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.

ON THE REPORT OF THE SPECIAL MASTER DATED JANUARY 28, 1992

REPLY OF THE STATES OF MICHIGAN, MARYLAND, AND NEBRASKA, AND THE DISTRICT OF COLUMBIA TO THE EXCEPTIONS OF THE STATES OF DELAWARE AND NEW YORK TO THE REPORT OF THE SPECIAL MASTER

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INTRODUCTION AND SUMMARY OF REPLY

In original actions the Court is vested with the broadest constitutional authority -- and responsibility -- to resolve disputes among the states. Especially in the field of unclaimed property, a field of historic state competence where Congress has no general mandate to act, the Court is the primary source of law when states disagree, acting as a court of equity to resolve their controversies.

The Master and the Undersigned States have each proposed that the Court exercise its authority to provide a fair

and convenient resolution to this unique case. The Master proposes a result derived from the backup "rule of convenience" adopted in 1965. The Undersigned States accept this proposal, but suggest that it can be adopted on a more straightforward basis than that suggested by the Master. In the event that the Court declines to accept the Master's result, the Undersigned States have proposed an "equitable allocation" approach that also provides an equitable and convenient resolution.

The essence of the Exceptions of Delaware and New York to the Special Master's Report is that the Court does not have the capacity to adopt a remedy to suit this case. Their position is that the two specific rules of convenience adopted 27 years ago to administer the $27,000 worth of mostly address-known property at issue in *Texas v. New Jersey*, 379 U.S. 674 (1965), forever occupy the entire field of unclaimed intangibles. They argue that in every case the Court must choose between its "primary" rule, devised as a fair and convenient method of allocating property owed to identified owners with known addresses, and its "backup" or "clean-up" rule, adopted solely as a matter of convenience (regardless of inequity) to cover "infrequent" instances of residual amounts of property owed to persons with no known address. Under the Delaware view, the Court must apply one of these mechanical tools, without any variation for any reason, in every case -- no matter how large or how different from *Texas v. New Jersey* -- including this case involving hundreds of millions of dollars of property as to which there are not only no addresses whatsoever, but no identified owners. New York appears willing to accept selected modifications of the rules, but only if they assist New York.

Despite the fact that the funds at issue actually belong to unidentifiable beneficial owners located in all the states, New York and Delaware would have the Court interpret its previous rules to send the lion's share of the funds to Delaware and/or New York, at the expense of the other states.

They say the Court is bound to do so because, once before, when faced with a request to vary its rule to achieve equity, it declined to do so. *Pennsylvania v. New York*, 407 U.S. 206 (1972).

Congress reversed the result in that case, however, accepting the position of the three dissenting Justices that reflexive adherence to the mechanical rules adopted for a factually different case would violate the equitable principles on which the rules were based. Rather than accepting this Congressional insight as the basis for resolving the even more distinguishable case here, New York and Delaware would require the Court to choose the *in*equitable course again so as to elicit a Congressionally imposed equitable solution.

Nothing in the Court's institutional relationship with Congress requires such a cession of authority. On the contrary, both the strength of the Court's authority in matters of original jurisdiction, and the historical limitation of Congressional action in the field of unclaimed property to situations where state escheat power intersects with specific federal functions, militate toward full exercise of the Court's responsibility to do equity here, and to "mould each decree" to fit the circumstances. Especially on the facts here, where the Court's original principles require supplementation of its original rules of thumb to cover a situation not comprehended by those rules, the Court is not only free to elaborate upon its past work, but is required to do so if its own institutional credibility is to be maintained.

The Court, therefore, can and must go beyond the *Texas v. New Jersey* rules of convenience to cover the present circumstances, maximizing equity to the extent practicable, but permitting rough equity where convenience and clarity require. The Court can adopt the Special Master's alternative, or the equitable allocation approach, without regard to whether they fit within the words of the 1965 rules of convenience, as long as the option chosen fits within the basic principle of

Texas v. New Jersey: *fairness among the states through an allocation that reflects their shares of the commercial activities relevant to the unclaimed property.*

In thus filling a gap in the original rules of convenience, the Court avoids any problems of *stare decisis* or of retroactivity. Application of the "primary" last-known-address rule in its own terms is impossible here, where there are no known owners or addresses. Large scale application of the state of incorporation "clean-up" rule would produce an inequitable result specifically proscribed by the Court. Consistency and fairness thus require, rather than preclude, the application to this case of a supplemental rule based on the Court's original equitable principles.

ARGUMENT

I. IT IS THE COURT'S RESPONSIBILITY TO ACHIEVE EQUITY AMONG THE STATES

A. Under the Constitution, The Court Has Primary And Unique Authority To Resolve This Dispute Among The States

Delaware repeatedly asserts that the Court should not revisit, modify or presumably even clarify its own case law, but should leave it to Congress to resolve exceptional cases. Exceptions and Brief in Support For Plaintiff, State of Delaware, No. 111 Orig., 52, 61, 71, 73, 76 (May 1992) (hereinafter "Del. Br."). Delaware's remarkable theory -- under which once the Court decides an issue, no further elucidation is permitted except by Congress -- demeans the Court's separate and primary constitutional role in original actions and reveals a misunderstanding of the process for judicial development of federal law.

As a matter of constitutional assignment of authority to the separate branches, the Court, under Art. III, § 2, has a

direct and "unrestricted ... general grant" of power to decide controversies between the states. *Kansas v. Colorado*, 206 U.S. 46, 82 (1907). Once the Court's original jurisdiction is properly invoked, its authority over the controversy is without limitation. Such broad authority was deemed particularly necessary with regard to controversies between states because the framers wanted to structure an impartial forum for the peaceful resolution of state disputes, which historically had led to disruptive, armed conflicts born of sovereign partisanship. *Georgia v. Pennsylvania Railroad Co.*, 324 U.S. 439, 450 (1945). In entering the Union, and signing the Constitution, the states ceded as much of their sovereignty as would be necessary for the Court's exercise of jurisdiction. "All the states have transferred the decision of their controversies to this court; *each had a right to demand of it the exercise of power which they had made judicial* by the Confederation of 1781 and 1788; that we should do that which neither states nor Congress could do, -- settle the controversies between them." *Kansas v. Colorado*, 206 U.S. at 84 (internal quotation, citation omitted, emphasis supplied). The Court was deliberately selected as the forum for the resolution of state conflicts, rather than Congress, which was the forum under the Articles of Confederation. *Id.*

In *Texas v. New Jersey*, the Court exercised its "unrestricted ... general grant" of power, recognizing that in the uniquely non-federal area of state escheat, it was responsible for developing and applying the principles for resolving conflicting state claims. 379 U.S. at 677. The Court chose as its guide fundamental notions of equity. *Id.* at 680-681, 683. This choice flowed naturally from the Court's prior original action cases involving other traditional areas of state power, such as water rights. In those cases, the Court recognized that the best means for accommodating the competing interests of independent state sovereigns was through the flexible and sensitive tool of equity. *See, e.g.*, *Connecticut v. Massachusetts*, 282 U.S. 660, 670-671 (1931).

See also Hecht Co. v. Bowles, 321 U.S. 321, 329 (1944) ("[f]lexibility rather than rigidity has distinguished" equity; "[t]he qualities of mercy and practicality have made equity the instrument for nice adjustment and reconciliation ...").[1]

Here too, the Court is faced with a dispute over an area of law and sovereign power that has historically been viewed as resting with the states.[2] The power of escheat has consistently been seen as an attribute of state, not federal, sovereignty.[3] Delaware's list of Congressional enactments on

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[1] Arguably, original jurisdiction -- viewed as a particular aspect of the "checks and balances" design for preservation of the federal system, including the role of independent states -- is an expression of a hesitancy to have the equitable interests of sovereign states adjudicated by a political body, whose constitutionally limited focus is to define and legislate federal interests. *Cf. Immigration and Naturalization Service v. Chadha*, 462 U.S. 919 (1983); *Maryland v. Louisiana*, 451 U.S. 725, 743 (1981) (noting that "unique concerns of federalism" form "the basis of ... original jurisdiction").

[2] Indeed, Delaware avidly contends that "traditional state interests -- such as property rights or the regulation of corporations" are at their "apex" here. Del. Br., 48. *See also id.* at 45, 47, 55. It goes so far as to analogize this case to cases such as *Paul v. Davis*, 424 U.S. 693 (1976), Del. Br., 47, which scholars believe to form the case law roots of "state rights." L. TRIBE, AMERICAN CONSTITUTIONAL LAW at 387 n.12 (1988). To the extent that preservation of state autonomy over traditional state interests -- federalism concerns -- are thus implicated, Delaware's call for Congressional supremacy is at odds with the sovereign interests of all states.

[3] States' sovereign rights, as represented under the law of escheat, have long been recognized. The federal government has no corresponding right. *See Hodgson v. Wheaton Glass Co.*, 446 F.2d 527, 535 (3d Cir. 1971)("There is never a permanent escheat to the United States ... A State may succeed via escheat to the money"); *In Re Moneys Deposited*, 243 F.2d 443, 445 (3d Cir. 1957)(where "United States has no beneficial interest therein but holds the money as statutory trustee for the rightful owners when and if they are determined . . . ," upheld "adjudication that the state is entitled as parens patriae of the missing claimant . . . in the

specific unclaimed property issues, Del. Br., 71 n.85, highlights the fact that Congressional action in the field has been limited to instances where specific federal programs or interests were involved, and that, in the absence of such action, state escheat rights and rules prevail. *See* Section I.B., *infra*.

Delaware asserts that the Court should merely mechanically apply the old ground rules, no matter how inappropriate to the facts, yielding to Congress the role of adjudging the equities. The Court, however, has recognized that its equitable authority includes the authority to "mould each decree" to the facts of a case. *Hecht Co. v. Bowles*, 321 U.S. 321, 329 (1944). *See also Mitchell v. De Mario Jewelry Inc.*, 361 U.S. 288, 291 (1960)(noting that equity assumes an "even broader and more flexible character" in cases involving the public interest); *Holmberg v. Armbrecht*, 327 U.S. 392, 396 (1946) ("[e]quity eschews mechanical rules"); *Union Pacific Railway Co. v. Chicago, Rock Island, & Pacific Railway Co.*, 163 U.S. 564, 600-601 (1896)("in the increasing complexities of modern business relations, equitable remedies have necessarily and steadily been expanded").

In short, it is the responsibility of the Court to determine the applicability, scope and meaning of its own case law, and it is the responsibility of the Court to make the modifications and clarifications that its own equitable

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absence of the claimant and of anyone else competent to inherit the claim"); *Panhandle Eastern Pipe Line Co. v. FPC*, 179 F.2d 896, 903 (8th Cir. 1949)(once trust fund "fully administered" at federal level, state "will, no doubt, ultimately receive the residual portion of the undistributed funds to which it may be entitled ...."); *American Loan & Trust Co. v. Grand Rivers Co.*, 159 F. 775 (W.D. Ky. 1908). The Court has been solicitous of the states' prerogatives in the face of claims of overriding federal interests. *See e.g., Anderson National Bank v. Luckett*, 321 U.S. 233 (1944); *United States v. Klein*, 303 U.S. 276 (1938).

principles require.[4] Under the Constitution, where the states are the parties, this responsibility is explicitly "judicial," not legislative, and the states are entitled to "demand" its exercise by the Court.[5]

B. The Court Should Not Abdicate Its Primary Role Merely Because Congress May Have The Power To Rectify An Inequitable Result

Delaware supports its argument for Congressional primacy by pointing to instances where Congress has acted with regard to unclaimed property, including 12 U.S.C. §§ 2501-2503 (1974), in which Congress changed the result in *Pennsylvania v. New York*. Del. Br., 71-72. Delaware's position is that this Congressional "activity" establishes that "Congress -- not the Court -- is the appropriate body" to effect equity here. *Id.* at 73. That position ignores Congress's own constitutional role, and misreads the effect of Congress's prior actions involving unclaimed property.

1. Congress Does Not Have And Has Not Exercised General Jurisdiction Over State Unclaimed Property Issues

Congress is a body of limited and enumerated powers. *Kansas v. Colorado*, 206 U.S. at 81-82. Unlike the Court, Congress has no express or general authority to resolve controversies between states. Congress does have power to approve state compacts,[6] but no compact is at issue here and the existence of such an option is not a basis for the Court to

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[4] *Cf. Funk v. United States*, 290 U.S. 371, 384 (1933) ("[n]o rule of the common law could survive the reason on which it was founded. It needed no statute to change it but abrogated itself.")

[5] *Kansas v. Colorado*, 206 U.S. at 84.

[6] U.S. CONST. art. I, § 10.

decline to exercise its authority. *Nebraska v. Wyoming*, 325 U.S. 589, 616 (1945).

Congress may enact legislation that may affect states pursuant to one of its enumerated powers under Art. I, § 8 of the Constitution. These powers are at once both vast and limited. The powers are vast, because once triggered, Congress may take into account all the interests and considerations -- state, federal, even global -- bearing on a subject matter; it is not institutionally confined to resolving cases or controversies between parties based on the relative equities. Congress may also choose not to act, unlike the Court, which is obligated to decide state disputes properly before it. *Cf. Kentucky v. Indiana*, 281 U.S. 163, 176 (1930) (noting that the court has the "authority and duty to determine for itself all questions" arising due to state disputes); *Cohens v. Virginia*, 19 U.S. (6 Wheat.) 264, 404 (1821).[7] Congress's power, however, is also limited; its actions must fall within one of the areas of enumerated federal interest outlined in the Constitution, and both its ends and means must not impinge on interests constitutionally reserved to others. *Cf. New York v. United States*, 60 U.S.L.W. 4603 (U.S. June 19, 1992).[8]

Contrary to the suggestions of Delaware, Congress has

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[7] Over New York's opposition, the Court granted Delaware leave to file. *Delaware v. New York*, 486 U.S. 1030 (1988). No state is now raising an issue as to whether this case is justiciable or whether the Court is the appropriate forum. *Cf. Maryland v. Lousiana*, 451 U.S. 725 (1981).

[8] At least one of the Court's prior cases, *Kansas v. Colorado*, 206 U.S. 46 (1907), suggests that the outer limit of the Court's authority over issues cognizable under its original jurisdiction is greater than that of Congress. There, where the Court was faced with a state dispute and a claim by the United States, the Court found that the relevant enumerated powers of the federal government would not reach to resolve the state dispute. *Id.* at 86-90.

demonstrated particular sensitivity to the limits of its power in matters involving unclaimed property. The federal laws relating to unclaimed property that Delaware cites to buttress its assertion of Congressional authority, Del. Br., 71 n.85, uniformly involve areas of peculiar federal interest -- veterans (*e.g.*, 38 U.S.C. § 1970(h) (1991)), postal service (*e.g.*, 31 U.S.C. § 1322 (1983)), Native Americans (*e.g.*, 25 U.S.C. § 375d (1983)), government employee compensation (*e.g.*, 5 U.S.C. § 8705(d) (1967)), federal taxes (*e.g.*, 26 U.S.C. § 6408 (1989)). *See also, e.g., United States v. Oregon*, 366 U.S. 643, 648-649 (1961) (rejecting Tenth Amendment challenge to federal statute vesting property of deceased wards of a veterans hospital in the United States because Congress acted within delegated power). Nothing in the words or history of 12 U.S.C. §§ 2501-2503, in which Congress reversed the result in *Pennsylvania v. New York*, suggests that Congress was occupying or even generally entering this field. Rather Congress premised that law on a finding that attempts by states to preserve their equitable entitlement under that decision, through recordkeeping requirements, would burden interstate commerce.[9] Congress was merely correcting what it perceived to be an erroneous and inequitable result.

The existence of potential Congressional authority to assert an enumerated power to correct perceived judicial error in an egregious case does not alter the basic structural assignment of responsibilities to the separate branches. Congress is certainly not assigned co-equal responsibility for adjudicating disputes among the states, nor does any concept of comity between the branches require the Court to yield its

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[9] This assertion of Congress's power over interstate commerce was seen by some as crossing the line of Congress's constitutional authority. *See* 120 CONG. REC. 4673, 4675 (1974) (Statement of Mr. Javits).

prerogatives to Congress.[10] This controversy is before the Court now, and the Court should neither abdicate its obligation to seek an equitable resolution, nor feel compelled to apply its prior rule mechanically and inequitably, on the basis that Congress might have the authority to rectify an inequitable result.

2. In Enacting 12 U.S.C. §§ 2501-2503, Congress Confirmed That the Court Should Supplement The Rules of Texas v. New Jersey Where Equity Requires.

Completely ignoring the legislative history of 12 U.S.C. §§ 2501-2503, Delaware argues that the legislation has no relevance beyond the specific property listed. In fact, when Congress acted in 1974 to change the result in *Pennsylvania v. New York*, the Committee and sponsors explicitly stated that the decision in that case had taken too narrow a view of the Court's prerogative, and duty, to expand upon its own equitable rulings, especially when necessary to preserve the principles underlying such rulings. Congress believed that it was returning to the controlling legal principles adopted by the Court in *Texas v. New Jersey*.

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[10] Thus, the Court's role here is quite different from its role in *Quill Corp. v. North Dakota*, 60 U.S.L.W. 4423 (U.S. May 26, 1992). There the Court dealt with an area of interstate commerce where Congress has the paramount authority, and where the Court's authority is secondary, flowing from so-called "dormant" implications of the Commerce Clause. *Id.* at 4425, 4428. Here, the constitutional structure is reversed, with the Court exercising a specifically assigned, paramount power of its own over the states in a field peculiarly infected with state interest. There is, thus, no institutional or structural rationale for deference by the Court to Congress. Moreover, unlike *Quill*, this case involves not changed circumstances, but facts simply not contemplated in the prior rules adopted by Court.

As discussed in our prior submission,[11] in responding to *Pennsylvania v. New York*, Congress adopted the dissenting Justices' interpretation of the applicable law.[12] The Committee's Report incorporated the comments of Arthur F. Burns, Chairman of the Board of Governors, Federal Reserve System, that the result in *Pennsylvania v. New York* was an "obvious inequity" which the bill corrects by adopting the "similar position" advanced by Justice Powell in dissent. S. REP. NO. 93-505, 93d Cong., 1st Sess. 3 (1973). The Committee noted that "[c]onflicting claims and the effect of a recent United States Supreme Court decision currently result in inhibiting ... an equitable distribution." *Id.* at 2. *See also* 120 CONG. REC. 4673, 4679 (1974)(Statement of Mr. Sparkman)(noting "that we have done just as Justice Powell suggested.")

Senator Tower, one of the bill's original sponsors, explained that in presuming that the state of purchase of money orders was the address of the purchaser, the bill was "*clearly in line with the intent of the Supreme Court in its consideration of this problem*" in *Texas v. New Jersey*. 120 CONG. REC. at 4529 (emphasis supplied).[13] Congress's

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[11] Exceptions of the States of Michigan, Maryland, and Nebraska, and the District of Columbia to the Report of the Special Master, No. 111 Orig., 13 n.15 (May 1992).

[12] Justice Powell's dissent, joined by Justices Blackmun and Rehnquist, stated that "[t]he reasons underlying *Texas v. New Jersey* could best be effectuated by a relatively minor but logical deviation in the manner in which that rule is implemented in this case." 407 U.S at 219. The dissent advocated a modification that would preserve the equitable preference of the state of the creditor, with reliance on "relevant information" that "would be more easily obtainable". *Id.* at 220.

[13] Congress used its interstate commerce power to avoid the recordkeeping burden that states would impose to maintain their equitable entitlement to escheat under the "last known address of the creditor" preference. *See* 12 U.S.C. § 2501(5). "From a practical standpoint, ...

provision for retroactive treatment of its law to the date of the decision in *Texas v. New Jersey*,[14] confirms that Congress desired to jettison the majority opinion in *Pennsylvania v. New York*, and have future state unclaimed property disputes resolved in accordance with the original principles of *Texas v. New Jersey*, as interpreted by Justice Powell and his fellow dissenters.[15]

Delaware, in other contexts, strenuously asserts that state law should "inform", and indeed bind, the Court in

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unless a State wants to develop cumbersome and costly recordkeeping requirements, all the money to which that State is otherwise entitled will go as a windfall to one State, the corporate domicile of the issuer". 120 CONG. REC. at 4528 (Statement of Mr. Sparkman). "[T]he legislation is intended to do equity while avoiding the unnecessarily cumbersome recordkeeping requirements that would drive up the cost of these instruments to the consumer," *id.* at 4529, in situations where addresses were not kept by holders "as a matter of business practice." 12 U.S.C. § 2501(1).

[14] "One of the objectives of this proposed law, in addition to fostering an equitable distribution of abandoned money orders among all the States in their fair share, is to relieve the courts of very tedious and lengthy lawsuits involving these claims. The reason the committee selected the 1965 date was to provide for a smooth transition of the law to follow as closely as possible the Supreme Court decision, Texas against New Jersey, which was decided February 1, 1965. If we substitute any date other than 1965, we unnecessarily create a hiatus in the law and would further encourage lawsuits rather than settling this matter -- per the request of the Supreme Court -- once and for all." 120 CONG. REC. 4673, 4674 (1974) (Statement of Mr. Tower). *See also* 120 CONG. REC. at 4529.

[15] Delaware's attempt to give Congress's action its narrowest scope also conflicts with the text of the statute, which includes a "money order, traveler's check, *or other similar written instrument*" on which, broadly defined, a banking, business, or financial organization "is directly liable." 12 U.S.C. § 2503 (emphasis supplied). *See also* 12 U.S.C. § 2502. Delaware's contradictory focus on the exclusion of "third party bank checks" as requiring a narrow construction is unsupported in the legislative history.

determining federal common law principles. Del. Br., 46-49. Yet it overlooks the recognized proposition that Congressional action, through federal statutes, also bears upon determination of the federal common law. *See Moragne v. States Marine Line*, 398 U.S. 375, 390-392 (1970); *Connecticut v. Massachusetts*, 282 U.S. 660, 670 (1931). *See also Mitchell v. De Mario Jewelry*, 361 U.S. at 292 ("there is inherent in the Courts of Equity a jurisdiction to... give effect to the policy of the legislature"). The fact that Congress acted only in terms of the particular types of property brought to its attention does not undermine the force of what it was saying with regard to the reasoning of the decision in *Pennsylvania v. New York.*[16]

In essence, as the legislative history confirms, Congress agreed with the *Pennsylvania v. New York* dissenters that, whatever the merits of the *Texas v. New Jersey* distribution mechanism for the majority of unclaimed property dispositions, an alternative must obtain where its application

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[16] As the Court itself has recognized, the fact that Congress acts only with regard to a particular subject matter -- in this case particular types of unclaimed property -- should not invariably limit the import of what Congress has done or said. *United States v. Hutcheson*, 312 U.S. 219, 235 (1941). Rather, the Court has expressed its understanding that the nature of the legislative process may be directed at a particularly defined problem -- one brought to Congress's attention at the time -- but still be expressing a proposition with wider implications. *Id.* "'The major premise of the conclusion expressed in a statute, the change in policy that induces enactment, may not be set out in terms, but it is not an adequate discharge of duty for courts to say: We see what you are driving at, but you have not said it, and therefore we shall go on as before.'" *Id.*, *quoting*, *Johnson v. United States*, 163 F. 30, 32 (1st Cir. 1908)(opinion of Mr. Justice Holmes on circuit). And the Court has given affirmative recognition to such Congressional developments by modifying, where appropriate, its case law. *Id. See also United States v. Fausto*, 484 U.S. 439 (1988); *Moragne v. States Marine Line*, 398 U.S. 375 (1970); *Eli Lilly and Co. v. Medtronic, Inc.*, 872 F.2d 402 (Fed. Cir. 1989), *aff'd*, 496 U.S. 661 (1990).

produces inherently inequitable results. In its explanation of its action, in the particular action it took, and in making its particular action retroactive, Congress was not, as Delaware would have it, merely saying, "We have corrected the Court's error here, and will correct any future such error when the time comes." Rather it was saying, "There was a conceptual error in the way the Court handled this case. We think the Court should not have made that error here, and should not do so in the future. We have corrected it here in hopes that we will not need to do so in other cases."

That conceptual error, of course, was the conclusion that the Court was required to apply its prior rule even if, in the words of the dissent, that would "defeat ... each of the beneficial justifications for that rule." *Pennsylvania v. New York*, 407 U.S. at 218 (Powell, J., dissenting). Congress rejected the majority's holding that "we do not regard the likelihood of a 'windfall'... as sufficient reason for carving... [an] exception to the Texas rule." *Id.* at 214. Thus, in any case where such inequities would result if the rule of convenience were applied mechanistically, the Court must decide in a manner that respects the equitable interests of the states. In other words, it must act to distribute "escheats among the States in proportion to the commercial activities of their residents." *Texas v. New Jersey*, 379 U.S. at 681.

While the Court, with perhaps some element of hyperbole, did express the hope in *Texas v. New Jersey* that the rules of convenience adopted to allocate the small amount of property at issue there would satisfy the states' needs "once and for all," 379 U.S. at 678,[17] Congress clearly thought

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[17] Contrary to Delaware's suggestion, Del. Br., 9, many issues have arisen as to the applicability and reach of *Texas v. New Jersey*. For example, at least one court has noted that for owner-unknown property, the Court's rules are simply inapposite. *O'Connor v. Sperry & Hutchinson Co.*, 379 A.2d 1378 (Pa. Commw. Ct. 1977), *aff'd*, 412 A.2d 539 (Pa. 1980). "As this case demonstrates the Court's optimism regarding the

some supplementation -- preferably by the Court -- was justified after only seven years. Now, twenty-seven years after *Texas v. New Jersey*, with the states arrayed in four different directions as to how the principles of that case should be interpreted and applied here, it is clear that the existing rules of thumb will not, as the Court had hoped, be "generally acceptable to all the States," *id.* at 683, if applied inflexibly here.

II. THE "LAW" OF *TEXAS V. NEW JERSEY* PRECLUDES APPLICATION OF THE OLD BACKUP RULE HERE, AND REQUIRES ADOPTION OF AN EQUITABLE SOLUTION.

Notwithstanding the impassioned arguments of Delaware and New York, expanding upon the original rules to meet the needs of this case does not raise *stare decisis* concerns: first, as a matter of law, because the general equitable principles of the original decision explicitly require supplementation of the old rules here, and, second, as a matter of fact, because this case is so different in nature from its precursors. Indeed it is the route proposed by Delaware and New York that violates the underlying equitable principles -- the "law" -- of *Texas v. New Jersey* and must be rejected.

A. *Texas v. New Jersey* Makes Clear That Equity Is the Court's Overriding Principle and That Only Insubstantial Departures From That Standard Will

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universality of its rule was perhaps too great." 379 A.2d at 1381 n.3. *See also* 412 A.2d at 541 n.4 (distribution there under the Court's rule would mean that "no state would be able to demonstrate that its claim to escheat is paramount" because of the absence of creditor information). Other courts, noting that the Court's decision was not directed at state jurisdiction, have permitted states to take custody of property under circumstances that, standing alone, seem contrary to the distribution scheme of the Court. *See, e.g., State v. Liquidating Trustees of Republic Petroleum Co.*, 510 S.W.2d 311 (Tex. 1974).

be Tolerated to Achieve Convenience

New York and Delaware fail to distinguish between the Court's basic principles, applicable to all unclaimed intangible property cases, and the particular rules of thumb that the Court chose, in the context of the facts at hand, to effect those principles. The principles of *Texas v. New Jersey*, the general "guideposts"[18] set forth by the Court, are fully applicable here:

> 1. Decisions as to "which State's claim to escheat is superior to all others"[19] that might have jurisdiction over the unclaimed funds, "should be determined primarily on principles of fairness." 379 U.S. at 680.
>
> 2. Fair allocations "tend to distribute escheats among the States in proportion to the commercial activities of their residents." *Id.* at 681.
>
> 3. Primary focus should be on the location of the "creditor", *i.e.*, the true owner, rather than the "debtor". *Id.* at 680.
>
> 4. Despite "obvious virtues of clarity and ease," state of incorporation is not an equitable standard. *Id.*
>
> 5. For administrative convenience, reasonable surrogates for the actual location of lost owners may be used. *Id.* at 681.

Fulfilling its original jurisdiction responsibility, the Court also selected specific means to allocate the property under those general principles in light of the facts at hand:

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[18] *Pennsylvania v. New York*, 407 U.S. at 216 (Powell, J., dissenting).

[19] *Texas v. New Jersey*, 379 U.S. at 679.

1. To achieve an approximation that was both fair and convenient, the location of each creditor would be presumed to be the location most easily determined from "available" data, *i.e.*, the address shown on the books and records of the holder of the unclaimed property, 379 U.S. at 680-681; and

2. Solely for purposes of convenience, in exceptional instances where the creditor's address did not appear on the debtor's records, the state of domicile of the debtor would be entitled to hold the funds, always subject to a superior claim by another state. *Id.* at 682.

The Court recognized that these rules would not accomplish perfect equity. In the context of its primary rule, it conceded that the address of the creditor on the books and records of the debtor might not always reflect the creditor's technical domicile, or even his actual location. 379 U.S. at 681. But because that information was the best "available," *id.* at 681 n.11, and because "such situations probably will be the exception, and any errors thus created, if indeed they could be called errors, probably will tend to a large extent to cancel each other out", the Court did not think such minor and random inaccuracy destroyed the general fairness of the last known address rule in allocating intangible property in proportion to the relevant commercial activities in the states. *Id.* at 681.

In considering state of incorporation, however, the Court in effect recognized that the biases were not likely to be random or offsetting. It said that general use of that standard, despite its convenience, "would too greatly exalt a minor factor to permit escheat of obligations incurred all over the country by the State in which the debtor happened to incorporate itself." 379 U.S. at 680. The Court therefore allowed state of incorporation to be used only to provide certainty in the special cases, "likely to arise with comparative infrequency," of property with no address (or no applicable

law in the state of address), and only "to cut off the claims of private persons ..., retaining the property for itself only until some other state comes forward with proof that it has a superior right to escheat." *Id.* at 682.

Mechanistic application of the state of incorporation "clean-up" process here would thus violate both the qualitative and quantitative precepts laid down by the Court: without any equitable justification, huge amounts of funds would be diverted from all the states where the lost owners presumably lived to the state "in which the debtor happened to incorporate itself." 379 U.S. at 680. Neither Delaware nor New York can show anything in the 1965 opinion which suggests that the Court would have interpreted its principles to *require*, or even permit, hundreds of millions of dollars of property to be allocated in this manner.[20]

B. The Underlying Principles of *Texas v. New Jersey* Control Here Since That Case's Rules of Convenience Did Not Address the Circumstances of This Case.

The simple fact, which Delaware and New York overlook, is that neither of the *Texas v. New Jersey* rules of convenience directly covers this type of case. Those mechanisms were designed for distribution of modest amounts of owner-known property, most of which was also address-known, with an even smaller residue of owner-known but

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[20] Delaware indicates that it hopes to get some $139 million out of this case. Del. Br., 20 n.31. New York indicates that in the past six years alone, it has taken hold of $631 million of affected property which it hopes to retain under various theories, including state of incorporation. Exceptions of the State of New York to the Report of the Special Master, No. 111 Orig., 91 (May 26, 1992) (hereinafter "N.Y. Br.").

address-unknown items.[21] Under those circumstances, the "infrequent" instances not covered by the "primary" rule of thumb could be covered by an arbitrary "clean-up" rule with only a minor offense to equity.

This case involves huge amounts of property, all of which is not merely address-unknown, but also owner-unknown. Thus, the Court is faced with circumstances it did not address in 1965, and for which its rules of convenience provide no answers. The "primary" rule cannot apply because there is no information as to the identity of individual creditors or their addresses.

New York suggests that, since the Court in *Texas v. New Jersey* was satisfied with an "apparent" address, *i.e.*, the creditor's last known address on the books and records, the Court here should be satisfied with an "apparent" creditor, *i.e.*, the mass of broker-agents with whom the holder does business, most or all of whom New York presumes to have New York addresses. N.Y. Br., 74-76. Yet there was no dispute in *Texas v. New Jersey* over the identity of the actual creditor, only his or her location. Thus, there was no cause for the Court to address the unusual and quite distinct situation of creditor-unknown property. The Court did consider and adopt a surrogate for the *location* of the creditors. It did not deal with the possible need for a surrogate for the *identity* of the creditors. Moreover, unlike the primary rule in *Texas v.*

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[21] Delaware's misunderstanding of the case is highlighted by its use, from the very start of its exceptions, of the term "owner/address unknown" to describe the property covered by the "backup rule." *See, e.g.*, Del. Br., E-2. *Texas v. New Jersey*, however, contains no such term, and nowhere describes the dichotomy suggested by Delaware: "a 'creditor' -- who is either 'known' but 'lost' (under the primary rule) or 'unknown' (under the backup rule)...." Del. Br., 31. The Court's division is between "vanished creditors" with an "address on the records of the debtor", 379 U.S. at 681, and "property owed persons ... as to whom there is no record of any address." *Id.* at 682. "Owner unknown" property is never mentioned.

New Jersey, which was bottomed on the equity inherent in distributions to the various states of the creditors, New York's version of the primary rule would accomplish no such equitable distribution, rough or otherwise, since it would grant most of the property to New York.[22]

Application of the state of incorporation clean-up rule here also would not be consistent with any of the Court's basic principles. The property would not be allocated "among the States in proportion to the commercial activities of their residents." 379 U.S. at 681. The allocation would not focus on creditors rather than debtors. It would not limit use of state of incorporation to "clean-up" use for infrequent residues of address-unknown property within a universe of address-known property. Rather application of the rule to this creditor-unknown property would convert what the Court viewed as a minor and temporary custodial expedient into a major grant of permanent escheat, creating what both the majority and dissent in *Pennsylvania v. New York* recognized as a totally undeserved "windfall". 407 U.S. at 214, 220. This is true because the nature of the property as creditor-unknown virtually insures that no other state could assert a superior claim as the state of the creditor.[23]

In fact, what Delaware and New York are asking for is an extension of the backup rule beyond its original boundaries, an extension which, in the words of the dissenters in *Pennsylvania v. New York*, the Court had in 1965 "specifically repudiated" as "inconsistent with 'principles of

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[22] New York's attempt to re-cast these "apparent" creditors as presumptive actual creditors is discussed in Section III B below.

[23] Of course, if the Court accepts our position that each other state is entitled to make a "superior" equitable allocation claim against that custodian state for a share of these funds, based on its citizens' estimated share of the commercial activities which gave rise to the funds, such windfalls would be reversed.

fairness'". 407 U.S. at 218, *quoting, Texas v. New Jersey*, 379 U.S. at 680. It is those states which are asking the Court to violate its precedents, and it is the Master and the intervenors who are asking the Court to be true to its principles and precedent by filling the gap in its guidelines with an equitable rule responsive to the size and facts of this case.

C. *Pennsylvania v. New York*, Even if Binding, Would Not Require Use of the Old Backup Rule Here

Even if *Pennsylvania v. New York* were a viable precedent, the majority opinion there does not preclude adoption of a different administrative means of distribution in different circumstances. What motivated the majority to apply the *Texas v. New Jersey* disposition mechanism in *Pennsylvania v. New York* was its stated inability to distinguish the two cases. The majority expressed hesitancy to vary application of the *Texas v. New Jersey* rule merely based on a "higher percentage of unknown addresses." 407 U.S. at 214. It noted that, under the facts, it was "not told what percentage is high enough to justify an exception to the Texas rule, nor is it entirely clear that money orders constitute the only form of transaction where the percentage of unknown addresses may run high." 407 U.S. at 214-215. The Court also noted that Western Union's records might indeed, upon fuller review, contain many of the necessary addresses, *id.* at 215, thus reducing the proportion of address-unknown items. The majority worried that varying the means of distribution simply on the basis of the "adequacy" of the holder's records would require a fact-intensive inquiry in virtually every case. *Id.*

Finally, the Court pointed out that the states had it within their power and control to demand that Western Union keep adequate records. *Id.* In other words, because it thought

the states had the ability to minimize the proportion of money orders which would pass under the arbitrary backup rule, the 1972 Court, like the 1965 Court, was willing to allow a minor amount of inequitable allocation (the "windfall" cited by both majority and minority) to persist.

This case, however, does not call upon the Court to distribute a universe of discrete items, like checks or money orders, belonging to known owners, with a lower or "higher percentage of unknown addresses." Here the entire universe consists not of discrete "debts" to identifiable creditors, but of undifferentiated residues of complex accounts each belonging to one or many creditors unknown -- and for all practical purposes unknowable -- to the holder. There is no question of the "adequacy" of a holder's records, just an informational void. Neither the individual holder nor the individual states can adopt or require an informational system that will close this data gap.

Thus the reasons for the *Pennsylvania v. New York* majority's refusal to develop an alternative distribution mechanism for that case do not obtain under the facts of this case. The Court may reaffirm the prior precedents, both as to their law and as to their implementing mechanism, and their applicability to the majority of unclaimed property dispositions, and still reach a different equitable result responsive to the facts of this case. If a bright dividing line is necessary, that line is clearly crossed where there are no addresses, and where the state has no means of protecting its equitable rights by requiring records that would show creditors' addresses. On the other side of that line, neither the last known address on the books and records rule nor the state of incorporation of the holder rule provides even a modicum of equity.

The Court is thus fully justified in doing today what the Court did in 1965, selecting a rule for these cases which optimizes equity while minimizing inconvenience. Whether

that rule is the rule suggested by the Master, which modifies the backup rule in the interests of equity, or the equitable allocation approach advocated by some states, which attempts more directly to reflect the distribution of relevant commercial activities among the states, as the Court's underlying first principles instruct, it can be adopted without any need to "overrule" either *Pennsylvania v. New York* or *Texas v. New Jersey*.

III. THE FACTUAL ARGUMENTS OF DELAWARE AND NEW YORK PROVIDE NO JUSTIFICATION FOR GRANTING THEM DISPROPORTIONATE SHARES OF THE FUNDS AT ISSUE

On one theory or another, New York and Delaware would each like to get all or most of the broker-held funds. This despite the fact that 85% or more of the brokers' customers, the people who engaged in the transactions giving rise to the unclaimed overages, and who were likely to be the actual beneficial owners, were probably located in other states.[24]

A. The State of Incorporation Is Not the State Where the Relevant Commercial Activities Occurred.

Delaware attempts to transmute the Court's use of state of incorporation as a convenient back-up mechanism into a meaningful selection by the Court of the "second best" state. To do this, Delaware asserts that the *Texas v. New Jersey* rule evolved from the Court's prior decisions upholding the exercise of jurisdiction over unclaimed property by a state of

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[24] *See* Appendix A to Exceptions of the States of Michigan, Maryland, and Nebraska and the District of Columbia to the Report of the Special Master, No. 111 Orig., A-1 - A-4 (May 1992) (New York and Delaware together had about 13% of the specified indicators of brokerage activity).

incorporation, and was a substantive selection of the state with "constructive dominion." Del. Br., 33-34.[25]

No reading of *Texas v. New Jersey* supports a claim that the "backup" rule, explicitly adopted as a rule of convenience, also reflected a substantive, equitable determination of the state with the strongest, or even a strong, claim to permanent possession of unclaimed property belonging to address-unknown creditors. Certainly, if this were the case, the Court would have selected a different locational factor than the one that it characterized as "a minor factor" which it declined to "exalt" by permitting it to "escheat... obligations incurred all over the country." 379 U.S. at 680. Clearly the Court did make such a substantive determination in selecting the primary mechanism of *Texas v. New Jersey*, relying on the equities first, and then on convenience. In selecting a backup mechanism, the Court was not, as Delaware suggests,[26] answering Justice Jackson's call for a "lawyerlike definition of state power."[27] Rather, the Court was only doing exactly what it said it was doing:

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[25] Delaware's revisionist history is certainly inconsistent with the view of the dissenting Justice in *Texas v. New Jersey*, who felt the Court's decision was a radical departure from the precedents upon which Delaware now relies to reconstruct a family tree. 379 U.S. at 683 (Stewart, J., dissenting). And, it also appears inconsistent with the actual views of Justice Jackson, from whom Delaware borrows, who believed that many states could claim "constructive dominion" over the unclaimed property. *Connecticut Mutual Life Insurance Co. v. Moore*, 333 U.S. 541, 558-559, 562 (1948)(Jackson, J., dissenting). In fact, in a later opinion, Justice Jackson appeared to express disapproval of state of incorporation. *Standard Oil Co. v. New Jersey*, 341 U.S. 428, 443-445 (1951)(Frankfurter J., dissenting joined by Jackson, J.). *See also id.* at 445 (Douglas, J., dissenting).

[26] Del. Br., 33.

[27] *Connecticut Mutual Life Insurance Co. v. Moore*, 333 U.S. 541, 563 (1948) (Jackson, J. dissenting).

selecting an administratively convenient "solution" for a situation "likely to arise with comparative infrequency" in order to promote "certainty." 379 U.S. at 682.

In an understandable effort to provide the equitable weight which the Court found lacking in the backup mechanism, Delaware asserts that its user-friendly corporate laws, which attract so many incorporators, demonstrate Delaware's equitable entitlement to a major share of several hundreds of millions of dollars actually belonging to the citizens of other states. Delaware fails, however, to demonstrate that the state of incorporation -- of either the holder or the issuer -- is necessarily or even usually the situs of any significant portion of the commercial activity that gave rise to the unclaimed property. The state of incorporation is usually neither the locus of the economic activity of the issuer as upstream creator of the dividends and interest, nor the source of the trading activity of individual investors that actually causes the distributions to get lost on their way to the true beneficial owners. On the contrary, the witnesses from the Depository Trust Corporation (DTC), the brokers, and Citibank testified that the state of incorporation of these holders had no impact on the conduct of their securities business.[28] The record simply does not support Delaware's argument that its attraction for incorporators relates in any meaningful way to the generation of the unclaimed property here.

The fact that almost all the large brokers were incorporated in Delaware is less important than the fact that only a third of one per cent of their offices and brokers are located and transact business there. The fact that 40 or 50% of the largest corporations are domiciled in Delaware does not offset the fact that only a third of one per cent of the nation's

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[28] Cirrito Dep., 118-121; Shearer Dep., 453-454; Principe Dep., 152-153. *See also* Shearer Dep., 519; Scott Dep., 188-189.

shareholders live there.[29] Almost nothing happens in Delaware that produces the income stream from which this property ultimately derives or that generates or supervises the securities transactions that actually separate this property from its beneficial owners. The state's routine issuance of the birth certificate of the corporate "artificial being" does not create a substantial equitable nexus between Delaware and the unclaimed property here.[30]

Nor is Delaware entitled to greater equitable credits because of its corporate regulation. While Delaware corporations are indeed governed in certain respects by Delaware law, Delaware in no sense regulates or polices the day-to-day investment activities through which citizens of all the states purchase securities and receive the distributions they generate. It is the states where shareholders live which have primary responsibilities for registering and policing the local offices and registered representatives of securities brokers whose interactions with state citizens generate the transactions which cause the unclaimed property at issue here. Through their administrative agencies, courts, and laws, all of the states receive, investigate and respond to complaints by investors in the state against those so registered.[31] Moreover, while

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[29] *See* Exceptions of the States of Michigan, Maryland, and Nebraska and the District of Columbia to the Report of the Special Master, No. 111 Orig., 7 n.5, 8 n.6 (May 1992).

[30] Del. Br., 54. Even the case cited by Delaware for the proposition that the state of incorporation plays an important role, notes that large corporations "have shareholders in many states and shares that are traded frequently" and are dependent upon this public ownership for the provision of capital. *CTS Corp. v. Dynamics Corporation of America*, 481 U.S. 69, 90 (1987).

[31] *See* Final Brief of the Designated States in Support of Their Dispositive Motion and in Opposition to the Other States' Dispositive Motions, No. 111 Orig., 6-7, Appendix D-E (January 30, 1990). Appendix D of the Final Brief of the Designated States is the affidavit of

Delaware suggests that the cost of its corporate protection activities justifies its receipt of the proceeds of unclaimed property held by its corporate domiciliaries, Del. Br., 69, Delaware can and does charge those corporations fees and taxes to defray the cost of those activities.[32]

B. New York's "Creditor-Broker" Theory Is Unsupported By Logic Or Evidence

1. The Record Establishes That The Unknown Owners Are Likely To Be Brokers' Customers In All The States Rather Than Brokers In New York.

No party, save New York, argues against the proposition that the unclaimed property here is wholly creditor-unknown. And all parties, save New York, appear to agree that whoever those creditors may be, they are likely to

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Michael Fines, the Superintendent of Securities for the State of Rhode Island. Mr. Fines describes generally the regulation and enforcement activities of his office over brokers and others in that state, and particularly his office's authority over investor complaints. Appendix E is the affidavit of Ellyn L. Brown, Securities Commissioner for the State of Maryland, who similarly describes the oversight and enforcement functions over securities dealers and investor complaints undertaken by Maryland. Attached to Ms. Brown's affidavit is an example of a typical investor complaint to the Maryland Securities Division. This complaint involved the failure of an investor to receive from his broker recognition of a stock dividend, and accrued dividends on the split stock, precisely the type of error which might lead to an "overage" in the broker's accounts.

[32] Delaware reports that the budget for its Division of Corporations is $4 million per year. Del. Br., 69. But its unclaimed property receipts since 1965 -- most presumably from the backup rule -- have been "hundreds of millions of dollars," *id.* at 74, including over $30 million in 1990. National Assn. of Unclaimed Property Administrators, NAUPA Unclaimed Property Statistics (For year ending 6-30-90). Thus, even without the corporate fees and taxes, it is way ahead of the game, and certainly needs no further subsidy at the expense of the other states.

be located in states throughout the country. Unlike the holders in *Texas v. New Jersey*, where the property was mostly uncashed checks sent to specific people at specific addresses, the holders here do not have a check, a name, or an address. The unclaimed funds are net balances in accounts, funded by large distribution payments in and reduced by many, perhaps many thousands, of small payments out. The holder cannot find out who the true owner is unless that owner, or his or her agent, makes a claim.[33] The record establishes that holders must rely on claims -- on information external to their systems -- to determine the actual owner. In the absence of a claim, the holder only knows that the overage is attributable to a security once held by one or more among a group of its customers, located in many states, who were the beneficial owners before or around the record date. As discussed above, the character of this property as creditor-unknown is a material distinction between this case and the Court's prior cases, and New York's attempt to wrap this property in the garb of owner-and-address-known property fails in the face of the evidence.

As a simple matter of logic, New York's assertion that the intangibles here are owner-known is unsustainable. If the actual creditor were identified, the particular amount would presumably have been paid to that creditor (whether another broker, a bank, or some intermediary's customer), or to the state of the actual last address (not the "trading address") of the creditor on the holder's books if a check to the creditor were returned. In short, funds owed to identifiable creditors in known locations are not within the scope of this case, as every party, except New York, recognizes and as the evidence

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[33] If such a claim is made and is successful, then that part of the overage is, of course, no longer unclaimed property.

clearly establishes. Mas. Rep., 10-11, 58, 61-67.[34]

Lacking facts to contradict that logical conclusion, New York attempts to escape logic by postulating that, in almost every case, the true beneficial owner of the unclaimed distribution has been made whole by its agent and that the agent is invariably left as the creditor. N.Y. Br., 74. To begin with, New York's assertion is based on the assumption that there is only one type of unclaimed overage, resulting from a buying broker's failure to re-register certificates before the relevant record date. N.Y. Br., 17; Mas. Rep., 66 n.57. But as the Master notes, the evidence showed that "overages" in the hands of brokers result from a variety of different "glitches" in the flow of dividend and interest payments, many of which do not even permit what New York suggests is the universal phenomenon. Mas. Rep., Appendix B, Findings 57-59 at B-16 - B-17.

Yet, even under New York's assumption as to the cause for this unclaimed property, it does not follow that the actual creditor is a broker. New York suggests that a buyer's agent would always advance the funds to its customer, even though it did not receive the distribution, because that customer was "long" on the agent's records on the record date. Yet, the evidence here shows that unless the customer's right to the advanced funds is confirmed, in which case the broker is entitled to, and routinely seeks, reimbursement of its advance from the holder's overages, the credit to the customer can and will be reversed.[35] Thus, a customer remains the

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[34] As the Master noted, it was the "unanimous conclusion" of the industry deponents "that the unclaimed funds at issue are net of all successful efforts to identify appropriate recipients and are truly owner-unknown." Mas. Rep., 61.

[35] Cirrito Dep., 62-63; Shearer Dep., 144-145, 164; Principe Dep., 80-82, 160-161; Scott Dep., 140. New York refers to the same pages of Mr. Cirrito's deposition in support of its claims, N.Y. Br., 31; however

true party in interest with respect to the advanced amount. *See* Mas. Rep., 62 n.54.

Advancing unreceived funds to a customer, under New York's assumption, would leave the broker with an "underage." Whenever a broker is left with an underage, it will take every possible step to research the reason for the underage and make a claim for recovery of the missing distribution.[36] Brokers have special staffs, procedures, and forms to do this, and it is done "routinely" by all brokers.[37] Thus, even where an advance to a customer does occur, so that a temporary underage is created, that underage is almost invariably resolved with a claim and is thus highly unlikely to leave the contra-party with unclaimed funds. In fact, the record before the Master showed that none of the examples of belated claims for abandoned property submitted to New York, and included by New York in its discovery responses as "representative" of the claims it receives, appear, on their face, to fit New York's "creditor-broker" theory.[38]

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this testimony actually contradicts New York's position.

[36] *See e.g.*, Principe Dep., 113-115; Shearer Dep., 217-222, 235-236; Cirrito Dep., 72, 91.

[37] Principe Dep., 115-116; Shearer Dep., 277-279; Cirrito Dep., 75-76.

[38] *See generally* Response of the Designated States in Opposition to the Dispositive Motions of New York, Delaware, Texas, *et al.* and Alabama, *et al.*, Against the Complaint of the Designated States, No. 111 Orig., 17-18 n.21 (December 19, 1990); Reply of the Designated States to the Briefs in Opposition to the Motion of the Designated States for a Dispositive Order, No. 111 Orig., 9-10 (January 18, 1990). For example, one claim resulted from a transfer agent's failure to cancel 100 shares that had been registered in the name of Cede & Co., resulting in an overage to DTC. *See* New York's Document Production In Response to Interrogatory 25 at N4917-4990 (Bates stamp). New York's broker-related claims resulted from errors in internal bookkeeping at brokerage houses, producing failures to distribute dividends received to proper accounts. *Id.* at N4991-

The corollary of this evidence is that it is much more likely that an overage would have been paid by a broker to New York as unclaimed property if a customer rather than a broker were the one left with the "underage", because a customer is far less equipped than a broker to notice, research and assert a claim. This conclusion is supported by the one example of a customer's investment account statement available in the record.[39] In this example, the customer was provided neither the record date for the distribution nor the amount of the distribution per share. Thus any error in either of these factors, or in the number of shares held on the record date or in the computation of the amount the customer was owed, would be difficult, if not impossible, for a typical customer to detect. Moreover, if the error were a complete omission of a distribution, especially on shares newly purchased, the customer would see nothing on the broker's monthly statement to suggest that there was a problem.

New York ignores its own admissions that the holders in this case, whether brokers, banks, or depositories, virtually always act as agents for their customers or participants'

5015. Other claims were submitted by beneficial owners. *See id.* at N5016-5027. *See also* Exhibits 5-6 of Appendix of Exhibits to Brief In Support of Motion for Partial Summary Judgment of the Plaintiff Intervenor States of Alabama, Alaska *et al.*, No. 111 Orig. (October 30, 1990). Even New York's principal piece of evidence, the "Affidavit of Robert Griffin" does not support its basic theory. In the only example provided in the affidavit, the "creditor-broker" was a bank, and the bank under the facts had no claim. The "holding" broker's payment of dividends to the bank had created an overage at the bank, at the expense of the broker's own customer. *See* Reply of the Designated States, *supra.*

[39] Prudential Bache Exhibit 7, Example D.

customers.[40] And it ignores the fact that the unclaimed property arises from the commercial activities of these customers in every state of the Union, through the buying, selling, and transferring of security certificates, or through other changes in ownership or custody, which result in temporarily misdirected distributions.[41]

2. Nothing In The Record Supports New York's Assertion That A Creditor, Even a "Creditor-Broker," Can Be Identified Solely From Review Of A Holder's Books and Records.

Relying principally on the "Affidavit of Robert Griffin," an employee of the New York State Comptroller, N.Y. Br., 80, New York contends that review of an individual holder's records would reveal the name of a creditor, *i.e.*, a broker who represented the contra-party in the transaction which gave rise to the unclaimed property.[42] Under New York's construction of *Texas v. New Jersey*, the revelation of this name -- the "apparent" creditor -- coupled with an

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[40] Renewed Motion for Judgment on the Pleadings Against the Plaintiff-Intervenor States (New York), No. 111 Orig., 62 (October 30, 1990).

[41] *See* Exception of the States of Michigan, Maryland, and Nebraska, and the District of Columbia, to the Report of the Special Master, No. 111 Orig., 18 n.22 (May 1992).

[42] New York estimated that it would take 36 person years of auditing to track one year's unclaimed overages through the system, but concluded that it is not "cost effective ... to reconstruct these transactions." Brief in Opposition To Motion For Leave To File Complaint (New York), No. 111 Orig., 8 (May 9, 1988).

assumption of a New York address,[43] triggers a distribution of broker-held unclaimed property to New York under the primary distribution mechanism.

This interpretation of the evidentiary force of the Griffin Affidavit is contrary to the testimony of every single brokerage witness that it is impossible to trace a particular overage to a particular owner solely from the books and records of the holder.[44] Indeed, contrary to the impression fostered by New York, Mr. Griffin does not say that he actually reconstructed and traced any overages to determine who the true beneficial owners were. He merely assumed that "creditor-brokers" were always the true owners of the

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[43] Under New York's theory, the state of the last known address as shown on the holder's books would be replaced with its own invention: the state of the assumed "trading address" of brokers with whom the holder does business, whether or not they are the actual creditors and whether or not the relevant activity which gave rise to the unclaimed property took place in the state of the so-called "trading address." Of course, the term "trading address" does not appear in *Texas v. New Jersey*, nor as far as is apparent from any of New York's filings, in any other unclaimed property case. *See also* Mas. Rep., 67 n.59. New York defines "trading address" as the place where brokers "receive" delivery of securities, *i.e.*, "the official address used by the National Securities Clearing Corporation ... the service that delivers physical certificates *between brokers and bankers in New York.*" N.Y. Br., 80 n. 59 (emphasis added). It is thus no surprise that "most, if not all" remitting brokers have "trading addresses in New York." *Id.* Yet, New York is not the situs of the widely dispersed commercial activities of securities investors which should govern distribution of this property, since the brokers are merely transparent agents for their customers in every state. It is obvious as the Master noted, that "trading address" is a "conception created out of whole cloth... to rationalize what ... [New York] has been doing for years." Mas. Rep., 67 n.59.

[44] Shearer Dep., 192-193, 198; Principe Dep., 95-97, 102, 104-105; Cirrito Dep., 73, 92-93.

unclaimed property at issue.[45]

More significantly, however, the procedure described by Mr. Griffin does not even establish that holders can identify a "creditor-broker." The Griffin Affidavit contains only one example, a $1100 overage on a Houghton Mifflin dividend at "Broker X."[46] Mr. Griffin assumed that because Broker X had an overage of $1100 on a distribution of 22 cents a share, the transaction at issue must have been a 5000 share sale. In fact, the overage could just as well have resulted from two 2500 share sales, or a 5000 share clerical error (*e.g.*, "7000" recorded as "2000") in recording a customer's sale, or even a 5000 share purchase transferred prematurely, and there would be no way of discerning which of these transactions in fact caused the overage, solely from the books and records of the holder. One would have to check the records of all the other possible combinations of affected contra-parties, *i.e.*, information external to the holder's books and records, to see who actually had the equivalent underage. *See also* Mas. Rep., 62-63.

Thus, the New York version of the primary rule not only produces a result which is illogical and inequitable, it depends on factual assumptions for which there is no evidence in the record.

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[45] Affidavit of Robert Griffin, p. A-6 (May 5, 1988).

[46] Affidavit of Robert Griffin, p. A-3, *citing*, Exhibit IV, p. A-12.

IV. UNDER THE APPROACH SUGGESTED HERE, THE COURT WOULD NOT OVERRULE ANY PRECEDENT, NOR WOULD ANY STATE'S REASONABLE EXPECTATIONS BE FRUSTRATED; THUS THERE IS NO RETROACTIVITY ISSUE.

We have shown that the Court can reach an equitable result in this case, without overruling or substantially departing from its precedents, by returning to the basic principles underlying the decision in *Texas v. New Jersey*. Under this approach, the original implementing mechanisms of *Texas v. New Jersey* could still apply in the vast majority of unclaimed property dispositions, with the alternative adopted here applying only in circumstances where application of the old rule "derogates the reasons supporting it." *Pennsylvania v. New York*, 407 U.S. at 216 (Powell, J., dissenting).[47] If, like the majority in that case, the Court desires a brighter line rule, it can limit the applicability of its decision here to situations, like this one, where, because the property is inherently owner-and-address-unknown, it is *not* within the power or control of the individual holder or the state to reduce the incidence of "no-address" property to the insignificant levels to which the "backup" rule was meant to apply.

This solution to the present case would not only eliminate *stare decisis* questions, it would also resolve any "retroactivity" concerns. A decision based on the particular facts of this case will leave the states in the same posture as they were in *Texas v. New Jersey*, which was explicitly made

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[47] *See also Pennsylvania v. New York*, 407 U.S. at 214 ("In some sense, there is some inconsistency between that result and our refusal in Texas to make the debtor's domicile the primary recipient of unclaimed intangibles.")

applicable to all of the funds at issue, some of which traced to periods long before the decision.[48] The judicial exercise of filling in a gap in existing case law does not trigger formal retroactivity analysis, and applying a ruling to the facts before the Court, which almost always are past facts, is the normal judicial practice.[49] That approach also avoids Delaware's "retroactivity" concerns, which relate to fact situations *not* before the Court involving its claims to garden variety unclaimed no-address property that it has already received under the *Texas v. New Jersey* backup mechanism.

Even assuming that the retroactivity analysis of *Chevron Oil Co. v. Husen*, 404 U.S. 97 (1971),[50] were applicable here, that analysis supports full retroactivity. As

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[48] *See Pennsylvania v. New York*, 407 U.S. at 212-213.

[49] "In the ordinary case no question of retroactivity arises. Courts are, as a general matter, in the business of applying settled principles and precedents of law to the disputes that come to the bar." *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439, 2442 (1991) (plurality opinion).

[50] "First, the decision to be applied non-retroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed. Second, ... we must... weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation. Finally we [must] weig[h] the inequity imposed by retroactive application, for where a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the injustice or hardship by a holding of nonretroactivity."
404 U.S. at 106-107. If any one of these factors is found lacking, the decision must be retroactively applied. *Ashland Oil, Inc. v. Caryl*, 497 U.S. 916 (1990).

the Master correctly notes, a key factor in the Court's retroactivity analysis is a party's reliance on prior case law. Mas. Rep., 73. The record does not indicate that Delaware has taken any action -- other than suing New York -- in reliance on an assumption that the backup mechanism for small amounts of no-known-address property would be applied to the large amounts of no-known-owner property at issue here.[51] To adapt Delaware's own description of the similar situation in 1965, "there was no rule governing" this type of property, "and hence no expectations" as to which state had the superior claim. *See* Del. Br., 78. Nor has New York relied in taking custody of these funds on anything beyond its own state law, which attempts in the first instance to take possession of all unclaimed property of a holder who conducts any activity in New York.

Under New York's state law, it could take custody of all unclaimed property held by banks, financial institutions and business organizations *doing business* in the state.[52] It was

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[51] As noted in our Exceptions, it is not entirely clear whether the Master is proposing to go beyond the facts of this case and also revise the old backup mechanism in all other cases. That is a separate issue from the adoption of an equitable rule for the present case, and would at most require a separate and distinct retroactivity analysis that would not alter the analysis for this case.

[52] *See, e.g.*, N.Y. ABAND. PROP. LAWS, Art. III, § 300(4). New York seems to be among those states, which at least in the past, have assumed that they perform a convenient service to other states by taking hold of the unclaimed property of holders within their jurisdiction, regardless of the rules of *Texas v. New Jersey*, with the expectation that other states will recover their appropriate shares through claims on the taking state. *See e.g., O'Connor v. Sperry & Hutchinson Co.*, 379 A.2d 1378 (Pa. Commw. Ct. 1977), *aff'd*, 412 A.2d 539 (Pa. 1980); *New Jersey v. Chubb Corp.*, 570 A.2d 1313 (N.J. Super. 1989). *See also* N.Y. Br., 82 (state takings voidable by other states).

these broad provisions of New York law which enabled New York to seize all of the unclaimed "overages" held by banks, brokerages, and depositories, without regard to their state of incorporation, their status as creditors, or even their "trading address". For New York, this state law rule worked well, at least until Delaware filed suit. Only then, was New York faced with the obvious problem that its state statute did not comport with the Court's case law, either in terms of legal principles or implementing mechanisms.

New York concedes that it is "[t]he core principle of... escheat jurisprudence, that a state lacks the jurisdiction to unilaterally cut off the rights of other states asserting superior claims to the property .... Accordingly, New York's escheats ... [under its law] were voidable, subject to the rights of states claiming the property." N.Y. Br., 82.[53] Yet, instead of conceding that any other state has superior rights here, New York responded with its "creditor-broker" theory, which, as the Master clearly demonstrates, is a manufactured creature that bears no resemblance to the facts or the equities of the Court's primary distribution mechanism for address-known property. Mas. Rep., 58-68, 73 n. 66.

In its unilateral takings, New York clearly was not generally applying or relying on a "state of incorporation" rule, because that rule would have sent almost all the brokers' funds to Delaware. Only when the large amount of unclaimed overages held by the New York domiciled Depository Trust Corporation (DTC) was brought into the fray, did New York suddenly become interested in state of incorporation -- as to DTC. Unfortunately for New York, this later round of post

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[53] Under New York law all of its takings are merely custodial, and are always subject to claims. *See* Memorandum of State Executive Department Division of Budget, "Unclaimed Property -- Simplifying Administration," 1980 New York Laws 1709, 1710; N.Y. Br., 2.

hoc rationalization placed it in a difficult logical box. If, as it asserted against Delaware's claim to brokerage funds, it had been relying on a "creditor-broker" theory to support its initial taking of unclaimed property under the primary mechanism of *Texas v. New Jersey*, that "creditor-broker" theory would have covered most of DTC's unclaimed dividend and interest payments regardless of DTC's state of incorporation. This is true because those dividend and interest payments are almost always owed to one or more "participants" in DTC who are themselves brokers and banks whose addresses, all over the country, are well known to DTC. *See* Mas. Rep., 61 n.53.

In short, the initial foundation of New York's taking of the unclaimed property involved here was its own broad statute -- this and only this can serve as the basis for judging New York's reliance interests. New York's creative efforts to sanctify its actions *nunc pro tunc* through selective use of the Court's terminology, under theories crafted solely for the purposes of this litigation, does not rise to the level of a protected reliance interest. Because New York's abandoned property statute and its actions in no way derived from the Court's prior precedents, New York can claim no "settled expectations" based on precedent, or otherwise claim any equitable entitlement to keep what it had no right to take.[54]

While the absence of reliance alone defeats

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[54] Of course, under the Master's approach or the equitable allocation approach, New York will be permitted to keep a major portion of the funds it collected from those doing business there. New York is the location of many principal executive offices, the issuer of many governmental securities, and has the largest average share of shareholders, brokerage offices, and registered representatives. *See* Appendix A to Exceptions of the States of Michigan, Maryland, and Nebraska, and the District of Columbia to the Report of the Special Master, No. 111 Orig., A-1 (May 1992).

prospectivity claims here,[55] none of the other *Chevron* factors support prospective-only treatment of a decision in this case. As discussed above, an equitable decision here does not require an overruling of precedent; rather the case can be decided within the principles and limits of *Texas v. New Jersey*. Even if this were considered a case of first impression, those principles, reiterated and reinforced by Congress's action rejecting *Pennsylvania v. New York*, not only "foreshadowed," but predicted a different equitable resolution in a case like this one.

Adopting the Master's approach, or the equitable allocation approach, will further, not retard, the equitable foundation of the Court's decision in *Texas v. New Jersey*. Certainly, in the words of *Chevron*, a "substantial inequitable result[]" would occur if the half-billion or more dollars involved in this case were distributed to states solely on the basis of convenience and without regard to equity.

As the Master noted, any burden on New York is largely one it "imposed on itself" by taking a "calculated gamble." Mas. Rep., 76 n.68. And, neither New York nor Delaware can assert that a taking under the backup mechanism gave them either a vested, long term interest or comfortable entitlement to keep vast amounts of unclaimed property. The Court made clear in 1965 that the backup rule merely "cut off the claims of private persons only." 379 U.S. at 682. Property received under that rule was always subject to "superior" claims from other states, including claims derived from laws enacted after such funds were received by the state of incorporation. *Id.*

New York admits that its policy was to collect all it

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[55] *Ashland Oil, Inc. v. Caryl*, 407 U.S. 916 (1990).

could in "voidable" escheats, subject to superior claims. N.Y. Br., 82. Now the time has come for New York to bear the responsibilities to the other states entailed by that policy. As a result of the decision in this case, other states' superior claims to past unclaimed property will be established, just as they were in *Texas v. New Jersey*. It is neither unexpected nor unfair that New York's voidable escheats yield to the Court's determination of superior state claimants under its longstanding principles of equity among the states.

CONCLUSION

For the reasons stated in the Exceptions previously filed by the Undersigned States, and in this Reply, the Court should either

> (1) adopt the recommendations of the Special Master and direct New York to pay any "excess receipts" attributable to distributions with respect to securities, collected by New York from securities brokers, depositories, banks, and any other agents or intermediaries for securities investors, to each other state in which the issuer of the underlying security had its principal executive office at the time of the respective distributions, or
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> (2) adopt in principle the "equitable allocation" approach for the unclaimed property at issue in this case, based on the proportions in each state of the commercial activities which gave rise to such unclaimed property, namely, the securities investment activity of each state's citizens, and remand the case to the Special Master to recommend an appropriate decree implementing that approach.

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