SUPREME COURT OF THE UNITED STATES

DELAWARE, *Plaintiff,*

v. Nos. 220145 & 220146 (Consolidated)

ARKANSAS, *et al., Defendants.*

October 24, 2018

REBUTTAL EXPERT REPORT OF CLAYTON P. GILLETTE

I, Clayton P. Gillette, provide this Rebuttal Report under Federal Rule of Civil Procedure 26(a)(2)(D)(ii) to assist the Court in its resolution of this matter and to respond to some of the contentions made in the Expert Report of Ronald Mann dated September 19, 2018 (the "Mann Report").

1. Professor Mann's first stated opinion is that "[n]either a bank nor MoneyGram is directly liable," within the meaning of 12 U.S.C. § 2503, "on the MoneyGram official checks or MoneyGram money orders" evaluated in his report. (Mann Rep. ¶ 19(a).) This conclusion is based on his contention that the term "directly liable" as used in that statute is derived from the liability scheme for parties to negotiable instruments under Articles 3 and 4 of the Uniform Commercial Code (the "UCC"). (*See, e.g.*, Mann Rep. ¶¶ 22-28.) I disagree with that assumption. Professor Mann offers no support for his argument that "direct liability" is defined by, or has any particular meaning within, the UCC's liability scheme. Indeed, the

term "directly liable" is not found with respect to the liability of drawers, indorsers, or drawees on instruments anywhere in Article 3 or in the Official Comments thereto.[1] Because the term "directly liability" is not utilized or defined in the relevant portions of the text of the UCC or applicable case law, and because equating the term with "unconditional liability" is inconsistent with the stated objectives of Federal Disposition Act,[2] I disagree with Professor Mann's conclusions that flow from what I view as this erroneous assumption.

2. Professor Mann notes that liability for parties on most check and check-like instruments under the UCC is conditional. Drawers are generally not liable on instruments until the instruments have been dishonored; drawees are generally not liable on instruments until the drawees have accepted them. The one exception involves a cashier's check, which Professor Mann notes imposes unconditional liability on the drawer/drawee on issuance. I do not dispute Professor Mann's statement of these basic principles of the liabilities of parties to instruments.

3. The UCC's liability scheme for parties to instruments, however, is not (and was not at the time of the enactment of the Federal Disposition Act) predicated on anything commonly called "direct liability" or "indirect liability." Nor were those terms used in the UCC to indicate conditional or unconditional liability. Instead, the

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[1] Official Comment 4 to § 3-605 to the UCC uses the term "directly liable" in the context of guarantor liability, which is a completely distinct concept from the issue of liability on instruments on which Professor Mann bases his opinion.

[2] As I did in my initial report, I use the term "Federal Disposition Act" to refer to the Disposition of Abandoned Money Orders and Traveler's Checks Act, 12 U.S.C. § 2501, *et seq.*

principle of indirect liability described by Professor Mann was expressed by calling drawers "secondary parties," based on the understanding that they were liable only if the drawee dishonored an instrument. Pre-Revision U.C.C. § 3-102(1)(d) (1972) (defining "secondary party" as a drawer or indorser). Although the term "primarily liable" was not used with respect to drawees within the definitions of the UCC, both commentators and courts used the term to refer to the liability of those who were liable on issuance, such as issuers of cashier's checks, or drawees that had accepted checks and thus satisfied any condition to liability on the instrument. With rare exceptions, courts and commentators did not use the phrase "direct liability" as a synonym for "primary liability" in that context.[3] When courts and commentators did use the term "direct liability" with respect to check-like instruments during the period when the Federal Disposition Act was being considered, they were addressing issues other than the liability of drawers, indorsers, or drawees on the instrument. For example, courts sometimes used the phrase "direct liability" when addressing whether a depositary or collecting bank that transferred a check bearing a forged

[3] I am aware of occasional, though infrequent, uses of the term "directly liable" in the manner used by Professor Mann. For example, in *Ward v. Federal Kemper Insurance Comany*, 489 A.2d 91 (Md. Ct. Spec. App. 1985), the court noted: "When the drawer draws a check on the drawee and delivers the check to the payee, the check ordinarily is regarded as only a conditional payment of the underlying obligation. . . . Until those conditions are met, no one is directly liable on the check itself. . . ." *Id.* at 95. I have also found pre-UCC cases that refer to certification of a check as a process that renders the certifying bank "directly liable" to the holder. *See, e.g., Gray v. First Nat'l Bank of Birmingham,* 80 So. 2d 528, 530 (Ala. 1955); *Dawson v. Nat'l Bank of Greenville*, 144 S.E. 833 (N.C. 1928). Because these cases constitute rare, if not unique, uses of the terms as used by Professor Mann or are not UCC cases at all, they do not affect my conclusion that the term "directly liable" lacks any specific or well-understood meaning within the UCC liability scheme.

indorsement was "directly liable" to the drawer. *See, e.g.*, *Allied Concord Fin. Corp. v. Bank of America*, 80 Cal. Rptr. 622 (Cal. Ct. App. 1969); HENRY J. BAILEY, THE LAW OF BANK CHECKS 201 n.90 (4th ed. 1969). Other cases using the term involved the issue of whether a depositary or collecting bank could become "directly liable" to a payee where the bank acted in bad faith. *See, e.g.*, *Knesz v. Central Jersey Bank & Tr. Co.*, 477 A.2d 806 (N.J. 1984). Those issues involve liability under theories such as conversion for payment of a check under improper circumstances rather than the liability that a party to a check bears by virtue of its role on the check itself.

4. In contrast to the absence of the term "direct liability," during the period when the Federal Disposition Act was enacted, courts and commentators consistently referred to the liability of drawees who had accepted checks, so that any condition to liability had been satisfied, and to issuers of cashier's checks as being "primarily liable." *See, e.g.*, HENRY J. BAILEY, THE LAW OF BANK CHECKS 218 (4th ed. 1969) ("A person primarily liable is one who by the terms of the instrument is absolutely required to pay it; that is, the maker of a note or the acceptor of a draft or bill of exchange. A bank certifying a check becomes primarily liable and presentment is not necessary to charge the bank."); *Tepper By and Through Michelson v. Citizens Fed. Sav. & Loan Ass'n,* 448 So.2d 1138, 1140 (Fla. Dist. Ct. App. 1984) ("The act of accepting the instrument renders the drawee primarily liable as an acceptor. . . . A cashier's check is a check on which the issuing bank acts as both the drawer and the drawee. Its own act of issuance renders the bank a drawee who has accepted the draft; thus the issuing bank becomes primarily liable as an acceptor.") (citing J. White and

R. Summers, *Uniform Commercial Code* § 17–5 (2d ed. 1980)); *Society Nat'l Bank of Cleveland v. Capital Nat'l Bank*, 281 N.E.2d 563 (Ohio Ct. App. 1972) ("In issuing the cashier's checks, [issuing bank], rather than [remitter], became primarily liable on them."); *Santos v. First Nat'l State Bank of New Jersey*, 451 A.2d 401 (N.J. Super. Ct. App. Div. 1982) ("Timely presentment for payment is necessary to charge parties who are secondarily liable on an instrument. *N.J.S.A.* 12A:3–501. . . . However, presentment is not required to charge parties primarily liable, such as the maker of a note, acceptor of a draft, or a bank that certifies a check. . . . 3 *Anderson, Uniform Commercial Code* (2 ed. 1971)"); *see also Hackett v. Broadway Nat'l Bank*, 570 S.W.2d 184 (Tex. Civ. App. 1978) (dishonor of check satisfied conditions to drawer liability and thus rendered drawer "primarily liable").[4]

5. As I have noted above, courts and commentators who discussed the UCC at the time of the enactment of the Federal Disposition Act referred to parties to checks whose liability was subject to the satisfaction of conditions were referred to as "secondarily liable," not as parties with "indirect liability." *See, e.g.*, HENRY J. BAILEY, THE LAW OF BANK CHECKS 218 (4th ed. 1969) ("On the other hand, the Code declares that, unless excused, presentment is necessary to charge secondary parties to an instrument such as the drawer and any indorser of a check."); *Tepper By and Through*

[4] Some courts erroneously described the drawer as "primarily liable." *See, e.g., Shotts v. Pardi*, 483 S.W.2d 879, 881 (Tex. Civ. App. 1972) ("A drawer of a check is primarily liable. An indorser is secondarily liable."). Nevertheless, the important point is that even those courts used language of "primary" and "secondary" liability to describe the liability of parties on checks. They did not use the language of "direct" or "indirect" liability.

Michelson, 448 So.2d at 1140 ("The drawer, on the other hand, is only secondarily liable on the instrument, in that there are conditions precedent to liability. W. Hawkland, *Commercial Paper* 52 (2d ed. 1979).").

6. When Article 3 of the UCC was revised in 1990, the terminology of "secondary" liability to define the responsibility of parties to the check was eliminated. But as with the prior version, revised Article 3 did not define (or otherwise refer to) the conditional or unconditional liability of parties to instruments as "direct" or "indirect." Instead, Official Comment 4 to revised § 3-414 was changed to state: "The liability of the drawer of an unaccepted draft is treated as a primary liability. Under former Section 3-102(1)(d) the term 'secondary liability' was used to refer to a drawer or indorser. The quoted term is not used in revised Article 3."

7. Professor Mann, however, equates unconditional liability under the UCC with the phrase "directly liable" as it is used in 12 U.S.C. § 2503. Similarly, he implies that those parties to instruments who have only conditional liability as set forth above must have "indirect liability," and thus are outside the scope of 12 U.S.C. § 2503. For the reasons set forth above, it is my opinion that Professor Mann's attempt to equate these terms is not supported by the UCC.

8. It is not surprising that Congress did not use either the terms or concepts of party liability under the UCC when it drafted 12 U.S.C. § 2503. The plain language of 12 U.S.C. § 2501 reveals that Congress was interested in the entirely different issue of equitably reporting and remitting the proceeds of certain unclaimed instruments. *See* 12 U.S.C. § 2501(3) ("[T]he States wherein the purchasers of money

orders and traveler's checks reside should, as a matter of equity among the several States, be entitled to the proceeds of such instruments in the event of abandonment."). Whether parties to instruments bear conditional or unconditional liability for payment of those instruments under the UCC is irrelevant to that objective. And stated above in Paragraph 3, the UCC does not equate direct liability with unconditional liability in any event.

9. There are additional reasons to reject the contention that Congress's use of the term "direct liability" in 12 U.S.C. § 2503 was derived from the UCC's liability scheme for parties to negotiable instruments. First, Professor Mann agrees that MoneyGram retail money orders and MoneyGram agent check money orders have no party who is "directly liable" as he uses the term. *See* Mann Report at ¶¶ 19(a), 38. Yet a money order was the quintessential instrument identified by Congress to exemplify the kind of instruments that it wanted covered by 12 U.S.C. § 2503. Thus, under Professor Mann's definition of the term "directly liable," Congress, according to Professor Mann, included only other instruments on which there was unconditional "direct," liability, even though Congress's primary example of a covered instrument did not possess that characteristic.

10. Second, given the clear and uncontroversial rationale of the Federal Disposition Act of ensuring equitable distribution of the proceeds from unclaimed property where 1) a holder's records allow identification of the location of purchase, and 2) it is appropriate to presume that the location of purchase is the location of the purchaser's residence, Professor Mann offers no explanation as to why Congress

would have applied the statute to cashier's checks, but not to teller's checks or other MoneyGram instruments as to which relevant records similarly exist and the Congressional presumption is similarly appropriate.

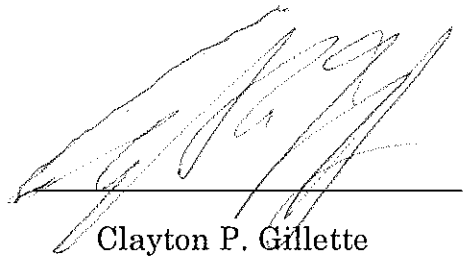
11. Professor Mann provides only one example—a cashier's check—of an instrument on which a party is "directly liable" under his definition of the term. (Mann Rep. ¶¶ 20, 28.) But if a cashier's check were the only instrument subject to the statute other than money orders and traveler's checks, then the statute would have been drafted quite differently. In the first instance, it would have been sufficient to say that covered instruments were "a money order, traveler's check, or a draft drawn by the drawer on itself." There would have been no need to speak in terms of an "other similar written instrument (other than a third party bank check) . . . ." In the second instance, since a cashier's check is necessarily drawn on a bank, there would have been no need to speak of an instrument "on which a banking or financial organization or a business association is directly liable." A business association could not be "directly liable" on an instrument as Professor Mann has defined it, since only a cashier's check qualifies, and a "business association" could not be the issuer or drawee of a cashier's check. *See* U.C.C. § 3-104(g) (defining a "cashier's check" as "a draft to which the drawer and drawee are the same *bank* or branches of the same *bank*") (emphasis added). Thus, it makes sense to assume that the addition of the term "business association" was intended to capture situations in which a business association was a party to an instrument in some other capacity, such as being the drawer of the instrument – even though that meant the business association would

only be conditionally liable. It would have been unnecessary to use term "business association" to capture the situation in which a business association was the issuer of a traveler's check. The phrase "traveler's check" itself would have accomplished that, since a significant majority of traveler's checks were issued by business associations at the time. *See* Disposition of Abandoned Money Orders and Traveler's Checks, Sen. Report No. 93-505 at 3 (November 15, 1973) ("[T]here are five organizations supplying (issuing) most of the output of the travelers' check industry . . . . The largest organization, American Express, accounts for about two-thirds of the industry total; two nonbanking subsidiaries of large bank holding companies each control almost 15 per cent of that total. . . .").

12. If one did believe that Congress intended the applicability of 12 U.S.C. § 2503 to turn on principles of party liability under the UCC, it would have been anomalous for Congress to have distinguished between cashier's checks and teller's checks. Although, as a technical matter, cashier's checks do carry unconditional liability and teller's checks do not, the ultimate liability of issuers of both those instruments is equivalent. That is, both issuers of both cashier's checks and teller's checks bear exceptional and identical consequences in the event that they are wrongfully dishonored by the issuer of the cashier's check or the drawer of a teller's check. *See* U.C.C. § 3-411. That is because these instruments are typically viewed as being supported by the credit of a bank and failure to pay each would undermine confidence in checks issued by banks. Given their fungible objectives in commerce

and identical treatment in this regard, there is no clear reason for Congress to have distinguished between them for unclaimed property purposes.

Dated: October 24, 2018



Clayton P. Gillette