No. 111 Original

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

STATE OF DELAWARE,
Plaintiff,
and
STATE OF TEXAS,
Intervening Plaintiff,
v.
STATE OF NEW YORK,
Defendant.

On Exceptions to the Special Master's Report

MOTION FOR LEAVE TO FILE BRIEF IN REPLY FOR PLAINTIFF, STATE OF DELAWARE, AND BRIEF FOR PLAINTIFF, STATE OF DELAWARE, IN REPLY TO THE BRIEFS OF THE TEXAS GROUP INTERVENORS

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MOTION FOR LEAVE TO FILE BRIEF IN REPLY TO THE BRIEFS OF THE TEXAS GROUP INTERVENORS FOR PLAINTIFF, STATE OF DELAWARE

Plaintiff, State of Delaware, by its undersigned counsel, hereby respectfully moves for leave to file the attached Reply Brief.

In our Brief in support of Delaware's Exceptions to the Master's Report (filed May 26, 1992), we set out the reasons why the Report's two recommended departures from the *Texas* rule should not be adopted. Defendant, New York, and a group of putative Intervenors led by Michigan (the "Michigan group") each also filed exceptions and briefs at that time, setting forth their cases in chief. Briefs in response to each of these three opening

briefs were filed on July 27, 1992, by: Delaware; New York; the Michigan group; and each of the two subgroups of the putative Intervenors led by Texas (collectively, the "Texas group"). The Texas group's two briefs set out *its* primary case in chief, which defends the Report in all respects. The attached Reply Brief closes the circle by replying to the Texas group's two briefs.

While the Order of the Court setting the briefing schedule in this matter did not expressly provide for the filing of a reply brief in support of their exceptions by those parties filing exceptions, we submit that filing such a reply brief would be helpful to the Court in deciding this case. This would follow the usual practice in cases on the appellate docket, where the rules expressly contemplate and permit the filing of reply briefs (subject to stringent time limits with which we have complied) by the petitioners or appellants—parties situated similarly to Delaware insofar as it and the Texas Intervenors are concerned.

Delaware therefore respectfully moves for leave to file the attached Reply Brief.

Respectfully submitted,

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August 1992

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BRIEF FOR PLAINTIFF, STATE OF DELAWARE, IN REPLY TO THE BRIEFS OF THE TEXAS GROUP INTERVENORS

Plaintiff, State of Delaware ("Delaware"), respectfully submits this Reply Brief in response to the two briefs filed by the Texas group of putative Intervenors (the "Texas group" or the "Texas Intervenors").[1]

INTRODUCTION

The Texas Intervenors' defense of the Report lacks the candor of the Michigan group's. The Texas group's central theme is one of denial—denial that *stare decisis* is implicated by this case; denial that Congress, not this Court, would be the proper institution to alter or make *ad hoc* exceptions to the *Texas* rule; and denial that this case will have precedential effect in the future.

1. The Texas Intervenors fail to come to grips with the fundamental *stare decisis* concerns raised by the Report. Their assertion that the doctrine does not have "decisive effect" in this case (Tex. Br. 52) is mainly based on the misapprehension that "this case does not directly implicate the reliance interests of private persons." Tex. Br. 50; *accord* Ala. Br. 52. *Amici*—the private persons whose interests are said not to be implicated—strongly disagree. They have sought leave to file a brief explaining the ways in which the Report's recommendations would have a substantial, adverse impact on them. *See Amici Curiae* Brief of Securities Industry Ass'n, *et al.* (filed May 26, 1992). As for the other factors that give the doctrine of *stare decisis* special force in this case (*see* Del. Opening Br. 70-74; Del. Answering Br. 7), Intervenors do not even acknowledge any of them.

[1] We have referred to the two subgroups of the Texas group as the Arizona subgroup and the Alabama subgroup. The brief filed by the Arizona subgroup is denominated on its face as being filed by Texas and others; we will refer to it as the "Tex. Br.," and to the Alabama subgroup's brief as the "Ala. Br."

Stare decisis is not without limits; this Court has articulated a jurisprudence to guide it in evaluating whether to depart from precedent.[2] But Intervenors eschew that jurisprudence in favor of a more impulse-driven view of *stare decisis*. They do not argue that the present rules are no longer sound as a matter of legal principle, and they do not assert that the present rules are unworkable in practice. Instead, they seem to confine themselves to a single justification for abandoning the *Texas* backup rule—their view that as applied to this case the current rule does not comport with "the sense of justice." *See* Ala. Br. 52 n.79.

Leaving aside whether such a rationale is appropriate where Congress is able to alter the Court's rules, the Intervenors' view of the fairness of the rule appears to be too narrow. By focusing only on "owner/address unknown" securities distributions, Intervenors attempt to make it seem as though Delaware is hogging a disproportionate share of the intangible property escheated each year. But Delaware currently collects only about 2% of the total moneys in all categories escheated annually by the fifty states.[3] And the property seized by New York from Delaware brokerage corporations, which is all that Delaware seeks in this case, amounted to approximately $8.2 million a year over a seventeen-year period.[4] This

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[2] *See* Del. Opening Br. 70-76 (discussing, *inter alia*, *Hilton* v. *South Carolina Pub. Rys. Comm'n*, 112 S. Ct. 560, 563-64 (1991); *Patterson* v. *McLean Credit Union*, 491 U.S. 164, 172-75 (1989); *Walker* v. *Armco Steel Corp.*, 446 U.S. 740, 749 (1980); *United States* v. *Maine*, 420 U.S. 515, 527 (1975)); Del. Answering Br. 7-13 (discussing, *inter alia*, *Allied-Signal, Inc.* v. *Director, Div. of Taxation*, 112 S. Ct. 2251, 2261-62 (1992); *Quill Corp.* v. *North Dakota*, 112 S. Ct. 1904, 1914-16 (1992)).

[3] Delaware collects approximately $20 million a year; the National Association of Unclaimed Property Administrators reports annual collections of roughly a billion dollars for all states. See the materials cited in Del. Opening Br. 60.

[4] The total amount seized by New York from Delaware brokerage corporations was $139 million during the entire period from 1972

would increase Delaware's share of the total escheatable amounts by less than 1% per year. Moreover, there is reason to believe that by far the larger proportion of unclaimed *securities distributions* is escheatable under the primary rule. *See* Del. Opening Br. 12-14 n.17.[5] Thus, even assuming, *arguendo*, that Intervenors' population-based evaluation of fairness were "justice" (and that this Court, rather than Congress, should be making such a decision), the current distribution of unclaimed intangible property among the states cannot be said to offend the "sense of justice" at all, let alone enough to throw into doubt the settled rules governing escheat.

2. The Texas Intervenors' failure to come to grips with the doctrine of *stare decisis* is most obvious in their treatment of *Pennsylvania* v. *New York*, 407 U.S. 206 (1972). They do not acknowledge that in that case the Court evaluated the precise question they present here—whether the backup rule should be changed when it is suggested that a large proportion of one or another type of property will escheat to the state of the holder's incorporation. They dismiss the *Pennsylvania* case as being unimportant because Congress, by legislation, changed the case's result. But, as the Michigan group candidly points out, "[n]othing in the words or history of [the statute] in which Congress reversed the result in *Pennsylvania* v. *New York* suggests that Congress was occupying or even generally entering this field." Mich. Answering Br. 10.

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through 1988. (Del. Opening Br. 20-21 & n.31; 13-14 n.17.) (It is forecast that the sort of escheatable "overages" involved in this case will decline in the future. DeCesare Dep. 79-83; Cirrito Dep. 150-53.) This case's scope greatly increased with the coming of the Intervenors, who urged that the "issuer" be considered the "debtor" for the purpose of the Intervenors' obtaining escheatable funds held by the Depository Trust Company and the New York banks, which are New York-domiciled and as to which funds Delaware makes no claim.

[5] The Arizona subgroup does not dispute our statistics, and the Alabama subgroup appears to agree with them. *See* Ala. Br. 32-33 n.41; 40 n.56.

There can, of course, be no serious question about whether Congress *could* occupy or enter this field: Congress specifically invoked the Commerce Clause in enacting the legislation,[6] and surely the disposition of unclaimed securities distributions is within Congress' Commerce Clause powers. The Fourteenth Amendment also gives Congress the authority to alter the Court's rules in this area.[7] That Congress has not altered the *Texas* rule in its many visits to the escheat field—but may if it wants—is a strong reason to defer to Congress here. The Court recently confirmed that, in such circumstances, the present rules should not be judicially discarded. *Quill Corp.* v. *North Dakota*, 112 S. Ct. 1904, 1914-16 (1992).

3. Finally, Intervenors offer the Court no limiting principle for the rule changes they urge. The Intervenors act as though this case were an isolated event that will have no precedential effect. They act as though "ambiguity" can be "teased out" in the meaning of the word "debtor," but not in other elements of the rule. And they act as though the special rules they seek for distributions on publicly-traded securities will not lead to requests for special treatment for other types of property. They are wrong. This Court's goal—a "clear rule" designed to settle the conflict "once and for all," *Texas* v. *New Jersey*, 379 U.S. 674, 678 (1965)—would be subverted by what they urge. There is every reason to expect that if the Court were to "interpret" and "modify" the backup rule in the way the Texas group suggests, other states and groups of states will soon request that newly discovered "ambiguities" be resolved in their favor,

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[6] *See* Pub. L. No. 93-495, Title VI, § 601(4) & (5), 88 Stat. 1500, 1525 (1974) (codified at 12 U.S.C. § 2501(4) & (5) (1988)).

[7] The Court has held that the Due Process Clause protects a person from being subject to liability to more than one state to escheat a single piece of unclaimed property. *Western Union Tel. Co.* v. *Pennsylvania*, 368 U.S. 71, 75 (1961). Section 5 of the Fourteenth Amendment provides Congress with the authority to implement the Amendment by appropriate legislation.

and that new exceptions be made for other kinds of property.

ARGUMENT

I. THE TEXAS INTERVENORS HAVE PRESENTED NO LEGITIMATE JUSTIFICATION FOR ABANDONING THE "STATE OF INCORPORATION" RULE

For the most part, the Texas Intervenors urge a sort of plebiscite approach to the resolution of this issue. *See* Ala. Br. 46; Tex. Br. 50 (tallying the current positions). Plebiscites at an earlier stage of the case would have gone the other way. It was not until the Master's spontaneous suggestion that the present rule be discarded that the Texas Intervenors embraced this theory.[8] Unembarrassed by their earlier position, the Texas Intervenors make a series of misguided arguments. They erroneously assert that recent developments make their proposal easy to implement; they misweigh the relative benefits provided by the state of incorporation and the state of a corporation's principal executive office; and they fail to confront the precedential implications of the changes they urge.

A. No Recent Developments Justify a Departure From the *Texas* Rule

In an effort to demonstrate that implementation of the Master's proposal would be "easy," the Texas Intervenors offer up a series of *post hoc* rationalizations for their new-found desire to change the backup rule: they say that "experience" under the 1972 revision of U.C.C. § 9-103(3)(d) and under the 1966 revision of the Federal Tax Lien Act[9] is a "change in the law" justifying the departure (Tex. Br. 52-53 & n.38); they point to (old) SEC

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[8] See our scorecard on this and other changes in position, Del. Answering Br. App. A.

[9] Pub. L. No. 89-719, § 101(a), 80 Stat. 1125, 1125-31 (1966) (codified at I.R.C. § 6323(f)(2)).

regulations requiring issuers to list a principal executive office (Tex. Br. 52 n.38; Ala. Br. 49-51); and they claim that nominee registration is a new and "dramatic[]" development requiring revision of the "state of incorporation" rule (Tex. Br. 7, 54).

These rationalizations do nothing to demonstrate that any of the Court's *stare decisis* criteria have been met. Alleged ease of implementation of a *new* rule is generally not recognized as a reason to depart from an old rule. Moreover, none of these so-called developments support the assertion that the "principal executive office" rule would be easy to implement.

1. Only the Arizona subgroup relies on U.C.C. § 9-103 (3) (d) and on the Tax Lien Act, which it claims are a "change in the law." Tex. Br. 52 & n.38. Neither statute is recent; they date from 1972 and 1966. Both statutes require, in limited circumstances, that filings be made in a location determined by a corporation's "principal executive office" in order to perfect commercial security interests or federal tax liens. But both statutes are recognized as requiring an inherently subjective judgment; and experience with them demonstrates that the "principal executive office" test does not provide the certainty that the *Texas* rule's "state of incorporation" test does.

As we demonstrated in our opening brief, U.C.C. § 9-103(3) (d) requires a fact-specific, multi-factor judgment; litigation over the location of a "principal executive office" is common under the statute; and that the statute surely would cause more problems were it not for lawyers' cautious practice of filing in multiple jurisdictions in the event of any doubt. *See* Del. Opening Br. 57-58. The Intervenors do not deny any of this, but instead point out that the "principal executive office" is generally easier to identify than "principal place of business." Intervenors make the wrong comparison: they do not, and cannot, assert that their proposed rule is easier

to apply than the present one. The cases they cite (Tex. Br. 53) comparing a "principal executive office" test favorably to a "principal place of business" test also demonstrate that even the former test is fact-based and subject to litigation. Indeed, the Arizona subgroup fails to observe that one of the decisions it cites was reversed on appeal as having chosen—after a trial—the wrong office as the "principal" one. *In re Metro Communications, Inc.*, 95 B.R. 921, 926-30 (Bankr. W.D. Pa. 1989), *rev'd sub nom. Mellon Bank, N.A.* v. *Metro Communications, Inc.*, 945 F.2d 635, 643-44 (3d Cir. 1991), *cert. denied*, 112 S. Ct. 1476 (1992).

The same flaws inhere in the Arizona subgroup's reliance on the Federal Tax Lien Act. Again, Intervenors merely point out that its test is better than the "principal place of business" test. Tex. Br. 53. They do not mention that experience has revealed the "principal executive office" test to be as uncertain for the IRS as it is for commercial creditors under U.C.C. § 9-103(3)(d). As one court has observed, "[i]n the case of a corporation with multiple offices, *any* test directed at determining the most important office is to some extent subjective. Creditors and the Government could in good faith reach different conclusions as to the appropriate location for filing of federal tax liens." *S. D'Antoni, Inc.* v. *Great Atl. & Pac. Tea Co.*, 496 F.2d 1378, 1383 (5th Cir. 1974) (emphasis supplied). Other courts have also struggled to determine the proper location of a "principal executive office" under this statute. *E.g.*, *Brooks* v. *United States*, 833 F.2d 1136, 1144-45 (4th Cir. 1987); *Dimmitt & Owens Fin., Inc.* v. *United States*, 787 F.2d 1186, 1191-92 (7th Cir. 1986). As under U.C.C. § 9-103(3)(d), the only safety valve is multiple filings. But the analog in the escheat area to a secured party's filing in two states is a conflicting claim by two states—the very thing that the *Texas* rule was designed to prevent.

2. The Texas Intervenors attempt to resuscitate their argument that a "principal executive office" test is at all

workable by relying on SEC regulations requiring publicly-traded companies to list such an office. Indeed, this is all that is offered by the Alabama subgroup. Of course, the SEC regulations cover only publicly-traded corporations—not even their subsidiaries, which will often have substantial unclaimed property, are covered. And in response to our demonstration that the SEC regulations are utterly useless *outside* of this narrow area (Del. Opening Br. 59-61), the Intervenors say only that in every case other than this one, "holders" will also be "originators," and thus will know in which state their own principal executive offices are located. Ala. Br. 53 n.80. The question is not whether the party in whose hands property is subject to escheat knows where its own "principal executive offices" are.[10] The question is whether, in the event of a contest between two or more states, the issue is easily resolved without adjudication. The Master and the Intervenors say that, in the case of SEC issuers, the issuers' designation in their SEC filings should be conclusive; but beyond that narrow area, the possibilities for dispute are significant.[11]

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[10] Intervenors do not suggest that, outside of the SEC-registrant area, the holder (or whoever else the Intervenors claim is "debtor") can conclusively decide this issue as between the two contesting states.

[11] The Alabama subgroup's answer also points up the unusual nature of the "originator-as-debtor" rule it urges, which requires the holder to ascertain some or another piece of data about an "originator." In all its other applications, the *Texas* rule does not require the holder of the unclaimed funds to do research about any party other than the "creditor." Speaking volumes about the special nature of the rule they seek in the "issuer as debtor" context, Intervenors suggest that the situation of the "holder" *not* being the "debtor" will be rare outside of the present case. Ala. Br. 53 n.80. But even in the present context, finding the "originator" poses some perplexities. Consider the case of "conduit" issuers, such as mutual funds, collateralized obligation trusts, and the like. *See* Del. Opening Br. 51 n.64. Who are the "originators" there? Dozens or even hundreds of underlying issuers, in the case of mutual funds; thousands of geographically diverse homeowners, in the case of col-

It must be remembered that the "principal executive office" test for SEC registrants was available to the Court at the time of the *Texas* decision in 1965. SEC filing requirements in 1965 included a cover-page designation of a principal executive office, both under the Securities and the Securities Exchange Acts.[12] The Court in *Texas* rejected Pennsylvania's claim to the money at issue in that case based on the location of Sun Oil Company's principal executive offices, which were in Philadelphia (where no oil was produced, but where executives were headquartered). The Court concluded that "application of the rule [urged by Pennsylvania] would raise in every case the sometimes difficult question of where a company's 'main office' or 'principal place of business' or whatever it might be designated is located," because it leaves too much for "decision on a case-by-case basis." 379 U.S. at 680. The concept of a "principal executive office" or the SEC requirement that one be listed for its registrants is not a new star in the legal heavens; the Court rejected this test in 1965.

3. Finally, the Arizona subgroup claims to have identified "sweeping technological developments . . . including the changeover to depositories and nominee registration," which, it says, justify abandonment of the "state of incorporation" rule. Tex. Br. 54. We are unable to perceive a logical connection between an increase in the incidence of nominee registration and a need to abandon the

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lateralized mortgage pools. The Master's rule requires these "conduit" holders to escheat "owner/address unknown" funds to the states of all of their respective "originators." Searching for the "originator" is not workable.

[12] *See* Form S-1, 29 Fed. Reg. 12,676, 12,676 (Sept. 9, 1964), 17 C.F.R. § 239.11(a) (1965); Form 10-K, 27 Fed. Reg. 7,869, 7,871 (Aug. 9, 1962), 17 C.F.R. § 249.310(a)(3) (1964). Then and today, of course, SEC Form 10-K also required and requires a cover-page designation of the corporation's state of incorporation. *Id.*; 4 Fed. Sec. L. Rep. (CCH) ¶ 31,102 (1992) (current Form 10-K); *see also* 2 Fed. Sec. L. Rep. (CCH) ¶ 7,121 (1992) (current Form S-1).

present "state of incorporation" rule. In any event, the use of nominee registration was well-established by 1965, with 23.7 percent of the equity securities of publicly-owned companies in the hands of nominees.[13] The higher incidence of nominee-name registration today is hardly a "radical" change from a practice that has gone on for generations. Its pertinence to the "state of incorporation" versus "state of principal executive office" issue remains obscure.

B. Intervenors' "Fairness" Arguments Are Misguided

Intervenors' preference for the "principal executive office" test is based on the theory that it is "more likely to result in a return of funds to the jurisdictions where those funds were created." Ala. Br. 48; *see* Tex. Br. 44-45. Both the general principle and the specific test were advocated—and rejected—in 1965. The *Texas* Court refused to carve out an exception, requested by Texas, for mineral proceeds that had originated in Texas. 379 U.S. at 679 n.9. And the Court also declined to adopt a test looking to the company's "main office," "or whatever it might be designated." 379 U.S. at 680.

If anything, the Texas group's argument that there is a relationship between the main office and the company's business activities had *more* validity in 1965 than it does today. The connection between corporations' principal executive offices and their productive facilities has become increasingly attenuated. *See* Del. Opening Br. 65-68. Our description of the choices that govern where corporate executives establish their headquarters is neither "whimsical" (Ala. Br. 49) nor "fanciful" (Tex. Br. 45). We merely pointed out that these choices are often made by the management for the convenience of the senior

[13] *Final Report of the SEC on the Practice of Recording the Ownership of Securities in the Records of the Issuer in Other than the Name of the Beneficial Owner of Such Securities* 78 (Dec. 3, 1976).

executives,[14] and that the availability of these choices is increasingly possible because of improved communications and because of the growing disassociation, for good or bad, of the senior executives from the productive activities of the corporation. This is a major change in corporate practice; it is hardly "whimsical." These facts are well-documented in respected business publications, and are as valid as any proof in the record. Do the Intervenors really think that Texaco has found oil in Westchester County, New York, or Mobil in Fairfax County, Virginia (where their principal executive offices are recorded)? [15]

It is hard to understand how the Texas Intervenors can claim that the state where the management of the corporation chooses to headquarter its top executives identifies the jurisdiction "foremost in giving the benefits of its economy and laws to the company whose business activities made the intangible property [the dividends and interest] come into existence." Ala. Br. 47; Tex. Br. 44 (internal quotations omitted). The incorporating state provides the set of laws that governs the corporate powers, regulates the relationships among the corporation, its directors, and its stockholders, and supplies the judiciary for the resolution of corporate governance questions; the states where the plants and productive activities are located may regulate the company's day-to-day activities; but low personal income taxes on executives is the law-related factor cited by the authorities we quoted as to the choice of place for the executive headquarters. Del. Opening Br. 67. The Arizona subgroup asserts (Tex. Br. 45) that "[w]ith respect to the vast majority of com-

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[14] A change in the state of incorporation of a corporation (generally achieved by merging into a newly-formed corporation of the desired state) requires a stockholder vote; changing the location of the principal executive office of a corporation does not.

[15] *See* Texaco, Inc., 10-Q Report, First Quarter 1992, cover page; Mobil Corp., 10-Q Report, First Quarter 1992, cover page.

panies," most, if not all, of the company's activities will occur in the same state as the executive offices. The assertion is unsupported by any record or other authority, demonstrates the lack of record support for the Master's rule change, and reflects notions as to the way large corporations are run that are more appropriate to the beginning of this century than to its end.

The Texas Intervenors also fail to acknowledge the tangible benefits that the state of incorporation gives to the corporation and its shareholders. Del. Opening Br. 68-69. The Arizona subgroup counters that the relevant inquiry is whether the state's laws provide a benefit to the "*company*, not to its shareholders." Tex. Br. 45 (emphasis supplied). But, of course, a corporation is supposed to be run for the benefit of the shareholders.[16]

The Intervenors' argument against the "state of incorporation" rule from the standpoint of fairness boils down to envious comment on the fact that Delaware has a large percentage of the incorporations of major American businesses. The Intervenors never stop to analyze why this happens to be the case, and why it has been so for the better part of this century. What is the market telling them? The Intervenors choose not to listen. The Intervenors characterize Delaware's franchise taxes as very high (Ala. Br. 47; Tex. Br. 46), but clearly this does not contribute to Delaware's popularity. The now-obsolete suggestion is made very gently that this is because of disproportionate lenity in Delaware's laws; but the comparative case study that we provided (Del. Opening Br. 63-64 n.75), as to what happened to Pennsylvania when it considered an unbalanced corporate statute, is unanswered. The truth, which the Intervenors never admit, is that the

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[16] If we go with the Arizona subgroup in this regard and look simply at the corporation as a legal construct, obviously the case for the state of incorporation becomes even stronger. *See CTS Corp.* v. *Dynamics Corp. of Am.*, 481 U.S. 69, 89-90 (1987).

state of incorporation gives the benefit of its laws and the expertise of its judiciary to the corporations it incorporates; that Delaware is preeminent in doing this; that this is a great value to the nation's corporate, financial and industrial economy; and that this is an eminently rational basis for this Court's choice of a backup rule in 1965 and its reaffirmance in 1972.

C. The Texas Intervenors Fail to Confront the Precedential Nature of the Changes They Urge

The Arizona subgroup casually assumes that the change to the "principal executive office" test could be one of "general applicability." Tex. Br. 51; *see* Ala. Br. 53 n.80 (refusing to go that far, but arguing that doing so would be "simple" and "without difficulty"). But, as we have demonstrated, a generally-applicable "principal executive office" rule would lead to tremendous administrative difficulties. *See* pp. 6-9, *supra*; Del. Opening Br. 56-61. The Texas Intervenors simply do not come to grips with these problems.

Similar dodging takes place with regard to Delaware's concerns about retroactive application to it of the rule changes supported by the Texas group. Although most of the Intervenors earlier conceded that Delaware should not be subject to retroactive application of the rule changes (*see* Del. Exceptions E-7 to E-8 & n.2; Del. Opening Br. 78-79 & n.90), the Texas Intervenors now offer only equivocation. Tex. Br. 55 n.41; Ala. Br. 56-57 n.55. Although they acknowledge the dramatically different position as to retroactivity of Delaware as compared to New York, they say that no claim has been made against Delaware in *this* case and that Delaware would not be precluded in *future cases* from making arguments about its reliance on the old rules. But Delaware in this case seeks judgment for property already taken by New York to which Delaware claims entitlement. And if the Master's proposal becomes the law of the land, retrospective claims

will be made against Delaware for disgorgement of property taken under the "state of incorporation" test of the backup rule very quickly. Delaware's reliance on the present rules has been established and is undisputed.

II. THE STATE-LAW DEBTOR IS THE "DEBTOR" UNDER THE *TEXAS* RULE

A. "Debtor" Means "Debtor"

The Intervenors do not deny that the holders in this case fit within the ordinary meaning of the word "debtor" —the holders owe money to someone, commonly referred to as a "creditor." Instead, Intervenors question the utility of relying on the ordinary meaning of these words (Ala. Br. 12) and claim to have discovered that when the Court said "debtor" and "creditor" it actually meant "originator" and "ultimate intended recipient." Ala. Br. 16. We would have thought that if the *Texas* court meant "originator," it would have used that word or would have remembered that it meant "originator" a few years later when it decided, in *Pennsylvania*, that Western Union (which clearly was *not* the "originator" of the money it held) was a "debtor" under the *Texas* rule.

B. The Court Should Not Start Down the Path of Developing a Federal Common Law of Escheat Priorities on a Case-By-Case Basis

The Texas group's primary justification for its view that the Court should ignore the ordinary meaning of the words "debtor" and "creditor" is its assertion that the Court should develop a federal common law in this area, case by case. Ala. Br. 17-18; Tex. Br. 21-24. This, despite the Court's repeated statement that it does *not* wish " 'to devise new rules of law to apply to ever-developing new categories of facts.' " *Pennsylvania* v. *New York*, 407 U.S. at 215 (quoting *Texas* v. *New Jersey*, 379 U.S. at

679). The Intervenors, although a group of sovereign states, overlook that our federal system has, built into it, a presumption that state law will govern unless it has been displaced by federal law and a preference for the application of state law, even in federal-law regimes.

In a property regime—even one involving property acquired by a state through the exercise of its sovereign prerogatives—the presumption is firmly *against* the development and application of a federal common law. *See Oregon ex rel. State Land Bd.* v. *Corvallis Sand & Gravel Co.*, 429 U.S. 363 (1977).[17] In this case, also, state law creates the property rights at issue; federal law operates on top of the state regime only because conflicting state claims intruded on federal Due Process rights. *See* Del. Opening Br. 2-6, 33-37. The Intervenors respond that "fairness" requires development of new rules and new interpretations for this case. Tex. Br. 23; *see* Ala. Br. 18. But the purpose of the *Texas* rule was to provide a black-letter rule in an area where all litigation was necessarily within this Court's original jurisdiction, not to launch a series of *ad hoc* adjudications.

Even if the Texas Intervenors were correct that a federal common law should be developed, there is no reason why under federal common law a "debtor" should be an "originator" or a "former debtor," rather than just a "debtor." Any federal common law would build upon state law, inasmuch as state law is uniform and fully consistent with the natural reading of the *Texas* backup rule. Of course, the relevant state law is not the state

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[17] The Court there held that the states' title to riparian lands that had reemerged from navigable streams "is not governed by a general federal law, but rather by the laws of the several States." 429 U.S. at 378. The Court explained that "state law should [be] applied unless there [is] present some other principle of federal law *requiring* state law to be displaced." 429 U.S. at 371 (emphasis supplied).

escheat statutes,[18] which the Alabama subgroup incorrectly claims that we rely on. The state escheat statutes do not define the private debtor/creditor relationship—the states' commercial and corporation laws do. *See* Del. Opening Br. 37-39. These commercial laws are, in all relevant respects, uniform throughout the nation. *See* Del. Opening Br. 38-39 & App. D at 86a-89a. The Arizona subgroup's argument that, as a court of equity, the Court should "pierce[] all fictions and disguises" of these laws, Tex. Br. 26, 26-32, is a rhetorical excess. Thousands of transactions a day are completed in reliance on the validity and predictability of U.C.C. § 8-207(1) and the relevant state general corporation laws. A corporation's ability to rely on its register of stockholders in discharging its obligations is not a "fiction" or "disguise." It is a necessary element of modern commerce.

C. The Holders of Unclaimed Property in This Case Are Always Debtors Who Owe Money to Unknown Creditors Under State Law

In their academic zeal to unearth "ambiguities" that do not exist in the real world, the Texas Intervenors have forgotten what this case is about: money held by nominees who do not know whom to pay. No one denies that the nominee holders of the unclaimed property owe the money to someone. Thus, at the outset, it is common ground that they must be "debtors" of someone. We demonstrate below: (1) the nominee holders do not owe the money to the issuers (unlike paying agents); (2) the nominee holders have the right to use the money in their businesses, and have superior title to it over all but their principals—the beneficial owners or their other nominees; (3) the issuers no longer owe any debt upon payment to

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[18] The Alabama subgroup says that the details of these statutes can vary. Ala. Br. 11, 20-21. Indeed, that variability appears to have increased recently among the Alabama subgroup. *See* Del. Answering Br. 20-22 & nn.14-16 & Apps. B & C.

the holders of record; and (4) beneficial owners cannot receive distributions directly from issuers unless they are holders of record. Thus, the nominees are the only debtors, and their only creditors are unknown.[19]

1. The nominee holders are not the issuer's agents. They are stockholders of record or entities claiming under stockholders of record. As such, they have no duty to the issuer, and owe no debt to the issuer. They owe the money they receive to their principals—the beneficial owners or their other nominees. *See* Del. Opening Br. 37 & n.45. The DTC, for instance, considered—and rejected—a proposal that it serve as an agent for issuers. DTC Statement 3 (filed with the Special Master March 16, 1990). In these respects, holders of record stand in a funda-

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[19] The Arizona subgroup makes the astounding suggestion that an "issuer as debtor" rule would make it easier for beneficial owners to make claims on the states for recovery of escheated distributions, since there would be only one state—the state of principal executive office of the issuer—that would have the power to escheat unclaimed distributions under the backup rule. Tex. Br. 32. Presumably, the notion is that the rule would save the beneficial owner the trouble of tracing his missing dividend to the entity that surrendered the funds to escheat and of finding out from it which state it surrendered the money to. There are numerous problems with the notion: the beneficial owner will not know whether the funds were escheated under the primary rule or the backup rule; he may not know what the "principal executive office" of his issuer is, if he does not collect 10-Ks and 10-Qs; but, most fundamentally, one cannot expect that any state will release funds that it has taken into custody to a claimant without the claimant's showing that the funds he claims had been actually escheated to that state. In order to prove his claim, the beneficial owner will have to go through the same chain of proof that he would have to go through under the present system. In point of fact, most claims on the states for customers are made by their brokers, and the brokers know to which state they escheated the funds. Finally, the record indicates that in most cases the customers are paid their distributions in full by their brokers even if their brokers have undergone an "underage" with respect to an incoming distribution payment. Shearer Dep. 154-56, 190-91; Cirrito Dep. 61-63; Principe Dep. 79-83. Thus, it is generally not customers who are out-of-pocket as a result of the sort of escheats, subject to the backup rule, involved in this case.

mentally different relationship to issuers than do paying agents. The record is full of evidence that paying agents, in contrast to shareholders of record, are viewed in the industry as being the exclusive agents of issuers.[20] There is no record evidence to the contrary.[21]

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[20] *E.g.* Shearer Dep. 129-30; *see* DeCesare Dep. 38-40, 149-50 (the DTC considers paying agents and issuers as functional equivalents for purposes of distributions, and many issuers do not even use paying agents). The paying agent's contract is with the issuer. *See* Wellener Dep. 47; American Bar Foundation, *Commentaries on Model Debenture Indenture Provisions* § 10-3[3] at 318-19 (1986) (requiring company to enter into agreements with the paying agent, since a paying agent is "not a party to the indenture," but "a mere agent for the Company"). It is paid by the issuer for serving as the issuer's agent. Wellener Dep. 53. Its standard contracts require it to return unpaid funds to the issuer upon request, *id.* at 57-58; American Bar Foundation, *Commentaries on Model Debenture Indenture Provisions* § 10-3[5] at 322-23. The paying agents routinely return such funds upon request of the issuer, Wellener Dep. 63, 93, 130-31, 145-49, and issuers generally ask for the return of such funds. *Id.* at 148-49.

[21] Contrary to the Alabama subgroup's suggestion (Ala. Br. 22 n.25), section 317(b) of the Trust Indenture Act of 1939, Pub. L. No. 76-253, 53 Stat. 1149, 1173 (codified as amended at 15 U.S.C. § 77qqq(b) (Supp. II 1990)), does not make the paying agent an agent of the security holder. The federal law is an overlay, designed to protect security holders from dual insolvency of both the issuer and the paying agent. *See* American Bar Foundation, *Commentaries on Model Debenture Indenture Provisions* at 319-20. It does so by preventing the general creditors of the issuer *or* the paying agent from reaching funds that have reached the paying agent for payment to holders of record. That does not make the paying agent the agent of the security holder. The security holder is not qualified to give the paying agent instructions or otherwise control its actions. *See* n.20, *supra.* The paying agent is no more the "agent" of the security holder than a trustee of an express trust with full investment discretion is the agent of the trust's non-settlor beneficiaries. *See* William F. Fratcher, *Scott on Trusts* § 8 at 88 (4th ed. 1987) ("[a]n agent acts for, and on behalf of, his principal and subject to his control; a trustee as such is not subject to the control of his beneficiary").

Moreover, in cases of insolvency of a holder of record (for example, a broker-dealer), the beneficial owner has no recourse against

While an issuer's debt is discharged by payment to the shareholder of record, it is *not* discharged by payment to the paying agent. *See* Del. Opening Br. 38-40. As the American Bar Foundation's *Commentaries on Model Debenture Indenture Provisions* (1986) explains, "the obligation bargained for is that of the Company, and such obligation continues until satisfied . . . . [T]he deposit of funds with the Trustee or a paying agent . . . shall [not] operate to discharge the obligation of the Company in respect of such payment." *Id.* at 321.

Thus, in *Texas*, Sun Oil remained a "debtor" that could not locate its creditors. It appears from the Master's Report in that case that Sun Oil acted as its own paying agent, as many issuers do (*see* DeCesare Dep. 38-40). Report of the Special Master, *Texas* v. *New Jersey*, No. 13 Original, at 11 ¶ 6 (filed Dec. 2, 1963) ("[i]t is the practice of the Company to mail checks for cash dividends"). That might explain why the "paying agents" were "undiscussed" in *Texas*, as the Master in this case observed. Report 37. But since paying agents must return unclaimed moneys to the issuer (*see* p. 18 n.20, *supra*), even if there had been paying agents in *Texas*, they would have known exactly who their "creditor" was—Sun Oil.[22]

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the issuer. Thus, when Congress enacted the Securities Investor Protection Act of 1970, it did not view retail customers as having recourse to issuers for the replacement of dividends or of improperly transferred or pledged securities in cases of broker-dealer insolvency. *See* H.R. Rep. No. 1613, 91st Cong., 2d Sess. 2-3, *reprinted in* 1970 U.S.C.C.A.N. 5254, 5255-56.

[22] The Alabama subgroup's statement that Delaware "concede[s]" that the banks holding Sun Oil's money in the *Texas* case were "debtors" (Ala. Br. 22) is therefore misleading. So long as Sun Oil's whereabouts were known—as Sun Oil's surely were to its banks—neither the *Texas* backup rule nor any escheat principles whatever applied to the banks vis-a-vis their creditor, Sun Oil. And so long as Sun Oil had not paid its "lost" shareholders of record, *it* was a "debtor" with either "unknown" or "lost" creditors. The Alabama subgroup's assertion that "state common law technicalities" (Ala.

2. The nominee holders have a right to use the funds in their businesses, good against all the world except the unknown creditor.[23] The Intervenors do not deny this. *See* Ala. Br. 6 n.9, 25 n.29. Nor do they deny that, absent a payment, made to someone who was erroneously recorded as a holder of record (giving rise to a claim of unjust enrichment), an issuer may not demand the return of unclaimed distributions from a holder of record. In contrast, as between a *paying agent* and an issuer, the issuer has a superior right to custody. *See* p. 18, *supra; see also Clarke* v. *New York Trust Co. (In re Associated Gas & Elec.)*, 137 F.2d 607, 608 (2d Cir. 1943) ("the Company could require its agent to return on demand any of the funds not previously disbursed"); *State* v. *Jefferson Lake Sulphur Co.*, 36 N.J. 577, 588, 178 A.2d 329, 334 (corporation has "naked right to custody" of the fund), *appeal dismissed & cert. denied*, 370 U.S. 158 (1962).

Br. 20) made Sun Oil a non-debtor is also not so. The Alabama subgroup points to a few cases holding that a corporation becomes a "trustee" for its shareholders upon segregation of funds to pay a previously declared dividend. Ala. Br. 19-20. These cases do not contradict the black-letter rule that the declaration of a dividend creates a debt. *See* Del. Opening Br. 38-39 & n.47. Indeed, most of them recite that rule and build on it by seeking to protect the shareholders' money from the reach of the corporation's general creditors. But even if Sun Oil's act of setting aside money to pay its debts created a trust, doing so did not make it any less a "debtor." One's debts are not discharged by setting money aside—in a trust or otherwise. They are only discharged by payment.

[23] *See* Del. Opening Br. 29-30. The Michigan group actually purports to make a distinction between "owner-unknown" creditors (which it says are not subject to the *Texas* rule) and "address-unknown" creditors (which it says *are* subject to the rule). Mich. Answering Br. 19-20. The Michigan group never explains how for escheat purposes having a name but no address differs in any material way from having neither a name nor an address. The touchstone of the *Texas* primary rule is a last known address; the absence of such an address requires application of the backup rule. Whether the holder has an owner's *name* does not affect the application of these rules or their rationale.

3. The issuer is discharged from its debt under state law upon payment to the holder of record. *See* Del. Opening Br. 37-39. This fundamental rule of corporation law is relied on by issuers every day. No corporation would pay distributions to nominee holders if the rule were otherwise. Its validity is supported by the record, by case law and commentary, and by routine commercial practice. *Id.* It is acknowledged by the Master. Report 25. The Texas group now tries to fudge away this simple fact, mainly by pointing (Tex. Br. 27; Ala. Br. 23) to cases in which, because of exceptional circumstances, corporations *refused* to pay holders of record without proof that they were *also* beneficial owners. *E.g.*, *Merrill Lynch Pierce Fenner & Smith, Inc.* v. *North Eur. Oil Royalty Trust*, 490 A.2d 558, 563 (Del. 1985); *Davis* v. *Fraser*, 307 N.Y. 433, 444-45, 121 N.E.2d 406, 412 (1954); *Keech* v. *Zenith Radio Corp.*, 276 A.2d 270, 273 (Del. Ch. 1971).

The Intervenors' argument suffers from an elementary logical fallacy; whether issuers are *required* to pay holders of record does not bear on the rule that allows them to discharge their liability by doing so.[24] This case is about situations where the issuer *has* paid the holders of record. The law is so clear, and the cases relied on by the Intervenors so obviously unhelpful, that the Alabama subgroup is actually driven to say that "commercial cases have nothing to do with the law of escheat." Ala. Br. 23. But commercial law creates the debt. Without it, there simply would be no unclaimed property to be escheated. And commercial law is in accord with the ordinary meaning of the word "debtor": when the holder submits the unclaimed property to the state, the issuer (1) has no

[24] So far as we know, there are no modern cases requiring an issuer to pay a dividend twice—once to the record holder and once to a beneficial owner. U.C.C. § 8-207(1) protects the issuer from having to do so. That this provision does not use the word "debtor" is hardly remarkable, since it covers the situation in which an issuer ceases to owe an obligation.

claim on the property, and (2) has already been discharged from the debt it used to owe.[25]

4. Beneficial owners cannot obtain dividends directly from issuers without becoming holders of record. They are not "creditors" of the issuers—only of their nominees. Despite all the Texas group's talk about "fundamental economic relationships," this fact will not go away. A beneficial owner with securities in nominee name simply cannot look to the issuer for payment once the issuer has paid the record holder.[26] Thus, the Texas group concedes, as they must, that the SEC communications rules and other materials they rely on do not "affect the payment of distributions," Tex. Br. 29, and all but concedes that section 7.23 of the Model Business Corporation Act has never been implemented as to dividends. Tex. Br. 28 n.18.

CONCLUSION

The existing rules are a "lawyer-like" solution to the conflicting claims of states to escheat intangible property. They provide an overall structure that is fair to all states. Rather than live within this overall structure, the Texas Intervenors ask this Court to begin tinkering with it, in the hope that the type of property at issue in this case can be disbursed "equally" among the states.[27]

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[25] The case of Borden stock that was not properly reregistered, identified by the Arizona subgroup as demonstrating that on rare occasions issuers are not discharged of their debts because they have erroneously failed to pay the true record holder (Tex. Br. 25), is simply irrelevant. This case is about unclaimed property in the hands of nominee holders—not issuers.

[26] That is one reason why brokers' insolvencies led to a separately funded insurance system to protect brokers' customers. *See* pp. 18-19 n.21, *supra.*

[27] Recall, however, that in the absence of records—records no one has had a reason to maintain—New York will likely retain the lion's share of the moneys at issue in this case if the Intervenors prevail. *See* Del. Opening Br. 83 n.95.

If an exception from or change in the *Texas* rule is made in this case, it will not be in the same class as the proverbial "restricted rail ticket"—good for one day and train only—although that is what the Intervenors astoundingly suggest it can be. It will have widespread consequences, leading to a series of original jurisdiction cases in which further exceptions are sought and new "interpretations" are offered.

For the reasons stated herein and in our Opening Brief, there should be judgment against the Intervenors. Moreover, for the reasons stated in our prior filings, Delaware's Exceptions to the Report of the Special Master should be sustained in all other respects, and Delaware should have the relief against New York previously prayed for, and as set forth in the form of Decree attached as Appendix F to our Opening Brief.

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