ORIGINAL

OFFICIAL TRANSCRIPT

PROCEEDINGS BEFORE

THE SUPREME COURT

OF THE

UNITED STATES

CAPTION: STATE OF DELAWARE, Plaintiff v. STATE OF NEW YORK

CASE NO: 111, Original

PLACE: Washington, D.C.

DATE: Wednesday, December 9, 1992

PAGES: 1-52

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IN THE SUPREME COURT OF THE UNITED STATES

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STATE OF DELAWARE, :

Plaintiff :

v. : No. 111 Original

STATE OF NEW YORK :

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Washington, D.C.

Wednesday, December 9, 1992

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 11:52 a.m.

APPEARANCES:

DENNIS G. LYONS, ESQ., Washington, D.C.; on behalf of the Plaintiff.

JERRY BOONE, ESQ., Solicitor General of New York, New York,

New York; on behalf of the Defendant.

BERNARD NASH, ESQ., Washington, D.C.; in support of Report of Special Master.

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P R O C E E D I N G S

(11:52 a.m.)

CHIEF JUSTICE REHNQUIST: We'll hear argument next in No. 111 Original, the State of Delaware v. the State of New York.

Mr. Lyons.

ORAL ARGUMENT OF DENNIS G. LYONS

ON BEHALF OF THE PLAINTIFF

MR. LYONS: Thank you, Mr. Chief Justice and may it please the Court:

This case started as a sort of a collection case brought in this Court by Delaware against New York to enforce Delaware's rights under the clear teachings of the backup rule promulgated by this Court in the Texas case in the mid-1960's and reaffirmed by this Court in the Pennsylvania case in the early 1970's.

The property in question was so-called overages. These occur when an issuer of securities pays a dividend to its holders of record and you have a broker or some other party that holds for customers or clients as a holder of record, and what the issuer pays is more than what the broker owes to its customers.

It also occurs when the brokers are paid by the Depository Trust Company, which we will call the DTC, which is a nominee custodian set up by a cadre of brokers

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and custodian banks.

The property is owed here to unknowns. That is the agreed position of 49 of the States except for New York, which says that it may be owed to knowns, but it can't identify who they are at this point.

QUESTION: Why does this occur so often and generate so much revenue?

MR. LYONS: It occurs, I believe, because of the activities in the securities markets, that you have an issuer who's maintaining a record, you have securities which are traded, and they sometimes get traded in semibearer form.

In other words, a stock certificate comes out, it is endorsed and negotiable in blank form, and it passed from hand to hand, and the issuer, of course, doesn't know about this. It pays the record, and that results in someone being overpaid and someone being underpaid, and I think it has to do with the volume of trading and the fact that we have a stock-certificate-based trading system in most areas.

This does not involve the primary rule. The case is narrowly drawn simply to involve the backup rule. The primary rule, of course, involves lost stockholders, people who are on the record but who the issuer can't find, who the issuer has addresses for but has lost touch

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with, and lost customers of brokers, and we estimate in our brief -- there is no evidence in the record -- that the universe of the primary rule here, the escheats, is much larger than that of the backup rule.

What started as a collection case turned into a stampede. One by one, 48 States intervened, and they came up with a position that was different from the positions that were quite common between the plaintiff and the defendant in this case.

The effect of these positions was to enlarge the size of the universe that was in issue in the case. The property that Delaware sought was the property in the hands of the brokers who were incorporated in Delaware. The property that the intervenors sought for themselves was the property in the hands of the DTC, a very considerable amount of property, the property in the hands of the Delaware brokers, the property in the hands of the brokers incorporated elsewhere, and the property in the hands of the New York custodian banks, which make a specialty upholding securities for customers.

QUESTION: Mr. Lyons, if we were to apply the rule and the backup rule and the doctrines enunciated by this Court in prior cases, does that mean Delaware would prevail here?

MR. LYONS: Delaware would prevail --

QUESTION: I mean, it's the State of incorporation of the holder --

MR. LYONS: Yes.

QUESTION: Of the dividends.

MR. LYONS: Yes, it would, and New York would prevail as to the --

QUESTION: Treating the holder as the creditor --

MR. LYONS: As the debtor.

QUESTION: Debtor.

MR. LYONS: As the debtor, yes, Your Honor. That is our position, that the debtor here is the broker, is the DTC, but in particular, since the DT doesn't concern us -- New York gets that under our theory -- that the broker is the debtor.

QUESTION: Well now, the Special Master didn't take that view and didn't treat the broker as the debtor.

MR. LYONS: He came close to acknowledging, if Your Honor please, that the broker was a debtor under State law, and he said the State law was technical and that what we needed here was a Federal common law, and under Federal common law, even though it wasn't the case under State law, and I think that's quite clear -- there's a litany of reasons why it's clear -- we will treat the issuer as being the debtor.

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He had a little process whereby he teased out ambiguities, and after he finished teasing the ambiguities he had created an ambiguity, and he resolved it with a tie-breaker, in a sports analogy, and the tie-breaker was fairness, and the principle of fairness was to send the money back where it came from, and the money, he said, came from the issuer.

QUESTION: Like in the Western Union case.

MR. LYONS: Beg pardon?

QUESTION: Like in the Western Union case.

MR. LYONS: No, that was the decision of Congress in a very narrowly drafted statute, it was not the decision of this Court. This Court in the very conservative decision by Justice Brennan literally applied the teachings of the Texas case to that matter, and --

QUESTION: Well, what was Western Union to do when it couldn't find the payee, the money -- the person to whom the money was sent?

MR. LYONS: Western Union couldn't find either the payee --

QUESTION: Well --

MR. LYONS: Or the sender.

QUESTION: What if they couldn't find the payee?

MR. LYONS: Well, the --

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QUESTION: Then what did they do?

MR. LYONS: The sender was still the -- was still a creditor in that case, and if they had an address for the creditor they were to escheat it to the sender as the creditor.

QUESTION: Well, I'm not sure you could call the sender necessarily a creditor.

MR. LYONS: Well, he's given the money to the Western Union.

QUESTION: Like his son, or something like that, and they couldn't find the son.

MR. LYONS: Well, he's given the money to the Western Union. If the Western Union can't find his son, then on principles of equity it is clear under State law that Western Union can't keep the money, that they have to give it back to the sender.

QUESTION: Well, certainly these broker intermediaries didn't have any real claim to the funds themselves.

MR. LYONS: Oh, they do in this sense. They do not owe it back to the issuers. It is quite clear that they -- if they had to pay it back to the issuer --

QUESTION: Well, they don't -- they -- if they could find --

MR. LYONS: That --

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QUESTION: Well, that may be but if they could find the ultimate beneficiary they were supposed to send it on.

MR. LYONS: They're supposed to give it to the beneficiary.

QUESTION: So they didn't really have any title to it.

MR. LYONS: But they -- in the meantime they were earning the interest on it --

QUESTION: May be. May be.

MR. LYONS: They're using the money in their business.

Most -- that is, of course, a chronic position of a debtor in an escheat case, that in all these cases by definition the debtor in an escheat case owes the money to somebody else, but if that person cannot be found within the period of latency, then you have an escheat, so I think simply to say that the debtor owes the money to someone else doesn't resolve the question. It's the start of the question.

QUESTION: Thank you, Mr. Lyons. We'll resume there at 1:00 p.m.

(Whereupon, at 12:00 noon, the argument in the above-entitled matter recessed, to resume at 1:00 p.m. this same day.)

AFTERNOON SESSION

(12:59 p.m.)

CHIEF JUSTICE REHNQUIST: You may resume, Mr. Lyons.

MR. LYONS: Thank you, Your Honor. Before the break, I was making the point that State law should govern who the debtor is for the purpose of characterization of the backup rule. Under the State law, very clearly the brokers are not the issuer's agent, and the issuer is no longer a debtor. The issuer has paid the holders of record, and accordingly has no further obligation. It is only the brokers and the other intermediaries who have an obligation. They are a debtor. To be sure, they owe the money to somebody else, and they don't know who they owe it to, but the issuer is not a debtor, nor is the issuer their creditor.

As I was saying, the only basis for applying Federal common law here is to create a rule that comes out differently from the rule as it would come out under the laws of all 50 of the States.

What we have, I think, is a change for the sake of change, and a change for a purpose that was rejected in the Texas case itself, where it was contended that the mineral rights proceeds should go back and escheat to the State of Texas because it was from Texas soil that they

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had sprung, and the Court rejected that theory and said that those properties, like the rest, would be distributed under the primary rule if there was a known creditor with a last-known address and otherwise under the backup rule.

The Master, besides making what I think is a change in the rule that the debtor should be the debtor, which he did not acknowledge as a change, made an acknowledged change by changing the State of reference for the debtor from being the State of incorporation of the debtor to the State of principal executive office.

QUESTION: Mr. Lyons, before -- I'm sorry, if I may interrupt you, before you go on to that I just wanted to ask you one question that relates to your first point.

The brief points out that some 44 States have joined into an unclaimed property clearinghouse scheme. Is there any reason to believe that that scheme could not be converted readily to the Court's new rule of looking to the State of the issuer rather than to the State of the holder if, in fact, we follow the Master?

MR. LYONS: The securities industries' brief I think suggests numerous difficulties with that because of the way it focuses on the operations of the brokers, and they make numerous suggestions --

QUESTION: Do you adopt that position?

MR. LYONS: Yes, we do adopt -- we're in

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sympathy with their position.

It's interesting to note that the rules set down in the agreement for that clearinghouse quite clearly identify the holder as the debtor and the State of incorporation of the holder as the State of reference -- 44 States signed that.

The Master made this change of his own accord. The States that were contending for the issuer as debtor at that time were contending for the State of incorporation as the reference for the issuer, or for whoever was the debtor. This was a spontaneous change. There was no discovery on the merits of making the change.

There was no discovery as to really what a principal executive office was and what reference it had to the productive facilities of a corporation, and it appears from business publications and surveys that we have quoted in our brief, not having had a chance for discovery, that there is very little connection between the principal executive office, which is the Master's rule, and the productive activities of the corporation. It's just the place where the executive officers, the top brass, have their headquarters.

It seems to me that if the Court does not adopt the issuer as debtor rule, that the change falls of its own weight, because the Master placed great weight on the

fact that the 10-Q report and the 10-K report that issuers of securities file contain this information, and you have grievous difficulties applying the change rule once you get beyond the realm of the issuer.

But in any event, the basis that the Master gave for making the change from the State of incorporation was that it was fairer because it spread the money around more thoroughly. In other words, not to put too fine a point on it, Delaware had too many incorporations.

Let me say that no corporation is required to incorporate in Delaware. Delaware's statute is not copyrighted. It can be copied by another State, and some of them have. What brings corporations to Delaware is a perception that it's judiciary and that it's legislature function in the best interests of stockholders and in the best interests of corporate management at the same time, that they have a balanced approach.

The rule of the State of incorporation is a rule which creates an equality of opportunity. In other words, it is not that the money goes to Delaware, the money goes to whatever State the debtor was incorporated in if the backup rule is applicable and every State has an equal opportunity to do that, and if they could equal Delaware's record and the record of its Court of Chancery over the 200 years that it has been in existence, I think that it

would be a healthy thing.

There's clearly no administrative ease in the change. The administration, even in the context of issuer as debtor, is probably more difficult, and once you get beyond the area of issuer as debtor, where you do not have a 10-K and a 10-Q to serve as your pole star, then you have a rule which is difficult of administration, and I don't see any limiting principle in the Master's report that limits the change in the rule to this situation. What we have, then, is change for change's sake, I believe.

I will save the rest of my time for rebuttal if I may, Your Honor.

QUESTION: Very well, Mr. Lyons.

Mr. Boone, we'll hear from you.

ORAL ARGUMENT OF JERRY BOONE

ON BEHALF OF THE DEFENDANT

MR. BOONE: Thank you, Mr. Chief Justice, may it please the Court:

I would like to start by stating New York's concurrence in Delaware's analysis with respect to the backup rule and express our disagreement with Delaware with respect to the application of the primary rule.

The Master's report is propelled by the notion that it would be fairer to distribute the unclaimed

distributions in question widely among the States rather than to New York or New York and Delaware as a straightforward application of the Texas rule's command.

QUESTION: Why is that fairer? I don't understand why it's fairer to distribute it more widely.

MR. BOONE: Well, the Master's notion was that, since these are basically funds that are stuck among intermediaries who have no beneficial interest in those funds, it would be more equitable to return those funds to the States of the issuers and benefit their citizens, because they generate it, if you will, through their investment, the underlying securities.

QUESTION: Well, maybe we could give it to the Federal Government. Then it would -- you know, we could distribute it the way all the people want it to be distributed.

MR. BOONE: Well, Your Honor, that may be -- that would be another approach.

QUESTION: That's another approach, I agree.

MR. BOONE: What we're asking for is that it be distributed pursuant to the straightforward rules as they currently demand.

QUESTION: Yes, why isn't it fairer to just follow the Court's precedents here? Why do we have to go around writing new rules?

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MR. BOONE: I believe it is fairer, Your Honor. That's New York's position, that the Court has told New York and all States 27 years ago in Texas v. New Jersey that it was setting down very clear rules for establishing State's rights in determining what those escheat rights are and intangible obligations, and the Court reaffirmed that in Pennsylvania v. New York, and refused to modify even slightly the rule based on the same fairness notions or factors that motivated the Master here.

QUESTION: Well, I suppose Congress can certainly step in and change the formula and maybe if 48 States are out there asking them to do it, it wouldn't be too tough, would it?

MR. BOONE: That's correct, Your Honor, and I would suggest -- New York would suggest if there's something particularly unfair in this particular context about distributing or escheating these funds pursuant to the existing black letter escheat rules as set down by this Court, we would suggest that institutionally it would be better if it were left to Congress to make those changes as it did with respect to the Western Union money orders.

But if this case were to be decided on fairness grounds, I would point out that beneficial -- excuse me, brokers and other financial institution intermediaries do

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have beneficial rights in these funds, as I will elaborate, because our argument proceeds -- our primary rule argument, which I'd like to now focus on, proceeds from the traditional understanding of the primary rule.

That is, you identify -- the right to escheat belongs to the State of the creditor as identified on the broker's books in applying the last-known address principle.

Applying -- well, we submit that it is possible to identify with respect to brokers -- I should clarify with respect to, again, concurring in Delaware's analysis with respect to DTC, Depository Trust Corporation, a New York incorporated entity, and custodial banks, New York custodial banks.

There's no dispute by Delaware nor any other party in this litigation that those funds would escheat to New York under the traditional understanding of the backup rule, New York being the State of incorporation for those entities. So there is no dispute, and we would urge the Court in that regard to follow the traditional backup rule.

QUESTION: Between you and Delaware, or not?

MR. BOONE: On the backup rule there is no dispute. There is a dispute on the primary rule with respect to whether it can be applied to brokers, and I

will turn to that.

The Master concluded that it was not possible to apply the primary rule to two brokers, and we disagree with that conclusion, and we believe that the record will reflect that there is a genuine issue of material fact presented by New York's theory that would warrant a remand to allow New York to pursue additional, or discovery to prove certain facts.

We're on a very limited record here, where the Master directed that discovery would be limited to exploring the general architecture and structure of the financial institutions, or financial services industry, so we were not allowed to pursue more detailed discovery --

QUESTION: Well, did the Master --

MR. BOONE: As it relates to our theory.

QUESTION: Did the Master determine that the money we're talking about, as to that money, the creditors are not known? We don't know the identity of them.

MR. BOONE: That's correct.

QUESTION: And what you're arguing is for the application of some sort of presumption to determine who the creditors are, is that it?

MR. BOONE: No, Your Honor.

QUESTION: No.

MR. BOONE: There are three elements to our

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factual contention that the brokers can be identified, the creditor-brokers, and the first contention, or the first element, is that brokers' nominee float results from the exchange of physical certificates between brokers and banks, and the failure of the recipient broker or bank to reregister that certificate into its own name or nominee name before the record date. Therefore, the selling broker remains the registered owner and is paid the distribution to which it is no longer entitled.

So a situation arises that you can identify from the selling broker's books, who would be the debtor, who the purchasing broker is, which would be the creditor under our analysis.

We're not asking for a presumption. What we're asking for, at the outset of this litigation we introduced an affidavit of our director of audits for unclaimed funds, which has not been refuted in this record, and what that affidavit established was that it was possible to trace a particular transaction that gave rise to abandoned property holdings with a creditor-broker. Those particular transactions could be traced from a debtor-broker's books and records to identify a creditor-broker.

Now, there are hundreds of thousands of transactions that occur, so it would be impractical to trace each and every one of those, so what we've asked the

Court to do is to approve our use of a sampling approach which the Court has approved in other contexts, most notably to prove racial discrimination in employment discrimination suits and jury selection cases, so we're asking the Court to approve that, and we would then trace pursuant to that sample a certain number of transactions and then would extrapolate from that to the universe of such transactions.

QUESTION: Well, in --

QUESTION: Prove what?

MR. BOONE: Prove that the addresses on the debtor broker's books would identify a creditor-broker with a trading address in New York in almost every instance, so we're not --

QUESTION: Won't that simply get you in most instances to yet another holder? That isn't going to get you to an issuer, is it?

MR. BOONE: I'm sorry, I didn't hear you.

QUESTION: If you follow your process and you get to the now hidden set of books, they're going to -- or follow the books and you get yourself to a hidden entity, that entity is simply going to be another holder, isn't it, it's not going to be the issuer in many cases?

QUESTION: It's going to get to another person like the broker in Delaware.

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MR. BOONE: No, Your Honor. Under the traditional understanding of the primary rule, the creditor is defined as the apparent owner under debtor-broker's -- or, a debtor's books, whether that debtor is a record holder or an individual partnership, whatever.

So what would be identified from the debtor-broker's books who consummated that trade to his contra party, another broker, that will be reflected on the debtor-broker's books, and that is --

QUESTION: But it won't tell you whether the creditor-broker that you say can be identified is holding -- would have been trading on his own account or for somebody else.

MR. BOONE: Not necessarily, but the primary rule as it currently stands does not require the exploration of ownership. It only requires that you identify the last-known address of the apparent owner that's identified on that debtor's books and records.

QUESTION: You don't have to get to the beneficial owner under the primary rule, even as we've applied it.

MR. BOONE: That's correct.

QUESTION: You just get to the record only.

QUESTION: Even if you know who it is?

MR. BOONE: Well, first of all, I should point

out that the creditor-broker identified on the debtor-broker's books is the apparent owner, may be the beneficial owner. We don't know. The primary rule was not designed to probe the nature of the ownership.

QUESTION: Well, we don't know, whether we follow your theory or whether we follow the theory that Delaware wants, but the fact is, we have no more reason to believe that following your theory is going to result in a more ultimate equity than if we simply stop where Delaware would have us stop.

MR. BOONE: Well, if -- the express purpose of the Court's primary rule as we understand it, at least heretofore, is that it be effectuated where it can, and we're asking for an opportunity to do that, and we believe that we have raised an issue of material fact on this record that would warrant additional discovery in that regard.

QUESTION: What was the Master's position on this argument?

MR. BOONE: Well, the Master concluded that the creditor is the beneficial owner, which is at variance with the traditional understanding that the creditor is the apparent owner, the obligee, the party entitled to enforce payment of the debt.

So having concluded that, the Master basically

said, our factual argument will decide the point, and again, we're on a limited record. We specifically -- the parameters of the limited discovery did not allow probing of our factual theories and contentions, and they're also based on this Court --

QUESTION: Did you claim to the Master that if you were allowed this discovery you had any hope of proving that you would be closer to the real beneficial owner if you were allowed to follow your statistical analysis for the purposes of the primary rule?

MR. BOONE: The beneficial owner has been paid. It's the practice of the industry, as all of the various financial institutions -- the brokers and the banks and DTC -- testified in their testimony, that they pay their customer, who is generally regarded as the beneficial owner, although that customer may be acting for someone else, which is one of the problems of trying to parse the notion of beneficial ownership.

But the testimony was that the financial institutions would pay -- do pay their customers on the pay date regardless of whether the financial institution itself has received all of the distribution to which it is entitled from the issuer's paying agent, so the record will show that the customer, the beneficial owner, is paid.

What we're talking about are funds that are owed that are lost intra brokers, essentially -- that's our position -- and again, under the primary rule the creditor is the apparent owner.

I mean, there was no exploration of attributes of ownership as it has traditionally been interpreted by the various States in their abandoned property acts and by the uniform abandoned properties acts, and as understood by the financial services industry as reflected --

QUESTION: You're saying the Master just misunderstood this system that goes on, because he said -- I thought he said that neither these -- he treated the Delaware and New York entities as intermediaries who had no beneficial interest in these funds, and you say he's just wrong about that.

MR. BOONE: Yes, I -- that's correct. I say the testimony and the record will reflect that the financial institution intermediaries, if you will, the brokers specifically that we're referring to here, routinely pay their customers.

QUESTION: I thought he also offered you the opportunity -- maybe I'm wrong about this -- offered you the opportunity to put in whatever evidence you could about who, indeed, the real owners are. You were allowed to put in whatever you had. Is that wrong?

MR. BOONE: We were allowed within the general parameters -- I mean, our theory, in order to prove it, we submit, we concede, we have to trace -- we have to have an opportunity to trace the actual transactions.

We put in an affidavit at the very outset of this litigation that demonstrated that that could be done. It was based on the sampling of debtor-brokers in New York, and it indicated that you could trace a particular transaction from a debtor-broker and establish the creditor-broker which would be in New York, would have a trading address in New York, and in virtually all instances that has not been refuted on this record. There has been some hypothecation about why that application or that approach would fail.

QUESTION: Well, what was lacking? Was it interparty discovery? I mean, what was the Master supposed to do if you didn't have this evidence? He said if you have it, you can put it in. What --

MR. BOONE: Well, what the Master told us we could do is that we could trace -- we could do this, but it has to be done on an individual case-by-case basis and you have to be able to establish who the beneficial owner is.

When a broker is acting as a debtor --

QUESTION: Well, no, I thought he -- I thought

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he found you didn't even prove that in the overwhelming number of cases this is going to be the situation.

MR. BOONE: Well --

QUESTION: I mean, I'm not sure -- he didn't even buy the fact that you had proved the generality to be true, and whose fault is that?

MR. BOONE: No -- the brokers testified that they don't make the effort to determine -- to do the tracing or to discover who the creditor is. The debtor-broker who receives the overpayment makes no effort, unless it is claimed against, to demonstrate who that creditor is. So they make no efforts, that's established in the record.

What we're saying is that it can be done if we are permitted to make the effort.

QUESTION: Well, it seems to me there are two problems. One is -- which you object to, and I understand that. That's your objection in principle, that you should not have to do it in each case --

MR. BOONE: Correct.

QUESTION: One by one, that you should be able to generalize and apply some statistical generalization. That's one problem, and I give you that.

But the other one is, as I understand the Master, he didn't believe that your generalization was

true. He didn't believe that you had brought in enough demonstration, enough factual demonstration that this statistical analysis was correct that he was willing to buy it --

MR. BOONE: Well --

QUESTION: And that's a problem of proof that is your problem, not his.

MR. BOONE: Justice Scalia, the Master disagreed with our initial predicate -- premise that nominee float is the primary cause of the overage that results in escheating to New York or another State under the application of the primary rule.

There is testimony in the record from brokers that nominee float is the principal cause --

QUESTION: And there's testimony to the contrary --

MR. BOONE: There is, but --

QUESTION: And he just wasn't persuaded.

MR. BOONE: Well, I think what is -- what certainly goes to our raising a material issue of fact is that the DTC experience, where they have experimented, and this is in the record, with a certificateless security for the last 3 years, or for a 3-year period, there was no unresolved overage, which really bolsters and confirms the testimony that nominee float, these physical certificates

floating around that are not reregistered before the record date to the new owner, is the principal cause of the overage.

QUESTION: Well, this is basically a factual argument you're making, Mr. Boone, not a legal argument.

MR. BOONE: Well, our argument proceeds from the premise that the -- under the primary rule that the creditor is the apparent owner, which the Master disagreed with, so it is a mixed law-fact argument. Yes, I mean there are the factual contentions that I've elaborated that we would have to prove, and we believe the evidence, the testimony in the record, raises that issue of fact that entitles --

QUESTION: Well, he couldn't possibly have thought that you had made out a credible case for your New York broker-creditors, as you would have them, really had a beneficial interest in these proceeds that you're claiming, because what he ended up saying was that your position was wholly irrelevant to -- in terms of his disposition of the case, which he couldn't have said if he thought that you had made out a case for beneficial ownership in any of these proceeds.

MR. BOONE: Well, again, we're talking about -- the basic problem gets back to the contradiction of the Master's finding that the overage that we're speaking of

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is caused -- brokers routinely pay their customers.

QUESTION: Yes.

MR. BOONE: The Master did not --

QUESTION: That's right.

MR. BOONE: Find -- make that finding.

QUESTION: That's right.

MR. BOONE: We submit that the record will refute that.

QUESTION: Which means that your brokers in New York really should be recognized as the beneficial owners, because they had already paid their customers.

MR. BOONE: That's -- they are beneficial owners in the sense that the funds are owed to the broker.

QUESTION: And you would not owe -- and those funds that are owed to you, you would not owe to somebody else because you'd already paid them.

MR. BOONE: That's correct.

QUESTION: Yes.

MR. BOONE: And Your Honor, I would ask that with respect to retroactivity that because this Court is engaged in an original jurisdiction rulemaking, there is no need for retroactivity.

QUESTION: Thank you --

MR. BOONE: The laws are being changed.

QUESTION: Thank you, Mr. Boone.

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MR. BOONE: Thank you.

QUESTION: Mr. Nash.

ORAL ARGUMENT OF BERNARD NASH

IN SUPPORT OF REPORT OF SPECIAL MASTER

MR. NASH: Mr. Chief Justice, and may it please the Court:

I speak today on behalf of 44 States in support of the recommendations made by the Special Master.

A threshold issue before the Court is which State should escheat unclaimed securities distributions that become stuck in the hands of financial intermediaries in the course of transmission from issuers to beneficial owners.

The Special Master recommended that the State of the issuer has a superior equitable claim over the State of whatever intermediary happens to be holding the distribution when it becomes stuck. The existence of intermediaries, he held, does not change the fundamental economic relationship between the issuer and its investor. The intermediary never had and does not now have any ownership interest in the distribution. If it did, it would not be unclaimed property.

The Special Master's conclusion was fully consistent with the precedents of this Court -- in Texas v. New Jersey and Pennsylvania v. New York. We agree that

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those precedents should be followed.

In Texas v. New Jersey, the ruling of this Court accorded escheat priority to the State of the issuer, not to the State of any intermediary, the issuer being Sun Oil. There were intermediaries, transfer agents and paying agents, in that case.

Delaware and New York segment into a number of separate transactions the payment of dividends and interest by an issuer to its stockholders as those distributions are transmitted through brokerage firms and other intermediaries. The Master correctly rejected their segmentation and State-law-based theories. He explicitly utilized this Court's guiding principles of fairness and ease of administration in his recommendation.

In Texas v. New Jersey, this Court held fairness to be one of two criteria, and this Court defined fairness to accord escheat priority to the State that gave the benefits of its economy and laws to the company whose business activities made the intangible property come into existence.

QUESTION: Well, I thought our precedents would look to the State of incorporation if it's a corporation that you're looking to at all.

MR. NASH: With respect --

QUESTION: Isn't that so?

MR. NASH: That is correct, Justice O'Connor.

QUESTION: And the Master recommends not adhering to that precedent.

MR. NASH: That is correct, Justice O'Connor, with respect to his second recommendation of whether you change the locational test from State of incorporation to principal executive office.

His first recommendation that as between the State of the issuer or the State of the conduit intermediary broker firm is in full accord with both Texas v. New Jersey and Pennsylvania v. New York.

QUESTION: Well, as to that, would you concede that under most State law the broker intermediaries might be considered the debtors?

MR. NASH: I would concede that the broker intermediaries would be considered one of several debtors for a single transaction, exactly as the Master held. He explained in his recommendation that in this type of a transaction there are multiple intermediaries, that the issuer is a debtor for certain aspects of State law, the intermediaries are debtors for certain aspects of State law. The Uniform Commercial Code merely accords the issuer an affirmative defense.

The only statute before the Court in 1965 in Texas v. New Jersey was the Pennsylvania escheat statute.

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That Pennsylvania escheat statute, which is attached to the Master's report in the original 1965 case, defined holder as someone indebted to another, which therefore meant Sun Oil. It also defined holder as someone in possession of the property, which meant the transfer agents and paying agents.

The only explicit discussion of State law in Texas v. New Jersey resulted in the Court expressly rejecting State-law-based rules relating to technical concepts of domicile, choice of law, and Texas' claim that State law, which defined mineral interests and royalties as real property, should control.

In Standard Oil v. New Jersey in 1951, the Court explicitly rejected the Uniform Stock Transfer Act as a basis for defining the Federal law of escheat. The Delaware-New York State-law-based approach is inconsistent with this Court's general policy of not deciding original jurisdiction cases based on State law. Debtor was used as shorthand both in Texas v. --

QUESTION: You're suggesting that we should decide in all of these cases, as a matter of Federal law, who owes what to whom?

MR. NASH: That is not the issue faced by the Court. The Court is --

QUESTION: No, but why not? I mean, if you feel

free to ignore State law as to who owes what to whom in one respect, why not in all respects?

MR. NASH: The purposes of State debtor-creditor law were for purposes entirely unrelated to the principles underlying escheat priority between the States. The Court in Texas v. New Jersey specified the dual criteria which would be used to determine escheat priority. It identified, as criteria number 1, fairness, and criteria number 2, ease of administration.

QUESTION: You think it had no reference to what the State -- who the State thought the debtor and creditor were. That's sort of, just irrelevant. All we have to consider is fairness and ease of administration.

MR. NASH: That is correct. The term debtor was used descriptively as a shorthand, as a referent to identify the company whose domiciliary State had superior equitable interest.

QUESTION: Well, I'll ask the question I asked earlier. If you want to talk about fairness and ease of administration, why not just make it all payable to the United States?

(Laughter.)

MR. NASH: Because that would not be fair under the criteria --

QUESTION: It wouldn't be fair because of what?

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Because of State law.

MR. NASH: No, it would not be --

QUESTION: Because some other people have some rights to this money.

MR. NASH: It would not be fair because this Court's equitable criteria indicates that if the person entitled to the funds cannot be found, then the contra party ought to be the entity that created the wealth and the property that has been abandoned, and if you cannot return it to the true -- to the State of the true owner which has the asset, if you will, then instead of it being in limbo or going to the United States of America, it ought to go back to the State where the activities took place that created the wealth which is now lost.

QUESTION: Do we always look to the true owner? This gets back to a point that was discussed earlier. How do we apply the owner -- the owner -- is the owner considered always to be only the beneficial owner? We always look through the equitable owner to the beneficial owner, is that the rule that's applied?

MR. NASH: That is correct. That would be the primary rule, and the question is, under the secondary rule, that is the question presented in this case -- when the beneficial owner cannot be identified for escheat purposes, which State has the equitably superior claim for

that property?

QUESTION: You mean -- well, okay.

QUESTION: Mr. Nash, what if a claim arises, say, in Mr. Boone's State of New York between a property owner and the State of New York as to whether property in that State should escheat to the State of New York. Now, is the State of New York bound in adjudicating that dispute by our decision in this case and in our earlier cases?

MR. NASH: No. That would be a question of State law. What your -- what Texas v. New Jersey and Pennsylvania v. New York deal with is contests and disputes between the States.

QUESTION: So that the rules we lay down in these cases, and I do mean lay down, since they seem to be made up, are -- just bind litigants State against State, so to speak.

MR. NASH: That is correct, but New York statute would not be constitutional if it would then seek to take property from its citizens inconsistent with the rules of this Court, because --

QUESTION: Well, then you're saying that our decisions do bind not just States versus States but a New York private litigant against the State of New York.

MR. NASH: It does, Mr. Chief Justice, with

respect to whether New York has the power to take from that citizen.

Getting back to the question asked a moment ago, with respect to looking to Federal common law versus State law, this Court has held in several cases that in contests between States the Court looks to Federal common law and does not borrow from State law.

If we were to follow the Delaware-New York approach and allow escheat priority to be accorded the locational State, be it State of incorporation or State of principal executive office of the financial intermediary, that would result in a grossly inequitable movement of funds to but one or two States.

For example, under Delaware's theory, owner-unknown, unclaimed interest paid by taxpayers of California and California municipalities, for example, or any other State, paid on municipal bonds, would be escheated not by the State of the taxpayer but by another State, depending solely upon the fortuity of where California's distribution got stuck. If it happened to get stuck at DTC, New York would escheat because DTC is incorporated in New York. If it happened to get stuck at Merrill Lynch, Delaware would escheat because it -- Merrill Lynch happens to be incorporated in Delaware.

QUESTION: But of course, the same thing would

happen if we were not talking about an intangible here but we were talking about personal property that was owed from one person to another and it was handed over, transferred from one State to another physically, whatever State it happened to be in when the music ended would be the State that would have authority to escheat, wouldn't it, and you'd say, gee, that's purely arbitrary.

MR. NASH: Physical property has always been escheated where found.

QUESTION: Exactly. Exactly. Exactly. Aren't all our -- don't the rules of escheat begin with -- begin with -- an assumption of State power over the property, and State power over the property depends in turn upon State law with regard to such matters as indebtedness.

MR. NASH: State power over physical property depends upon the location of the physical property. State power over intangible property depends upon the location of the intangible property, and this Court has held in innumerable cases that the intangible property has touched a large number of States, so that any number of States would have the power to escheat intangible property, and that has led to the Texas --

QUESTION: Could it be any number, literally? We could just set forth a Federal rule that allows any State whatever, since this is intangible property --

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MR. NASH: No, but many States touch upon the intangible property. If you have distributions of a company incorporated or principal executive office in one State and the investor is in another State, and the contract is entered into in a third State, all I am saying is not that any State in the world can be fabricated --

QUESTION: It sounds --

MR. NASH: But many States have citizens who touch the intangible property before the transaction is completed, and each would have the power to escheat, and the question before the Court is, which State should have the equitable superiority.

QUESTION: That sounds very much like the contacts theory that was explicitly rejected in Texas v. New Jersey, the kind of theory that is used in conflict of laws, and we explicitly said that's a bad rule.

MR. NASH: I respectfully disagree. Texas v. New Jersey rejected the situs as the location. If anything, it is the Delaware rule that the situs of the property, meaning the situs of the holder, should escheat. That is what was rejected in Texas v. New Jersey.

Texas v. New Jersey resolved that the State of the issuer -- because Sun Oil was the issuer, had the authority -- the equitable superiority of the right to escheat.

QUESTION: Well, it did also reject the contacts rule, because there'd be several States with contacts. It said that cannot be the sole rule. That's what Justice Black said.

MR. NASH: That is correct, Justice Stevens.

The Federal money order statute, which was adopted by the Congress to govern escheat priority among the States, and not State laws developed for unrelated purposes, provides in our opinion far better guidance than State debtor-creditor law. In that statute, Congress gave escheat priority to the State in which the property originated. The State of the intermediary, Western Union, was accorded last place in the quest to escheat.

Another relevant Federal policy may be found in the SEC proxy rules, which permit issuers to bypass intermediaries and transmit proxy materials and corporate communications directly to beneficial owners.

QUESTION: Mr. Nash, can I ask you a question that's probably in the papers, it just slips my mind. Do all States have the same latency periods?

MR. NASH: They do not. They range from 3 to 7, and it might be one or two that's longer than 7.

QUESTION: Thank you.

MR. NASH: The Master's recommendation that the locational test be changed to State of principal executive

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office does depart from precedent, unlike his first recommendation that precedent controls, and that the State of the issuer rather than the State of the intermediary has escheat priority.

QUESTION: None of the parties urged that, did they?

MR. NASH: They did not.

QUESTION: But 44 States now agree that he resolved that issue satisfactorily.

MR. NASH: That is correct, and four additional States have not filed exceptions to that aspect of the recommendation.

Delaware and New York contend that stare decisis precludes this modification, viewing stare decisis, of course, as mechanical formula. They rely, however, principally if not exclusively on stare decisis decisions involving statutory interpretation.

This Court, however, has recognized that there is an essential difference between statutory interpretation on the one hand and case law and constitutional interpretation on the other. It is axiomatic that when the reason for common law rule no longer exists, the common law adapts. In this case, the passage of time has eroded the rationale underlying the State of incorporation locational test.

In 1965, the Court adopted State of incorporation as the locational test solely because of the administrative infeasibility then of implementing a main office or principal office test. The Court expressly stated that State of incorporation was a minor factor and rejected it as the primary rule.

The Court recognized that it would have been far more equitable to reward the State in which the issuer maintains its principal place of business because the Court stated that is the State that probably is foremost in giving the benefits of its economy and laws to the company whose business activities made the intangible property come into existence.

The principal executive office test recommended by the Master also would satisfy another aspect of the Texas v. New Jersey fairness criteria as articulated by the Court, namely, distributing escheats among the States in the proportion of the commercial activities of their residents.

Computer data bases today widely used throughout the securities industry make it feasible, unlike 27 years ago, to adopt a principal executive office locational test. Those data bases permit ready access to principal executive office information.

QUESTION: Why principal executive office? In

Texas v. New Jersey, we really didn't talk about -- we didn't talk about principal executive office. We said, in some respects the claim of Pennsylvania, where Sun's principal offices are located, is more persuasive. It isn't clear to me they were just talking about principal executive offices. They were talking about their main place of business.

MR. NASH: You are correct, Justice Scalia. The Court was talking about -- they used -- the Court used the term, main office and principal place of business interchangeably, and they were trying to get to a location where the activities took place. The Master's -- and the Court rejected that, rightly so. We do not propose that today, because that is by its very nature subjective, and would lead the Court into a quagmire of litigation and dispute.

Principal executive office, however, is a close proxy to the goal of the Court. It is objective. There is only one. It is readily identifiable. Every public company must file one or another type of report with the Securities and Exchange Commission at least annually, if not more frequently, the cover page of which must identify and specify not only the State of incorporation but the State of that company's principal executive office.

The Master found that the principal executive

office is a better locational proxy for where the activities took place that created the wealth, and --

QUESTION: Some of those filings, as I understand from the briefs, change every year. That is, the office listed on the front changes annually, and if you don't know when the payment that goes with a particular stock was made, how can you tell what was their executive office at that year?

MR. NASH: The statements made in the briefs are gross exaggerations. They encompass companies that do not pay dividends or interest. This Court may take judicial notice that there are approximately 1,700 companies listed on the New York Stock Exchange, and the Master found that there are less than 1 percent per year changing their principal executive office.

QUESTION: Isn't there just a particular date of a particular year that property becomes escheatable?

MR. NASH: That is correct, and the Master's proposed decree states that the principal executive office shall be deemed that set forth on the SEC filing within the 12 months preceding the escheat period, so you have to look merely to one principal executive office per year. I was making the point that Delaware grossly exaggerated the frequency of the change.

In fact, with the advent of computer data bases

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and software, it is just as easy today to implement a principal executive office rule as it is a State of incorporation test. Moreover, congressional guidance again in the money order statute suggests the congressional preference, at least for money orders and travelers checks, of principal place of business, which this is close to but not quite, rather than State of incorporation.

Turning to disgorgement, all of the Master's recommendations should apply to all of the property in this case. First, the Master's conclusion that the relevant State is that of the issuer should apply fully, because, as I said earlier, it is but an application of Texas v. New Jersey, not a change in any existing rule.

Given that New York must disgorge, the question becomes, which locational test should govern. We submit that the funds should be distributed based upon the new principal executive office test adopted in this case should the Court adopt the Master's recommendation. It would make little sense to adopt an equitably superior rule and then distribute the funds under a rejected rule.

We submit that no reliance interests are implicated.

If there are no further questions --

QUESTION: Does the record show how much total

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money is at issue --

MR. NASH: The record --

QUESTION: If New York has to disgorge? Is there any notion of what the size of the disgorgement will be?

MR. NASH: Yes, Justice White. The record shows that from 1985 through 1991, New York escheated approximately $631 million.

I would state that New York continued escheating on the basis of its primary rule theory notwithstanding that the lawsuit was filed in 1988 and notwithstanding that in 1980 Paine, Weber refused to pay over such funds to New York and Paine, Weber put New York on notice that its statute did not authorize the escheat.

QUESTION: So its roughly -- it's been at least $100 million a year.

MR. NASH: Since 1985 that is the average. I just cannot state the numbers are higher or lower prior thereto. I might add that in Texas v. New Jersey the Court awarded disgorgement on a fully retroactive basis. Indeed, the Court denied a motion filed after the decision by New Jersey to impose a 2-year limitations period.

QUESTION: How much money was involved in that case?

MR. NASH: I do not recall the number, but far

less --

QUESTION: Something like $26,000, wasn't it?

MR. NASH: Far less sums.

QUESTION: Not quite as powerful a case for --

MR. NASH: But it is a rule of law at the moment, at least.

QUESTION: We weren't really changing the prior decision in that case, either. We were laying down the rule for the first time.

Do you happen to know, Mr. Nash, whether New York would have to disgorge more under the principal executive office test that you propose than it would under the place of incorporation test?

MR. NASH: The Court may take judicial notice of the fact, again, by running through the same data bases that our firm ran through, that approximately 21 percent of the dividends paid by New York Stock Exchange companies -- I think it was in 1990 or 1989, I forget, were paid to New York companies that have principal executive offices therein and under a State of incorporation rule I believe there were approximately 10 percent would --

QUESTION: So they probably do -- they'd probably have to turn over less, or disgorge less under the rule that you propose as opposed to the State of

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incorporation.

MR. NASH: That is correct, and there is also a practical limitation, as the Master found, and that is the records really do not exist once you get much -- sometime in the mid-1970's to --

QUESTION: How about Delaware, comparing the two tests?

MR. NASH: Comparing the two tests, Delaware has -- would receive somewhat less than 1 percent of the money under a State of principal executive office rule and somewhere between 40 and 50 percent of the money under a State of incorporation rule. Again, that is not in the record. That -- I ask the Court to take judicial notice of that from data bases.

Thank you.

QUESTION: Thank you, Mr. Nash.

Mr. Lyons, you have 5 minutes remaining.

REBUTTAL ARGUMENT OF DENNIS G. LYONS

ON BEHALF OF THE PLAINTIFF

MR. LYONS: Thank you, Your Honor.

In reply to the argument of New York that the property here really could be shown to be primary rule property, I would urge not only the point that Justice Scalia made, that there are findings of the Master that impede that conclusion, but that it involves the proof of

what I believe to be an impossibility.

And that is that I, from my records, can ascertain who owns a stock certificate which is essentially in bearer form that I gave to Mr. X on October 15, who holds that stock certificate on November 15, which is the record date for the dividend, because it is that person and those claiming under him who have the claim, and there is no way my records as the debtor, as the delivering broker, can show who owned that certificate, who had that certificate in his vault, at any moment after the time I delivered it to the first party.

Addressing the arguments of the intervenors, it is said that the issuer under State law is one of many debtors. We say that is not so, that section 8-207 of the Uniform Commercial Code says that the issuer is not a debtor once it has paid the holder of record, and that is what has happened here. The issuer is not a debtor under State law.

It is said to be an affirmative defense. Yes, it's an affirmative defense called payment, and payment is a very good affirmative defense. It's the best affirmative defense on a note that I can imagine.

The location rule as to whether we will admittedly change the rules from the State of incorporation to the State of principal executive office,

obviously implicates the hard core rules of stare decisis. This is a rule laid down by the Court in emphatic terms that it was setting a permanent rule. Justice Black says that over and over, and that was the treatment given it in the Western Union case.

Congress can override this at any time within constitutional limits. This is like a statutory interpretation. It is subject to the work of Congress under the Commerce Clause --

QUESTION: Mr. Lyons, why would stare decisis here apply less to statutory interpretation rather than the more relaxed form that applies to constitutional interpretation and to common law?

MR. LYONS: Well, because this -- in most constitutional interpretation the Congress can't change the rules. Here, Congress can because these are clearly in commerce, these distributions, and also Congress has certain powers under section 5 of the due process clause which is also functional, but in this area, clearly you have distributions in commerce. They're the same basis as for the securities laws.

Finally, it is said that there are changes in circumstance from 1965 to 1992 making the State of incorporation rule obsolete. There are none. There were data bases back then that have the principal executive

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office, the 10-Q reports and the 10-K reports were the same, have the same cover display, and there are data bases that have the State of incorporation.

Nothing has changed. The choice is the same, and what we are having is an arbitrary rule not originally supported by the parties who are now supporting it, which the Master decided to do.

There were some questions about the amount of disgorgement in this case. Let me say that the disgorgement from New York would be much greater under the rule contended for as the issuer as debtor, because under that rule New York would lose the DTC moneys which are a very big piece of this, and it would lose the money for the New York- incorporated banks and the New York-incorporated brokers. There are some of them.

We pursued this case originally as a collection case, that this was something which was clearly covered and which New York should not have escheated under the established rules. We do not view it as disgorgement, we view it as collection.

What you have, I think, if the rules are changed to redefine the issuer as debtor, or to redefine the State of principal executive office, is a -- not only a change in the rules which will unsettle expectations and bust the budgets of a number of States, but an unwarranted

departure from an area where certainty should be the rule.

Thank you, Your Honor.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Lyons. The case is submitted.

(Whereupon, at 1:58 p.m., the case in the above-entitled matter was submitted.)

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State Of Delaware v. State Of New York

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BY Lora M. May

(REPORTER)