to them, however, it cannot be said that they relied upon a rule of priority among State unclaimed property laws. In any event, *Texas v. New Jersey* does not cut off their right to claim their property in the future, it only determines to which State such claims must be directed.

Therefore, the principal reliance interests that might be substantially affected by the proposed modification to the back-up rules belong to the States, not private persons.[35] In this unique litigation, moreover, all of the States are parties and therefore have a full and complete opportunity to bring before the Court any reliance interests at stake. Thus, the concern of stare decisis with the reliance interests of parties not before the Court is not implicated.

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[35] As this Court has noted, in cases dealing not with "substantive property law as such, but rather with an issue substantially related to the constitutional sovereignty of the States," the "considerations of *stare decisis* play a less important role." *Oregon ex rel. State Land Bd. v. Corvallis Sand & Gravel Co.*, 429 U.S. 363, 382 (1977).

Delaware errs in arguing that this Court must defer to Congressional action to modify the locational test in a common law rule of this Court's creation. The Congress has not taken action in the interstate escheat priority area, except to make an adjustment in one limited form of transaction (money orders and travelers checks).[36] The proposed modification of the back-up rule locational test, on the other hand, while minor, is a change of general applicability. There is no basis to presume that Congress would take it upon itself to make a change of general applicability in an area addressed by this Court through its exclusive original jurisdiction of interstate controversies.

To the extent that Congress has taken action, of course, the change it effected is consistent with the change proposed by the Special Master.[37] The fact that Congress has not undertaken to enact this modification across the board, however, should not be taken as an endorsement of the present rule in other factual settings. As this Court has cautioned, the circumstances of Congressional silence must be "very persuasive" to bar this Court from "re-examining its own doctrines," since "[t]o explain the cause of non-action by Congress when Congress itself sheds no light is to venture into speculative unrealities." *Helvering v. Hallock*, 309 U.S. 106, 119-20 (1940). Thus, "[i]t is treacherous at best to find in Congressional silence alone the adoption of a controlling

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[36] None of the many federal statutes cited by Delaware as "displacing state authority to escheat," Del. Br. 71-72 & n. 85, purports to alter the rule of *Texas v. New Jersey*, or to impose a federal law of escheat of general applicability. These statutes address specific property in specific instances. Thus, they cannot fairly be construed as implying Congressional endorsement of the present locational test under the backup rule of *Texas v. New Jersey*.

[37] The secondary rule applied by Congress with respect to money orders and travelers checks relies upon the "principal place of business" of the issuer. 12 U.S.C. § 2503(2) & (3) (1988).

rule of law." *Boys Markets, Inc. v. Retail Clerk's Union, Local 770*, 398 U.S. 235, 241 (1970) (quoting *Giroud v. United States*, 328 U.S. 61, 69 (1946)).

Finally, even if the doctrine of stare decisis had any decisive effect in this litigation, Delaware is incorrect in suggesting that the modification suggested by the Special Master is not justified by changes occurring since 1965. As the Special Master correctly noted, the courts have now had substantial experience with "principal executive office" tests, and that experience has confirmed the certainty and reliability of this rule as compared to the "principal place of business" test used in 28 U.S.C. § 1332 (1988).[38]

The "chief executive office" standard was substituted for "chief place of business" as the locational test for debtors with respect to security interests in general intangibles under the Uniform Commercial Code in 1972.[39] *Compare* U.C.C. § 9-103(2) (1962) *with* U.C.C. § 9-103(3)(d) (1972). Courts applying the revised provision have consistently praised it as adding simplicity and precision to the law. For example, the

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[38] Delaware discounts the significance of "principal executive office" tests in laws relating to perfection of liens because secured parties can file in multiple places. This argument misses the point. SEC filings by issuers of securities will relieve holders of unclaimed securities distributions of any significant doubt as to the location of an issuer's principal executive offices. The point of the use of "principal executive office" tests in lien laws is that legislators have passed these statutes, and courts have praised them, as an improvement over "principal place of business" and other imprecise tests. This experience is a change in the law that was not available to the Court when it decided *Texas v. New Jersey* in 1965.

[39] The phrases "chief executive office" and "principal executive office" are synonymous. Indeed, the words "chief" and "principal" are typically used to define each other. *Black's Law Dictionary* 216, 1073 (West 5th ed. 1979); *Webster's Ninth New Collegiate Dictionary* 232, 935 (Merriam-Webster 1989).

Ninth Circuit has hailed this revision in the following words:

> The subsequent revision of § 9[-]103 greatly assists in clearing up this confusion over the proper interpretation of 'place of management.'

In re J.A. Thompson & Son, Inc., 665 F.2d 941, 950 (9th Cir. 1982). *See also In re Metro Communications, Inc.*, 95 B.R. 921, 927 (Bankr. W.D. Pa. 1989) (citing *J.A. Thompson* and *Golf Course Builders* as placing "great weight" on change to "chief executive office"); *In re Golf Course Builders Leasing, Inc.*, 768 F.2d 1167, 1170 (10th Cir. 1985).

Similarly, "principal executive office" was adopted in 1966 as the locational test to determine where tax liens must be filed by the federal government. Pub. L. No. 89-719, Title I, § 101(a), 80 Stat. 1125, 1125-31 (1966) (amending 26 U.S.C. § 6323). The purpose of this terminology was to make the identification of the place for filing and searching for liens as "simple and certain as possible." *Dimmit & Owens Financial, Inc. v. United States*, 787 F.2d 1186, 1190-91 (7th Cir. 1986). The Senate report explains that "principal executive office" is "the most readily identifiable of all the offices that a business may maintain, appearing, as it does, on the annual reports filed with most States and on similar returns, and avoids the uncertainty of determining which of the many business offices that a taxpayer may maintain is its principal one." S. Rep. No. 1708, 89th Cong., 2d Sess. 11 (1966), *reprinted in* 1966 U.S. Code Cong. & Ad. News 3722, 3732.[40]

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[40] The Congressional enactment relating to money orders and travellers checks, to the extent that it relies upon "principal place of business" to locate corporate issuers, is of course also a legal development that has occurred since 1965. 12 U.S.C. § 2503(2) & (3). Moreover, in addition to the

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The change to principal executive office is also amply justified by the sweeping technological developments in the securities industry since 1965, including the changeover to depositories and nominee registration and the extensive use of computerized record-keeping (*ante* 6-8). It is now apparent that dividends on company stock are not escheated under the back-up rule "with comparative infrequency" as the *Texas v. New Jersey* Court predicted, 379 U.S. at 682, and that computer data systems have rendered the "principal executive office" test simple and efficient to implement.

POINT III.

THE DECREE IN THIS CASE SHOULD APPLY TO ALL UNCLAIMED DISTRIBUTIONS WRONGFULLY TAKEN BY NEW YORK IN VIOLATION OF *TEXAS V. NEW JERSEY*

The Special Master recommends that the proposed decree in this case should apply to all of the intangible property in issue that New York has taken in prior years under its overbroad abandoned property law. Report 70-77. Texas, *et al.*, submit that this result is compelled by the prior actions of New York, the nature of custodial taking itself, and this Court's prior rulings in *Texas v. New Jersey* and *Pennsylvania v. New York*. Even if this Court applies the

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[40](...continued)
statutes cited above, a "principal executive office" standard was added in 1980 to the venue provisions governing eight causes of action relating to common carriers. Federal Railroad Safety Authorization Act of 1980, Pub. L. 96-423, §§ 3, 5, 8, 9 & 12, 94 Stat. 1811, 1811-16 (1980)(amending 45 U.S.C. §§ 6, 34, 64(a)(1), 432(e), 436(a)(1), 438(c) and 439(c), and 49 U.S.C. § 26(h)). Uniformity of application was obviously important to these amendments, which were intended "to allow the consolidation of related suits involving one carrier in one court." H. Rep. No. 1025, 96th Cong., 2d Sess. 15, *reprinted in* 1980 U.S. Code Cong. & Ad. News 3830, 3839-40.

retroactivity analysis set forth in *Chevron Oil v. Huson*, 404 U.S. 97 (1971), however, the conclusion that New York must yield up the property it has wrongfully taken is inevitable.[41]

A. The Rulings By This Court In *Texas v. New Jersey* and *Pennsylvania v. New York* Establish That The Proposed Decree Should Apply To All Unclaimed Distributions Previously Taken By New York

This Court recognized in *Texas v. New Jersey* that a State's custody of unclaimed property under the back-up rule is subject to a later claim by States which have or acquire a superior right to take custody of the unclaimed property. 379 U.S. at 682. Thus, the custodian State's right to possession is inherently subject to disgorgement in favor of either a State with a superior right to custody or, in the case

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[41] Delaware also argues that the Special Master's proposed decree in this case should not be retroactively applied to property previously taken by Delaware. However, no claim has been asserted in this litigation against any property held by Delaware. Moreover, there is no indication whether Delaware has previously taken any unclaimed distributions on securities, or the circumstances under which Delaware may have taken custody of any property pursuant to the backup rule at all.

As will be demonstrated hereinafter, the Special Master correctly found that New York has no defense to disgorgement of the funds it has taken, principally because New York did not take the property in reasonable reliance upon either the primary or the backup rule of *Texas v. New Jersey*. With respect to Delaware, however, it may be that the equitable circumstances are not identical to those surrounding New York's past actions. If Delaware has taken unclaimed property under the backup rule from entities which were simultaneously both the issuer and the holder of the property, then Delaware (unlike New York) may have taken such property in reasonable reliance upon the "corporate domicile" locational test contained in the backup rule. This may provide Delaware with an equitable defense to disgorgement, not available to New York. Accordingly, Texas *et al.*, limit their response on the disgorgement issue to the property previously taken by New York.

of a custodial taking statute, to the missing owners when they come forward.[42]

Following this Court's decision in *Texas v. New Jersey*, the State of New Jersey moved this Court to impose a cut-off on the rights of other States to assert claims to intangibles it had previously taken. The Court denied New Jersey's motion. 381 U.S. 948 (1965). This disposition serves to further confirm that a State's right to take custody of unclaimed property under *Texas v. New Jersey* is inherently subject to divestment in favor of another State with a superior right.

Subsequently, in *Pennsylvania v. New York*, the State of New York contended that the rule announced in *Texas v. New Jersey* should be given only non-retroactive effect. Report of John F. Davis, Special Master, pp. 12, 14. Special Master Davis rejected this position, observing that it is "supported neither by argument nor reason." *Id.* at p. 21. Thus, he recommended that the Court's prior ruling "be applied to all the items involved in this case regardless of the date of the transactions out of which they arise." *Id.* This recommendation was adopted by this Court, 407 U.S. at 212-

[42] The custodial nature of a State's entitlement under the back-up rule, and under custodial taking statutes in general, serves to sharply distinguish this case from cases involving taxation. The retroactive application of a court decision determining a State's right to retain unclaimed property is not based on the same concerns as those informing the retroactive application of a court decision determining a State's power to tax. Unlike tax revenues, which a State receives as its own property and expends to provide essential services to its citizens, custodial unclaimed property is merely held in a State's possession as custodian. A State cannot legitimately contend that it relied on custodial unclaimed property in its planning and budgeting, or that it has expended the funds in reliance on a right to retain the funds permanently. Accordingly, the disgorgement of custodial unclaimed property cannot have the disastrous effect on a State and its citizens that could occur if a State were required to make massive refunds of tax revenues.

13, 215, despite the fact that New York had already taken part of the unclaimed funds at issue in the *Pennsylvania v. New York* litigation from Western Union. *See Western Union Telegraph Co. v. Pennsylvania*, 368 U.S. 71, 74 (1961) ("New York had already seized and escheated a part of the very funds here claimed by Pennsylvania").

Significantly, the Court in *Pennsylvania v. New York* did *not* engage in the retroactivity analysis for civil cases announced just one year before in *Chevron Oil v. Huson*, 404 U.S. 97 (1971). Delaware erroneously argues that this was because there was no rule of law in this area before *Texas v. New Jersey*, Del. Br. 78. This argument is incorrect, however, because the *Chevron* analysis is also triggered by decision of "an issue of first impression whose resolution was not clearly foreshadowed," 404 U.S. at 106, a description which fits *Texas v. New Jersey* perfectly. Instead, the reason that this Court did not engage in the *Chevron* retroactivity analysis in *Pennsylvania v. New York* is because retroactivity is implicit in the unique area of unclaimed property disputes between States.

Retroactivity is inherent in the very nature of custodial taking of unclaimed property. As this Court has recognized, States acquire unclaimed property under custodial taking statutes only as conservators for the missing owners. *Connecticut Mutual Life Ins. Co. v. Moore*, 333 U.S. 541, 547 (1948). All that New York acquires under its Abandoned Property Law, for example, is the right to hold unclaimed property until the missing owners appear. The possibility of eventually disgorging the unclaimed property therefore is inherent in the very nature of custodial taking.

Therefore, New York received the owner-unknown unclaimed distributions in this case solely as conservator, knowing that such distributions are subject to disgorgement in favor of unknown owners or of States with a superior custodial right. It acquired no ultimate entitlement to the funds. If New York has spent the money, knowing the limited nature of its entitlement, it has only itself to blame for any burden entailed in disgorgement. "No State can be heard to complain about damage inflicted by its own hand." *Pennsylvania v. New Jersey*, 426 U.S. 660, 664 (1976). Accordingly, in light of the underlying purposes of this Court's rulings in the area of unclaimed property disputes between States, the question of retroactivity should be deemed foreclosed by the Court's summary disposition of that issue in *Pennsylvania v. New York*, without regard to the standard retroactivity analysis applied in other areas of the law.

B. Even If Standard Retroactivity Analysis Is Applied, The Ruling In This Case Should Be Fully Retroactive

In the event that this Court determines that it should consider in this case the retroactivity analysis applied in other areas of the law, that analysis dictates that the Court's ruling herein should be fully retroactive.

In *Chevron Oil v. Huson*, 404 U.S. 97, 105-107 (1971) this Court established a three-prong test for non-retroactivity. First, the rule to be applied non-retroactively "must establish a new principle of law," by "overruling clear past precedent" or by "deciding an issue of first impression whose resolution was not clearly foreshadowed." 404 U.S. at 106. Second, in light of the "prior history" and the "purpose and effect" of the rule, the Court should consider whether non-retroactivity would "further or retard its operation." *Id.* at 106-07. Finally, the Court should "weigh" the "inequity imposed by retroactive application." *Id.* at 107.[43]

The first prong of the *Chevron Oil* analysis is not met when a decision merely "contribute[s] to the development" of the Court's jurisprudence in a given area, *Ashland Oil v. Caryl*, 110 S. Ct. 3202, 3205 (1990) (per curiam) (prior decision did not create new principle of law by extending Commerce Clause "internal inconsistency" test beyond original context). This standard is therefore not met by the Special Master's recognition of issuers of securities as debtors under *Texas v. New Jersey*.

The conclusion that the term "debtor" in *Texas v. New Jersey* was used in a descriptive sense, and that this description best fits the issuers of securities rather than mere intermediaries in the securities industry, was inherent in the Court's reasoning in *Texas v. New Jersey* and *Pennsylvania v. New York*. This aspect of the Report neither overrules those precedents nor decides a question of first impression whose resolution was not clearly foreshadowed. To the extent that the decree resolves a disputed issue concerning the application of the rule of *Texas v. New Jersey*, it is an issue as to which New York cannot claim reliance upon a "clear past precedent," *Chevron*, 404 U.S. at 106. Thus, this aspect of the proposed decree does not represent a "clear break from prior precedent," *American Trucking Ass'ns v. Smith*, 496 U.S. 167, 184 (1990) (plurality opinion), and the

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[43] The Court has reexamined the doctrinal underpinnings of retroactivity in two recent cases. *See James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991); *American Trucking Ass'ns v. Smith*, 496 U.S. 167 (1990). While each case produced sharply divided opinions, neither *Beam* nor *American Trucking* forecloses the application of *Chevron Oil* in all cases. Assuming the continued viability of prospective adjudication and the appropriateness of a *Chevron Oil* analysis in the present case, such analysis clearly leads to retroactive relief in this case.

first prong of the *Chevron Oil* analysis is not met.[44]

The second prong of *Chevron Oil* also demands retroactive application of the proposed decree. This prong requires the Court to look at the "prior history" and "purpose and effect" of the rule, and to decide whether retroactivity will "further or retard its operation." Even if a decision concededly establishes a new principle of law, retroactive application is nonetheless required if it "furthers the purposes and effect" of the applicable law. *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477, 485 (1989) (decision that pre-dispute agreements to arbitrate claims under Securities Act are enforceable is retroactive despite reversal of clear precedent to contrary). Such is the case here.

The "prior history" of the rule includes this Court's rejection of arguments against disgorgement both in the denial of New Jersey's motion in *Texas v. New Jersey* and in the rejection of New York's non-retroactivity argument in *Pennsylvania v. New York.* The "purpose" of the rule is to distribute unclaimed property to those States with a logical and cogent connection to the property, and its "effect" is to confer only temporary custody over the unclaimed property pending disposition to the unknown owner or to a State with a superior right to custody. Retroactive application of the proposed decree will further this purpose and effect, by redistributing the unclaimed distributions from New York, which seized them without legal justification, to those States who in fairness should have custody of those distributions for

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[44] The proposed minor adjustment of the locational test for the back-up rule, from state of incorporation to chief executive office, is a refinement rather than a reversal of the rule. However, to the extent that this minor change is deemed "new law" under the first prong of the *Chevron* analysis, the second and third prongs nevertheless dictate that the decree should be retroactive.

the benefit of their citizens. Thus, as this Court confirmed without hesitation in 1972, the rule should be applied retroactively.

New York misinterprets the second prong of *Chevron Oil* as hinging on whether retroactivity is required for deterrence effect. This is plainly incorrect, since the Court has often applied decisions retroactively where no deterrence effect was involved. *See, e.g., Rodriguez de Quijas v. Shearson/American*, 490 U.S. 477, 485 (enforceability of arbitration agreements held retroactive); *Goodman v. Luken Steel*, 482 U.S. 656, 662-64 (1987) (statute of limitations held retroactive). However, even if deterrence were the determinative issue, New York would lose. Unlike the state officials in *American Trucking Ass'ns v. Smith*, 496 U.S. 167 (1990), upon which New York relies, New York enacted and enforced its abandoned property with respect to the unclaimed distributions at issue in this case in contravention of established precedent.[45] Indeed, New York seized the distributions without the benefit of any genuine justification at all, other than the physical presence of various brokerage and bank operations in New York. It is difficult to imagine a more appropriate case for the deterrence effect of applying a decision retroactively. Otherwise, there will be no disincentive for States to grab unclaimed property in the future in contravention of existing precedent, confident that they will not be required at a later date to disgorge the funds. This is precisely the climate of uncertainty and expensive litigation between competing States that the Court in *Texas v. New Jersey* sought to avoid. 379 U.S. at 679.

Finally, the third prong of the *Chevron Oil* test also

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[45] Of course, *American Trucking* is also plainly distinguishable because that decision involved taxes rather than unclaimed property. *See* footnote 41, *ante* at p. 56.

militates in favor of retroactivity. It would be unfair to deprive States with a logical and cogent connection to the unclaimed property at issue of their right to take custody thereof. It is not unfair to require disgorgement on the part of the State of New York, since it took custody of the unclaimed property only as conservator, subject to later relinquishment.

In any event, it is plain that New York did not rely upon *Texas v. New Jersey* in the sense contemplated by *Chevron Oil*, because the theories it advances were created after-the-fact for purposes of this litigation. New York did not in actuality rely upon those theories in seizing the property at issue. New York seized the unclaimed distributions in contravention of the rules of *Texas v. New Jersey*, not in reliance upon any interpretation (reasonable or otherwise) of those rules.

With respect to brokers, New York now claims that it took the unclaimed distributions on the ground that they are owed to "creditor brokers" with presumed "trading addresses" in New York. On its face, this theory is inconsistent with *Texas v. New Jersey*. Nowhere does that decision authorize the use of an invention such as "trading address," nor a presumption that any kind of last known addresses are generally within a particular State, nor the substitution of mere intermediaries for "creditors."[46]

With respect to custodian banks and DTC, it is equally

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[46] Even if this theory were somehow derived from *Texas v. New Jersey*, moreover, the plain fact is that New York never really relied upon it. As discussed *ante* at 37, New York's statute regarding brokers does not conform to its own theory, much less *Texas v. New Jersey*, and New York's theory is also contradicted by New York's own prior statements, and a stipulation in a prior case, that brokers' records do not reveal the identity of, nor any last known addresses for, the owners of the property.

clear that New York did not rely upon *Texas v. New Jersey*. New York now asserts that it took unclaimed distributions from national banks on the ground that they have their "principal operations" in New York. N.Y. Br. 19 n. 21. This theory is not within the *Texas v. New Jersey* rule. 379 U.S. at 680 (declining to adopt "principal place of business" test). As to other banks and DTC (a limited purpose trust company chartered under New York banking law), New York now claims that it took unclaimed distributions on the ground that such banks are chartered in New York. New York's statute, however, is not limited to banks chartered in New York. N.Y. Aband. Prop. L. § 103(c) (McKinney 1991) ("banking organizations" defined to include banks "subject to" as well as "organized under" the laws of New York). In fact, New York's statute even applies to unclaimed distributions held by "the New York agency or agencies of all foreign banking corporations licensed to do business in [the State of New York]," regardless of their charter. N.Y. Aband. Prop. L. § 300(4) (McKinney 1991).[47] New York thus did not rely upon any interpretation of *Texas v. New Jersey*, reasonable or otherwise, in taking unclaimed distributions from either brokers or banks. Accordingly, even assuming that the *Chevron Oil* analysis is applicable to this case, the Court should conclude that retroactivity is required by the three-prong test announced in that case.

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[47] New York's rationale as to banks is also contradicted by its unclaimed property handbook, which states that its abandoned property law does not apply to out-of-state branches of New York banks, but does apply to international banking facilities located in New York. New York Office of Unclaimed Funds, *Handbook for Reporters of Unclaimed Funds* 32 (2d ed. 1988) (App. p. 16a). Thus, the determinative factor in New York's actual practice is plainly the physical proximity of the branch holding the funds, not whether the bank is domiciled in New York.

C. New York May Not Avoid Its Obligation To Surrender The Unclaimed Property It Has Wrongfully Taken By Asserting The Equitable Doctrine Of Laches

Remaining to be considered is whether, given retroactive application of the rule of decision in this case, the State of New York should be permitted to retain millions of dollars that it has wrongfully taken from intermediaries in the securities industry on the basis of the equitable doctrine of laches. Texas, *et al.*, submit that it should not.

This Court has long held that the doctrine of laches is not applicable to governments in the exercise of their sovereign rights. *Illinois v. Kentucky*, 111 S. Ct. 1877, 1883 (1991); *Guaranty Trust Co. of New York v. United States*, 304 U.S. 126, 132 (1938). As this Court stated in *United States v. California*, 332 U.S. 19, 40 (1947), "officers who have no authority at all to dispose of Government property cannot by their conduct cause the Government to lose its valuable rights by their acquiescence, laches or failure to act."

This rule should be applied to preclude the application of the doctrine of laches in this case. The millions of dollars of unclaimed securities distributions at issue here, when remitted to those States entitled to take custody of the funds, will inure to the benefit of all of the citizens of those States. As such the interests of the citizenry of all of the States involved in this litigation are at stake. The entitlement of States to enforce their custodial taking statutes for the benefit of their citizens should not be abridged by any alleged delay by State officials in asserting their citizens' rights in this case.

Even if the doctrine of laches were not absolutely precluded, however, it still could not be successfully asserted by the State of New York. It is well settled that laches requires "prejudice to the other party," *Gutierrez v. Waterman Steamship Co.*, 337 U.S. 206, 215 (1963). Moreover, "prejudicial harm does not occur merely because one loses what he otherwise could have kept." *Cruz v. Hauck*, 762 F.2d 1230, 1238 (5th Cir. 1985). Rather, prejudice consists of "a disadvantage in asserting and establishing a claimed right or defense, or other damage caused by detrimental reliance." *Id.*

In this case New York has not suffered the kind of harm that triggers the doctrine of laches. The funds that New York received under its unclaimed property law were received only as custodian. New York cannot claim detrimental reliance because it received the funds knowing that it may be required to surrender them in the future.[48] Consequently, the equities in this case require that New York be ordered to disgorge the unclaimed property it has wrongfully taken.

CONCLUSION

The Special Master's Report presents an insightful and thorough, not to mention commercially practical, analysis of this Court's opinions in *Texas v. New Jersey* and *Pennsylvania v. New York.* Recognizing the issuers of securities as debtors of unclaimed securities distributions applies the back-up rule of *Texas v. New Jersey* fairly to the unclaimed property in this case, and the Special Master's proposed adjustment of the locational test for such issuers is a welcome enhancement of the rule. Texas, *et al.*,

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[48] Indeed, it strains reason to convert New York's temporary possession of such funds, which it was never entitled to keep, from an undeserved windfall into a "detriment." *See Travelers Express Co. v. Cory*, 664 F.2d 763, 770 (9th Cir. 1981)(court finds no "reliance to detriment" on the part of holder who retained unclaimed funds it would otherwise have been required to surrender).

respectfully urge this Court to adopt the Report of the Special Master and to implement his Proposed Decree.

Respectfully Submitted,

DAN MORALES
Attorney General of Texas
WILL PRYOR
First Assistant Attorney General
MARY F. KELLER
Deputy Attorney General for Litigation, *Counsel of Record*
JAMES A. THOMASSEN
Assistant Attorney General
JEFFREY A. CORYELL
Assistant Attorney General
P. O. Box 12548
Capitol Station
Austin, Texas 78711
(512) 463-2018

Attorneys for the State of Texas

[Counsel for Additional States Joining In This Brief Listed On Following Pages]

GRANT WOODS
Attorney General of Arizona
GAIL H. BOYD
Assistant Attorney General
Counsel of Record
1275 West Washington
Phoenix, Arizona 85007
(602) 542-1719

GALE A. NORTON
Attorney General of Colorado
Counsel of Record
RAYMOND T. SLAUGHTER
Chief Deputy Attorney General
TIMOTHY M. TYMKOVICH
Solicitor General
MAURICE KNAIZER
Assistant Attorney General
110 Sixteenth St., 10th Floor
Denver, Colorado 80202
(303) 620-4610

RICHARD BLUMENTHAL
Attorney General of Connecticut
WILLIAM J. PRENSKY
Assistant Attorney General
Counsel of Record
110 Sherman Street
Hartford, CT 06105
(203) 566-4899

LARRY ECHOHAWK
Attorney General of Idaho
THEODORE V. SPANGLER, Jr.
Deputy Attorney General
Counsel of Record
LAWRENCE G. SIRHALL, Jr.
Deputy Attorney General
P. O. Box 36
Boise, Idaho 83722
(208) 334-7530

HUBERT H. HUMPHREY, III
Attorney General of Minnesota
ALAN GILBERT
Assistant Attorney General
Counsel of Record
1100 Bremer Tower
Seventh Pl. & Minnesota Street
St. Paul, MN 55101
(612) 296-3546

TOM UDALL
Attorney General of New Mexico
GURU TERATH SINGH KHALSA
Assistant Attorney General
Counsel of Record
P. O. Drawer 1508
Santa Fe, NM 87504
(505) 827-6083

LACY H. THORNBURG
Attorney General of North Carolina
ANDREW A. VANORE, Jr.
Chief Deputy Attorney General
M. ANN REED
Senior Deputy Attorney General
DOUGLAS A. JOHNSTON
Assistant Attorney General
Counsel of Record
P. O. Box 629
Raleigh, NC 27602
(919) 733-3064

CHARLES S. CROOKHAM
Attorney General of Oregon
JACK L. LANDAU
Deputy Attorney General
VIRGINIA L. LINDER
Solicitor General
Counsel of Record
DONALD C. ARNOLD
Chief Counsel
General Counsel Division
WILLIAM R. COOK
Assistant Attorney General
100 Justice Building
Salem, Oregon 97310
(503) 378-4402

T. TRAVIS MEDLOCK
Attorney General of South Carolina
RAY N. STEVENS
Chief Deputy Attorney General
RONALD W. URBAN
Deputy Attorney General
Counsel of Record
P. O. Box 125
Columbia, SC 29214
(803) 737-4430

CHARLES W. BURSON
Attorney General & Reporter of Tennessee
MICHAEL W. CATALANO
Deputy Attorney General
Counsel of Record
450 James Robertson Parkway
Nashville, TN 37219-5025
(615) 741-3499

JAMES E. DOYLE
Attorney General of Wisconsin
BURNEATTA BRIDGE
Assistant Attorney General
Counsel of Record
P. O. Box 7857
Madison, WI 53707-7857
(608) 266-3067

MARY SUE TERRY
Attorney General of Virginia
STEPHEN D. ROSENTHAL
Chief Deputy Attorney General
GAIL STARLING MARSHALL
Deputy Attorney General
MARY YANCEY SPENCER
Deputy Attorney General
E. SUZANNE DARLING
Assistant Attorney General
Counsel of Record
101 North Eighth Street
Richmond, Virginia 23219
(804) 225-4486

APPENDIX

APPENDIX

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§ 13(d)(1) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78m(d)(1):

(d) Reports by persons acquiring more than five per centum of certain classes of securities

(1) Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to section 78*l* of this title, or any security of an insurance company which would have been required to be so registered except for the exception contained in section 78*l*(g)(2)(G) of this title, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940 [15 U.S.C. § 80a-1 *et seq.*] or any equity security issued by a Native Corporation pursuant to section 1629(d)(6) of Title 43, is directly or indirectly the beneficial owner of more than 5 per centum of such class shall, within ten days after such acquisition, send to the issuer of the security at its principal executive office, by registered or certified mail, send to each exchange where the security is traded, and file with the Commission, a statement containing such of the following information, and such additional information, as the Commission may by rules and regulations, prescribe as necessary or appropriate in the public interest or for the protection of investors--

(A) the background, and identity, residence, and citizenship of, and the nature of such beneficial ownership by, such person and all other persons by whom or on whose behalf the purchases have been or are to be effected;

(B) the source and amount of the funds or other consideration used or to be used in making the purchases, and if any part of the purchase price is represented or is to be represented by funds or other consideration borrowed or otherwise obtained for the purpose of acquiring, holding, or trading such security, a description of the transaction and the names of the parties thereto, except that where a source of funds is a loan made in the ordinary course of business by a bank, as defined in section 78c(a)(6) of this title, if the person filing such statement so requests, the name of the bank shall not be made available to the public;

(C) if the purpose of the purchases or prospective purchases is to acquire control of the business of the issuer of the securities, any plans or proposals which such persons may have to liquidate such issuer, to sell its assets to or merge it with any other persons, or to make any other major change in its business or corporation structure;

(D) the number of shares of such security which are beneficially owned, and the number of shares concerning which there is a right to acquire, directly or indirectly, by (i) such person, and (ii) by each associate of such person, giving the background, identity, residence, and citizenship of each such associate; and

(E) information as to any contracts, arrangements, or understandings with any person with respect to any securities of the issuer, including but not limited to transfer of any of the securities, joint ventures, loan or option arrangements, puts or calls, guaranties of loans, guaranties against loss or guaranties of profits, division of losses or profits, or the giving or withholding of proxies, naming the persons with whom such contracts, arrangements, or understandings have been entered into, and giving the details thereof.

§ 16(a) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78p(a):

(a) Filing of statement of all ownership of securities of issuer by owner of more than ten per centum of any class of security

(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to section 78*l* of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78*l*(g) of this title, or within ten days after he becomes such beneficial owner, director or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

Uniform Commercial Code § 8-320:

Transfer or Pledge Within Central Depository System

(1) In addition to other methods, a transfer, pledge, or release of a security or any interest therein may be effected by the making of appropriate entries on the books of a clearing corporation reducing the account of the transferor, pledgor, or pledgee and increasing the account of the

transferee, pledgee, or pledgor by the amount of the obligation or the number of shares or rights transferred, pledged, or released, if the security is shown on the account of a transferor, pledgor, or pledgee on the books of the clearing corporation; is subject to the control of the clearing corporation; and

(a) if certificated:

(i) is in the custody of the clearing corporation, another clearing corporation, a custodian bank, or a nominee of any of them; and

(ii) is in bearer form or indorsed in blank by an appropriate person or registered in the name of the clearing corporation, a custodian bank, or a nominee of any of them; or

(b) if uncertificated, is registered in the name of the clearing corporation, another clearing corporation, a custodian bank, or a nominee of any of them.

(2) Under this section entries may be made with respect to like securities or interests therein as a part of a fungible bulk and may refer merely to a quantity of a particular security without reference to the name of the registered owner, certificate or bond number, or the like, and, in appropriate cases, may be on a net basis taking into account other transfers, pledges, or releases of the same security.

(3) A transfer under this section is effective (Section 8-313) and the purchaser acquires the rights of the transferor (Section 8-301). A pledge or release under this section is the transfer of a limited interest. If a pledge or the creation of a security interest is intended, the security interest is perfected at the time when both value is given by the pledgee and the appropriate entries are made (Section 8-321). A

transferee or pledgee under this section may be a bona fide purchaser (Section 8-302).

(4) A transfer or pledge under this section is not a registration of transfer under Part 4.

(5) That entries made on the books of the clearing corporation as provided in Section (1) are not appropriate does not affect the validity or effect of the entries or the liabilities or obligations of the clearing corporation to any person adversely affected thereby.

Uniform Commercial Code § 8-406:

Duty of Authenticating Trustee, Transfer Agent, or Registrar

(1) If a person acts as authenticating trustee, transfer agent, registrar, or other agent for an issuer in the registration of transfers of its certificated securities or in the registration or transfers, pledges, and releases of its uncertificated securities, in the issue of new securities, or in the cancellation of surrendered securities:

(a) he is under a duty to the issuer to exercise good faith and due diligence in performing his functions; and

(b) with regard to the particular functions he performs, he has the same obligation to the holder or owner of a certificated security or to the owner or pledgee of an uncertificated security and has the same rights and privileges as the issuer has in regard to those functions.

(2) Notice to an authenticating trustee, transfer agent, registrar, or other agent is notice to the issuer with resect to the functions performed by the agent.

Statement of the Depository Trust Company:

* * *

[p. 1] **CREATION OF DTC BY ITS PARTICIPANTS**

The Depository Trust Company ("DTC") is a limited purpose trust company which was incorporated under the New York Banking Law in 1973. In addition, DTC is a member of the Federal Reserve System, a "clearing corporation" within the meaning of Article 8 of the Uniform Commercial Code (which authorizes book entry transactions)[1] and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934, as amended.[2] In order to fully understand DTC's role in the national system of clearance and settlement, it is helpful to consider how and why DTC came into existence.

DTC was born out of the securities industry's paperwork crisis in the late 1960's, when processing problems caused a major disruption in the financial industry. At that time, settlement of securities trades was accomplished by physical deliveries of certificates vs. payment.

[p. 2] In 1968, the New York Stock Exchange ("NYSE") commenced operation of its Central Certificate Service ("CCS") a securities depository established to serve NYSE member firms, which was designed to alleviate these problems. Certificates which were deposited by NYSE member firms with CCS were registered in the name of the NYSE's nominee, Cede & Co., so that they could be

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[1] *See* N.Y. Uniform Commercial Code § 8-320 (McKinney 1964)

[2] *See* 15 U.S.C.A. § 78q-1 (1981)

expeditiously delivered, appropriately endorsed to others. The use of nominee name to facilitate the transfer of securities was not a novel practice when CCS was founded:

> Nominee registration is an old arrangement primarily used by insurance companies, mutual funds, brokerage houses, banks and trust companies. The practice was begun to avoid requirements of registrations and to facilitate securities delivery . . . Generally securities registered in the name of fiduciaries that require documentation for transfer are not considered to be in good deliverable form to settle a contract. The selling broker, therefore, must transfer the shares into his or her nominee name before delivery. To avoid this double transfer and extensive documentation, financial institutions adopted the practice of leaving the securities in their nominee name . . . A nominee is a partnership formed to facilitate securities transactions. Each general partner is authorized to make transfers on behalf of the nominee partnership. There is widespread use of nominee ownership in American corporations. The New York Stock Exchange periodically prepares a census of shareowners of most publicly held corporations. The reports indicate that the percentage of securities held by nominees has increased substantially since 1952." M. Torosian, *Securities Transfer: Principles and Procedures* 127-128 (1988) *See Also*, E. Guttman, *Modern Securities Transfers* ¶4.04 [1] [d] at 4-16. (1987).

[p. 3] Thus, using a nominee partnership as the registered owner of securities is a well established practice which is primarily designed to facilitate the settlement of securities trades; the role of the nominee in receiving and crediting dividend and interest distributions is merely an ancillary outgrowth of modern settlement systems.

Although the efficiencies realized by CCS were substantial, they were not adequate to deal with the paperwork crisis because banks and non-NYSE brokers could not participate in CCS. In 1970, agreement was reached by the NYSE, the American Stock Exchange, the National Association of Securities Dealers, and the New York Clearing House Banks to form an interindustry organization, the Banking and Securities Industry Committee ("BASIC"), to study the problems causing the paperwork crisis and seek solutions.

The BASIC committee considered the possibility of creating a transfer agent depository or TAD. Under the TAD proposal, the depository would act as a *transfer agent* for the issuer. However, after careful consideration of the TAD proposal, the BASIC committee *rejected it*--proposing instead the establishment of a comprehensive securities depository system which could be built upon the existing CCS system. [p. 4] Thus, DTC was developed as a depository for the benefit of its users or Participants, *not* a depository acting as an agent for issuers.[[3]]

Pursuant to the plans developed by the BASIC committee, DTC was incorporated in 1973 as a limited purpose trust company to acquire the business of CCS and to expand the benefits of the depository approach to others in the financial

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[3] DTC has contracts with its Participants which will be produced to the parties and which incorporate DTC's rules by reference. In contrast, except in the case of Book Entry Only issues (which do not give rise to abandoned property, as more fully described below), where issuers and their agents make certain written representations to DTC, DTC has no contractual relations with issuers. The only regulatory obligation that DTC has to issuers is to provide them with a Security Position Listing for a fee upon request. *See* Rule 17Ad-8.

industry, particularly banks.[4]

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[p. 11] **DIVIDEND ANNOUNCEMENTS, LATE DEPOSITS, AND SECURITIES IN TRANSFER**

DTC learns of upcoming distributions from issuers and subscription services and by monitoring Exchange publications and the financial press. It announces upcoming record dates to its Participants so they will be able to verify receipts from DTC. In addition, the announcements advise Participants that they must stamp deposit tickets accompanying deposits close to record date with a legend requesting special-handling by DTC. Since DTC gives immediate credit for deposited securities to the Participant upon deposit, it will pay the upcoming distribution to that Participant, and therefore DTC must take special steps to insure that the certificate which has been deposited will be cancelled and re-registered quickly enough for Cede & Co. to be the record owner on record date.

[p. 12] Securities in process of withdrawal by the WT or RWT method (as opposed to urgent COD withdrawals) will be shown as "in transfer" on DTC's books on record date and therefore the Participant withdrawing the securities will not receive the distribution from DTC. Instead, the new registered owner will receive the distribution directly from

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4 The Securities Industry Automation Corporation ("SIAC") was incorporated by the NYSE and American Stock Exchange ("AMEX") during this time period. SIAC plans, develops, implements and manages a variety of automated information-handling and communications systems for the NYSE, the AMEX and the National Securities Clearing Corporation ("NSCC"). SIAC and DTC lease office space in the same building and have entered into contractual relationships relating to shared space. However, SIAC does not perform any facilities management functions for DTC and is not involved in the distribution system for dividend and interest payments.

the issuer's agent.[5]

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[p. 14] **FORMS OF TRANSACTIONS THAT GIVE RISE TO ARGUABLY ESCHEATABLE PROPERTY AT DTC**

For distributions payable in DTC's NDFS system, DTC compares the distribution received from the Paying Agent to the net of all Participants' long, short, and pledged positions on DTC's books on Record Date, and the resulting balance, will be an underpayment or an overpayment.[6] In time, a portion of an overpayment may become arguably escheatable. In order to understand how escheatable property arises at DTC, it is necessary to distinguish between overpayments, unclaimed dividends, "Cede float" and errors.

An overpayment is cash or stock from the Paying Agent that exceeds the distribution computed from Participants' accumulated long, short and pledged positions on DTC's books on Record Date. [p. 15] Overpayments may result from out-of-balance conditions between DTC's records and the issuer's, or they may be attributable to a phenomenon in fully certificated issues, including certain FAST issues which

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[5] If, because of a delay in registration, DTC receives the payment instead of the new owner, DTC will experience an overpayment. DTC monitors these WT's and if DTC receives an overpayment because re-registration followed Record Date, DTC pays the distribution to the Participant through an adjustment journal entry. Discrepancies in information received from the transfer agents could give rise to abandoned property as more fully described below.

[6] Since underpayments do not give rise to arguably escheatable property unless in the process of correction they are transmuted into overpayments, the causes and resolution of underpayments will not be discussed here.

is referred to as the "Cede float."[7]

CEDE FLOAT AND ABANDONED PROPERTY

For BEO issues, since Cede can be the only record owner of the securities, DTC knows the size of the entire Cede & Co. position on the issuer's books. Moreover, the accumulated Participant positions on DTC's books equal the entire Cede & Co. position on the issuer's books. Since, as explained above, the address of DTC Participants and their successors cannot be lost, theoretically all overpayments in these issues are errors, not debts. Although DTC has never had an unresolved overpayment in a BEO issue after three years, if an overpayment were not resolved in that time frame it would not be deemed abandoned under New York law.

[p. 16] However, in the case of fully certificated registered issues and half FAST issues,[8] it is usually the case that the

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7 Distributions paid to DTC's Participants on their verified record date positions never evolve into escheatable property at the DTC level, because DTC's few closely monitored Participants can not get lost. Even if they go out of business, a receiver or trustee will be the proper recipient of the distribution from DTC. Even if they could get lost, DTC would have their last addresses. Unpaid debts whose creditors last addresses are known are not in issue in this case.

8 Since the bearer bonds in DTC's custody should balance exactly the accumulated Participant positions on DTC's books and since the coupons or bonds DTC presents for income or redemption collection must also balance Participants' positions, overpayments on bearer distributions are subject to error resolution and do not evolve into abandoned property. A tiny amount of the property deemed abandoned and subject to custodial taking by the state consists of "found" bearer bonds, our classification of a loose bond occasionally found in the vault whose unique number is not recorded in DTC's vault records and for which DTC has no record (such as a deposit slip) of the Participant who delivered it to DTC for safekeeping. In the opinion of DTC's counsel, these items escheat as lost property, not

total position of DTC's Participants on DTC's books will not equal the number of securities that are registered in the name of Cede & Co. on the issuer's books. That is because certificates registered in the name of Cede & Co. have been withdrawn from DTC by COD before record date and may be "floating" around in the stream of commerce for some time before they are re-registered.

A detailed explanation of DTC's procedures for honoring urgent withdrawals or COD's in fully certificated registered issues and half FAST issues may clarify the concept of Cede float and its potential for creating debt due unknown owners that may escheat:

1. DTC, upon receipt of the COD removes a certificate in the proper denomination registered to Cede & Co. from the vault;
2. debits the long position on DTC's books of the withdrawing Participants;
3. deletes the certificate number from the record of certificates on deposit and reduces the vault position;

[p. 17] 4. endorses the certificate with the facsimile signature of Cede & Co.; and
5. gives the physical certificate to the Participant.

When the certificate is withdrawn from DTC's vault, it enters the stream of commerce outside the depository. Cede & Co. is still the registered owner known to the issuer. Whether and when the recipient of a certificate registered in the name of Cede & co. submits the certificate for re-registration is entirely within the control of the recipient. DTC has no way of knowing how many hands such a certificate passes through or whether at any point in time it is still outstanding. During the period from when the

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distributions whose beneficial owner cannot be found.

certificate leaves DTC until it is re-registered it is called by DTC "Cede float." While DTC knows who withdrew Cede float, the withdrawing Participant is unlikely still to be the owner of Cede float not promptly reregistered. It is presumed the Participant withdrew the COD to make physical delivery to a party unknown to DTC. Thus, the withdrawing Participant's address is not considered to be the "last known address of the creditor" for the unclaimed distribution.

On payable date for a distribution to security holders, the paying agent sends DTC distributions on all securities evidenced by certificates of which Cede & Co. was the registered owner on the record date. This includes both certificates which are still in the depository system and the Cede float. After Cede & Co. pays distributions to all Participants having long positions on DTC's records on the record date, at least a portion of any remaining balance is assumed to be applicable to the Cede float rather than mere error or out-of-balance conditions. The balance [p. 18] of distributions received from the paying agent is therefore recorded in the "Unclaimed Dividends" account. These funds and property do not belong to DTC. They belong instead to the unknown beneficial (not record) owner on the record date.

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Stipulation of Agreed Facts:

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

In The Matter Of The Application Of The Office Of The State Comptroller, Petitioner, For A Certification That Certain Property Held By Paine Webber Jackson & Curtis, Incorporated, Respondent, Be Deemed Abandoned Property

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STIPULATION OF AGREED FACTS

Before Hearing Officer Daniel Gutman:

WHEREAS a controversy exists between the parties hereto, it is hereby stipulated and agreed by and between the undersigned counsel for the respective parties that the following facts are not in dispute:

* * *

7. The books and records maintained by Paine Webber do not reveal the identity of, or any last known addresses for, any persons to whom such dividends, interest or cash may be owed, nor do such books and records reveal whether Paine Webber is the owner of such property.

* * *

New York Office of Unclaimed Funds, Handbook for Reporters of Unclaimed Funds (2d ed. 1988):

HANDBOOK FOR REPORTERS OF UNCLAIMED FUNDS

SECOND EDITION

[SEAL OF THE STATE OF NEW YORK]

1988

EDWARD V. REGAN
STATE COMPTROLLER

STATE OF NEW YORK
OFFICE OF UNCLAIMED FUNDS

* * *

[p. 32] **X. CLARIFICATION OF ISSUES MOST FREQUENTLY RAISED BY REPORTING ORGANIZATIONS**

BANKING INSTITUTIONS
ARTICLE III

* * *

ACCOUNTS NOT REPORTABLE - Deposits held at a foreign or out of state branch of a New York bank are not subject to the Abandoned Property Law. However, funds held at an International Banking Facility (IBF) established in New York are subject to the statute.

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[p. 40] **STOCKBROKERS (ARTICLE V-A)**

1. Unclaimed amounts received in this state and securities held in this state for unknown parties or addressee unknown are subject to Article V-A of the New York State Abandoned Property Law regardless of whether or not the broker is incorporated in New York.

*   *   *

New York Office of the State Comptroller, Abandoned Property Law Handbook for Brokers and Dealers (1983):

ABANDONED PROPERTY LAW
HANDBOOK
FOR
BROKERS AND DEALERS

1983 EDITION

[SEAL OF THE STATE OF NEW YORK]

EDWARD V. REGAN
STATE COMPTROLLER

STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER
ALBANY, NEW YORK 12236

[PHOTO]

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PART 3

EXPLANATORY COMMENTS
ON
ARTICLE V-A

ABANDONED PROPERTY LAW
ITEMS DEFINED AS ABANDONED PROPERTY

An unclaimed amount owing by a broker or dealer is deemed abandoned property under one of six classifications established in Section 511. A seventh classification (Sec. 511.6) ceased to be effective after December 31, 1975.

1. The first class includes (a) any cash dividend and bond interest received in this state by a broker or dealer (or nominee) as the holder of record of a security which has remained unpaid to the person or persons entitled thereto for a period of three years following receipt, and (b) cash dividends and bond interest payable on or with respect to a security which has been deemed abandoned. The unpaid amounts in category (a) often occur when the broker or dealer ceases to hold the security at the time of receipt of the dividend or bond interest, the security having already been traded, and the persons or customers entitled to such payment cannot be identified (unknown). The unpaid amounts in category (b) are not subject to a three year waiting period and are reportable as abandoned property, if held, as soon as the security involved has been deemed abandoned or upon receipt, if received thereafter.

   These unpaid amounts are reportable in Schedule A of the Abandoned Property Report (Sec. 511, Subd. 1)

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4. The fourth class consists of any securities held in this state for a customer or unknown person by a broker or dealer (or nominee), as the holder of record of a security where for three successive years, all amounts paid on the security by such broker or dealer (or nominee) have remained unclaimed. This class also includes any stock dividends received on such securities. These dividends are deemed abandoned when received. This class of unclaimed property generally results from an inability to identify the owner of the security, to locate the owner of a dormant customer account or to have a customer accept delivery of his securities or amounts paid thereon to which he is entitled. The unknown owner situation often occurs as discussed in subparagraph 1 above when a stock dividend is received by the broker or dealer after the underlying security had already been traded and delivered.

   These securities are to be reported in Schedule C of the abandoned property report. (Sec. 511).

   However, if at any time within the three years preceding the thirty-first day of December in any year, a broker or dealer has received from his customer evidence in writing indicating that the customer is aware of the existence of the account in which the unclaimed amount or security is recorded, then such unclaimed amount or security and the balance in the account shall not be deemed abandoned property. The three year dormancy period preceding abandonment recommences with each such written contact. (Sec. 511, Subd. 3, last paragraph).

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