NO. 111 ORIGINAL

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

STATE OF DELAWARE,

Plaintiff,

STATE OF TEXAS,

Plaintiff-Intervenor,

VS.

STATE OF NEW YORK,

Defendant.

REPLY OF THE STATE OF NEW YORK TO THE EXCEPTIONS AND BRIEF OF THE STATE OF DELAWARE AND THE EXCEPTIONS OF THE STATES OF MICHIGAN, *ET AL.*

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SUMMARY OF ARGUMENT

Both New York and the plaintiff State of Delaware except to the Special Master's Report because it violates the Court's debtor-creditor rules set down in *Texas v. New Jersey*. The Report requires that unclaimed securities distributions held by financial institutions as the record owners escheat to the issuers' jurisdictions even though the issuers are not the debtors of this property after paying the record owners.

Delaware's bid for judgment against New York is based on a narrow factual claim under the *Texas* backup rule that the creditors of the property held by New York's debtor brokers are unknown and that New York is relying upon a statistical presumption to locate the creditors of this property in New York. This claim is untenable on the present evidentiary record. The creditors of unclaimed distributions held by debtor brokers *are* identified on the debtor brokers' books and records because the abandoned property is the result of nominee float. *See* Exceptions of the State of New York to the Report of the Special Master at 26-34. New York escheats this property from debtor brokers in New York, in conformity with the *Texas* primary rule, since the creditors identified on their books are New York-addressed entities in virtually all instances. New York's proposed use of statistical evidence is *not* for the purpose of creating a presumption that the creditors are in New York. It is solely intended to establish that in virtually all instances the creditors' addresses *actually on the debtor brokers' books* are in New York. *See* Brief in Opposition to Motion for Leave to File Complaint, Exhibit A (Affidavit of Robert Griffin, Director of Audits, Office of Unclaimed Funds, Office of the New York State Comptroller).

New York was not permitted to develop its factual basis for escheating this property under the *Texas* primary rule because the discovery allowed by the Special Master was limited to testing the validity of the intervenors' legal theories. The Court's recognition that fairness requires escheat in the first instance to the creditor's jurisdiction identified by the debtor's records entitles New York to a full opportunity to demonstrate that it satisfies the requirements of the *Texas* primary rule with regard to the property held by debtor brokers in New York.

The plaintiff-intervenor States of Michigan, Maryland and Nebraska, and the District of Columbia ("Michigan, *et al.*,"), argue in favor of their "equitable allocation approach or option,"[1]

[1] The "equitable allocation approach or option" was previously known as the "California, *et al.*," theory. It was redesignated by Michigan, *et al.*, after the Special Master rejected the theory and the former lead State of California, as well as the States of Ohio and Rhode Island, withdrew their support for it.

which they assert is preferable to the operation of the *Texas v. New Jersey* escheat rules or the Special Master's recommended departures from those rules. Michigan, *et al.*'s, "equitable allocation approach" was correctly rejected by the Special Master because it is inconsistent with *Texas v. New Jersey* and *Pennsylvania v. New York* and is administratively burdensome. The "equitable allocation approach" is a more overt, but equally radical departure from the Court's escheat precedents than that recommended by the Special Master. It also compounds the administrative problems inherent in the Master's result. Although the Special Master recognized the antipathy between the Michigan, *et al.*, "equitable allocation approach" and the Court's escheat precedents, he failed to appreciate that his own result suffers from the same or similar problems.

ARGUMENT

POINT I

DELAWARE IS NOT ENTITLED TO JUDGMENT AGAINST NEW YORK

Delaware's request for judgment against New York is based upon its misunderstandings of New York's legal position and the evidentiary record. First, Delaware asserts that all of the creditors of the unclaimed distributions held by New York's debtor brokers are unknown, thereby rendering the *Texas* primary rule inapplicable to this property. Second, Delaware characterizes New York's claim to this property as based upon a statistical presumption as to the creditors' locations similar to the approach rejected by the Court in *Pennsylvania v. New York*. *See* Exceptions and Brief for the State of Delaware at 83-86.

Delaware is wrong on both counts. Contrary to Delaware's assertion, the creditors of this property *are* identified on the debtor brokers' books and records, and New York's reliance on statistical proof is for the sole purpose of establishing that the creditors are *actually* located in New York. Since the Court has expressed a clear preference for the rights of the creditors' jurisdictions to escheat intangibles, and has permitted escheat by the debtor's domicile only as a last resort, New York should be given the opportunity to pursue discovery beyond that authorized by the Special Master to demonstrate its right to this property under the *Texas* primary rule.[2] *See* Exceptions of the State of New York to the Report of the Special Master at 77-81.

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[2] Delaware also incorrectly suggests that New York requires debtor brokers to report the property owed to non-New York residents who cannot be located. *See* Exceptions and Brief for the State of Delaware at 18, 21, n.31. This is not New York's practice since such property is owed to the State of residence in accordance with the *Texas* primary rule. New York applies its abandoned property statute, which predates *Texas v. New Jersey*, in full compliance with the rules announced there governing the escheat of abandoned intangibles.

A. The Creditors Of The Abandoned Property Held By New York's Debtor Brokers Are Brokers And Banks With New York Addresses On The Debtors' Books

New York presented specific facts to demonstrate that New York-addressed entities based in New York are the creditors of the unclaimed distributions on the records of New York debtor brokers and, therefore, New York is entitled to escheat this property under the *Texas* primary rule. At the very outset of this case, New York introduced the Affidavit of Robert Griffin, the Director of Audits for the Office of Unclaimed Funds, Office of the New York State Comptroller. *See* Brief in Opposition to Motion for Leave to File Complaint, dated May 9, 1988, Exhibit A. The Griffin Affidavit was drawn from actual audits of New York debtor brokers conducted after 1985. Representative samples of the brokers' records established that the records can be used to reconstruct the transactions that generated the brokers' abandoned property holdings, and that the reconstructed records would show that the creditors are brokers and banks with New York addresses in almost every instance.[3] This is consistent with the fact that the manual delivery of certificated securities between New York brokers and banks, which is the cause of the brokers' abandoned property (nominee float), is conducted through the National Securities Clearing Corporation ("NSCC"), a group that consists almost entirely of New York-addressed creditor entities. Griffin Affidavit at A-6; *see also* Shearer Dep. at 80 (stating that Merrill Lynch uses the NSCC service for the delivery of physical certificates only to locations in New York City).

New York's right to escheat the unclaimed distributions of New York debtor brokers under the *Texas* primary rule is not based upon a statistical presumption that the creditor brokers and

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[3] In response to Delaware's First Interrogatories, New York set forth the amounts of unclaimed distributions it escheated between 1972 and 1988 from New York debtor brokers incorporated in Delaware. *See* Exceptions and Brief for the State of Delaware at 14, n.17. Contrary to Delaware's assertion, the figures included debt securities.

banks are located in New York. *See* Exceptions and Brief for the State of Delaware at 83; *also* at 19. New York's reliance on statistical evidence is for the sole purpose of demonstrating that the creditors' addresses actually present on the debtors' books are in New York. This would be done by means of a statistically valid sampling of the debtors' books to identify the actual creditors of the unclaimed distributions, and an extrapolation from the results to establish that the creditors of this property are New York-addressed brokers and banks. The reliability of the results obtained by statistical sampling has been recognized by the Court in other contexts. *See* Exceptions of the State of New York to the Report of the Special Master at 81.

Thus, New York's reliance on statistical evidence has two predicates: that it is possible to apply the last known address provision of the *Texas* primary rule to the property held by debtor brokers; and that New York can demonstrate thereby that it is the State of the creditors' last known address on the books of New York debtor brokers in virtually all instances. The only alternative to the use of statistical proof would be the tracing of each and every transaction on the debtors' records. This would be enormously time consuming and require the expenditure of considerable State funds and manpower to establish the precise identity of each creditor. Such expenditures of the State's resources would not accrue to the benefit of its citizens since the creditors identified in this manner would be entitled to the property. Moreover, the State would, in effect, be doing the work of the brokers who have already made the determination not to trace the transactions or make claims for the property. Given the right of the creditor's jurisdiction to escheat abandoned intangible property under the *Texas* primary rule whenever possible, and that the use of statistical proof is an efficient and reliable means of implementing the primary rule in this case, New York should be permitted to pursue its claim to the property held by New York debtor brokers as the jurisdiction of the creditors' last known address.

B. The Debtor Brokers' Abandoned Property Holdings Are Caused By Nominee Float, A Cause Which Preserves The Creditors' Identities On The Debtors' Books

Evidentiary support for New York's legal arguments under the *Texas* primary rule was provided by the brokers' testimony that the cause of their unclaimed distributions is nominee float. *See* Exceptions of the State of New York to the Report of the Special Master at 26-34. Because of the particular characteristics of nominee float, the creditors of the resulting unclaimed distributions can be determined from the debtor brokers' books and records, whereas the creditors of DTC's Cede float can not. Delaware's failure to perceive the difference between nominee float and Cede float, and its further assertion that New York has never explained the difference, is simply wrong. *See* Exceptions and Brief for the State of Delaware at 85.

New York devoted a major portion of its main brief (as it did in its submissions to the Special Master) detailing the evidentiary record with particular emphasis on the different operations of financial institutions giving rise to unclaimed property. *See* Exceptions of the State of New York to the Report of the Special Master at 17-34. Nominee float, the cause of the brokers' unclaimed distributions, results when physical certificates are exchanged between a broker and another broker or bank to settle a trade in that security. The selling broker's records can be used to reconstruct the trade and trace the delivery to the purchasing broker or bank. *See* Report of the Special Master at Appendix B, Fact (62), at B-18 (referring to use of the brokers' overage accounts, daily stock records, and delivery tickets to trace the trade). Since the purchasing broker owns the security, it is the creditor, identified on the selling broker's books, of a distribution paid to the debtor (selling) broker after the record date.[4]

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[4] The custodial service's division of a bank also sends out physical certificates to settle trades for its customers. Unlike brokers, however, the bank does not participate in the trade and does not record the identities of potential creditors.

By contrast, DTC's Cede float is the by-product of a withdrawal procedure whereby DTC's participants can obtain physical certificates on an emergency basis. Since the ownership of the certificate does not change until after the participant has traded it, a transaction unknown to DTC, the creditor of a distribution wrongly paid to DTC cannot be determined from its records.

Delaware's assertion that the unclaimed distributions held by debtor brokers are owner unknown because they are also caused by various errors, including missed transfers and out-of-balance conditions, is refuted by the evidentiary record. *See* Exceptions and Brief for the State of Delaware at 84.[5] This misunderstanding over the cause of the brokers' abandoned property is shared by the Special Master, and led to his erroneous conclusion that the property is owed to the *debtor* brokers' own customers but remains unpaid because the errors cannot be corrected. Report at 62, n.54, and 66, n.57. The property is in fact owed to the *creditor* brokers and banks that purchased the underlying securities (nominee float) for their customers (the beneficial owners), and paid their customers the distributions to which the customers were entitled with the brokerages' own funds.[6]

The testimony relied on by Delaware to establish that errors, missed transfers and out-of-balance conditions cause unclaimed

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[5] Delaware's attempt to portray the securities industry as generally inefficient in paying distributions is remarkable in view of the fact that 99.98% of the distributions reach their correct destinations, and the individual amounts that do not are relatively small. *See* Exceptions and Brief for the State of Delaware at 16. As the Special Master concluded: "In a tribute to the efficiency of the distribution system, such payments indeed make their way through the system . . . without incident in the overwhelming percentage of instances." Report at 10. *See also* Motion for Leave to File Brief and Brief of *Amici Curiae* at 21: "The existence of unclaimed distributions is an unintended by-product of securities processing - an irritant to the holders who attempt to develop error-free systems for processing distributions."

[6] Indeed, Delaware's concession that there are no unclaimed distributions on book-entry-only securities (certificateless issues), confirms the conclusion that it is the movement of the physical certificates themselves, not errors in related bookkeeping, that causes the brokers' abandoned property. *See* Exceptions and Brief for the State of Delaware at 15.

distributions establishes only that these are causes of initial overages, not that they cause property to escheat. *See* Exceptions and Brief for the State of Delaware at 84, n.96. The record owners testified that such overages are transient in nature because they are caught by their computerized systems and corrected. *See* Exceptions of the State of New York to the Report of the Special Master at 23-24, 27-28, and 30. In addition, the record owners' customers alert them to discrepancies. *Id.* Thus, when the debtor brokers report the property to New York at the end of the dormancy period, routine overages due to errors, missed transfers and out-of-balance conditions have been corrected and the residue of the property is attributable to nominee float. The testimony refuting Delaware's (and the Special Master's) conclusion that the property in question is owed to the unidentified customers of the debtor brokers because of recordkeeping errors is corroborated by the *amici curiae*:

> Thus, as explicated in the discovery proceedings before the Master, the unclaimed distributions held by financial institutions are generally not attributable to the fact that a customer of that financial institution has not been paid its distribution.

Motion for Leave to File Brief and Brief of *Amici Curiae* at 20, n.13.

Delaware's next argument flows from the initially correct observation that even if the brokers' unclaimed distributions are caused by nominee float, their records can only be used to identify "the *first* bearer holder of the certificate," not the owner of the certificate on the record date. Exceptions and Brief for the State of Delaware at 84-85. Delaware then asserts, incorrectly, "that *that* person's identity is the relevant inquiry" - an argument it incorrectly attributes to New York as well. *Id.* at 85. On this point, Delaware's position is aligned with the erroneous conclusion of the Special Master "that in applying the primary rule, the last-known-addresses of the beneficial owners, not other intermediaries will control." Report at 67.

As the evidentiary record established, however, the customers (beneficial owners) of the record owners (creditor brokers and

banks) are not owed anything. They are paid the distributions by their brokers and banks based on their increased ownership positions in the underlying securities. The distributions are in fact owed to the record owners who did not receive them because of nominee float. If there is a later bearer holder, it is a result of another, more distant, transaction related to another contractual relationship and has nothing to do with the debtor-creditor relationship involved with the unclaimed funds. As *amici curiae* state:

> Brokerage firms, banks, and depositories have made a substantial commitment in compliance procedures and computer systems to ensure that beneficial owners are paid the distributions to which they are entitled. The distribution system - comprising legal, accounting, and technological components - is highly effective, in part because financial institutions generally credit their customers' accounts on the payment date, whether or not the financial institution has received payment of the distribution from the issuer.

Motion for Leave to File Brief and Brief of *Amici Curiae* at 20; *see also* Exceptions of the State of New York to the Report of the Special Master at 30-31.

Moreover, the *Texas* primary rule requires that the property escheat to the jurisdiction of the creditor's last known address identified by the debtor's books and records. This rule applies regardless of whether the creditor so identified is another financial institution or an individual and does not require the debtor to look beyond that identification. As New York has already argued, requiring the debtor to determine whether the creditor has ultimate beneficial ownership interests in the property would defeat the Court's goal of creating a primary rule of escheat whose operation does not depend on the particular facts of each case. *See* Exceptions of the State of New York to the Report of the Special Master at 76 (citing *Texas v. New Jersey*, 379 U.S. at 679; *Pennsylvania v. New York*, 407 U.S. at 215); *see also* Motion for Leave to File Brief and Brief of *Amici Curiae* at 11-12.

In addition, since the debtor brokers cannot determine whether the creditors identified on their books are also beneficial owners, the property held by debtor brokers would never escheat under the *Texas* primary rule if the creditors were defined by the nature of their underlying ownership interests. *See* Exceptions of the State of New York to the Report of the Special Master at 77-79. Accordingly, Delaware's position (and that of the Special Master), that the primary rule does not apply to the first creditor identified by the debtor's books would necessitate the escheat of all of this property under the *Texas* backup rule, a result which the Court has expressly disfavored. 379 U.S. at 682.

Finally, Delaware erroneously asserts that "[i]t was undisputed on the record that brokers and banks cannot identify the creditor who is owed the unclaimed distributions involved in this case." Exceptions and Brief for the State of Delaware at 84. As the Griffin Affidavit established, tracing nominee float is possible but would require careful research on the part of the debtor brokers. These entities testified, however, that they do not research any overages beyond the corrective steps attached to locating errors and other bookkeeping problems. They wait, instead, for the creditor brokers and banks to come forward with a claim, at which point they undertake the research needed to validate it. Hence, if the creditor brokers do not make a claim because the amounts of the particular items involved are small, the debtor brokers keep the funds and eventually escheat them without knowing the creditors' identities. This does not mean, as Delaware contends, that the creditors are not identifiable from the debtor brokers' books. It simply means that the debtor brokers have not made the effort to trace the overpayment. *See* Exceptions of the State of New York to the Report of the Special Master at 81.

Accordingly, the evidentiary record and New York's factual submissions demonstrate that the unclaimed distributions held by debtor brokers must be treated differently for escheat purposes than those held by banking institutions and DTC. Since the debtor brokers' holdings are attributable to their sales of certificated issues and the manual delivery of the underlying

physical certificates (nominee float), the creditors can be identified from the debtors' books and records. New York is requesting the opportunity, consistent with the Court's recognition of the superior rights of the creditor's jurisdiction, to demonstrate that it is entitled to escheat this property under the *Texas* primary rule. The limited discovery authorized so far in this case related only to the threshold issue of whether the intervenors' legal theories were consistent with the Court's escheat precedents. For these reasons, Delaware's request for judgment against New York should be rejected.

POINT II

THE "EQUITABLE ALLOCATION APPROACH" IS A GROSS DOWERING OF UNCLAIMED PROPERTY TO ALL THE STATES IN VIOLATION OF THE *TEXAS V. NEW JERSEY* AND *PENNSYLVANIA V. NEW YORK* RULES

In a sweeping plea to the Court's "equitable discretion," the Michigan, *et al.*, States propose that unclaimed securities distributions be allocated to all the States according to each State's alleged share of the commercial activities of the nation's beneficial owners. Michigan, *et al.*, Brief at 3-4, 17-18. The Special Master rejected this "equitable allocation approach/option" on *stare decisis* grounds as completely inconsistent with *Texas v. New Jersey* and *Pennsylvania v. New York*, and because he believed that an approach of such broad generality was better suited for Congressional action than the Court's judicial decision-making. Report at 50-55. The Master's rejection of the "equitable allocation approach" on these grounds was entirely correct. The Master failed to perceive, however, that his own deconstruction of the *Texas* rules was proposed for reasons similar to those underlying the "equitable allocation approach" and raises comparable legal and practical objections.

A. The "Equitable Allocation Approach" Would Require The Court To Expressly Depart From The *Texas v. New Jersey* Escheat Rules

In *Texas v. New Jersey* the Court established clear rules to govern the escheat of all types of intangible obligations based

upon the locations of the creditors and debtors of the property. Under the *Texas* primary rule, the property escheats, as the creditor's asset, to the creditor's jurisdiction identified by the debtor's books and records. 379 U.S. at 681-682. Under the backup rule, the debtor's domicile may escheat the property only in the event that an attempted application of the primary rule fails. *Id.* at 682.

Michigan, *et al.*'s, "equitable allocation approach" bears no resemblance whatsoever to the *Texas* rules. Under the "equitable allocation approach," all of the property in question would escheat to all of the States according to a gross formula approximating where beneficial owners own, buy, and sell their securities. Michigan, *et al.*, Brief at 19-20. The formula would be derived from three purported indicators of individual investment activity within a State: number of shareholders, branch offices of brokers and registered brokerage representatives. *Id.* The average of a State's percentage of these variables would be applied to the pool of unclaimed securities distributions to determine each State's proportionate share. *Id.*

Michigan, *et al.*, contend that the Court should adopt the "equitable allocation approach" because it serves as a "global proxy" for the location of the missing beneficial owners whose commercial activities in the underlying securities were the proximate cause of the unclaimed distributions. Michigan, *et al.*, Brief at 20. These States propose that the Court reject the application of the *Texas* rules to the particular type of intangible property involved in this case because that would not disperse the property to all the States. *Id.* at 2. They also criticize the Special Master for manipulating the *Texas* backup rule for the same reason.[7] *Id.* at 2-3, 7-9, 14. Although Michigan, *et al.*,

[7] Specifically, Michigan, *et al.*, conclude, as do New York and Delaware, that the Master's adoption of the Texas, *et al.*, and Alabama, *et al.*, position that the securities issuers are debtors after paying distributions to the record owners was a calculated and inappropriate first step in totally revamping the *Texas* backup rule. Michigan, *et al.*, Brief at 3, 7-9, 14. The second step, changing the rule's locational surrogate from state of incorporation to chief executive office, completed the process of converting the backup rule from a "cleanup rule" or "rule of convenience" into a mechanism for dispersing the property in question to all the States. *Id.*

correctly except to the Master's misapplication of the *Texas* rules based upon his adoption of the Texas, *et al.*, and Alabama, *et al.*, issuer-debtor theory, the "equitable allocation approach" is equally wrong. Michigan, *et al.*'s, purported appeal to the equitable principles that undergird the *Texas* primary rule is fundamentally misconceived, and their rationale for departing from the *Texas* rules - dispersal of the property to all the States - is in direct conflict with *Pennsylvania v. New York.*

The *Texas v. New Jersey* escheat rules are not broad-based vehicles for allocating abandoned intangibles among the States by volume of commercial activity. Although the Court observed that the application of the *Texas* primary rule "will tend to distribute escheats among the States in proportion to the commercial activities of their residents" (379 U.S. at 681), it viewed this as a favorable consequence of the rule's adoption, not as the reason for the rule itself. Indeed, if the Court had intended to create a mechanism for allocating abandoned property to the States according to their commercial activities, it would not have chosen to do so by announcing a rule which depended upon the adequacy of the debtors' books to identify the creditors. A more direct path to allocation would certainly have been chosen had this been the Court's principal concern.

The Court formulated the *Texas* primary rule with two concerns in mind: fairness - in the sense of treating the debt as the creditor's asset; and certainty - a clear rule that would be applied to all types of intangible property. 379 U.S. at 678, 680. Accordingly, the Court conferred the primary right to escheat abandoned intangibles on "the State of the creditor's last known address as shown by the debtor's books and records." *Id.* at 680-681. The Michigan, *et al.*, "equitable allocation approach," by contrast, violates the principle of fairness embodied in the primary rule by permitting the jurisdictions of unidentifiable beneficial owners to escheat even though there is no last known address or other demonstrable nexus connecting those jurisdictions to the creditors of the property.[8] The "equitable allocation

[8] As New York has also demonstrated, the beneficial owners of the underlying securities are not the creditors of the property because they are routinely paid

(Footnote continued)

approach" also dispenses with the certainty and convenience of relying upon the debtors' books and records to identify the creditors and substitutes complex and administratively burdensome allocation formulas. As the Special Master correctly concluded, this allocation approach is a "free-form effort" which "totally recasts" the *Texas* rules. Report at 52.

Even if the Court were inclined to consider the "equitable allocation approach" despite its pervasive negation of precedent, it should be rejected because it accomplishes a random redistribution in which any particular item of unclaimed property is divided in a manner completely unrelated to the commercial activities that gave rise to it. Nor would this redistribution balance out in the aggregate. The fallacy of the "equitable allocation approach" is that it seeks to correlate certain indicia of the brokers' commercial activities in each State - number of customers, branch offices and registered brokerage representatives - with the unclaimed distributions and the beneficial owners of the underlying securities. However, brokerage data relating to *all* securities cannot possibly be used to determine a State's proportionate share of the *relevant* commercial activities. As established by the evidentiary record, brokers conduct enormous numbers of daily transactions for their customers,[9] but only transactions around a record date, which may not be timely recorded by the issuer's transfer agent, are even remotely relevant to the incidence of unclaimed distributions. The brokers' transactional activity also includes high volume trades for large institutional customers of custodian banks, such as pension funds and insurance companies. These

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all of the distributions to which they are entitled by their brokers or banks. These entities are the only creditors. *See* Exceptions of the State of New York to the Report of the Special Master at 30-34; *see also* Motion for Leave to File Brief and Brief of *Amici Curiae* at 20. Thus, even if the equitable allocation approach were rationally related to the transactions or locations of the beneficial owners, it would not satisfy the *Texas* primary rule's concern for determining the creditors' jurisdictions.

[9] For example, Prudential-Bache has approximately 300,000 different securities on its books and conducts between 30,000 and 40,000 trades a day. *Cirrito* Dep. at 18, 167.

institutions conduct their trading activity from locations completely unrelated to the beneficial owners, who may be anywhere and who have no connection with the actual transactions conducted on their behalf. *See* Scott Dep. at 29. Finally, the transactions that generate Cede float, the cause of abandoned property at DTC, cannot be identified from the commercial activities of beneficial owners at the brokerage level. These facts, coupled with the undisputed recognition that relatively few transactions give rise to unclaimed distributions (only 0.02% of all distributions become abandoned), confirm the conclusion that the "equitable allocation approach" completely ignores the creditors of the unclaimed property.

> But this [approach] not only moves from an individual security to aggregates, it stops not far short of a *reductio ad absurdum* of this position: distribute the funds based on population.

Report at 53.[10]

Michigan, *et al.*, cannot, therefore, succeed on their claims without abrogating *Texas v. New Jersey*. Accordingly, their claims should be dismissed.

B. The "Equitable Allocation Approach" Seeks A Departure From The *Texas* Rules For Reasons Previously Rejected In *Pennsylvania v. New York*

Michigan, *et al.*, request adoption of the "equitable allocation approach" as a means of avoiding the Special Master's recommendation that all of the property in question escheat under the *Texas* backup rule. These States argue that this result is inconsistent with the Court's intention to have intangibles

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[10] The Special Master also addressed his comments to an alternate approach now referred to by Michigan, *et al.*, as a "holder-by-holder" allocation. *See* Michigan, *et al.*, Brief at 20. This method would require the use of separate allocation formulas for every brokerage firm, rather than combined statewide formulas. The Special Master recognized that this allocation method did not cure the fundamental misconceptions inherent in the "equitable allocation approach," and Michigan, *et al.*, concede that this method would also be administratively burdensome. Michigan, *et al.*, Brief at 20. *See* Section I.C., *post.*

escheat under the primary rule, and could result in a windfall to Delaware if the Court adopted the Master's definition of the issuer as the debtor but retained the state of incorporation provision of the backup rule. Michigan, *et al.*, Brief at 11. However, the Court rejected similar arguments in *Pennsylvania v. New York* as justification for departing from the *Texas* rules. In addition, it is clear that the *Texas* rules can be strictly applied in this case without creating a windfall or the disproportionate escheat of property under the backup rule.

In *Pennsylvania v. New York* the Court refused to depart from the literal application of the *Texas* primary rule on the ground that the debtor in that case, Western Union, did not routinely record the addresses of its money order creditors. The Court concluded that neither making the debtor's domicile the primary recipient of unclaimed intangibles, nor the likelihood of a windfall to that jurisdiction, outweighed the need for clear rules to be applied in all escheat cases.

> In other words, to vary the application of the *Texas* rule according to the adequacy of the debtor's records would require this Court to do precisely what we said should be avoided - that is, "to decide each escheat case on the basis of its particular facts or to devise new rules of law to apply to ever-developing new categories of facts."

407 U.S. at 215 (citing *Texas v. New Jersey*, 379 U.S. at 679).

Michigan, *et al.*, assert, however, that because the aggregate dollar amounts are greater here than in *Pennsylvania v. New York*, the Court should conclude that this case is factually distinguishable and not controlled by precedent. Michigan, *et al.*, Brief at 11-12. The Special Master's correct response to this argument is that the Court "expressly considered and rejected in *Pennsylvania v. New York* a focus on dollar amounts" precisely because of its overriding concern with avoiding the uncertainty that such an approach would introduce. Report at 51-52. Predication of the *Texas* rules on subjective evaluations of dollar amounts would convert the rules into breeding grounds for

litigation over whether a "reasonable demarkation [sic] line has been crossed." *See* Michigan, *et al.*, Brief at 11.

Equally untenable is Michigan, *et al.*'s, contention that *Pennsylvania v. New York* is factually distinguishable because it did not involve escheat of all unclaimed money order funds under the *Texas* backup rule. Michigan, *et al.*, Brief at 11-12. In *Pennsylvania v. New York*, an indeterminate number of creditors could be identified by examining Western Union's individual money order applications (as opposed to its ledger books which contained no identifying creditor information). In this case, if the creditors are defined as the "ultimate intended beneficial owners" in conformity with the Master's Report, then all of the property in question must escheat under the *Texas* backup rule since the debtors' books and records do not identify such individuals or entities. However, like analyzing aggregate dollar amounts, looking to the proportion of unclaimed funds that will be allocated pursuant to the backup rule rather than the primary rule destroys any semblance of certainty in applying the *Texas* rules. In addition, the Special Master noted that "there is no reason to believe that the percentage of unclaimed funds relative to the total funds that pass through the securities distribution system is any greater here than in the Court's prior cases." Report at 52. Thus, the Master correctly concluded that this case is, in reality, "no different." *Id.* at 51. Moreover, Michigan, *et al.*, never explain why the factual distinctions upon which they rely should lead to different legal rules.

This does not mean, however, that the Special Master was correct that all of the property in this case should escheat under the *Texas* backup rule. Indeed, Michigan, *et al.*'s, attempt to circumvent *Pennsylvania v. New York* builds upon the Master's erroneous conclusion that the creditors of the property in question are the "ultimate beneficial owners" of the underlying securities rather than the creditors actually identified by the debtors' books. Michigan, *et al.*, simply bootstrap their arguments in support of the "equitable allocation approach" to this erroneous definition of the creditors. They urge the Court to dispense with the primary rule in this case because beneficial ownership interests are not evident from the debtor brokers'

books, thereby resulting in the escheat of this property under the backup rule pursuant to the Master's Report.

However, as New York has demonstrated, if the creditors of the property in question are defined in accordance with the *Texas* primary rule, then all of the property does not escheat under the backup rule. It is New York's position, and the one adopted by all the States in their own abandoned property laws, that the primary rule must be applied to the creditors of the debt obligation identified by the debtors' books, not to unidentifiable individuals or entities with ultimate beneficial ownership interests. *See* Exceptions of the State of New York to the Report of the Special Master at 56-60. Since debtor brokers do maintain records which identify their creditors - the brokers and banks entitled to claim the distributions erroneously paid to the debtor brokers - the *Texas* primary rule can be utilized to determine those jurisdictions with the right to escheat unclaimed distributions in the hands of the brokerage firms. *Id.* at 33-34. Accordingly, a large percentage of the property in question can continue to pass under the *Texas* primary rule simply by defining the creditors correctly. This eliminates Michigan, *et al.*'s, rationale for the "equitable allocation approach" as a means of preventing resort to the backup rule for the escheat of all unclaimed distributions.[11]

Michigan, *et al.*'s, alternate argument that *Pennsylvania v. New York* "should carry little, if any, weight" is also meritless. Michigan, *et al.*, Brief at 12-13. The dissent by three Justices in *Pennsylvania v. New York* was confined to "a relatively minor but logical deviation" in the *Texas* primary rule for Western Union's unclaimed money order proceeds. 407 U.S. at 219-220. Two years later, when Congress essentially adopted the dissenters' position for unclaimed sums payable on money orders, travelers checks, or other similar instruments other than third party bank checks (*see* 12 U.S.C. §§ 2501, *et seq.*), it did so based upon the express finding

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[11] The remainder of the property in question - the unclaimed distributions held by DTC and custodian banks - must escheat under the *Texas* backup rule because the records of these entities contain no identifying information concerning the creditors.

that a substantial majority of the purchasers reside where the instruments were purchased. 12 U.S.C. § 2501(1). Congress did not make this law applicable to distributions on securities or otherwise alter the general applicability of the last known address provision of the *Texas* primary rule.

C. The "Equitable Allocation Approach" Raises Even Greater Administrative Complexities Than The Special Master's Report

The substantial administrative burdens surrounding implementation of the Special Master's recommendation that all of the property in question escheat under the *Texas* backup rule to the States where the securities issuers are located, rather than to the jurisdictions of the record owners, have already been described to the Court. *See* Exceptions of the State of New York to the Report of the Special Master at 65-69. *See also* Motion for Leave to File Brief and Brief of *Amici Curiae* at 13-20, expressing the concerns of the Securities Industry Association, The New York Clearing House Association, American Bankers Association, and The Depository Trust Company, over reporting the property in question to the issuers' jurisdictions.

Michigan, *et al.*'s, "equitable allocation approach" generates many of the same problems as the Master's recommendation since both are ultimately tied to the goal of dispersing the property in question to all the States. However, the Michigan, *et al.*, "equitable allocation approach" adds a further dimension to these complexities because it is based on an allocation by distribution rather than by issuer. Accordingly, every distribution on every issue is divisible among 51 jurisdictions, unlike the Master's recommendation which sends all distributions on a particular issue to the issuer's jurisdiction. In addition, the allocation formulas are based upon constantly shifting data such as each State's percentages of shareholders, brokers' branch offices, and registered brokerage representatives. Record owners would have to compile and review such data on a regular basis and revise the formulas for every distribution and distribution period in order to implement the "equitable allocation approach." Finally, severe difficulties would hamper the ability of individuals (or a State

asserting a superior claim under the *Texas* primary rule) to claim their property, since they must determine the percentage allocated to each jurisdiction and bring 51 claims. *See* Report at 55.[12]

Although Michigan, *et al.*, assert that they have ready answers for these administrative concerns, they have not provided any. *See* Michigan, *et al.*, Brief at 25-29. Instead, they maintain that their approach is open "to flexible implementation procedures yet to be devised by the states," an argument they have repeatedly fallen back upon when pressed for details. *Id.* at 27. The idleness of these States' responses is apparent from their suggestion that the allocation formulas could be updated at convenient intervals, such as every 5 or 10 years. *Id.* at 29. Such a contrived deference to convenience is clearly at the expense of applying the "equitable allocation approach" with the benefit of any reasonably accurate or even relevant data. Therefore, Michigan, *et al.*, have not countered the Report's conclusion that the "equitable allocation approach" is an extremely burdensome, unworkable proposal.

D. The Special Master Correctly Concluded That The "Equitable Allocation Approach" Is Best Addressed To Congress

Adopting the "equitable allocation approach" (or the Special Master's unprecedented interpretation of the *Texas* rules) would violate the doctrine of *stare decisis*. *See* Exceptions of the State of New York to the Report of the Special Master at 73; Exceptions and Brief for the State of Delaware at 70-76. "Considerations in favor of *stare decisis* are at their acme in cases involving property and contract rights, where reliance interests are involved." *Payne v. Tennessee*, 111 S. Ct. 2597, 2610 (1991); *see also Planned Parenthood of Southeastern Pennsylvania v. Casey*,

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[12] Although Michigan, *et al.*, discuss the "equitable allocation approach" only in the context of the distributions held by New York's record owners, it is apparent that their approach, and all of its administrative complexities, would apply as well to the property held by record owners and paying agents throughout the country.

60 U.S.L.W. 4795, 4801 (U.S. June 30, 1992) (Nos. 91-744 and 91-902). Moreover, the Special Master correctly concluded that Congress is better suited to carrying out exceptions to the *Texas* rules for particular types of transactions or property, as it did for money orders and travelers checks. Report at 54.

The argument of Michigan, *et al.*, that the adoption of the "equitable allocation approach" would not be inconsistent with the Court's original jurisdiction, or the judicial resolution of controversies in other contexts, is simply beside the point. *See* Michigan, *et al.*, Brief at 20-25 (citing, *e.g.*, *Nebraska v. Wyoming*, 325 U.S. 589 (1945), involving an equitable apportionment of water rights among three States). The "equitable allocation approach" radically departs from the Court's rules *already in place* for the resolution of disputes such as these, and would require vast changes in highly complex and settled commercial and state law practices affecting all financial institutions and States. These are "significant reasons to believe that Congress is better suited than the Court to weigh the merits of the equitable allocation approach." Report at 54.

Finally, were the Court to overcome all of the objections and adopt the "equitable allocation approach," it should only do so prospectively. The Court's past pronouncements on retroactivity would dictate this result. Not only is this a "sweeping new rule," thereby satisfying the first prong of *Chevron Oil v. Huson*, 404 U.S. 97 (1971), its complexities applied retroactively would create administrative havoc. Even the use of an artificial "single formula" to cover all prior funds, suggested by Michigan, *et al.*, would depend upon obtaining *past* statistics for each State's "commercial activities." Michigan, *et al.*, Brief at 29. Such a daunting task, made more so by its inexactness, coupled with the adverse effects that the resulting allocations would have on claimants' rights, clearly satisfies the Court's equitable concerns favoring the prospective operation of new legal principles. *Chevron Oil v. Huson*, 404 U.S. at 106-107.

CONCLUSION

The complaints in intervention of Michigan, *et al.*, should be dismissed because their "equitable allocation approach" requires a fundamental departure from *Texas v. New Jersey* and *Pennsylvania v. New York*. The Court should apply the *Texas* rules to the abandoned intangible property in this case, thereby rejecting the Special Master's Report and dismissing the complaints in intervention of Texas, *et al.*, and Alabama, *et al.*, and remand the matter for further proceedings before the Master concerning the factual issues raised by New York.

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Respectfully submitted,

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