

JUSTIN MONSENEPWO

The Law Applicable to
Security Interests
in Intermediated Securities
Under OHADA Law

*Max-Planck-Institut
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Securities Under OHADA Law

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To Laurie, Glory, Grace, and Hope

Preface

This book is the result of my doctoral research, accepted as a doctoral dissertation by the Faculty of Law of the Julius Maximilian University of Würzburg in January 2021. It aims at finding clear and efficient conflict of laws rules for the determination of the law governing proprietary rights in respect of security interests in intermediated securities under the law of the Organisation for the Harmonisation of Business Law in Africa (hereinafter referred to as OHADA). In the OHADA region, securities holding patterns have drastically changed in the last decades. Besides securities certificates that are held directly by an investor, there are an increasing number of securities that are held via an intermediary within a so-called “indirect holding system”. These securities that are indirectly held with intermediaries (or intermediated securities) are often provided as collaterals. However, if the intermediated system has increased the breadth and the depth of the securities markets in the OHADA regions, it has also allowed different and divergent applicable laws to occur within a cross-border securities holding chain. Unfortunately, there is no common and adapted legal approach in the OHADA region as to the determination of the law governing proprietary issues affecting intermediated securities. Consequently, an investor will suffer a risk if the adjudicating forum selects an unexpected law by which the validity of the collateral interest in the intermediated securities is to be ascertained.

From a substantive law perspective, the current rules governing the constitution, the perfection, and the realisation of the pledge of intermediated securities are enshrined in Articles 146 et seq of the OHADA Uniform Act on Security Interests. Unlike the Geneva Securities Convention, the Financial Collateral Directive, and Article 8 of the Uniform Commercial Code, the scope of Articles 146 et seq of the Uniform Act on Security Interests does not encompass title transfer collateral agreements, including repurchase agreements. Under Article 149 of the Uniform Act, the pledged securities account must take the form of a special account open in the name of the account holder and maintained by the issuing legal entity or a financial intermediary.

From a private international law perspective, the *lex rei sitae* (or the *lex cartae sitae*) rule is currently applied in all OHADA Member States to determine the law applicable to security interests in intermediated securities. However, with the dematerialisation (*Entmaterialisierung*) of securities certifi-

cates, the root of title is no longer either a piece of paper or the company's register. Rather, it is an electronic book entry on the books of a central operator. Therefore, it is difficult to determine the "situs" of intermediated securities in an indirect holding system. In search for a more appropriate connecting factor, this book analyses the European PRIMA rule (Article 9(2) of the Settlement Finality Directive, Article 9 of the Finality Directive, and Article 24 of the Winding-up Directive), whereby the law applicable to book entry securities provided as collateral is the law of the jurisdiction where the relevant register, account, or centralised deposit system is located. However, the PRIMA rule leads to severe difficulties since there is no criterion able to determine beyond doubt the office of an intermediary which maintains a specific account or the location of a securities account. Indeed, a securities account is a legal relationship between two entities. Since (legal) relationships do not have a location, it is not possible to speak of the location of an "account" or even the location where the account is "maintained". In addition, in modern global trading, some or even all the functions pertaining to the maintenance and servicing of a securities account are undertaken from more than one office or even outsourced to third parties in different locations. Therefore, any attempt to "localize" the securities account or the place where it is maintained would give rise to more legal uncertainty. In light of these difficulties, this book analyses the rules of the Hague Securities Convention and submits that they offer more legal certainty and predictability compared to the *lex rei sitae* and the PRIMA rules, as Article 4 of the Hague Securities Convention focuses on the *relationship between an account holder and its intermediary* by looking to the law in force in the jurisdiction expressly chosen in the agreement between the investor and the intermediary to govern either the issues falling within the scope of the Convention or the account where the securities are held. In that regard, this book suggests several options, among which the most satisfactory is an accession by OHADA to the Convention.

There are many people whom I wish to thank for the completion of this work. First of all, I sincerely thank my supervisor (*Doktorvater*), Professor Dr. Christoph Teichmann, for his advice and guidance for my doctoral research and more generally for my life in Germany. I do count myself very fortunate to have worked under the supervision of such a tremendous mentor. I also extend my sincerest gratitude to Professor Dr. Eva-Maria Kieninger for her thoughtful and helpful comments on this work as the second examiner. During the entire period of my doctoral research, she was always ready to assist me and to share her invaluable time. I also wholeheartedly thank Professor Dr. Karl Kreuzer, Dr. Christophe Bernasconi, Professor Dr. Jean-Michel Kumbu, Professor Dr. Jan Neels, Prof. Dr. Marta Pertegás, and Dr. Karin Linhart for their excellent comments and orientations on different aspects of

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31 July 2022

Justin Monsenepwo

Foreword

The core purpose of the Organisation for the Harmonisation of Business Law in Africa (OHADA) is not only to promote economic development and integration but also to guarantee legal certainty for investors and companies in its Member States. Its instruments (mainly Uniform Acts) and institutions (such as the Common Court of Justice and Arbitration) have enabled OHADA to reach a remarkably high level of legal harmonisation. Moreover, pursuant to the Treaty on the Harmonisation of Business Law in Africa, the OHADA Member States have transferred relevant parts of their legislative and judicial sovereignty to OHADA, making it one of the few regional economic integration organisations besides the European Union that may join the Hague Conference on Private International Law (HCCH) as a Member. OHADA itself may also become party to HCCH Conventions in areas which fall within OHADA's competence.

Interestingly, in recent years the field of private international law has become increasingly prominent in the OHADA region. One need only look to the integration process in other parts of the world – such as within the European Union, the Association of Southeast Asian Nations (ASEAN), or the Southern Common Market (Mercosur) – to realise that there is a strong nexus between the facilitation of cross-border trade and the unification of private international law. This includes uniform rules on jurisdiction and choice of forum, the applicable law, recognition and enforcement of foreign judgments, and international cooperation. In 2013, the HCCH and OHADA concluded an agreement designed to enhance cooperation between the two organisations, increase the visibility of the work of the HCCH in the OHADA region, examine the possibility for HCCH instruments to be brought into effect in OHADA Member States, and for OHADA Member States to become Members of the HCCH. In addition, in 2019 OHADA launched the drafting of a Uniform Act on private international law. Against this background, the publication of this book on the law applicable to security interests in intermediated securities is not only timely but is also an important contribution to the development of private international law in Africa.

In recent decades, the OHADA region has witnessed a shift from securities being held directly by an investor to a system in which many securities are held via an intermediary. In that system, securities are held and transferred by

electronic book-entry debits and credits to securities accounts of primarily dematerialised or immobilised securities. However, neither OHADA nor its Member States have adapted their conflict of laws rules to the issues that are of crucial practical importance for holdings and dispositions of intermediated securities. To fill this gap, this book compares different solutions existing under national, regional, and international instruments. More specifically, it analyses the *lex cartae sitae*, the “look through approach”, and the “place of the relevant intermediary approach” (PRIMA). It demonstrates that these rules are deficient because they attempt to determine the *situs* of either the securities or the securities account. The book suggests that OHADA would greatly benefit from the legal certainty and predictability afforded by the HCCH Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary (HCCH 2006 Securities Convention). The HCCH 2006 Securities Convention does not attempt to formulate a conflict of laws rule based on the concept of *situs*. Rather, its primary rule is based on the relationship between an account holder and an intermediary. Supporting this approach, the book recommends that all OHADA Member States (or OHADA itself) become party to the HCCH 2006 Securities Convention.

This publication is essential reading for policy makers, academics, market participants, and legal practitioners in the OHADA region and beyond. I am convinced that its in-depth analysis of OHADA’s substantive and conflict of laws rules will go a long way in filling the gap in this area and encouraging further development in the future.

On a personal note, I have had the pleasure of knowing the author, Mr Justin Monsenepwo, since his early involvement with the HCCH Permanent Bureau in 2015. Over the years, I have been delighted to see him develop such a close relationship with the HCCH, contributing to the joint effort to facilitate the increased participation of African States in the work of the organisation. This publication is yet another of Mr Monsenepwo’s tangible contributions.

Dr. Christophe Bernasconi
Secretary General, HCCH

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Abbreviations

AEC	African Economic Community
ALI	American Law Institute
AMU	The Arab Maghreb Union
ARK.	Arkansas
AU	African Union
B.O.	Bulletin Officiel
BCL	Banque Centrale du Luxembourg
BGBI	Bundesgesetzblatt
BGH	Bundesgerichtshof
BGHZ	Entscheidungssammlung des Bundesgerichtshofs in Zivilsachen
Bull. civ.	Bulletin civil
BW	Burgerlijk Wetboek
CAA	Caisse autonome d'amortissement
CAEMC	Central African Economic and Monetary Union
CCJA	Common Court of Justice and Arbitration
CJEU	Court of Justice of the European Union
CCP	Central counterparty
CFA	Communauté Financière Africaine (African Financial Community) – Coopération Financière en Afrique Centrale (Financial Cooperation in Central Africa)
CGE	Committee of Governmental Experts
Chinese PIL Act 2010	Law of the People's Republic of China on the Application of Laws to Foreign-Related Relations
CMF	Commission des Marchés Financiers (Financial and Capital Market Commission)
CNO	Commissions Nationales OHADA
Commission	Commission of the European Communities
Committee	Committee on Foreign Relations of the United States Senate
CSD	Central Securities Depository
COMESA	Common Market for East and Southern Africa
Ct.	Court
D.	Dalloz
DRS	Direct Registration System
ECB	European Central Bank
ECCAS	Economic Community of Central African States

ECOWAS	Economic Community of West African States
eds	editors
EEC	European Economic Community
EFMLG	European Financial Markets Lawyers Group
EGBGB	Einführungsgesetz zum Bürgerlichen Gesetzbuch
ERSUMA	Ecole Régionale Supérieure de la Magistrature
ESCB	European System of Central Banks
ESMA	European Securities and Markets Authority
et seq	et sequens
EU	European Union
EuZW	Europäische Zeitschrift für Wirtschaftsrecht
FAST	Fast Automated Securities Transfer
Financial Collateral Directive	Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements
FCMC	Financial and Capital Market Commission (Commission des Marchés Financiers)
GEDIP	European Group of Private International Law
Geneva Securities Convention	UNIDROIT Convention of 9 October 2009 on Substantive Rules for Intermediated Securities
GMRA	Global Master Repurchase Agreement
GMSLA	Global Master Securities Lending Agreement
Hague Conference	Hague Conference on Private International Law
Hague Principles	Hague Principles on Choice of Law in International Commercial Contracts
Hague Securities Convention	Hague Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary
HCCH	Hague Conference on Private International Law
Hrg	Hearing
ICMA	International Capital Market Association
ICSD	International central securities depository
Insolvency Regulation	Council Regulation (EC) n° 1346/2000 of 29 May 2000 on Insolvency Proceedings
Int'l Bus. LJ	International Business Law Journal
Interim Report	Interim Report of the Advisory Committee on Settlement of Market Transactions (Exposure Draft, 15 February 1991)
IPRax	Praxis des Internationalen Privat- und Verfahrensrechts
ISDA	International Swaps and Derivatives Association
ISIN	International Securities Identification Number
ISO	International Organisation for Standardisation
J.O.	Journal Officiel
J.O.R.C.I.	Journal Officiel de la République de Côte d'Ivoire
JORDC	Journal Officiel de la République Démocratique du Congo
L	Législation

La	Louisiana
LGDJ	Librairie Générale de droit et de jurisprudence,
MEFISLA	Master Equity & Fixel Interest Stock Lending Agreement
Mexico City Convention	1994 Inter-American Convention on the Law Applicable to International Contracts
MiFID	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU Text with EEA relevance
MTAC	Market Transaction Advisory Committee
MTFs	Multilateral Trading Facilities
MGESLA	Master Gilt Edged Stock Lending Agreement
n	note
n°	Number
NCCUSL	National Conference of Commissioners on Uniform State Laws
NJOZ	Neue Juristische Online-Zeitschrift
NJW	Neue Juristische Wochenschrift
NPS	New Platform System
NSCC	National Securities Clearing Corporation
NYSE	New York Stock Exchange
OAS	Organisation of American States
OAU	Organisation of African Unity
OECD	Organisation for Economic Co-operation and Development
OHADA	Organisation pour l'harmonisation en Afrique du droit des affaires (Organisation for the Harmonisation of Business Law in Africa)
OHADA Treaty	Treaty on the Harmonisation of Business Law in Africa
OJ	Official Journal of the European Union
OSLA	Overseas Securities Lender's Agreement
P.U.F.	Presses universitaires de France
PAF	Presses Académiques Francophones
Preliminary Draft	Preliminary Draft of a Uniform Text on the Law of Obligations
PRIMA	Place of the relevant intermediary approach
RDW	Regional Discussion Workshops
Rec.	Recueil
RECs	Regional Economic Communities
REIO	Regional Economic Integration Organisation
RIW	Recht der internationalen Wirtschaft
Rome I Regulation	Regulation (EC) 593/2008 of 17 June 2008 on the Law Applicable to Contractual Obligations
Rome II Regulation	Regulation (EC) n° 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations
Rules of Procedure of the CCJA	Rules of Procedure of the Common Court of Justice and Arbitration of 18 April 1996

s	section
S Ct	Supreme Court
SA	Société anonyme (public limited company)
SADC	Southern African Development Community
SARL	Société à responsabilité limitée
SAS	Société par actions simplifiée
SCA	Security financial collateral arrangements
SEA	Securities Exchange Act
SEC	Securities Exchange Commission
Settlement Finality Directive	Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems
Shareholders' Rights Directive	Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies
Special Commission	Special Commission on General Affairs and Policy of the Hague Conference on Private International Law
SPILA	Swiss Private International Law Act
ss	sections
SSS	Securities Settlement System
TFEU	Treaty on the Functioning of the European Union
TRADES	Treasury Reserve Automated Debt Entry System Regulations
UCC	Uniform Commercial Code
UCITS	Undertaking for collective investment in transferable securities
UNCITRAL	United Nations Commission on International Trade Law
UNIDROIT	International Institute for the Unification of Private Law
Uniform Act on Com- mercial Companies	Uniform Act on the Law of Commercial Companies and Economic Interest Groups
U. Pitt. L. Rev.	University of Pittsburgh Law Review
U.S.	United States of America
Vol.	Volume
WAEMU	West African Economic and Monetary Union
Winding-up Directive	Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the Reorganisation and Winding up of Credit Institutions
WM	Wertpapier-Mitteilungen. Zeitschrift für Wirtschafts- und Bankrecht
WpHG	Wertpapierhandelsgesetz

General Introduction

“It is now obvious that the evolution and growth [of the African continent] will be a function of how we manage to attract domestic and international investment into the region. An important aspect of such evolution would be a uniform and harmonised system of business laws, clearly formulated and transparently applied all over the region.”¹

Based on this apt rationale, fourteen central and western African states created, on 17 October 1993, the *Organisation pour l’Harmonisation en Afrique du Droit des Affaires* (the Organisation for the Harmonisation of Business Law in Africa, hereinafter referred to as OHADA)² to develop simple, modern, and unified business law rules for the African continent. More than two decades after its creation, OHADA has seventeen Member States³ and has adopted ten so-called Uniform Acts⁴, which cover numerous business law

¹ Nana Addo Dankwa Akufo-Addo, MP, Attorney General and Minister of Justice of Ghana, 31 July 2002 (see Boris Martor et al, *Business Law in Africa: OHADA and the Harmonisation Process* (Eversheds, London 2002) xxii).

² Treaty on the Harmonisation in Africa of Business Law, signed in Port Louis on 17 October 1993, 4 J.O. OHADA n° 4, 1 November 1997, 1 et seq, available at <<http://www.ohada.com/traite/10/treaty-on-the-harmonisation-of-business-law-in-africa.html>> (accessed 4 January 2021). The OHADA Treaty was revised in Quebec on 17 October 2008 (available at <<http://www.ohada.com/traite/937/treaty-on-the-harmonization-in-africa-of-business-law-signed-in-port-louis-on-17-october-1993-as-revised-in-quebec-on-17-october-2008.html>> (accessed 4 January 2021)). Please note that OHADA is sometimes referred to in English academic publications as “OHBLA”; see for instance Kenfack Douajni, ‘OHBLA Arbitration’ (2000) 17(1) *Journal of International Arbitration* 127; Franco Ferrari, ‘The Ohbla Draft Uniform Act on Contracts for the Carriage of Goods by Road’ (2001) *Revue de Droit des Affaires Internationales* 898; Thierry Lauriol, ‘Legal Aspects of Creating Security Interests over Mining Titles in the States Parties to the OHBLA’ (2001) 19 *Journal of Energy & Natural Resources Law* 207; Franco Ferrari, ‘International Sales Law in the Light of the OHBLA Uniform Act Relating to General Commercial Law and the 1980 Vienna Sales Convention’ (2001) *Revue de Droit des Affaires Internationales* 599. However, this thesis will use the acronym “OHADA”.

³ As of January 2021, the Member States of OHADA are Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Côte d’Ivoire, Democratic Republic of Congo, Equatorial Guinea, Gabon, Guinea, Guinea-Bissau, Mali, Niger, Republic of the Congo, Senegal, and Togo.

⁴ For a definition and an in-depth analysis of this term, see part II, chapter 1, section D of this thesis.

areas such as company law, commercial law, bankruptcy, arbitration, mediation, security interests, accounting, the carriage of goods by road, and enforcement measures.

In recent decades, the pattern of securities holding in the OHADA region has significantly changed.⁵ Indeed, following the rapid advance of information technology,⁶ the liberalisation of capital movement, and the financial deregulation of a wide range of financial products and services in the global context, there has been a shift from a direct to an indirect holding system in which the interests of an investor in respect of the underlying securities are recorded in the books of an intermediary⁷ (such as a bank or a securities firm). In turn, that

⁵ Sandrine Kablan, *Système bancaire en Afrique de l'Ouest: Efficacité et rôle dans le développement financier* (L'Harmattan, Paris 2012) 11, 12, 49, 64. See also the preamble of the Cameroonian *Loi n° 99-15 portant création et organisation d'un marché financier* of 22 December 1999, which is available at <<http://bibliotheque.pssfp.net/index.php/textes-et-lois/lois/613-loi-n-99-015-du-22-decembre-1999-portant-creation-et-organisation-dun-marche-financier/file>> (accessed 4 January 2021). For a description of this evolution and of the *Entmaterialisierung* of securities at the global level, see Dorothee Einsele, *Wertpapierrecht als Schuldrecht: Funktionsverlust von Effektenurkunden im internationalen Rechtsverkehr* (Mohr Siebeck, Tübingen 1995) 7 et seq.

⁶ See Joanna Benjamin, Madeleine Yates & Gerald Montagu, *The Law of Global Custody* (2nd edition, Butterworths, London 2002) 13 et seq; Hans Angermueller, 'Foreword' in Kathleen Tyson-Quah (ed), *Cross-Border Securities Repo, Lending and Collateralisation* (Sweet and Maxwell, London 1997) for an overview of the effects of the shift from the Industrial Age to the Information Age on the global financial market.

⁷ The term "intermediary" is often used under OHADA law: Articles 640(1), 642(1), 747(2), and 764 2°) of the Uniform Act on the Law of Commercial Companies and Economic Interest Groups (J.O. OHADA n° 2, 1 January 1997, 1 et seq, hereinafter referred to as Uniform Act on Commercial Companies), Articles 148(3), 149, 150(3), 151(2), 152, 153 2°), and 155 of the Uniform Act on Security Interests (*Acte uniforme portant organisation des sûretés*, J.O. OHADA n° 22, 15 February 2011). However, there is no definition of that term under OHADA law. Under the Cameroonian *Loi n° 99-15 portant création et organisation d'un marché financier* of 22 December 1999, financial intermediaries are investment service providers that can be either financial institutions or investment firms. In comparison, see the definition of that term under German law in § 2(1) of the WpHG, under US law in § 8-102(a)(15) of the UCC. See also Article 1(a) of the Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary (hereinafter referred to as the Hague Securities Convention), which defines the term "securities" as "any shares, bonds, or other financial instruments or financial assets (other than cash), or any interest therein". Under Article 1 of the UNIDROIT Convention on Substantive Rules for Intermediated Securities (hereinafter referred to as the Geneva Securities Convention), "securities" means "any shares, bonds, or other financial instruments or financial assets (other than cash) which are capable of being credited to a securities account and of being acquired and disposed of in accordance with the provisions of this Convention". Under European law, see Article 2(h) of the Directive 98/26/EC of 19 May 1998 on Settlement Finality in Payment and Securities Settlement Systems (hereinafter referred to as the Settlement Finality Directive) in connection with section B of the

intermediary has its interest recorded with another intermediary and so on up the chain until the intermediary is either recorded as the registered owner on the books of the issuer or the issuer's official record holder, or itself holds the certificates or other documents of title representing the securities.⁸ In other words, the indirect holding system suggests the image of a series of Russian dolls, one inside the other, with the smallest doll containing the jewel. The dolls are unique and different from one another, but the value of all the dolls alike derives from the jewel. In this analogy, the jewels equate to the underlying securities, and each doll equates to a different party's interest in securities.⁹

Such intermediated securities are very often given as collateral in cross-border transactions to enable market participants and central counterparties to manage credit risk in the OHADA region.¹⁰ The collateralisation of intermediated securities allows market actors to raise the funds needed for economic growth and risk management.¹¹ Indeed, besides cash, interests in securities are the most sought-after form of collateral asset in the financial markets within the OHADA region. As interests in securities are highly liquid and easily valued, they are used to collateralise vast financial exposures under bank-loan, swap, repossession, and securities lending arrangements. In addition, besides these private commercial arrangements, central banks use intermediated securities as collateral in their money market operations.¹² Conse-

Annex to the Council Directive 93/22/EEC of 10 May 1993 on Investment Services in the Securities Field (OJ L 141, 11 June 1993, 27–46).

⁸ Bradley Crawford, 'The Hague Prima Convention: Choice of Law to Govern Recognition of Dispositions of Book-Based Securities in Cross Border Transactions' (2003) 38 Canadian Business Law Journal 157, 157–158; Steven L. Schwarcz & Joanna Benjamin, 'Intermediary Risk in the Indirect Holding System for Securities' (2002) 12 Duke Journal of Comparative & International Law 309, 310; Christophe Bernasconi & Harry C. Sigman, 'The Hague Convention on Securities' (2006) 6 Anuario Espanol de Derecho Internacional Privado 1191, 1192.

⁹ Joanna Benjamin, 'Cross-Border Electronic Transfers in the Securities Markets' (2001) The International Lawyer 31, 35.

¹⁰ Sandrine Kablan (*supra* n 5) 41. This is also the case at the global level. See Richard Potok, 'Legal Certainty for Securities Held as Collateral' (1999) 18 International Financial Law Review 12, 12–13; Dorothee Einsele (*supra* n 5) 125–132; Joanna Benjamin, Madeleine Yates & Gerald Montagu (*supra* n 6) 39; Thomas J. Werlen, 'The Present and Future of the Use of Collateral in International Financial Transactions, with a Particular Focus on Switzerland' (2002) Rapports suisses présentés au XVI^{ème} Congrès international de droit comparé 2029.

¹¹ Ulrich Drobniç & Ole Böger, *Proprietary Security in Movable Assets* (Sellier European Law Publishers, München 2015) 205.

¹² See for instance the annual Margin Survey by the International Swaps and Derivatives Association (hereinafter referred to as ISDA; formerly the International Swap Dealers Association) and the European Repo Market Surveys, carried out at the request of the European Repo Council of the International Capital Market Association (hereinafter re-

quently, the functioning of entire financial markets in the OHADA region completely depends upon the existence of efficient means for providing security in the form of financial collateral.

However, in most jurisdictions in the OHADA region, the rules determining the law governing certain rights in respect of intermediated securities have not been updated to deal with the new conflict of laws problems created by these new forms of investment property.¹³ *Faute de mieux*, courts in all the OHADA Member States apply the *lex rei sitae* (or *lex cartae sitae*)¹⁴ rule to questions of title over securities as an extension of the choice of law rule for tangible movables.¹⁵ This rule operates satisfactorily in a direct holding system in which the

ferred to as ICMA). See also Gulenay Rusen, 'Financial Collateral Arrangements' (2007) 2 *Journal of International Commercial Law and Technology* 250, 250–251.

¹³ See also Jürgen Basedow, 'The Effects of Globalization on Private International Law' in Jürgen Basedow & Toshiyuki Kono (eds), *Legal Aspects of Globalization: Conflict of Laws, Internet, Capital Markets and Insolvency in a Global Economy* (Kluwer Law International, The Hague 2000) 6, who foresaw the sharp rise in the number of legal conflicts bearing transborder elements as a consequence of globalisation and the increased interconnectedness of individuals, societies, and economies.

¹⁴ *Lex rei sitae* is a latin phrase which means "the law where the property is situated". This rule can be traced back to the work of the *statutists*, in particular to Aldricus (late twelfth/early thirteenth century) and, more particularly, to Bartolus (thirteenth/fourteenth century). Savigny confirmed the principle later, in the nineteenth century (Friedrich Carl von Savigny, *System des heutigen römischen Rechts* (Band 8, 1840) 169). Under that rule, the validity and the enforceability of the pledge is governed by the law of the place where the security is located (see part II, chapter 1 of this study). See also Thomas Rauscher, *Internationales Privatrecht: mit internationalem und europäischem Verfahrensrecht* (3rd edition, C.F. Müller GmbH, Heidelberg 2009) s 541; Eric Dirix, 'Belgium' in Harry C. Sigman & Eva-Maria Kieninger (eds), *Cross-Border Security over Tangibles* (Sellier, München 2007) 240; Bernard Audit & Louis d'Avout, *Droit international privé* (7th edition, Economica, Paris 2013) s 740; Alexander von Ziegler et al (eds), *Transfer of Ownership in International Trade* (2nd edition, Kluwer Law International B.V., Alphen aan den Rijn 2011) 121. Under German law, this rule has been codified since 1999 in Article 43(1) EGBGB (*Gesetz zum Internationalen Privatrecht für außervertragliche Schuldverhältnisse und für Sachen* of 21 May 1999 (BGBl, 1999 I, 1026); however, this rule was already recognised before 1999 (BGH 20 March 1963 – VIII ZR 130/61, BGHZ 39, 173 (174); BGH 28 September 1994 – VI ZR 95/93, NJW 1995, 58 (59); BGH 9 May 1996 – IX ZR 244/95, NJW 1996, 2233 (2234)). For details regarding the *lex rei sitae* rule under German law specifically, see Arnd Goldt, *Sachenrechtliche Fragen des grenzüberschreitenden Versandkaufs aus international-privatrechtlicher Sicht* (Duncker & Humblot, Berlin 2002) 27, 58 et seq; Ingo Scholz, *Das Problem der autonomen Auslegung des EuGVÜ* (Mohr Siebeck, Tübingen 1998) 3; Cordula Thoms, *Einzelstatut bricht Gesamtstatut: zur Auslegung der „besonderen Vorschriften“ in Art. 3 Abs. 3 EGBGB* (Mohr Siebeck, Tübingen 1996) 35–36.

¹⁵ For instance, under the law of the Democratic Republic of the Congo, see Article 9 of the Decree of 4 May 1895; under the law of Gabon, see Article 44 of the Civil Code (*Journal Officiel de la République gabonaise*, September 1995); under the law of Burkina Faso, see Articles 1002 and 1003 of the *Loi du 13 du 16 novembre 1989 portant institution*

investor has a direct relationship with the issuer and ownership of the securities can be established by verifying the issuer's records (in case of registrable securities) or by ascertaining the availability of the certificate (in case of bearer securities). However, in the modern, indirect holding system, neither the location of certificates, nor the issuer's records, nor the jurisdiction of incorporation identify the investor as a member of the company or as the holder of the intermediated securities.¹⁶ Therefore, the *lex rei sitae* rule is not a suitable connecting factor for issues in respect of intermediated securities. Since the conflict of laws rule applied in the OHADA region is not adapted to the indirect holding system, a collateral taker may incur a significant legal risk since the adjudicating forum may select an unexpected legal regime by which to judge the validity of the collateral interest in the intermediated securities. Yet safe and efficient markets require that those dealing with intermediated securities be able to determine, in advance and with certainty, which law will govern their interests in those securities in case there is a dispute.

Against this background, this thesis aims at finding clear and efficient conflict of laws rules for the determination of the law governing proprietary rights in respect of security interests in intermediated securities under OHADA law. To do so, this study adopts a three-part structure. The basic approach adopted by this study is to ensure that any conflict of laws rules suggested for the OHADA region will be in line with the substantive rules governing the indirect holding system in general and with security interests in intermediated securities in particular.¹⁷ Therefore, in the first two parts this study sets out the structure of the indirect holding system in the OHADA region and the substantive rules on the collateralisation of intermediated securities. The delineation of the substantive rules related to security interests in intermediated securities in the second part, though brief, provides a foundation to inform the discussion of conflict of laws issues in respect of the collateralisation of intermediated securities under OHADA law, which is this study's *pièce de résistance*.

The first part explains the OHADA region's intermediated system. It first examines the history, mission, institutions, and instruments of OHADA (chap-

et application d'un code des personnes et de la famille. See also Article 46(1) of the *Código Civil* under the law of Guinea Bissau. In comparison with commonwealth Africa, see Richard Frimpong Oppong, *Private International Law in Commonwealth Africa* (Cambridge University Press, New York 2013) 255 et seq.

¹⁶ Richard Potok, Guy Morton & Antoine Maffei, 'The Legal Regime of Securities: The Need for a New Deal in Securities Law' (2003) *Business Law International* 226, 227; Bradley Crawford (*supra* n 8) 161; James Steven Rogers, 'Conflict of Laws for Transactions in Securities Held Through Intermediaries' (2006) 39 *Cornell International Law Journal* 285, 286.

¹⁷ For a similar approach, see Jens Haubold, 'RIMA – Kollisionsregel mit materiell-rechtlichem Kern' (2005) 9 *RIW* 2005 656.

ter 1). Furthermore, it describes and examines the shift from a direct to an indirect holding system which has occurred in the OHADA region over the last few decades. Moreover, it analyses the basic structure and the key features of the indirect holding system which now exists in the OHADA region and compares it to that of other jurisdictions (chapter 2). The second part is broader in scope. Following a functional approach,¹⁸ it compares and explores the national, regional, and international substantive law rules regarding the collateralisation of intermediated securities. More specifically, it examines how security interests in intermediated securities are taken, perfected, and realised under the OHADA Uniform Act on Security Interests and the Uniform Act on Commercial Companies (chapter 1); under Chapter V of the Geneva Securities Convention (chapter 2); under the Settlement Finality Directive¹⁹ and the Financial Collateral Directive²⁰ in EU law (chapter 3); and under the Uniform Commercial Code in jurisdictions in the United States (chapter 4).

The third part, which is the focal point of this thesis, addresses the conflict of laws issues in respect of the law applicable to security interests in interme-

¹⁸ At the Paris Congress of 1900, *Lambert* and *Salleiles* defined comparative law as the discovery of concepts and principles common to all civilised legal systems (Édouard Lambert, 'Conception générale et définition de la science du droit comparé' (1905) Procès-verbaux des séances et documents, Congrès international de droit comparé I 26). However, in the 1920s, this formalist, universalist approach to comparative law was gradually replaced by the functionalist approach, which was first introduced by Ernst Rabel (Zentaro Kitagawa, 'Development of Comparative Law in East Asia' in Mathias Reimann & Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (Oxford University Press, New York 2006) 34). In lieu of the rules themselves, this approach chooses as its starting point the concrete social problems that the rules then help to resolve. Since the second half of the twentieth century, the functionalist approach has become the prevailing theory and the mantra of contemporary comparative law (for instance, in Germany, see Hein Kötz, 'Comparative Law in Germany Today' (1999) 51 *Revue internationale de droit comparé* 753, 755 et seq; in the United States, see Mathias Reimann, 'The Progress and Failure of Comparative Law in the Second Half of the Twentieth Century' (2003) 50 *American Journal of Comparative Law* 671, 679 et seq; John Reitz, 'How to do Comparative Law' (1998) 46 *American Journal of Comparative Law* 617, 620–623; in France, see Marc Ancel, 'Le problème de la comparabilité et la méthode fonctionnelle en droit comparé' in Ronald H. Graveson et al (eds), *Festschrift für Imre Zajtay* (Mohr Siebeck, Tübingen 1982) 1–6; in Italy, see Pier Giuseppe Monateri, 'Critique et différence: Le droit comparé en Italie' (1999) 51 *Revue internationale de droit comparé* 989, 991 f; for a more critical analysis of this approach, see Ralf Michaels, 'The Functional Method of Comparative Law' in Mathias Reimann & Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (Oxford University Press, New York 2006) 339).

¹⁹ Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems (OJ L 166, 11.6.1998, p. 45–50).

²⁰ Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements (OJ L 168, 27.6.2002, p. 43–50).

diated securities. First, it establishes that the traditional *lex rei sitae* rule, which is applied in all the OHADA Member States, is no longer suited to the intermediated system (chapter 1). In search of viable conflict of laws rules, this thesis further examines the place of the relevant intermediary approach²¹ (hereinafter referred to as PRIMA) under European law (chapter 2), the choice of law provisions under the Uniform Commercial Code (chapter 3), and the Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary²² (hereinafter referred to as the Hague Securities Convention). The third part also examines alternative conflict of laws rules and connecting factors such as the so-called “substantive law solution” or the law of the system and explores whether the applicable law can be the law the collateral taker and the collateral provider chose to govern the proprietary aspects of their collateral agreement (chapter 5). Lastly, chapter 6 compares the choice of law treatment of all the aforementioned conflict of

²¹ Under the PRIMA rule, the law that is applicable to certain questions in respect of book-entry securities is determined by the place of the most relevant intermediary (or rather, by the place of the securities account). Under EU law, this rule is enshrined in Article 9(1) of the Settlement Finality Directive, Article 9(1) of the Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on Financial Collateral Arrangements (OJ L 168, 27 June 2002, 43–50, hereinafter referred to as the Financial Collateral Directive), and Article 24 of the Directive 2001/24/EC of the European Parliament and of the Council of 4 April 2001 on the Reorganisation and Winding up of Credit Institutions (OJ L 125, 5 May 2001, 15–23, hereinafter referred to as the Winding-up Directive). This rule is further analysed in part II, chapter 2 of this thesis.

²² The text of the Convention is available at <<https://www.hcch.net/en/instruments/conventions/full-text/?cid=72>> (accessed 4 January 2021). The Hague Securities Convention was developed under the auspices of the Hague Conference on Private International Law (hereinafter referred to as the Hague Conference), which is an intergovernmental organisation which was created in 1955 by an agreement among its original sixteen member nations and which aims “to work for the progressive unification of the rules of private international law.” For more details on the Hague Conference, see Hans Van Loon, ‘Globalisation and the Hague Conference on Private International Law’ (2000) 2 *International Law Forum du droit international* 230; Fernando Paulino Pereira, ‘Les ponts entre la Conférence de La Haye de Droit International Privé et les instruments conclus dans le cadre de l’Union Européenne’ in Joaquim Joan Forner i Delaygua, Cristina González Beilfuss & Ramón Viñas Farré (eds), *Entre Bruselas Y La Haya – Estudios sobre la unificación internacional y regional del Derecho internacional privado – Liber amicorum Alegría Borrás* (Marcial Pons, Ediciones Jurídicas y Sociales, Madrid 2013) 697; Andreas Bucher, ‘La Conférence de la Haye sans Convention’ in Joaquim Joan Forner i Delaygua, Cristina González Beilfuss & Ramón Viñas Farré (eds), *Entre Bruselas Y La Haya – Estudios sobre la unificación internacional y regional del Derecho internacional privado – Liber amicorum Alegría Borrás* (Marcial Pons, Ediciones Jurídicas y Sociales, Madrid 2013) 277 et seq; Christophe Bernasconi, ‘Some Observations from the Hague Conference on Private International Law’ (2007) 101 *American Society of International Law Proceedings* 350.

laws rules in different variations and fact patterns from an OHADA perspective. Overall, part III of this study intends to validate that any criterion for determining the governing law should not rely on the attribution of a “location” to an intermediary, a securities account, or an office where a securities account is maintained. Therefore, it rejects the *lex rei sitae* rule, the “look-through” approach,²³ and the PRIMA rule. Instead, it submits that the OHADA region should retain a connecting factor (or a system of connecting factors) which focuses on the *relationship between the account holder and the relevant intermediary* in respect of a particular securities account.

It is important to highlight that this study is confined to *collateral transactions* in respect of intermediated securities in the OHADA region. Therefore, it does not address other issues, such as the nature of the investor’s interests in intermediated securities, methods of transfer, insolvency law, the creation and issue of the underlying securities, the rights and duties of the issuer as against the direct holders of such securities and third parties, or upper-tier attachment.²⁴ Furthermore, this study does not address questions in respect of the law applicable to *contractual* aspects of collateral transactions in intermediated securities. Indeed, a collateral transaction always has two components: the *contractual* element, which addresses the parties’ obligations under the transaction, and the *proprietary* element, which deals with the transfer of rights in the property.²⁵ This study discusses only the identification of the appropriate law to govern the *proprietary* aspects of a collateral transaction in intermediated securities. More particular, it focuses on the law governing: (i) the creation, perfection, and enforcement of pledges of intermediated securities and (ii) issues of priority between competing security interests in intermediated securities.

Moreover, cross-border collateralisation of intermediated securities involves three questions of private international law: (i) Which court is competent to hear the case (a question of international direct jurisdiction?) (ii) Which

²³ The difficulty generated by the application of the *lex rei sitae* rule to the intermediary system is that it requires an approach that “looks through” the different tiers of intermediaries up to the level of the issuer or register (*see* part II, chapter 1, section B, subsection II of this thesis).

²⁴ This issue arises when a person with an interest lower in the chain of holdings seeks to attach or otherwise claim an interest in securities held at a higher level where there is no record of that person’s entitlement (*see* Article 22 of the Geneva Securities Convention).

²⁵ Randall D. Guynn & Nancy J. Marchand, ‘Transfer of Pledge of Securities held through Depositories’ in Hans van Houtte (ed), *The Law of Cross-Border Securities Transactions* (London, Sweet & Maxwell 1999) 57. On the concept of *Wertpapierstatut* under German law, *see* RG 27.4.1895, JW 1895, 302 et seq; 10.3.1934, IPRspr 1934 n° 11; BGH 26.9.1989, BGHZ 108, 353, 356 = 1989 n° 59; OLG Düsseldorf 30.7.2003, NJOZ 2004, 1213, 1215 = IPRspr 2003 n° 53; Regierungsbegründung zu § 17a DepotG, BT-Drucks. 14/1539 of 17.9.1999, 15.

law governs the issue before the court (a question of governing law)? and (iii) What is the effect of a judgment rendered by the court (a question of recognition and enforcement of the judgment of a foreign court)?²⁶ However, this study discusses *only* the second issue, meaning the *conflict of laws* questions. It does not address questions regarding international jurisdiction or the recognition and enforcement of foreign judgments in respect of security interests in intermediated securities.²⁷

²⁶ It is worth noting that in Article 3(1) of the *Introductory Act to BGB* (EGBGB) under German law, the term “private international law” (*internationales Privatrecht*) has a narrow meaning, referring to the law determining the law governing a case (*Sachverhalt*) containing a foreign element: “The applicable law is determined by the provision of this Chapter, if the facts of a case [*Sachverhalt*] are connected with a foreign country.” See Jan Kropholler, *Internationales Privatrecht* (6th edition, Mohr Siebeck, Tübingen 2006) 103; Christoph Teichmann, ‘The Law Applicable to the European Private International Company’ in Hirte Heribert & Christoph Teichmann, *The European Private Company – Societas Privata Europaea (SPE)* (De Gruyter, 2013) 72.

²⁷ The limited scope of this study does not mean, however, that there is no legal uncertainty as to the determination of the law governing the contractual aspects of cross-border transactions in intermediated securities. Similarly, there are issues regarding international jurisdiction as well as recognition and the enforcement of foreign judgments in respect of cross-border transactions in intermediated securities in the OHADA region. For a discussion of these issues, see Justin Monsenepwo, ‘Apport des instruments de la Conférence de La Haye au droit des affaires dans l’espace OHADA’ (2016) 5 *Schriftenreihe Junges Afrikazentrum* 1, 12 et seq.

Part I

The Intermediary System in the OHADA Region

Chapter 1: The Organisation for the Harmonisation of Business Law in Africa

A. *Historical Perspective*

OHADA traces its origin to 1991, when the ministers of finance of the Franc Zone¹ met in Ouagadougou to assess the feasibility of a project aiming at attracting foreign investors through the harmonisation of business law in Africa.² They reached the conclusion that the situation as it existed at that time was one of judicial and legal uncertainty. They also voiced their aware-

¹ The “CFA franc zone” or “the Franc Zone” consists of fourteen countries in sub-Saharan Africa, each affiliated with one of two monetary unions. On the one hand, Benin, Burkina Faso, Côte d’Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo are members of the West African Economic and Monetary Union (hereinafter referred to as WAEMU), which was founded in 1994 based on the West African Monetary Union created in 1973. On the other hand, Cameroon, Central African Republic, Chad, Republic of Congo, Equatorial Guinea, and Gabon belong to the Central African Economic and Monetary Union (hereinafter referred to as CAEMC). Both WAEMU and CAEMC maintain the same currency, called the CFA franc, which stands for *Coopération Financière en Afrique Centrale* (Financial Cooperation in Central Africa) within CAEMC and *Communauté Financière Africaine* (African Financial Community) within WAEMU. Except for Guinea-Bissau (which was colonised by Portugal) and Equatorial Guinea (which was colonised by Spain), all the above-mentioned countries are former French colonies. For more details on the historical origins and the current institutional setting of the CFA Franc Zone, see Hubert Gérardin, *La Zone Franc: Tome 1, Histoire et Institutions* (L’Harmattan, Paris 2000) 23 et seq; Anne-Marie Gulde & Charalambos Tsangarides (eds), *The CFA Franc Zone: Common Currency, Uncommon Challenges* (International Monetary Fund Book, Washington 2008); David Fielding, *The Macroeconomics of Monetary Union: An Analysis of the CFA Franc Zone* (Routledge, London 2005); Sylvanus B. Agbahey, *Globalisierung der Finanzmärkte und Finanzkrisen: Erfahrungen mit den Emerging Markets – dargestellt am Beispiel der Westafrikanischen Wirtschafts- und Währungsunion* (LIT, Münster 2006); Heike Michelsen, *Auswirkungen der Währungsunion auf den Strukturanpassungsprozess der Länder der afrikanischen Franc-Zone (Development Economics and Policy)* (Peter Lang, Bern 1995). For a more critical analysis of the CFA franc, see Kako Nubupko, *Sortir l’Afrique de la servitude monétaire: A qui profite le franc CFA?* (La Dispute, Paris 2016).

² Martin Kirsch, ‘Historique de l’Organisation pour l’harmonisation du droit des affaires en Afrique’ (1998) 827 *Penant*: revue trimestrielle de droit africain 129, 129–130.

ness that the lack of legal and judicial predictability in Africa was hardly conducive to investment. In October 1991, a subsequent meeting of the ministers of finance of the Franc Zone was held in Paris. During that meeting, a High-Level Mission³ was established to assess the feasibility of creating a harmonised business law regime in Africa.

From March to September 1992, the members of the High-Level Mission travelled to countries within the Franc Zone to collect recommendations from government officials as well as legal and business practitioners. These recommendations indicated that the investment and business environment within the Franc Zone suffered from legal and judicial insecurity. Indeed, except for states such as Senegal,⁴ Mali,⁵ Guinea,⁶ and Niger,⁷ many countries within the Franc Zone were still applying the French legislation bequeathed to them during the colonisation.⁸ This legislation included the French *Code Napoléon* (dating from 1804) and the *Code de commerce* (dating from 1807) as well as laws in respect of *sociétés anonymes* (24 July 1867) and *sociétés à responsabilité limitée* (dating from 7 March 1925). These rules inherited from the colonisation were never adapted to suit the African countries' economic fabric. Consequently, they were prejudicial to the establishment and growth of business.⁹ Moreover,

³ The High-Level Mission was composed of seven members and chaired by Keba M'Baye, former president of the Supreme Court of Senegal, former vice-president of the International Court of Justice, and former president of the Constitutional Court of Senegal.

⁴ Between 1963 and 1985, Senegal drafted and adopted a new *Code des obligations civiles et commerciales* with 1,561 articles governing the general theory of obligations, special contracts, security interests, bankruptcy, and companies.

⁵ In 1986, Mali adopted a new *Code de commerce* with 1,174 articles governing traders, the *fonds de commerce*, commercial leases, commercial sales agreements, commercial contracts, and commercial intermediaries.

⁶ In 1992, Guinea adopted a new *Code des activités économiques* with 1,606 articles governing the status of traders, companies, and bankruptcy.

⁷ In 1992, Niger adopted a new *Code de commerce* with 508 articles applying to the status of traders, commercial companies, and commercial intermediaries.

⁸ Some authors even consider the "legal legacy" of France in its former colonies to be one of the "benefits of the colonisation" ("bienfaits de la colonisation"). See Michel Guy, *Bâtisseurs d'empire* (Edition du Loisir, Paris 1940) 6; Edmond Jouve, 'La jurisfrancité et l'émergence d'une francophonie politique' (1999) Actes de la 18^{ème} biennale de la langue française held in Ouagadougou 1999, Actes XVI, 120; Jacques Vanderlinden, *Les systèmes juridiques africains* (P.U.F., Paris 1983) 44 et seq. However, the influence of French law on OHADA law is, still significant. See Claudia Inès Feviliye-Dawey, '50 ans d'indépendance juridique de la République du Congo' (2010) *Revue congolaise de droit et des affaires* 1, 15; Abdulmumini Oba, 'The Future of Customary Law in Africa' in Jeanmarie Fenrich, Paolo Galizzi & Tracy E. Higgins (eds), *The Future of African Customary Law* (Cambridge University Press, Cambridge 2011) 58.

⁹ Peter Winship, 'Law and Development in West and Central Africa (OHADA)' (2016) 272 *SMU Dedman School of Law Legal Studies Research Paper* 1, 3; Martin Kirsch (*supra* n 2) 130.

the wide disparity between these countries' codes, regulations, rules, and international instruments in respect of business law constituted a formidable barrier to local and foreign investments. In addition to these disparities, the inadequate training judges and other legal officers had been receiving in business law was another subject of concern. In light of the above, the High-Level Mission considered it important to establish an authority to develop and adopt new rules, a common court to apply them, a centre for the training of judges as well as other legal officers, and a streamlined administrative organ for the coordination of these operations.¹⁰ In other words, a new organisation had to be created.

The High-Level Mission submitted a report on the feasibility of the harmonisation project during the meeting of the ministers of finance of the CFA Franc Zone on 17 September 1992. On 5 and 6 October 1992, during the *Conférence des chefs d'Etat et des délégations de France et d'Afrique* (the Conference of Heads of States of France and Africa, hereinafter after referred to as the Conference) held in Libreville, the president of the Republic of Senegal presented the project of harmonisation of business law in Africa to the African heads of state and to the French delegation. The Conference endorsed the proposal and called for its prompt implementation by the justice and finance ministers of the Franc Zone.¹¹ The project aimed to provide each state with clear, modern business law rules as well as to facilitate cross-border transactions and regional economic integration.¹²

For the implementation of the harmonisation project, the Conference established a *Directoire* composed of Keba M'Baye, Martin Kirsch, and Michel Gentot.¹³ Based on its mandate, the *Directoire* assessed the possible merits of harmonising the following areas: corporate law, commercial law, transportation law, insolvency law, the law of security interests, enforcement proceedings, competition law, arbitration law, and labour law. The *Directoire* then established a comprehensive inventory of legislation in all the States within the Franc Zone and set up a commission of experts to determine the most effective formulation for the harmonised legal texts.¹⁴

¹⁰ Boris Martor et al, *Business Law in Africa: OHADA and the Harmonisation Process* (Eversheds, London 2002) 4–5.

¹¹ “[...] [O]nt approuvé le projet d’harmonisation du droit des affaires conçu par les ministres des Finances de la zone franc, désiré de sa mise en œuvre immédiate et demandé aux ministres des Finances et de la Justice de tous les pays intéressés d’en faire un priorité.” In English, it reads: “[...] [E]ndorsed the project for harmonisation of business law devised by the Franc Zone finance ministers, called for its immediate implementation, and asked the finance and justice ministers of all the countries concerned to make it a priority”.

¹² Martin Kirsch (*supra* n 2) 131.

¹³ Martin Kirsch was honorary Justice of the French Cour de cassation. Michel Gentot was President of the litigation section of the French Conseil d’Etat.

¹⁴ Martin Kirsch (*supra* n 2) 131.

On 18 and 19 December 1992, the ministers of justice of the Franc Zone held a meeting to identify priorities for implementing the harmonisation project. This, the Dakar Meeting, identified three main priorities:

- (i) The elaboration of a treaty on the harmonisation of business law;
- (ii) The determination of the legal areas which would be harmonised; and
- (iii) The design of the institutional frame of the organisation.¹⁵

On 19 and 20 April 1993, the heads of state and nearly four hundred business and legal professionals gathered in Abidjan for a workshop on the harmonisation of business law (*Séminaire sur l'harmonisation du droit des affaires*). During the colloquium, the Member States of the Franc Zone approved the methodology of the *Directoire*.¹⁶ The discussions and the conclusions allowed the *Directoire* to finalise a preliminary draft of the treaty. From 7 to 8 July 1993, the justice ministers of the Franc Zone held a meeting in Libreville to examine and improve an instrument called the Preliminary Draft of the Treaty on the Harmonisation of Business Law in Africa (hereinafter referred to as the Preliminary Draft of the OHADA Treaty). Besides a preamble, the Preliminary Draft of the OHADA Treaty encompassed general provisions as well as provisions on the Uniform Acts, on litigation in respect of their interpretation and the implementation, on arbitration, and on the organisation's institutions.¹⁷

On 21 and 22 September 1993, the ministers of justice and finance of the Franc Zone met in Abidjan and adopted the finalised version of the treaty. On 17 October 1993, the Treaty on the Harmonisation of Business Law in Africa¹⁸ (hereinafter referred to as the OHADA Treaty) was signed in Port-Louis, Mauritius, by fourteen African countries: Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Congo, Côte d'Ivoire, Equatorial Guinea, Gabon, Mali, Niger, Senegal, and Togo.¹⁹ According to Article 52 of the OHADA Treaty, these States had to ratify the OHADA Treaty in line with

¹⁵ Joseph Issa-Sayegh & Jacqueline Lohoues-Oble, *Harmonisation du droit des affaires* (Bruylant, Brussels 2002) s 204.

¹⁶ Martin Kirsch (*supra* n 2) 132.

¹⁷ Joseph Issa-Sayegh & Jacqueline Lohoues-Oble (*supra* n 15) s 206.

¹⁸ Treaty on the Harmonisation in Africa of Business Law, signed in Port Louis on 17 October 1993, 4 J.O. OHADA n° 4, 1 November 1997, 1 et seq, available at <<http://www.ohada.com/traite/10/treaty-on-the-harmonisation-of-business-law-in-africa.html>> (accessed 4 January 2021). The OHADA Treaty was revised in Quebec on 17 October 2008 (available at <<http://www.ohada.com/traite/937/treaty-on-the-harmonization-in-africa-of-business-law-signed-in-port-louis-on-17-october-1993-as-revised-in-quebec-on-17-october-2008.html>> (accessed 4 January 2021)).

¹⁹ All these states are French-speaking countries except for Cameroon (which is bilingual: English and French), Equatorial-Guinea (which is also bilingual: Spanish and French), and Guinea-Bissau (whose official language is Portuguese).

their internal constitutional rules.²⁰ In most of these States, however, the issue of Member State sovereignty was at the centre of the ratification process of the OHADA Treaty.²¹ On 18 September 1995, the OHADA Treaty came into force after Niger deposited the seventh instrument of ratification on 5 June 1995 (Article 52 of the OHADA Treaty).²² Subsequently, Guinea Bissau, Guinea Conakry, and the Democratic Republic of Congo joined the organisation, bringing the total number of members to seventeen.²³ The following table summarises the chronological order of ratification and entry into force of the OHADA Treaty for each Member State.

Table 1: Chronological Table of the Ratifications of the OHADA Treaty

Member States	Ratification	Deposit of the instrument of ratification	Entry into force
Guinea-Bissau	15 January 1994	26 December 1995	20 February 1996
Senegal	14 June 1994	14 June 1994	18 September 1995
Central African Republic	13 January 1995	13 January 1995	18 September 1995
Mali	7 February 1995	23 March 1995	18 September 1995
Comoros	20 February 1995	10 April 1995	18 September 1995
Burkina Faso	6 March 1995	16 April 1995	18 September 1995
Benin	8 March 1995	10 March 1995	18 September 1995
Niger	5 June 1995	18 July 1995	18 September 1995
Côte d'Ivoire	29 September 1995	13 December 1995	11 February 1996
Cameroon	20 October 1995	4 October 1996	3 December 1996

²⁰ For instance, Côte d'Ivoire ratified the OHADA Treaty through Decree n° 95-674 of 7 September 1995, J.O.R.C.I. n° 52 of 9 December 1997, 13. Guinea-Conakry ratified the OHADA Treaty via Act n° 2000-8 of 5 May 2000.

²¹ See Gaston Kenfack Douajni, 'L'abandon de souveraineté dans le Traité OHADA' (1999) 830 *Penant: revue trimestrielle de droit africain* 125; Jean-Pierre Raynal, 'Intégration et souveraineté: le problème de la constitutionnalité du Traité OHADA' (2000) *Penant: revue trimestrielle de droit africain* 5.

²² It is worth noting that under Article 57 of the OHADA Treaty, Senegal is the depositary state of OHADA.

²³ As of January 2021, here is the chronological order in which the OHADA Treaty was ratified by the seventeen Member States: 1) Senegal, 14 June 1994; 2) Central African Republic, 13 January 1995; 3) Mali, 23 March 1995; 4) Comoros, 10 April 1995; 5) Burkina Faso, 16 April 1995; 6) Niger, 18 July 1995; 7) Guinea-Bissau, 6 September 1995; 8) Togo, 20 November 1995; 9) Côte d'Ivoire, 13 December 1995; 10) Benin, 30 April 1996; 11) Chad, 3 May 1996; 12) Cameroon, 4 October 1996; Gabon, 2 February 1998; 14) Republic of Congo, 28 May 1999; 15) Equatorial Guinea, 15 June 1999; 16) Guinea Conakry, 5 May 2000.; and 17) Democratic Republic of the Congo, 27 June 2012.

Member States	Ratification	Deposit of the instrument of ratification	Entry into force
Togo	27 October 1995	20 November 1995	19 January 1996
Chad	13 April 1996	3 May 1996	2 July 1996
Republic of Congo	28 May 1997	18 May 1999	17 July 1999
Gabon	2 February 1998	4 February 1998	5 April 1998
Equatorial Guinea	16 April 1999	15 June 1999	13 August 1999
Guinea	5 May 2000	22 September 2000	21 November 2000
Democratic Republic of Congo	27 June 2012	13 July 2012	12 September 2012

On 17 October 2008, the OHADA Treaty was revised in Quebec. The main innovations in the revised Treaty concern: (i) the creation of a new institution, the Conference of Heads of State and Government, whose role will be to decide “on any question relating to the Treaty”²⁴; (ii) three new OHADA working languages in addition to French, namely English, Spanish, and Portuguese; and (iii) an expansion of the *Cour Commune de Justice et d’Arbitrage* (hereinafter referred to as CCJA) from seven judges to nine.²⁵

B. Purpose of OHADA

I. Contribution to Regional Integration in Africa

The mission of OHADA is stated in the preamble of the OHADA Treaty. With the creation of OHADA, the Contracting States²⁶ intended to accomplish new progress on the path towards African unity. Indeed, the creation of OHADA aims to reaffirm the Contracting States’ commitment to establishing an African Economic Community (hereinafter referred to as the AEC). Indeed, prior to the creation of the Organisation of African Unity (hereinafter referred to as OAU), African leaders had acknowledged cooperation and integration among African countries in the economic, social, and cultural fields as important for the sustained development of the African continent.²⁷ Since the early 1960s,

²⁴ See *infra* (subsection C.I of this chapter).

²⁵ For more details on the revision of the OHADA Treaty, see Abdoulaye Harissou, ‘Nouveau Traité OHADA: forces et faiblesses’ (2010) *Revue de Droit Uniforme Africain* 1, 2; Claudia Inès Feviliye-Dawey, ‘La révision du traité de l’OHADA’ (2009) 1 *Revue Congolaise de Droit des Affaires* 35, 36; Gaston Kenfack Douajni, ‘Les innovations du Traité OHADA révisé’ (2009) *Revue uniforme de droit africain* 5.

²⁶ The term “Contracting States” refers to the fourteen States which originally created OHADA in 1993 and which are listed in the Preamble of the OHADA Treaty.

²⁷ Richard Frimpong Oppong, *Legal Aspects of Economic Integration in Africa* (Cambridge University Press, Cambridge 2011) 6.

African states were encouraged to combine their economies into sub-regional markets which would ultimately form a single, Africa-wide economic union. In 1980, the OAU Extraordinary Summit adopted the Lagos Plan of Action²⁸ as a major step towards the goal of integration. In June 1991, the OAU Heads of State and Government gathered in Abuja (Nigeria) and signed the Treaty establishing the AEC²⁹ during the 27th Ordinary Session of the Assembly. The AEC aims at promoting African economic integration to create a framework for development and for the mobilisation of human resources and material.³⁰ As per the AEC Treaty, the AEC must be established through a gradual process³¹ to be achieved through the coordination, harmonisation, and progressive integration of the activities of existing and future regional economic communities (hereinafter referred to as RECs)³² in Africa. Therefore, the creation of OHADA aims at contributing to regional integration, which is regarded as an important factor for economic development in Africa.³³

II. *Facilitating Investments and Improving the Economies of Its Members*

There are many different considerations which come into play for the creation of a business-friendly environment. One of these is the strong correlation between the ease of starting a business and economic growth. Indeed, reduc-

²⁸ The Lagos Plan of Action is available at <<https://www.merit.unu.edu/wp-content/uploads/2015/01/Lagos-Plan-of-Action.pdf>> (accessed 4 January 2021).

²⁹ The treaty establishing the AEC (also known as the Abuja Treaty) is available at <http://www.wipo.int/edocs/trtdocs/en/aec/trt_aec.pdf> (accessed 4 January 2021). It came into force after the requisite numbers of ratification in May 1994.

³⁰ Richard Frimpong Oppong (*supra* n 27) 82–84.

³¹ More particularly, the implementation of the Abuja Treaty is to take place in six stages over thirty-four years. In the first stage, the African states had to strengthen existing RECs and create new ones where needed. The second stage focuses on the stabilisation of tariff and other barriers to regional trade and on the strengthening of sectoral integration, particularly in the fields of trade, agriculture, finance, transport, communication, industry, and energy. It is also aimed at coordinating and harmonising the activities of the RECs. In the third stage, a free trade area and a customs union are to be established at the level of each REC. The fourth stage is centred on coordinating and harmonising tariff and non-tariff systems among RECs with a view to establishing a continental customs union. The fifth stage deals with the establishment of an African common market and the adoption of common policies. Lastly, the sixth stage focuses on the integration of all sectors, the establishment of an African central bank and a single African currency, setting up an African economic and monetary union, and creating and electing the first pan-African parliament.

³² The four main RECs in Africa are the Arab Maghreb Union (hereinafter referred to as AMU), ECCAS, COMESA, SADC, and ECOWAS.

³³ Note that the preamble of the OHADA Treaty underlines that OHADA is intended to constitute a “major asset for the gradual achievement of the economic integration of the countries belonging to the Franc Zone.” However, it may be inferred from a provision in Article 53(1) of the OHADA Treaty that OHADA is open to members of the African Union.

ing the time and costs associated with starting and conducting a business constitutes an effective way to develop countries' economies.³⁴ Legal and judicial insecurity were the main impediments to foreign investment and economic development in African countries, particularly in the sub-Saharan region. Compared to most regions of the world, starting a business there has historically been more cumbersome, complicated, time-consuming, and expensive.³⁵ Therefore, the harmonisation of business law and improvement in the functioning of the Member States' judicial systems were necessary to raise foreign investors' confidence, to facilitate trade between countries, and to develop a vibrant private sector in Africa.³⁶ In this regard, OHADA aims to facilitate local and (more importantly) foreign investments via simple, modern, and attractive business regulations.³⁷

However, it is interesting to note that the term "investment" and "investors" are scarcely used in the instruments of OHADA.³⁸ Indeed, the term "investment" appears only once in the OHADA Treaty:

"The High contracting authorities to the treaty on the harmonisation of business law in Africa [...] [c]onscious of the fact that it is essential that this law be applied with diligence in such conditions so as to guarantee legal stability of economic activities and to favour expansion of the latter and to encourage *investment* [my emphasis]."

Article 1 of the OHADA Treaty, which sets the objective of OHADA, does not mention the terms "investor" or "investment". It simply provides that the

³⁴ Leah Christine Nosal & Valentina Saltane, 'Harmonization Strikes a Chord of Success: Doing Business in OHADA Economies' (2016) IFC smart lessons brief: World Bank Group, available at <<http://documents.worldbank.org/curated/en/774741467993219991/Harmonization-strikes-a-chord-of-success-doing-business-in-OHADA-economies>> (accessed 4 January 2021) 1.

³⁵ Grégoire Bakandjeja Wa Mpungu in Grégoire Bakandjeja Wa Mpungu & Bernard Remiche (eds), *D'une économie populaire à une économie fiscalisée* (Larcier, Bruxelles 2010) 16; Roger Masamba, 'L'OHADA et le climat d'investissement des affaires en Afrique' (2006) 855 *Penant*: revue trimestrielle de droit africain 137, 137–138.

³⁶ Joseph Issa-Sayegh & Jacqueline Lohoues-Oble (*supra* n 15) s 203; Claire Moore Dickerson, 'Harmonizing Business Law in Africa: OHADA Calls the Tune' (2005) 44 *Columbia Journal of Transnational Law* 17; Peter Winship (*supra* n 9) 3.

³⁷ Claire Moore Dickerson, 'A Comparative Analysis of OHADA's Uniform Business Laws in West Africa: A French Civilian Structure's Impact on Economic Development' (2005) George Washington University Law School Public Law Research Paper 119, 119–120. For an empirical evaluation of the impact of OHADA law on the economies of its Member States, see World Bank, *Doing Business dans les Etats membres de l'OHADA 2017* (Banque Internationale pour la Reconstruction et le Développement/Banque mondiale, Washington 2017) available at <<http://www.doingbusiness.org/content/dam/doingBusiness/media/Special-Reports/DB17-OHADA-French.pdf>> (accessed 4 January 2021); Abdoullah Cissé, 'L'harmonisation du droit des affaires en Afrique: L'expérience de l'OHADA à l'épreuve de sa première décennie' (2004) 2 *Revue internationale de droit économique* 197.

³⁸ The instruments of OHADA are analysed under section D of this chapter.

objective of the Treaty is the harmonisation of business laws in the Member States through the adoption and elaboration of simple, modern, common rules adapted to their economies, the setting up of appropriate judicial procedures, and the encouragement of arbitration to settle contractual disputes. As to the Uniform Acts, only the Uniform Act on Commercial Companies³⁹ uses the term “investor”, in a very broad sense, in Articles 87, 90, 91, and 832.⁴⁰ Moreover, the term “investment” is mentioned only in Article 94 of the Uniform Act on General Commercial Law⁴¹ and in Article 32 of the Uniform Act on the Organisation and Harmonisation of Accounting of Companies⁴². It should be noted that none of the aforementioned provisions uses the terms “investment” or “investor” together with the terms “foreign” or “international”. Therefore, it may be submitted that the origin of the investment or the nationality of the investor is immaterial as a criterion under OHADA law. So not only foreign but also national investment and investors are subject to OHADA law as long as they operate in the territory of an OHADA Member State.

III. Unification in lieu of Harmonisation

In light of the above, Article 1 of the OHADA Treaty provides that the objective of the Treaty is to unify the business law rules of the Member States through:

- (i) The elaboration and the adoption of simple, modern, and common business law regulations⁴³ adapted to their economies;

³⁹ Articles 87, 90, 91, and 832 of that Act regulate public offerings (*appel public à l'épargne*) and, more specifically, the information that must be delivered to “investors”. For more details on the meaning of the term “investor” in the Act, see Salifou Mouhouain, ‘Brèves réflexions à propos de l’usage du terme « investisseur » dans l’Acte uniforme OHADA portant droit des sociétés commerciales’ (2018) 4 *Revue de droit international et de droit comparé* 439.

⁴⁰ Joseph Issa-Sayegh in Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds), *OHADA: Traité et Actes Uniformes Commentés et annotés* (Juriscope, Poitiers 2014) 15.

⁴¹ *Acte uniforme portant sur le droit commercial general* (Journal Officiel n° 23, 15 February 2011, 1 et seq), which entered into force on 1 January 1998. This Uniform Act was revised on 15 May 2010.

⁴² *Acte uniforme portant organisation et harmonisation des comptabilité des entreprises* (Journal Officiel n° 10, 20 November 2000, 1 et seq), which was revised on 26 January 2017.

⁴³ Under Article 2 of the OHADA Treaty, business law regulations comprise company law, the definition and classification of legal persons engaged in trade, proceedings in respect of lending and recovery of debts, means of enforcement, bankruptcy, receiverships, and arbitration. Further, business law regulations also include employment law, accounting law, transportation sales laws, and any such other matter that the Council of Ministers would decide unanimously to include in conformity with the objective of the OHADA Treaty and with Article 8 of the Treaty.

- (ii) The creation of appropriate judicial procedures; and
- (iii) The promotion of arbitration for the settlement of contractual disputes.

It is worth noting that Article 1 of the OHADA Treaty uses the term “harmonisation” instead of “unification”. However, in light of Articles 5 and 10 of the OHADA Treaty, OHADA *unifies* (and does not merely *harmonise*) business law in Africa. Harmonisation is the process of eliminating major differences and creating minimum requirements or standards.⁴⁴ As harmonisation does not seek to create a sole authority on the law of a specific subject, it is usually relatively partial and not comprehensive. Conversely, unification aims at achieving unity in substance and detail; it focuses on substituting for or combining two or more legal systems and replacing them with a single system.⁴⁵ Under Article 10 of the OHADA Treaty (in conjunction with Articles 1, 2, and 5 of the same Treaty), Uniform Acts are directly applicable and binding in the Member States notwithstanding any conflict they may give rise to in respect of previous or subsequent enactments of domestic provisions. Therefore, as mentioned *infra*,⁴⁶ the Uniform Acts supersede the previous and subsequent national provisions on the same topic in all the Member States. Only provisions which do not conflict with the Uniform Acts are spared from the overriding effect of OHADA law.⁴⁷ Therefore, OHADA aims at *unifying* and not simply at harmonising business law in Africa.

C. OHADA's Institutional Framework

OHADA has five institutions: (i) the Conference of Heads of State and Government (*Conférence des Chefs d'Etat et de Gouvernement*),⁴⁸ (ii) the Council of Ministers (*Conseil des Ministres*),⁴⁹ (iii) the Permanent Secretariat (*Secrétariat Permanent*),⁵⁰ (iv) the CCJA,⁵¹ and (v) the Regional School for Magis-

⁴⁴ See Christoph Teichmann, *Binnenmarktkonformes Gesellschaftsrecht* (De Gruyter Recht, Berlin 2006) 188; Martin Franzen, *Privatrechtangleichung durch die Europäische Gemeinschaft* (De Gruyter, Berlin 1999) 70 et seq; Winfried Schmeder, *Die Rechtsangleichung als Integrationsmittel der Europäischen Gemeinschaft* (Heymann, Köln 1978) 5–7.

⁴⁵ See Camilla Baasch Andersen, ‘Defining Uniformity in Law’ (2007) 5 *Revue de droit uniforme* 8; Innocent Fetze Kamdem, ‘Harmonisation, unification et uniformisation en droit des contrats: plaidoyer pour un discours affiné sur les moyens d’intégration juridique’ (2008) 3 *Uniform Law Review* 709, 710–712; Winfried Schmeder (*supra* n 44) 8.

⁴⁶ See subsection D.I.3 of this chapter.

⁴⁷ CCJA Advisory Opinion n° 001/2001/EP of 30 April 200; *Société Elf Oil Côte d’Ivoire (Total Fina Elf) v Société Cotracom* [2002] CCJA, Judgment n° 012/2002 du 18 April 2002, Juriscope.org, Ohada.com/Ohadata J-02-65; *Société Kossi v Paroisse Saint-Paul des Bois* [1999] Court of Appeal of Port-Gentil, 9 December 1999, Penant: *revue trimestrielle de droit africain* 2001 345.

⁴⁸ Article 27(1) of the OHADA Treaty.

⁴⁹ Articles 27(2) to 30 of the OHADA Treaty.

⁵⁰ Article 40 of the OHADA Treaty.

trates (*Ecole Régionale Supérieure de la Magistrature*, hereinafter referred to as ERSUMA).⁵²

I. *The Conference of Heads of State and Government*

The Conference of Heads of State and Government is an institution that was added by the 2008 revision of the OHADA Treaty (Article 27(1) of the OHADA Treaty). It is composed of heads of state and government of the Member States and is chaired by the head of state or government whose country chairs the Council of Ministers.⁵³ The Conference of Heads of State and Government has jurisdiction over all matters in respect of the OHADA Treaty (Article 27(1) of the OHADA Treaty).⁵⁴ The decisions of the Conference of Heads of State and Government are taken by consensus. However, if consensus cannot be reached, the decisions are taken by an absolute majority of the States represented at the meeting (Article 27(1) of the OHADA Treaty).

II. *The Council of Ministers*

1. *Composition*

The Council of Ministers is composed of the ministers of justice and finance of the Member States (Article 27(2) of the OHADA Treaty). Several reasons justify this unusual composition of the OHADA Council of Ministers. First, the unification of business law encompasses both legal and economic aspects. Indeed, the elaboration of unified business law rules must take into account the fabric of the economies of the Member States. The participation of the ministers of finance beside the ministers of justice in elaborating the Uniform Acts and managing OHADA ensures on one hand that the rules will be adapted to the commercial practices and economic realities in the Member States.

On the other hand, the ministers of justice participating in the Council of Ministers guarantees that the elaboration of the Uniform Acts complies with legal norms and principles applicable in the Member States. Firstly, having the ministers of both finance and justice from each Member State sit on the

⁵¹ Articles 14 to 26, 31, and 32 of the OHADA Treaty; Rules of Procedure of the Common Court of Justice and Arbitration of 18 April 1996 (*Règlement de Procédure de la Cour Commune de Justice et d'arbitrage*), J.O. OHADA n° 4, 1 November 1997, 9 et seq); Rule n° 001/2014/Cm Amending and Supplementing the Rules of Procedure of the Common Court of Justice and Arbitration of 18 April 1996 (*Règlement n° 01/2014/CM/OHADA modifiant et complétant le règlement de procédure de la Cour Commune de Justice et d'arbitrage du 18 Avril 1996*).

⁵² Article 41 of the OHADA Treaty.

⁵³ See Article 27(2) of the OHADA Treaty.

⁵⁴ See Claudia Inès Feviliye-Dawey (*supra* n 25) 40; Joseph Issa-Sayegh in Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds) (*supra* n 40) 52.

Council of Ministers is indicative of the Member States' commitment to making OHADA technically efficient. Secondly, from a historical perspective it is important to highlight that the project of harmonisation of business law in Africa was an initiative of the finance and justice ministers of the Franc Zone. Thirdly, it is important to underscore that many sub-regional and regional organisations in Africa do not have enough funds due to a lack of (or delay in) payment of contributions by their Member States. Since the finance ministers are generally responsible within their governments for providing the funds and contributing to international organisations, their inclusion was thought to be a way to encourage payment of the financial contributions by the Member States.

2. Functioning

Under Article 27(2) of the OHADA Treaty, the presidency of the Council of Ministers is taken for a predetermined period of one year by each of the Member States in turn according to a rotation system. In principle, the rotation follows the alphabetical order of the names of the Member States. Article 27 of the OHADA Treaty does not indicate in which language the alphabetical order is to be considered; however, as French is unofficially⁵⁵ the primary working language of OHADA, the rotation follows the alphabetical order of the French names of the Member States. The exception to the alphabetic principle is that newly acceded Member States chair the Council of Ministers for the first time in the order of their accession after all previous State parties have served as chairs (Article 27(2) of the OHADA Treaty). In case a Member State is not able to chair the Council of Ministers, the Council appoints the Member State that is alphabetically next in line. Nevertheless, if the Member State which was previously unable to serve as chair considers that it is so able to serve, it may promptly request that the Council of Ministers take an appropriate decision (Article 27(2) of the OHADA Treaty). Article 27(2) of the OHADA Treaty does not determine which of a Member State's ministers – justice or finance – should chair the Council. It must be assumed therefore that the Council of Ministers is chaired by one or the other minister depending on each Member State's diplomatic practice. In practice, particularly when it comes to legal matters, the Council of Ministers is chaired by the minister of justice.

The Council of Ministers meets at least once a year. Its meetings are convened by the chair, either on his or her own initiative or at the initiative of

⁵⁵ After the OHADA Treaty was revised in 2008, the official working languages of OHADA are French, English, Spanish, and Portuguese (Article 42 of the OHADA Treaty). But under Article 42(2), documents already published in French are in full effect pending translation of the documents into other languages. If there is any discrepancy between the different translations, the French version prevails.

one-third of the Member States (Article 288 of the OHADA Treaty). The agenda of the meetings of the Council of Ministers is proposed by the permanent secretary and set by the chair of the Council of Ministers. Except for decisions regarding the adoption of the Uniform Acts, which requires unanimity under Article 8 of the OHADA Treaty, decisions of the Council of Ministers are taken by an absolute majority of the Member States which are present and voting (Article 30 of the OHADA Treaty). To uphold equality among Member States, the second sentence of Article 30 of the OHADA Treaty provides that each Member State has only one vote.

3. Duties

The Council of Ministers adopts and amends the Uniform Acts (Articles 4 and 8 of the OHADA Treaty). Moreover, it may determine the areas of business law to be unified (Article 2 of the OHADA Treaty). It is also responsible for the adoption of the budgets of the Permanent Secretariat and the CCJA (Article 45 of the OHADA Treaty). Further, it appoints auditors to be in charge of certifying the accounts for each accounting period. The Council of Ministers also approves the annual counts of the organisation and is competent for appointing the permanent secretary (Articles 40(3) of the OHADA Treaty), general director of ERSUMA (Article 41(4) of the OHADA Treaty), and the members of the CCJA (Article 31(1) of the OHADA Treaty).

III. The Permanent Secretariat

1. Organisation

Headquartered in Yaoundé, the Permanent Secretariat is the executive body of OHADA (Article 40(1) of the OHADA Treaty). It is directed by a permanent secretary appointed by the Council of Ministers to a four-year term renewable once (Article 40(1) of the OHADA Treaty). According to Article 40(2) of the OHADA Treaty, the permanent secretary appoints three directors, each of whom is responsible for one of the following tasks:

- (i) Legal affairs and relations with institutions;
- (ii) Finance and accounting; and
- (iii) General administration as well as the administration of the OHADA's official journal.

2. Duties

Pursuant to Article 40(2) of the OHADA Treaty, the permanent secretary represents OHADA and assists the Council of Ministers. He or she is mainly responsible for assessing the areas where the unification of business law is necessary and suggesting to the Council of Ministers the annual program of har-

monisation. Indeed, the list of all the areas to be harmonised in Article 2 of the OHADA Treaty is not exhaustive since the Council may, in accordance with the purpose of the Treaty, unanimously decide to include any other area. For instance, by its decision of 23 March 2001,⁵⁶ the Council of Ministers unanimously decided to include several additional areas on the list in Article 2 of the OHADA Treaty.⁵⁷ In this regard, the Permanent Secretariat may suggest areas of law to be included into the harmonisation program of OHADA.

Moreover, the permanent secretary plays an important role in the elaboration process of the Uniform Acts. Pursuant to Article 6 of the OHADA Treaty, the Permanent Secretariat, in consultation with the governments of the Contracting States, oversees the preparation of the Uniform Acts. It is also responsible for circulating draft versions of the Uniform Acts to the governments of the Member States, which then have ninety days starting on the date of receipt of such draft to submit their written comments to the Permanent Secretariat (Article 7(1) of the OHADA Treaty). Depending on the circumstances and the nature of the text to be adopted, the permanent secretary may, at his or her discretion, extend the ninety-day period provided in Article 7(1) of the OHADA Treaty to a second equivalent term (Article 7(2) of the OHADA Treaty). Upon expiration of that period, the permanent secretary drafts a report that he or she forwards to the CCJA along with the draft version of the Uniform Act and the Member States' comments. The CCJA provides its advice within sixty days starting on the date of the receipt of a request for an opinion (Article 7(3) of the OHADA Treaty). Upon expiration of the new deadline, the Permanent Secretariat completes the final draft of the Uniform Act and ensures its publication in the official journal of OHADA after its adoption by the Council of Ministers (Articles 7(4) and 9 of the OHADA Treaty).

IV. The Common Court of Justice and Arbitration (CCJA)

1. Composition

The CCJA is composed of nine judges.⁵⁸ However, considering the tasks and the resources of OHADA, the Council of Ministers may decide to set a higher number of judges (Article 31(2) of the OHADA Treaty). Under Article 31(3) of the OHADA Treaty, judges of the CCJA are elected by the Council of

⁵⁶ Decision n° 002/2001/CM Related to the Program of Harmonisation of African Business Law.

⁵⁷ These areas are banking law, intellectual property law, company law, competition law, contract law, and the law of evidence.

⁵⁸ See Article 31(1) of the OHADA Treaty; Article 1 of Rule n° 001/2014/Cm/Amending and Supplementing the Rules of Procedure of the Common Court of Justice and Arbitration of 18 April 1996.

Ministers from among the nationals of the Member States to a non-renewable term of seven years⁵⁹ and must be:

- (i) Magistrates having at least fifteen years of professional experience and satisfying their countries' criteria for service in a senior judicial position;
- (ii) Lawyers who are members of the bar of at least one Member State and have at least fifteen years of professional experience; or
- (iii) Law professors with at least fifteen years of academic experience.⁶⁰

The members of the CCJA elect a president and two vice-presidents to terms of three and one-half years. Nonetheless, this period may not exceed that of the mandate of the person concerned as a judge of the Court.⁶¹ The CCJA sits as a full court. However, it may constitute chambers composed of three or five judges and chaired by the president or one of the vice-presidents of the court.⁶² When the court is in plenary session, the number of judges composing a chamber may be set to seven.⁶³

2. Functions

The CCJA has four main functions. First, it reviews drafts of the Uniform Acts. According to Articles 6 and 7 of the OHADA Treaty, the CCJA examines drafts of the Uniform Acts for consistency with the OHADA Treaty before the Council of Ministers adopts them. Secondly, the CCJA plays the role of a centre for arbitration, not only between private parties but also between a Member State (or one of its entities) and a private entity. As such, it supervises institutional arbitration pursuant to Articles 21 to 26 of the OHADA Treaty and the Arbitration Rules of Procedure of the CCJA of 11 March 1999. The CCJA does not in itself resolve the disputes; instead it appoints or confirms the arbitrators, stays informed of the conduct of the proceedings, and reviews draft awards. Further, it rules on any disputes which may arise with respect to recognition and execution of those awards.

Thirdly, the CCJA may be consulted by any Member State, by the Council of Ministers, or by any national court on the interpretation and the uniform appli-

⁵⁹ Under Article 31(6) of the OHADA Treaty, the CCJA may not include more than one national of any Member State.

⁶⁰ Article 31(5) of the OHADA Treaty provides that one third of the members of the CCJA must be lawyers or law professors.

⁶¹ Article 6(1) and (2) of the Rule n° 001/2014/Cm/Amending and Supplementing the Rules of Procedure of the Common Court of Justice and Arbitration of 18 April 1996.

⁶² Article 9 of the Rule n° 001/2014/Cm/Amending and Supplementing the Rules of Procedure of the Common Court of Justice and Arbitration of 18 April 1996.

⁶³ Article 21 second sentence of the Rule n° 001/2014/Cm/Amending and Supplementing the Rules of Procedure of the Common Court of Justice and Arbitration of 18 April 1996.

cation of the OHADA Treaty, the Regulations, the Uniform Acts, and decisions of OHADA (Article 14(1) of the OHADA Treaty). Fourthly, the CCJA is also a court of final appeal (Article 14(3) of the OHADA Treaty). As such, it rules on decisions in civil and commercial matters that are taken by appellate courts of the Member States in all matters pertaining to the application of the Uniform Acts and the Regulations of OHADA.⁶⁴ Judgments of the CCJA are directly enforceable in all Member States as if they were judgments of a national court. In no case may a decision contrary to a judgment of the CCJA be executed upon in a territory of a Member State (Article 20 of the OHADA Treaty).

3. Challenges faced by the CCJA and Trends in the CCJA's Case Law

a) Challenges faced by the CCJA

The challenges the CCJA faces are the most significant of any faced by an OHADA institution. First, since the CCJA is located in Abidjan (Côte d'Ivoire), its operations were significantly impeded by the 2010–2011 post-election violence in Côte d'Ivoire, when the outgoing president (Laurent Gbagbo) refused to step down after losing the presidential elections. Secondly, the CCJA is understaffed while its caseload is constantly increasing. Consequently, the CCJA is faced with such a significant backlog of cases that the Council of Ministers tasked the Permanent Secretariat with finding external financial assistance and consulting with national supreme courts.⁶⁵

In this regard, it is important to recall that Article 14 of the OHADA Treaty establishes the CCJA as the *Cour de cassation* in lieu of the Member States' supreme courts on all issues related to OHADA law. In theory, such a provision appears sound as it ensures unity in the judicial interpretation and application of OHADA law and moreover circumvents national judiciaries, which are often perceived as being full of political appointees and therefore regarded with scepticism. Nevertheless, such a provision makes backlogs an unavoidable problem given the current scarcity of resources at the CCJA. It also leads to jurisdictional conflicts with domestic supreme courts.⁶⁶ In addition, the Rules of Procedure of the Common Court of Justice and Arbitration

⁶⁴ This function represents the most significant of the activities of the CCJA (Emmanuel Douglas Fotso, *OHADA: Recueil de jurisprudence de la CCJA 2015* (L'Harmattan, Paris 2019) 7; Karin Linhart, *Internationales Einheitsrecht und einheitliche Auslegung* (Mohr Siebeck, Tübingen 2005) 137.

⁶⁵ See Minutes of the meeting of the Council of Ministers of 16–17 June 2011, available at <<http://web.ohada.org/actualite-cm/fr/cm/fj/actualite/3574,compte-rendu-de-la-reunion-du-conseil-des-ministres-delohada-juin-2011.html>> (accessed 4 January 2021).

⁶⁶ See Boubacar Diarra, 'Réflexions sur les problèmes de cohabitation entre la CCJA et les juridictions nationales de cassation' (2010) *Revue de droit uniforme africain* 82; Shamsidine Akrawati Adjita, 'Les problèmes de cohabitation entre la CCJA et les cours nationales de cassation' (2010) *Revue de droit uniforme africain* 85, 87.

of 18 April 1996 (hereinafter referred to as the Rules of Procedure of the CCJA)⁶⁷ do not provide for fast-tracked proceedings or any *procédure de non-admission de pourvoi*.⁶⁸ This would have allowed the CCJA to decline to hear cases which do not raise interpretative issues that require a decision by the CCJA. Instead, Article 26 of the Rules of Procedure of the CCJA requires that when an appeal is lodged, the chief justice of the CCJA appoints a judge to follow up on case management and report to the Court.

Lastly, the exclusive jurisdiction of the CCJA as the final interpreter of OHADA law gives rise to difficulties when the case requires interpretation of both OHADA and domestic law. There is no provision in the OHADA Treaty that addresses this issue. Indeed, Article 14(3) of the OHADA Treaty provides that the CCJA rule on all decisions taken by Member State appellate courts in all matters related to applying the Uniform Acts and the Regulations, with the exception of decisions applying criminal sanctions. But if a matter brought before the CCJA requires interpretation of both domestic law (for questions of civil procedure or the law of obligations, for instance) and OHADA law (for questions regarding a Uniform Act or a Regulation), does the CCJA have jurisdiction over the entire matter? Or should the parties lodge two separate appeals: one before the CCJA regarding matters of OHADA law, and another before the national supreme court for issues related to domestic law? An examination of CCJA case law reveals that it often considers that it has jurisdiction over the entire matter.⁶⁹ However, in a case that raised issues relating both to Nigerien civil procedure and contract law and to the Uniform Act on the Law of Commercial Companies, the Supreme Court of Niger held under Article 18 of the OHADA Treaty that the CCJA's jurisdiction does not always preclude the jurisdiction of the highest national courts.⁷⁰ The Supreme Court of Niger indicated that if the case rests solely or primari-

⁶⁷ As amended by Rule n° 001/2014/CM of 30 January 2014, available at <<http://www.ohada.com/reglements/1665/reglement-n-01-2014-cm-ohada-modifiant-et-completant-le-reglement-de-procedure-de-la-cour-commune-de-justice-et-d-arbitrage-du-18-avril-1996.htm>> (accessed 4 January 2021).

⁶⁸ In comparison, see Article L. 822-1 of the French *Code de justice administrative*.

⁶⁹ See for instance *Etat Côte d'Ivoire v Ayants droit de Bamba Fétigué et Akouany Paul* [2009] CCJA Judgment n° 023/2009 of 16 April 2009, Recueil de Jurisprudence n° 13, Janvier-Juin 2009, 77. In this case which related to Articles 28, 38, 40, 336, and 337 of the Uniform Act on Simplified Procedures for Recovery and Enforcement Measures, the CCJA determined that there was a violation of Article 106 of the Ivorian Code of Civil, Commercial, and Administrative Procedure. See also *Société Côte d'Ivoire Telecom v Société Loteny Telecom* [2008] CCJA Judgment n° 009/2008 of 27 March 2008, Actualités Juridiques n° 60–61, 430, note anonyme. In this case, the CCJA interpreted Article 33 of the Uniform Act on Simplified Procedures for Recovery and Enforcement Measures in connection with Article 50 of the *Code des télécommunications* of Côte d'Ivoire.

⁷⁰ J.O. OHADA n° 2, 1 January 1997, 1 et seq. This Uniform Act was revised on 5 May 2014.

ly on the interpretation of domestic law, the national supreme court has jurisdiction to adjudicate the matter. Conversely, if the case rests solely or primarily on OHADA law, the CCJA has jurisdiction pursuant to Article 14 of the OHADA Treaty.⁷¹ However, this decision does not determine whether the CCJA or a national supreme court has jurisdiction when the adjudication rests equally on interpretations of provisions of both domestic and uniform law.

b) Geographical Origins of the Appeals lodged before the CCJA

The only available statistics on CCJA case law cover the period from 1998 to 2010.⁷² They indicate that appeals to the CCJA remain the appanage of a few Member States. There were nearly 918 appeals to the CCJA from 1998 until 30 June 2010; nearly 51% of them emanated from Côte d'Ivoire (where the seat of the CCJA is located) while nearly 13% came from Cameroon, 6.64% from Senegal, 4.46% from Mali, and 4.03% from Niger. The percentage of appeals to the CCJA from other countries such as Burkina Faso, the Republic of the Congo, Gabon, Guinea, and Togo, oscillates around 2% and 3%. For Benin, Chad, the Central African Republic, Comoros, Guinea Bissau, and Equatorial Guinea, the percentage ranges between 0% and 1%.⁷³

The following table summarises the geographical origins of the appeals lodged before the CCJA.

*Table 2: Geographical Origins of the Appeals Lodged before the CCJA*⁷⁴

N°	OHADA Member States	Number of Appeals Lodged with the CCJA	Percentage
1.	Benin	15	1.64%
2.	Burkina Faso	24	2.62%
3.	Cameroon	128	13.94%
4.	Central African Republic	12	1.30%
5.	Chad	18	1.96%
6.	Comoros	1	0.10%

⁷¹ Niger Supreme Court, 16 August 2001, RBD 2002, 121 et seq.

⁷² See Flora Dalmeida Mele, 'Tendances jurisprudentielles de la CCJA par pays de provenance du pourvoi' (2010) 2 *Revue de droit uniforme africain* 58.

⁷³ Flora Dalmeida Mele (*supra* n 72) 58–61. In addition, in respect of the Uniform Acts related the appeals, it appears that the Uniform Act on Simplified Procedures for Recovery and Enforcement Measures (J.O. OHADA n° 6, 1 June 1998, 1 et seq) has garnered the lion's share of disputes. The distribution of decisions according to topics or areas of the Uniform Act on Simplified Procedures for Recovery and Enforcement Measure indicates that 34% of cases relate to the simplified procedure for obtaining an injunction to pay.

⁷⁴ Flora Dalmeida Mele (*supra* n 72) 61.

N°	OHADA Member States	Number of Appeals Lodged with the CCJA	Percentage
7.	Congo	22	2.39%
8.	Gabon	33	3.59%
9.	Guinea	31	3.37%
10.	Guinea Bissau	2	0.21%
11.	Côte d'Ivoire	472	51.41%
12.	Equatorial Guinea	1	0.10%
13.	Mali	41	4.46%
14.	Niger	37	4.03%
15.	Senegal	61	6.64%
16.	Togo	20	2.17%
	Total	918	100%

The fact that most of the cases originate from Côte d'Ivoire can be explained by several factors. First, the seat of the CCJA is located in Abidjan, Côte d'Ivoire. Therefore, it is less expensive and less time-consuming for parties residing in Côte d'Ivoire to lodge an appeal before the CCJA. Secondly, Côte d'Ivoire's economy is the most important in the OHADA region. As a consequence, business activities and related litigation are more important in Côte d'Ivoire than in other Member States.⁷⁵ Thirdly, many potential litigants are reluctant to lodge an appeal before the CCJA because of the costs of the procedure. While it is true that CCJA procedure relies essentially on writings, and oral argument is very rare under Article 34 of the Rules of Procedure of the CCJA, an appeal before the CCJA prior to the 2014 revision of the rules of procedure required residence in Abidjan for the duration of the proceedings, possibly even for a foreign attorney representing a non-Ivorian party on a *pro hac vice* basis or for mandatory local counsel.⁷⁶ This was regarded as unfairly advantaging Ivorian lawyers.⁷⁷ Hence, a 2014 revision of the rules of procedure modified Article 28 3), which now reads:

⁷⁵ See World Bank (*supra* n 37) 3.

⁷⁶ Article 28 3°) of the 1996 version of the Rules of Procedure of the CCJA provided: "For procedural purposes, the appeal shall contain election of domicile at the seat of the Court. It shall mention the name of the person with power of attorney to receive service of documents."

“For the purposes of the procedure, the election of domicile in the place where the Court has its seat is not obligatory. The address for service of process, where necessary, shall state the name of the person who is authorised and has agreed to accept all communications.”

This modification might undo the resistance, if not the hostility, to appealing before the CCJA. There has so far been no study on the impact of the revision of the Rules of Procedure of the CCJA.

V. The Regional School for Magistrates

The Regional School for Magistrates, ERSUMA, is a training and documentation centre on OHADA law under the permanent secretary of OHADA (Article 41(1) of the OHADA Treaty). It is composed of a board of directors, a school council, and a directorate. It is headed by a general director who is appointed by the Council of Ministers to a once-renewable, four-year term. The seat of ERSUMA is located in Porto-Novo (Benin). It organises several seminars for judges and court officials of Member States on OHADA law.⁷⁸

D. Instruments of OHADA

To unify business law in Africa, OHADA adopts Uniform Acts (I) and Regulations (II).

I. Uniform Acts

1. Object of the Uniform Acts

As mentioned above, OHADA aims at unifying business law in the Member States by elaborating and adopting simple, modern, and common rules (Article 1 of the OHADA Treaty). Article 5 of the OHADA Treaty provides that enactments for the adoption of the rules mentioned in Article 1 of the OHADA Treaty are to be known as “Uniform Acts”. Uniform Acts, the main instruments of OHADA, are unified legal provisions that regulate a specific area of business law. They are directly applicable in the OHADA Member States and override all contrary national provisions (Article 10 of the OHADA Treaty).

The areas of law which can be unified by OHADA’s Uniform Acts are listed in Article 2 of the OHADA Treaty, which provides:

“So as to implement the present Treaty, it is to be understood by business law regulations concerning company law, definition and classification of legal persons engaged in trade, proceeding in respect of credits and recovery of debts, legal enforcement, bankruptcy,

⁷⁷ Renaud Beauchard & Mahutodji Jimmy Vital Kodo, ‘Can OHADA Increase Legal Certainty in Africa?’ (2011) The International Bank for Reconstruction and Development/The World Bank, Justice & Development Working Paper Series 17/2011, 22.

⁷⁸ A list of the offered seminars can be found at <<https://www.ohada.org/en/ersuma-trainings>> (accessed 5 January 2021).

arbitration, employment law, accounting law, transportation law, sales laws, and any other matter that the Council of Ministers would unanimously decide to include as falling within the definition of business law [...].”

The list in Article 2 of the OHADA is restrictive as it limits the material scope of OHADA, *i.e.*, it limits the areas of law which OHADA can unify. It is worth noting that the provision in Article 2 of the OHADA Treaty reflects the difficulty of clearly delimiting the broad notion of “business law”, which encompasses the regulation of different components of an economy such as economic actors (traders, commercial companies, trade intermediaries, etc.), goods and services, economic activities (production, distribution, consumption, etc.), and the legal rules in respect of credit and competition.⁷⁹ It is very difficult to restrictively enumerate the areas the concept of “business law” encompasses and which hence are to be unified by OHADA. For that reason, Article 2 of the OHADA Treaty provides that the OHADA Council of Ministers may, in accordance with the purpose of the OHADA Treaty, unanimously decide to extend that list to include other areas. Indeed, the OHADA Council of Ministers decided in March 2001 to extend the list of areas that could be harmonised by OHADA to include competition law, banking law, intellectual property law, contract law, and the law of evidence.⁸⁰

2. The Process of Adopting Uniform Acts

a) Drafting

The subject matter covered by a Uniform Act is chosen according to the annual program for harmonisation approved by the Council of Ministers. Under the aegis of the Permanent Secretariat, a recognised expert in the relevant field prepares a preliminary draft, which is then transmitted to the governments of the Member States. During this drafting stage, national commissions⁸¹ examine the preliminary draft of the Uniform Act. These national commissions as well as the governments of the Member States must complete

⁷⁹ Joseph Issa-Sayegh & Jacqueline Lohoues-Oble (*supra* n 15) s 259–261. See also Roger Masamba, *L’OHADA en RDC: Manuel de vulgarisation* (Commission nationale OHADA, Kinshasa 2012) 9, who describes the term “business law” as *un concept au contours élastique* (a concept with a unclear or vague boundaries).

⁸⁰ J.O. OHADA n° 12, 2003, 6. The text of the Conclusions of the 2002 meeting of the OHADA Council of Ministers is available at <http://www.idcafrique.org/sites/default/files/journaux_officiels/12%20journal_officiel_n_12_0.pdf> (accessed 4 January 2021).

⁸¹ The OHADA Treaty does not contemplate national commissions, which are private bodies composed of experts in business law. Dr. Kwawo Lucien Johnson, a former permanent secretary, acknowledged that national commissions are a very useful innovation and promoted their official recognition within the OHADA system; as a result, the Council of Ministers adopted a proposal with respect to the creation and institutionalisation of national commissions in January 2003 (*see* J.O. OHADA n° 12 dated 28 February 2003, 23).

their examinations and notify their observations to the Permanent Secretariat within ninety days (Article 7 of the OHADA Treaty).⁸² At the expiration of that period, the Permanent Secretariat convenes the national commissions for a plenary session to reach a consensus on the draft. The Permanent Secretariat then returns the drafts to the Member States for their observations.⁸³

b) Advisory Opinion of the CCJA

After the completion of the drafting phase, the Permanent Secretariat sends the draft to the CCJA for an advisory opinion. The CCJA must determine whether the draft complies with the OHADA Treaty. The advisory opinion of the CCJA is very important as it ensures that all the Uniform Acts are in line with the “general spirit of OHADA”⁸⁴. The CCJA must give its opinion within thirty days (Article 7 of the OHADA Treaty).

c) Final Adoption

The adoption of the Uniform Act by the Council of Ministers is the final step. Adoption requires a unanimous vote by the Member States which are present, not considering any abstentions, with a quorum of two-thirds of the Member States (Article 8 of the OHADA Treaty). Therefore, a Member State’s abstention on a vote or failure to attend the meeting is not an obstacle *per se* to the adoption of Uniform Acts. Yet the unanimity rule allows any Member State, if present, to block the adoption of a Uniform Act by a negative vote. Consequently, this provision in Article 8 of the OHADA Treaty can be regarded as a veto right of each Member State.

d) Exclusion of Legislative Authorities

The exclusion of legislative authorities from the adoption process of the Uniform Acts had led to objections in Cameroon on constitutional grounds. Indeed, Article 2(1) of Cameroon’s constitution provides:

“National sovereignty shall be vested in the people of Cameroon who shall exercise same [*sic*] either through the President of the Republic and Members of Parliament or by way of referendum. No section of the people or any individual shall arrogate to itself or to himself the exercise thereof.”

⁸² The permanent secretary may, at his or her discretion, extend the ninety-day period provided in Article 7(1) of the OHADA Treaty to an equivalent term given the circumstances and the nature of the text to be adopted (Article 7(2) of the OHADA Treaty).

⁸³ It is important to underscore that the OHADA Treaty envisages neither the intervention of the national commissions nor this phase.

⁸⁴ Boris Martor et al (*supra* n 10) 22.

Further, Article 14 of Cameroon's constitution provides that legislative power shall be exercised by the parliament, which legislates and controls government action. In addition, Article 26 provides that rules governing civil and commercial obligations are reserved to the legislative power. Nevertheless, under Articles 43 and 45 of the constitution of Cameroon, "[t]he President of the Republic shall negotiate and ratify treaties and international agreements. Treaties and international agreements falling within the areas of competence of the legislative power as defined in Article 26 shall be submitted to parliament for authorisation to ratify." Moreover, Article 45 of the constitution provides that following their publication, "[d]uly approved or ratified treaties and international agreements override national laws, provided that the other party implements the said treaty or agreement." The ratification of the OHADA Treaty in Cameroon occurred through the authorisation granted by the parliament to the president of the republic by Decree n° 96/177 of 5 September 1996. On this basis, it may be concluded that the ratification of the OHADA Treaty is deemed to have led to a delegation of certain sovereign powers to OHADA and that this ratification has been ratified by Cameroon's parliament. The same rationale also applies to the other Member States.⁸⁵

3. *Effects of the Uniform Acts on National Law*

a) *Direct Applicability of the Uniform Acts*

Under Article 9 of the OHADA Treaty, Uniform Acts enter into force ninety days after their adoption subject to any special provision contained in the Uniform Act in that regard.⁸⁶ Uniform Acts may be relied upon against any party thirty days following their publication in the OHADA Official Journal. Pursuant to Article 10 of the OHADA Treaty, Uniform Acts are directly applicable and binding in all Member States, notwithstanding any previous or subsequent conflicting provision of national law. Because of the principle of "supranationality" enshrined in Article 10 of the OHADA Treaty, the binding legal force of the Uniform Acts throughout every Member State does not require a national transposition through a domestic legislative or regulatory act.

Article 10 of the OHADA Treaty plays an important role as it is the only provision of the OHADA Treaty which establishes the superiority and the overriding effect of Uniform Acts vis-à-vis the domestic law provisions of the Member States. Nevertheless, Article 10 of the OHADA Treaty still gives

⁸⁵ For a similar rationale under Congolese law and Senegalese law, see Roger Masamba (*supra* n 79) 5.

⁸⁶ Such was the case for instance with the Uniform Act on Collective Insolvency Proceedings (J.O. OHADA n° 7, 1 July 1998, 1 et seq) which, based on a suggestion by the CCJA, entered into force nearly nine months after its adoption so legal practitioners would have enough time to familiarise themselves with the new system.

rise to certain issues of the extent to which national laws are abrogated by virtue of the Uniform Acts.

A possible initial interpretation is that the abrogation foreseen in Article 10 of the OHADA Treaty concerns solely those laws (or particular provisions thereof) which are contrary to a Uniform Act. Adopting such an approach would give rise to several difficulties in that it would require a thorough analysis of the national laws to determine which of their specific provisions are contrary to a Uniform Act. A second possible interpretation of the provision in Article 10 of the OHADA Treaty is that a Uniform Act abrogates any national law which has the same subject matter.⁸⁷ Under this interpretation, it is immaterial to determine whether a national law may be contrary to a Uniform Act as the national law would automatically be abrogated upon entry into force of the Uniform Act. Such an interpretation has the advantage of achieving full unification and hence of ensuring simple and efficient application of the Uniform Acts in each Member State.⁸⁸ Nevertheless, the formulation in Article 10 of the OHADA Treaty does not lend itself to this second interpretation.

Moreover, further difficulties arise from the fact that the Uniform Acts encompass provisions which complement or, in certain instances, contradict Article 10 of the OHADA Treaty. For instance, Article 919 of the Uniform Act on Commercial Companies provides that all national laws which are contrary to the provisions of the Uniform Act are abrogated⁸⁹ while Article 916 of the same Uniform Act states that the Uniform Act does not abrogate laws applicable to companies that are subject to a special regime. Yet the very laws that are applicable to companies which are subject to a special regime are by definition contrary to the Uniform Act on Commercial Companies. In comparison, Article 336 of the Uniform Act on Simplified Recovery

⁸⁷ See Joseph Issa-Sayegh, ‘Réflexions et suggestions sur la mise en conformité du droit interne des Etats Parties avec les Actes uniformes de l’OHADA et réciproquement’ (2005) 850 *Penant: revue trimestrielle de droit africain* 7, 9.

⁸⁸ Filiga Michel Sawadogo, ‘Les actes uniformes de l’OHADA: aspects techniques généraux’ (2001) 3940 *Revue Burkinabè de droit* 46; Boris Martor et al, *Le droit uniforme africain des affaires issu de l’OHADA* (LexisNexis Litec, Paris 2004) s 72.

⁸⁹ The “gap-filling” function of national company law is therefore very limited under OHADA law; compared with domestic company law in Europe, European Union legislation has not so far achieved a coherent and complete set of company law rules (Christoph Teichmann ‘The Law Applicable to the European Private International Company’ in Hirte Heribert & Christoph Teichmann, *The European Private Company – Societas Privata Europaea (SPE)* (De Gruyter, 2013) 74; Stephan Rameloo, ‘The Proposed SPE Regulation and Beyond – Complementary Functions of Private International Law’ in Hirte Heribert & Christoph Teichmann, *The European Private Company – Societas Privata Europaea (SPE)* (De Gruyter, 2013) 105, 107, 110, 113; see also Mathias Habersack, *Europäisches Gesellschaftsrecht: Einführung für Studium und Praxis* (5th ed., C.H. Beck’sche Verlagsbuchandlung, München 2019) 71 et seq).

Procedures and Enforcement Measures⁹⁰ clearly provides that the Uniform Act abrogates all Member State provisions which govern simplified recovery procedures and enforcement measures. Consequently, even provisions which are complementary and not contrary to the Uniform Act on Simplified Procedures and Enforcement Measures are abrogated.

b) Interpretation of Article 10 by the CCJA

On 30 April 2001, the CCJA issued an advisory opinion providing certain indications as to the proper interpretation of Article 10 of the OHADA Treaty. The CCJA indicated that Article 10 of the OHADA Treaty contains a rule of “supranationality” since it provides for the direct and compulsory application of the Uniform Acts in the Member States and for their supremacy over provisions of domestic law whether prior or subsequent. Additionally, the CCJA stated that unless otherwise provided in the Uniform Acts themselves, the overriding effect of Article 10 concerns any existing domestic law or regulation, or the prohibition of any future domestic law or regulation. This overriding effect of OHADA law applies to any provision of domestic law having the same purpose as that of a Uniform Act or a Regulation, whether contrary or identical.

Moreover, the CCJA specified that the term “provision” must be interpreted as meaning an article of a text, a paragraph of that article, or a sentence of that article. Further, to highlight the overriding effect of the Uniform Acts vis-à-vis national laws, the CCJA indicated that tax law is not yet one of the business law areas to be harmonised under Article 2 of the Treaty. Nevertheless, if tax procedures include recovery procedures or enforcement measures similar to those laid down in the Uniform Act on Simplified Recovery Procedures and Enforcement Measures, those tax procedures must comply with the provisions of that Uniform Act.

Therefore, according to the 2001 advisory opinion of the CCJA, Article 10 of the OHADA Treaty is aimed at overriding any current or future national regulatory or legislative provision which has the same purpose as a Uniform Act. The abrogating effect of the Uniform Acts under Article 10 of the OHADA Treaty also applies to any provision identical to that of a Uniform Act; however, the CCJA specified if there are provisions of a national law in line with those of a Uniform Act, such non-conflicting provisions remain applicable. Therefore, each article of a national law must be examined separately and in detail. This interpretation of the CCJA does not ensure an efficient and a simple application of the Uniform Acts.⁹¹ However, it is in line with the actual formulation in Article 10 of the OHADA Treaty.

⁹⁰ Journal Officiel n° 6, 1 June 1998, 1 et seq.

⁹¹ Boris Martor et al (*supra* n 10) 19.

4. Current Uniform Acts

Pursuant to Articles 1 and 2 of the OHADA Treaty as well as a decision taken at the 2002 meeting of the OHADA Council of Ministers, the Council of Ministers has adopted ten Uniform Acts as of January 2021:

- (i) The Uniform Act on the Law of Commercial Companies and Economic Interest Groups (*Acte uniforme relatif au droit des sociétés commerciales et du groupement d'intérêt économique*),⁹² which entered into force on 1 January 1998. This Uniform Act was revised on 5 May 2014;
- (ii) The Uniform Act on General Commercial Law (*Acte uniforme portant sur le droit commercial général*),⁹³ which entered into force on 1 January 1998. This Uniform Act was revised on 15 May 2010;
- (iii) The Uniform Act on Security Interests (*Acte uniforme portant organisation des sûretés*),⁹⁴ which entered into force on 1 January 1998. This Uniform Act was also revised on 15 December 2010;
- (iv) The Uniform Act on Simplified Procedures for Recovery and Enforcement Measures (*Acte uniforme portant organisation des procédures simplifiées de recouvrement et des voies d'exécution*),⁹⁵ which entered into force on 10 July 1998;
- (v) The Uniform Act on Collective Proceedings for the Clearing of Debts (*Acte uniforme portant organisation des procédures collectives d'apurement du passif*),⁹⁶ which entered into force on 1 January 1999;
- (vi) The Uniform Act on Arbitration Law (*Acte uniforme relatif au droit de l'arbitrage*), which was adopted on 23 November 2017.⁹⁷ This Uniform Act has replaced the Uniform Act on Arbitration Law of 11 March 1999;
- (vii) The Uniform Act on the Organisation and Harmonisation of Accounting of Companies (*Acte uniforme portant organisation et harmonisation des comptabilité des entreprises*),⁹⁸ which was revised on 26 January 2017;
- (viii) The Uniform Act on Contracts of Carriage of Goods by Road (*Acte uniforme relatif aux contrats de transport de marchandises par route*) of 22 March 2003,⁹⁹ which entered into force on 1 January 2004;
- (ix) The Uniform Act on Cooperatives (*Acte uniforme relatif au droit des sociétés coopératives*) of 15 December 2010,¹⁰⁰ which entered into force on 16 May 2011; and

⁹² J.O. OHADA n° 2, 1 January 1997, 1 et seq.

⁹³ J.O. OHADA n° 23, 15 February 2011, 1 et seq.

⁹⁴ J.O. OHADA n° 22, 15 February 2011.

⁹⁵ J.O. OHADA n° 6, 1 June 1998, 1 et seq.

⁹⁶ J.O. OHADA n° 7, 1 July 1998, 1 et seq.

⁹⁷ J.O. OHADA, *numéro spécial*, 15 December 2017, 15 et seq.

⁹⁸ J.O. OHADA n° 10, 20 November 2000, 1 et seq.

⁹⁹ J.O. OHADA n° 13, 31 July 2003, 3 et seq.

- (x) The Uniform Act on Mediation (*Acte uniforme relatif à la médiation*), which was adopted on 23 November 2017.¹⁰¹

5. Uniform Acts “in the Pipeline”

The drafting of further Uniform Acts is underway on the law of obligations and contracts, labour law,¹⁰² competition law, and the recognition and enforcement of foreign judgments and foreign public documents. Of all these projects, the preparation of uniform legislation on the law of obligations seems to have progressed the most. In this regard, it is important to recall that in 2003 the OHADA Council of Ministers decided to seek support from the International Institute for the Unification of Private Law (UNIDROIT) for the elaboration of a Uniform Act on contracts law:¹⁰³

“Among the new subjects to be adopted by the last Council of Ministers and which would be the subject of Uniform Acts, the Permanent Secretariat recommends to the Ministers to adopt, for this year, a program of harmonization concerning:

- The law of cooperative and mutual societies;
- Banking law;
- Competition law; and
- Contract law.

While recognising the relevance of the Permanent Secretariat’s proposals for this ambitious program, the Council recommends that [...] the two following topics be harmonised as a matter of priority:

- The law of cooperative and mutual societies;
- Contract law, for which the Permanent Secretariat could request the expertise of UNIDROIT, Institution (*sic*) which has elaborated the principles relating to international commercial contracts.”¹⁰⁴

¹⁰⁰ J.O. OHADA n° 23, 15 February 2011.

¹⁰¹ J.O. OHADA, *numéro spécial*, 15 December 2017, 5 et seq.

¹⁰² See ‘Compte-rendu de la Réunion plénière des Commissions Nationales OHADA (CNO) sur l’examen de l’avant-projet d’Acte uniforme sur le droit du travail’ (2010) *Revue congolaise de droit et des affaires* 77.

¹⁰³ See Jacqueline Lohoues-Oble, ‘L’autonomie des parties: le caractère supplétif des dispositions de l’avant-projet d’Acte uniforme OHADA sur le droit des contrats’ (2008) *1/2 Uniform Law Review* 2008 319, 321, fn 7, who suggests that the collaboration with UNIDROIT was in response to criticism of the OHADA Uniform Acts, which are often regarded as civil-law oriented. The Council hoped that UNIDROIT, which since 1926 has been preparing international instruments in the fields of international trade law and uniform private law in general, could help produce a uniform act reconciling concerns of the civil and common law legal systems.

¹⁰⁴ The original French version reads: “Parmi les nouvelles matières à adopter par le dernier Conseil des Ministres et qui feraient l’objet d’actes uniformes, le Secrétariat Permanent propose aux Ministres d’adopter, pour cette année, un programme d’harmonisation portant sur: le droit des sociétés coopératives et mutualistes, le droit bancaire, le droit de la concurrence, et le droit des contrats. Tout en reconnaissant la pertinence des propositions

UNIDROIT acceded to the request of the OHADA Council of Ministers by providing the necessary expertise for the preparation of a draft Uniform Act.¹⁰⁵ This new Uniform Act project was sponsored by the Swiss government's Development and Co-operation Office. The secretariats of OHADA and UNIDROIT jointly determined the objectives and the drafting methods. After preparatory work and consultations with experts from nine OHADA Member States,¹⁰⁶ Professor Fontaine completed a preliminary draft Uniform Act on Contract Law (hereinafter referred to as the First Preliminary Draft) accompanied by explanatory notes.¹⁰⁷

Modelled after the UNIDROIT Principles of International Commercial Contracts,¹⁰⁸ the First Preliminary Draft encompassed only substantive law rules in respect of contracts: general provisions (Chapter 1, Articles 1/2 to 1/11), formation and authority of agents (Chapter 2, Articles 2/1 to 2/32), validity (Chapter 3, Articles 3/1 to 3/22), interpretation (Chapter 4, Articles 4/1 to 4/8), content and third party rights (Chapter 5, Articles 5/1 to 5/18), performance (Chapter 6, Articles 6/1 to 6/24), non-performance (Chapter 7, Articles 7/1 to 7/31), set-off (Chapter 8, Articles 8/1 to 8/5), merger of obligations (Chapter 9, Articles 9/1 to 9/3), conditional, joint, several, and alternative obligations (Chapter 10, Articles 10/1 to 10/21), assessment of rights, transfer of obligations, assignment of contracts (Chapter 11, Articles 11/1 to 11/29), limitation periods (Chapter 12, Articles 12/1 to 12/11), and protection of creditors and third parties (Articles 13/1 to 13/8).¹⁰⁹ Unfor-

du Secrétariat Permanent pour ce programme ambitieux, le Conseil recommande que [...] les deux matières ci-après soient harmonisées en priorité: le droit des sociétés coopératives et mutualistes, le droit des contrats, pour lequel le Secrétariat Permanent pourrait solliciter l'expertise d'UNIDROIT, Institution [sic] ayant élaboré les principes relatifs aux contrats du commerce international" (J.O. OHADA n° 12, 2003, 12).

¹⁰⁵ UNIDROIT proposed Professor Marcel Fontaine (emeritus professor, former director of the Centre de droit des obligations, Faculty of Law, Catholic University of Louvain-la-Neuve, Belgium, and member of the UNIDROIT Working Group for the preparation of the UNIDROIT Principles). See <<https://www.unidroit.org/121-research-scholarships-and-internships/516-preparation-by-unidroit-of-a-draft-ohada-uniform-act-on-contract-law>> (accessed 4 January 2021).

¹⁰⁶ Professor Fontaine completed three missions to nine OHADA Member States selected by the OHADA Permanent Secretariat: in 2003 (Senegal, Mali, and Burkina Faso), 2004 (Gabon, Republic of Congo, and Cameroon), and 2004 (Togo, Mali, and Burkina-Faso).

¹⁰⁷ The texts of the Preliminary OHADA Uniform Act on Contract Law and the Explanatory Notes are available respectively at <<https://www.unidroit.org/english/legalcooperation/OHADA%20act-e.pdf>> and <<https://www.unidroit.org/english/legalcooperation/OHADA%20explanatory%20note-e.pdf>> (accessed 4 January 2021).

¹⁰⁸ Mbeng Tataw Zoueu, 'Libres propos sur l'avant-projet d'Acte uniforme OHADA sur le droit des contrats (communication)' (2008) 1/2 Uniform Law Review 503.

¹⁰⁹ For more details on the substantive rules of the preliminary draft of the OHADA Uniform Act on Contract Law, see Marcel Fontaine, 'The Draft OHADA Uniform Act on

unately, UNIDROIT stopped providing assistance to OHADA in preparing the contemplated Uniform Act on contract law. Further, the First Preliminary Draft was criticised for extending its material scope of application to civil contracts and for replicating the UNIDROIT Principles.¹¹⁰

On 12 December 2007, the OHADA Council of Ministers decided to re-launch the preparation of a Uniform Act on contract law.¹¹¹ The Permanent Secretariat approached the Foundation for Continental Law, which set up a Working Group¹¹² to draft a preliminary draft. Unlike the first project, which focused solely on contract law, this new project took aim at modernising the “general theory of obligations”¹¹³ (*théorie générale des obligations*). In 2015, the Working Group, which was composed of Prof. Dr. Joseph Issa-Sayegh, Prof. Dr. Paul-Gérard Pougoué, and Prof. Dr. Filiga Michel Sawadogo,¹¹⁴ submitted to the OHADA Council of Ministers a preliminary draft of a uniform text on the law of obligations¹¹⁵ (hereinafter referred to as the Preliminary Draft).¹¹⁶

Contracts and the UNIDROIT Principles of International Commercial Contracts’ (2004) Uniform Law Review 573, 573–584; Dorothé C. Sossa, ‘Le champ d’application de l’avant-projet d’Acte uniforme OHADA sur le droit des contrats: contrats en général/contrats commerciaux/contrats de consommation’ (2008) 1/2 Uniform Law Review 339, 339–353; Bénéï Yvonne-Bernard Ano, ‘L’avant-projet d’Acte uniforme sur le droit des contrats: son impact sur la formalisation des garanties (communication)’ (2008) 1/2 Uniform Law Review 477, 477–479; Emile Bile Kangah Junior, ‘Quelques considérations sur l’avant-projet d’Acte uniforme OHADA sur le droit des contrats (communication)’ (2008) 1/2 Uniform Law Review 481, 481–483; Marcel Fontaine, ‘Le Code civil du Québec et l’avant-projet OHADA sur le droit des contrats’ (2010) 88 Canadian Bar Review 433; Idrissa Kere, ‘L’OHADA et l’harmonisation du droit des contrats: propos et questions préliminaires’ (2008) Uniform Law Review 197, 197–202; Kalongo Mbikayi, ‘La confirmation des principes de bonne foi et de loyauté dans l’avant-projet d’Acte uniforme OHADA sur le droit des contrats’ (2008) Uniform Law Review 223, 223–228.

¹¹⁰ See Paul Gérard Pougoué, ‘L’avant-projet d’acte uniforme OHADA sur le droit des contrats: les tribulations d’un universitaire’, Ohada.com/Ohadata D-07-41 1, 2 et seq.

¹¹¹ The text of the conclusions of the OHADA Council of Ministers from Niamey in 2007 is available on the website of the presidency of the Republic of Niger at <<http://www.presidence.ne/article/communiqué-du-conseil-des-ministres-du-mardi-09-mai-2017#sthash.6L4P4Bg4.dpbs>> (accessed 4 January 2021).

¹¹² The members of the Working Group were Professors Joseph Issa-Sayegh, Paul Gérard Pougoué & Filiga Michel Sawadogo.

¹¹³ For more details on the codification of the general theory of obligations, see Jacques Mestre, ‘Les difficultés de la recodification pour la théorie générale du contrat’ in *Le Code civil 1804-2004, Livre du Bicentenaire* (Paris, Editions Dalloz-Jurisclasseur 2004) 231 et seq.

¹¹⁴ The Working Group was assisted by Prof. Dr. Dorothé Cossi Sossa, Prof. Dr. Ndiaw Diouf, and Prof. Dr. Roger Masamba.

¹¹⁵ Joseph Issa Sayegh, Paul Gérard Pougoué & Filiga Michel Sawadogo, *Projet de texte uniforme portant droit général des obligations dans l’espace OHADA* (OHADA, Fondation pour le Droit Continental, 2015).

II. Regulations

Regulations are adopted by the Council of Ministers to fulfil and implement the OHADA Treaty (Article 4 of the OHADA Treaty). They are of the same nature as the OHADA Treaty.¹¹⁷ They are directly applicable in all Member States. As of January 2021, the Council has adopted the following regulations:

- (i) Rules of Procedure of the Common Court of Justice and Arbitration (*Règlement de procédure de la Cour Commune de Justice et d'Arbitrage*) of 18 April 1996, as amended by Rule n° 001/2014/CM of 30 January 2014;
- (ii) The Arbitration Rules of the Common Court of Justice and Arbitration (*Règlement d'arbitrage de la Cour Commune de Justice et d'Arbitrage*) as amended on 23 November 2017;¹¹⁸
- (iii) The Financial Regulations of the OHADA Institutions;¹¹⁹ and
- (iv) The OHADA Staff Regulations.¹²⁰

III. Chronological Table of the Uniform Acts and the Regulations

The following table chronologically summarises the dates of adoption, publication, and revision of all the Uniform Acts and Regulations.

Table 3: Chronological Table of the Uniform Acts and the Regulations

Instrument	Date of Adoption	Publication	Revision
Rules of Procedure of the Common Court of Justice and Arbitration of 18 April 1996	18 April 1996	1 November 1997	30 January 2014
Uniform Act on General Commercial Law	17 April 1997	1 October 1997	15 December 2010

¹¹⁶ For more details on the preliminary draft and a comparison thereof with the Hague Principles on Choice of Law in International Commercial Contracts, see Jan Neels, 'The Role of The Hague Principles on Choice of Law in International Commercial Contracts in the Revision of the Preliminary Draft Uniform Act on The Law of Obligations in the OHADA Region' (2018) 3 81 *Tydskrif vir Hedendaagse Romeins-Hollandse Reg* 464, 465 et seq.

¹¹⁷ Joseph Issa-Sayegh & Jacqueline Lohoues-Oble (*supra* n 15) 112.

¹¹⁸ J.O. OHADA, *numéro spécial*, 15 December 2017, 29 et seq.

¹¹⁹ J.O. OHADA, n° 8, 14.

¹²⁰ J.O. OHADA, n° 5 of 1 July 1998, 18.

Instrument	Date of Adoption	Publication	Revision
Uniform Act on the Law of Commercial Companies and Economic Interest Groups	17 April 1997	1 October 1997	30 January 2014
Uniform Act on Security Interests	17 April 1997	1 July 1998	15 December 2010
Uniform Act on Simplified Procedures for Recovery and Enforcement Measures	10 April 1998	1 June 1998	--
Uniform Act on Collective Proceedings for the Clearing of Debts	10 April 1998	1 July 1998	10 September 2015
Uniform Act on Arbitration	11 March 1999	15 May 1999	23 November 2017
Arbitration Rules of the Common Court of Justice and Arbitration	11 March 1999	15 May 1999	23 November 2017
Uniform Act on the Organisation and Harmonisation of Accounting of Companies	23 March 2000	20 November 2000	26 January 2017
Uniform Act on Contracts of Carriage of Goods by Road	22 March 2003	31 July 2003	–
Uniform Act on Cooperatives	15 December 2010	15 February 2011	–
Uniform Act on Mediation	23 November 2017	15 December 2017	–

E. Summary and Evaluation

Many western and central African countries had outdated or incomplete legal systems. This led to legal uncertainty which, in turn, hindered local and foreign investment. Local and foreign investments require a secure legal and commercial environment that will protect private property and contractual rights. More importantly, this kind of environment cannot be achieved without a strong and independent judicial system that can ensure the proper application of the law and the efficient settlement of disputes.

Against this background, fourteen African States created OHADA on 17 October 1993 to develop modern, unified, and easily accessible business

law rules. Article 2 of the OHADA Treaty identifies certain areas falling within the scope of business law under the OHADA Treaty. These areas are company law, the definition and classification of legal persons engaged in trade, proceedings in respect of credits and the recovery of debts, means of enforcement, bankruptcy, arbitration, employment law, accounting law, transportation and sales law, and any other such matter that the Council of Ministers would, in conformity with the objective of the OHADA Treaty, decide unanimously to include.

OHADA unifies business law mainly through instruments called Uniform Acts which are directly applicable in all OHADA Member States. As of January 2021, OHADA has unified several areas of business law, such as commercial law, company law, bankruptcy, security interests, arbitration, mediation, the carriage of goods by road, accounting law, and enforcement proceedings.

Moreover, OHADA has established a single court, the Common Court of Justice and Arbitration (CCJA), which plays the roles of arbitration centre for and court of final appeal over any dispute arising in the OHADA region in respect of OHADA law. Moreover, the CCJA is also responsible for interpreting the OHADA Treaty, the Uniform Acts, the Regulations, and the decisions of OHADA. Beside the CCJA, OHADA comprises a Conference of Heads of State and Government, a Council of Ministers, a Permanent Secretariat, and a Regional Training Centre for Legal Officers, all of which play a pivotal role in the development and dissemination of OHADA law.

This thesis aims to determine the appropriate connecting factor (or system of connecting factors) by which to determine the law applicable to *in rem* rights in respect of security interests in intermediated securities under OHADA law. Exploring the history, mission, competence, institutions (particularly the CCJA), and instruments of OHADA is crucial for analysing the conflict of laws issues which arise when intermediated securities are used as collateral in the OHADA region.

More particularly, understanding of the breadth of competence of OHADA under Articles 1 and 2 of the OHADA Treaty is critical for determining whether OHADA can (i) modify an existing Uniform Act (such as the Uniform Act on Security Interests, the Uniform Act on Commercial Companies, or the Uniform Act on General Commercial Law), (ii) adopt a new “Uniform Act on the Law Applicable to Certain Rights in Respect of Intermediated Securities”, or (iii) accede to the Hague Securities Convention. The chapter on the question of accession to the Hague Securities Convention is most relevant since it can be argued that, pursuant to Article 10 of the OHADA Treaty, OHADA is not competent to adopt international conventions to be directly applicable in all the Member States. Conversely, it may also be contended that OHADA is a “[r]egional Economic Integration Organisation which is constituted by sovereign States and has competence over certain matters gov-

erned by [the] Convention”¹²¹ and that it can therefore accede to the Hague Securities Convention.¹²²

In addition, understanding the instruments of OHADA (particularly the Uniform Act on Security Interests) and their relationship with national law is important to analyses of the Uniform Act on Commercial Companies and the Uniform Act on Security Interests. These contain the provisions governing pledges of securities accounts under OHADA law.¹²³

Chapter 2: Basic Structure and Functioning of the Indirect Holding System in the OHADA Region

A. Development of Commercial Practices in the OHADA Region regarding the Holding of Securities

I. Traditional Direct Holding of Securities under OHADA Law

1. Presentation of the Traditional Direct Holding System under OHADA Law

Traditionally, securities in the OHADA region were held, traded, and settled exclusively in a “direct holding system” in which owners of securities had a direct relationship with the issuer as depicted in the figure below.¹²⁴

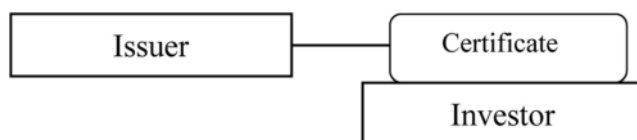


Figure 1: Non-intermediated Securities Holding – Physical Certificates

There is no definition of the term “securities” under OHADA law. However, from the provisions in Articles 51 to 55 and Article 744 of the Uniform Act on Commercial Companies, securities encompass bonds and other debt instruments which are traded in the capital markets. They also include shares and other equity instruments whether or not they are traded in the capital mar-

¹²¹ Article 18(1) of the Hague Securities Convention.

¹²² This very point is addressed under the section entitled “Conclusion and Legislative Recommendations” of this thesis.

¹²³ See chapter 1 of part II of this thesis.

¹²⁴ As an exception, Article 764 2°) of the 1998 version of the Uniform Act on Commercial Companies allowed some public limited companies to also issue intermediated securities as described in the next subsection. Nevertheless, securities in the OHADA region were overwhelmingly directly held by investors.

kets.¹²⁵ Under Article 745 first sentence of the Uniform Act on Commercial Companies, securities can be in the form of either bearer securities or registered securities. Article 745 second sentence of the Uniform Act provides that some provisions of this Uniform Act or of the Articles of association may exceptionally impose exclusively the nominative form. Some securities must, at least for a certain period, be exclusively in the nominative form.¹²⁶

Bearer securities are embodied in a piece of paper, and the holder of that paper is the holder of those securities. Under the 1998 version of the Uniform Act on Commercial Companies, securities were in principle¹²⁷ freely transferable upon following certain formalities.¹²⁸ For companies not launching a public offer,¹²⁹ the transfer of registered shares occurred by transferring them on the company's registers while the transfer of bearer securities occurred through simple delivery of the bearer securities. In the former case, the holder's rights resulted from the single registration on the company's registers; however, in the latter case the bearer of the share was deemed to be the owner thereof. Moreover, since bearer securities were negotiable instruments, the *bona fide* purchaser¹³⁰ recipient obtained good title (even if that of the trans-

¹²⁵ Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds) (*supra* n 40) 601.

¹²⁶ These are initial shares which are not fully paid up (Article 749 of the Uniform Act on Commercial Companies), registered shares with a double voting right (Article 752 of the same Uniform Act), shares which are admitted to trading on the stock exchange of a Member State and which belong to (i) managers, (ii) administrators, (iii) permanent representatives of legal entities that are board members, or (iv) their minor children not emancipated or spouses not judicially separated (Article 830(1) and (3) of the same Uniform Act). Moreover, shares that are not admitted, neither to trading on a stock exchange nor to performing operations of a central depository, must take the nominative form (Article 748-1 of the same Uniform Act).

¹²⁷ Articles 765 et seq of the Uniform Act on General Commercial Law contains provisions restricting the transferability of securities.

¹²⁸ Armand Charlebois Mankou-Nguila, 'La notion de siège social en droit OHADA: brève analyse comparative de la jurisprudence de la CCJA (Cour Commune de Justice et d'Arbitrage de l'OHADA) et de la CJCE (Cour de Justice des Communautés Européennes)' (2010) *Revue congolaise de droit et des affaires* 23, 23–30.

¹²⁹ Under Article 81 of the Uniform Act on Commercial Companies, the following companies are deemed to launch a public issue (*faire appel public à l'épargne*): (i) companies whose securities are admitted to trading on the stock exchange of a Member State from the date of the admission of such securities; and (ii) companies or any person offering its securities to the public of a Member State under the conditions set out in Article 83 of the same Uniform Act.

¹³⁰ See Tadas Klimas, 'Bona Fide Purchasers, Vindication and the Security of Acquisitions in Lithuanian Law' (2004) 50 *Lithuanus* 65; Giuseppe Dari-Mattiacci & Carmine Guerriero, 'Law and Culture: A Theory of Comparative Variation in Bona Fide Purchase Rules' (2015) 35(3) *Oxford Journal of Legal Studies* 543, 543–544.

feror was defective) and took the bearer securities free of any equities affecting them in the hands of the transferor.¹³¹

2. Advantages and Disadvantages of the Direct Holding System

The direct holding system allowed the issuer to easily identify the investor (except for an investor in unregistered (bearer) securities) as there were no intermediaries¹³² between the issuer and the investor. Moreover, investors could easily exercise the rights attached to their securities, such as payment of dividends or other distributions, voting rights, rights to receive any relevant information, etc.¹³³ In addition, the advantage of the non-intermediated securities holding chain is that since there is no intermediary the investor does not bear the risks related to an insolvency of the intermediary.¹³⁴

¹³¹ See Louise Gullifer, 'Ownership of Securities, the Problems Caused by Intermediation' in Louise Gullifer & Jennifer Payne (eds), *Intermediated Securities, Legal Problems and Practical Issues* (Hart Publishing, Oxford 2010) 1.

¹³² OHADA law does not define the term "intermediary". In comparison, Article 1(d) of the Geneva Securities Convention defines an intermediary as "a person (including a central securities depository) who in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity." Similarly, Article 1(1)(c) of the Hague Securities Convention defines the term "intermediary" as "a person that in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity." Moreover, it is important to note that the term "intermediary" (*intermédiaire de commerce*) is used in the Uniform Act on General Commercial Law (see Book 7, Articles 169 et seq of the same Uniform Act). However, under the Uniform Act on General Commercial Law, a "commercial intermediary" is defined as "a natural person or legal entity empowered to act, or with the means to act, usually and professionally on behalf of another person, merchant or not, in order to conclude a legal act of commercial nature with a third party." Therefore, the term "intermediary" (or "commercial intermediary") under the Uniform Act on General Commercial Law shall not be referred to in this study as it merely refers to middlemen on trades, such as commission agents (Articles 192 et seq of the same Uniform Act), commercial agents (Articles 216 et seq of the same Uniform Act), etc.

¹³³ In this regard, it is interesting to note that holding shares through intermediaries creates several problems for corporate law, such as how to handle the right to vote. The analysis of this interesting question is beyond the scope of this study. However, for more details on this issue, see Richard C. Nolan, 'Indirect Investors: A Greater Say in the Company?' (2003) *Journal of Corporate Law Studies* 73; Jennifer Payne, 'Intermediated Securities and the Right to Vote in the UK' in Louise Gullifer & Jennifer Payne (eds), *Intermediated Securities, Legal Problems and Practical Issues* (Hart Publishing, Oxford 2010) 187 et seq; Richard C. Nolan, 'The Continuing Evolution of Shareholder Governance' (2006) 65 *Cambridge Law Journal* 92.

¹³⁴ In comparison, this issue is addressed in Articles 14 and 26 of the Geneva Securities Convention on loss sharing in case of insolvency of the intermediary in an intermediary system. For more details on this issue, see Gabriel Moss, 'Intermediated Securities: Issues Arising on Insolvency' in Louise Gullifer & Jennifer Payne (eds), *Intermediated Securities, Legal Problems and Practical Issues* (Hart Publishing, Oxford 2010) 61 et seq.

However, in the direct holding system the transfer of securities occurs through the delivery of the securities certificates to a buyer under a contractual agreement to transfer. Generally, the buyer would endorse the securities and the issuer would record such transfer from the seller to the buyer in its register. Since the direct holding system in the OHADA region was dependent on the movement of pieces of paper, the physical exchange of certificates made transfers of securities labour-intensive, time-consuming, expensive, and even risky. Indeed, the paper certificates could be mislaid, lost, stolen, or even counterfeited.¹³⁵ Furthermore, while in transit to the transferee, the securities were not available for use or investment, which is a problem in the increasingly fast-moving markets of the OHADA region; this would lead to a so-called “pipeline liquidity (or illiquidity) risk”¹³⁶.

II. The Intermediated System under OHADA Law

1. Development in Commercial Practices

The aforementioned disadvantages of the direct holding system have led to the development of an indirect holding system in the OHADA region. Moreover, the shift with computers and the Internet over the past decades, from the industrial age to the information age,¹³⁷ has further facilitated the emergence of the

¹³⁵ Comparatively, the direct holding system also gave rise to similar difficulties internationally in the 1960s, when the gigantic amount of paper that had to be physically moved around the globe began to overwhelm the global financial system, eventually resulting in the so-called “paper crisis” or “paper crunch” on Wall Street in the late 1960s. The daily volume on the NYSE more than quadrupled from about three million shares per day in 1960 to approximately thirteen million shares per day in 1968. See US Securities and Exchange Commission, ‘Study of Unsafe and Unsound Practice of Brokers and Dealers’ (December 1971) 176; Joel Seligman, *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Finance* (3rd edition, Aspen Publisher, Michigan 2003) 489; Kenneth Kettering, ‘Repledged Deconstructed’ (1999) 61 *University of Pittsburgh Law Review* 45; David C. Donald, ‘The Rise and Effects of the Indirect Holding System – How Corporate America Ceded its Shareholders to Intermediaries’ (26 September 2007) <http://www.ilf-frankfurt.de/fileadmin/_migrated/content_uploads/ILF_WP_068.pdf> (accessed 4 January 2021).

¹³⁶ See Roy Goode, ‘The Nature and Transfer of Rights in Dematerialised and Immobilised Securities’ in Fidelis Oditah (ed), *The Future for the Global Securities Market: Legal and Regulatory Aspects* (Oxford-Norton Rose Law Colloquium, Oxford 1996) 108–109.

¹³⁷ The Information Age (also known as the Computer Age, the Digital Age, or the New Media Age) is a historic period of the twenty-first century marked by the rapid shift from traditional industries brought by the Industrial Revolution to economies based on information technology with computers and internet (see Daniel J. Solove, *The Digital Person: Technology and Privacy in the Information Age* (New York University Press, New York 2004) 1–3). For an overview of the effects on the global financial market of the shift from the Industrial Age to the Information Age, see Hans Angermueller, ‘Foreword’ in

intermediated system in the OHADA region as mechanisms used to transfer securities and keep records thereof no longer rely heavily on pen and paper.¹³⁸

Under the indirect or intermediated holding system, there is no direct relationship between the investor and the issuer for the vast majority of securities.¹³⁹ Indeed, securities certificates are no longer held by investors themselves.¹⁴⁰ Rather, the interests of an investor in respect of the underlying securities are recorded on the books of an intermediary (such as a bank or a securities firm), which in turn has its interest recorded with another intermediary, and so on up the chain until one arrives at an intermediary who either (i) is recorded as the registered owner on the issuer's or its official record holder's books or (ii) holds the certificates or other documents of title representing the securities. These securities held with an intermediary, indirectly held securities, or intermediated securities¹⁴¹ exist in an indirect holding system or intermediated system¹⁴² which creates a pyramidal, tiered holding

Kathleen Tyson-Quah (ed), *Cross-Border Securities Repo, Lending and Collateralisation* (Sweet and Maxwell, London 1997).

¹³⁸ Sandrine Kablan *Système bancaire en Afrique de l'Ouest: Efficacité et rôle dans le développement financier* (L'Harmattan, Paris 2012) 11, 12, 49, 64. See also the preamble of the Cameroonian *Loi n° 99-15 portant création et organisation d'un marché financier* of 22 December 1999, which is available at <<http://bibliotheque.pssfp.net/index.php/textes-et-lois/lois/613-loi-n-99-015-du-22-decembre-1999-portant-creation-et-organisation-du-n-marche-financier/file>> (accessed 4 January 2021); Dorothee Einsele, *Wertpapierrecht als Schuldrecht: Funktionsverlust von Effektenurkunden im internationalen Rechtsverkehr* (Mohr Siebeck, Tübingen 1995) 7 et seq.

¹³⁹ Alessio M. Paces, 'Financial Intermediation in the Securities Markets: Law and Economics of Conduct of Business Regulation' (2000) 20 *International Review of Law & Economics* 479, 481; Christophe Bernasconi & Harry C. Sigman, 'The Hague Convention on Securities' (2006) 6 *Anuario Espanol de Derecho Internacional Privado* 1191, 1195.

¹⁴⁰ See for instance Tom C.W. Lin, 'Infinite Financial Intermediation' (2015) 50 *Wake Forest Law Review* 643, 658, who has explained the impossibility of substantial disintermediation.

¹⁴¹ As to the terminology, the term "intermediated system" illustrates the static legal aspect of intermediated securities holding patterns. However, the term "securities settlement system" focuses on the functional side of the intermediated system from the perspective of settlement processes (Changmin Chun, *Cross-Border Transactions of Intermediated Securities: A Comparative Analysis in Substantive Law and Private International Law* (Springer, Heidelberg 2012) 3). See Arionna Pretto-Sakmann, *Boundaries of Personal Property: Shares and Sub-shares* (Hart Publishing, Oxford 2005) 49, who asserts that "sub-securities" are a more specific and desirable name.

¹⁴² Intermediated securities are also called *indirectly held securities* and the intermediated system is also called an *indirect holding system*. The notion of indirect holdings has two different meanings. It means first that investors as securities holders may exercise their rights against the issuer only through the intermediary with whom they opened their accounts, and they consequently have no relationship with the issuer. It means, second, that where securities are held with an intermediary, investors are thought to hold securities

pattern with several key participants at different tiers in the securities holding chain, including:

The issuers, with whom the holding chain originates and who may be a company issuing bonds or shares or even a government issuing bonds;

The intermediaries, who in the middle of the chain and include the central securities depositories (hereinafter referred to as CSDs) or international central securities depositories (hereinafter referred to as ICSDs) responsible for keeping securities papers as well as the banks and other financial institutions who maintain securities accounts on behalf of investors or on their own behalf,¹⁴³ and

Investors, who are at the end of the holding chain and who can be individuals, companies, pension funds, and collective investment funds that acquire securities.¹⁴⁴

indirectly through their intermediary independently of whether they can exercise their rights directly against the issuer. In the first view, the focus is on the relationship between the issuer and the investors; in the second view, however, more consideration is given to the mere fact that there is a relationship between investors and intermediaries. The legal regimes of the UK and the US rest on the first understanding while the Korean, Japanese, and Swiss legal concepts are based on the second. Because the terms “indirectly held securities” and “indirect holding system” do not reflect a neutral approach and could be misleading regarding the legal status of investors, the Explanatory Report on the Hague Securities Convention and the Geneva Securities Convention employed the terminology of “intermediated securities” and “intermediated system”. Nevertheless, starting with the second consultation document regarding the EU Securities Law Directive, the EU Commission began using the term “account-held securities” as a neutral term for intermediated securities (see European Commission, *Legislation on Legal Certainty of Securities Holding and Dispositions (Consultation Document)*, DG Market G2 MET/OTacg D(2010) 768690) (hereinafter referred to as European Commission, *Legal Certainty*).

¹⁴³ The Central Securities Depository (CSD) is a very important player in the securities settlement system. A CSD is situated at the top of the pyramid of a country’s intermediated (or indirect) securities holding system. The oldest CSD is the *Wiener Giro- und Kassenverein* founded in Austria on 4 March 1872. Clearstream Banking, Frankfurt (CBF) in Germany, Korea Securities Depository (KSD) in the Republic of Korea, Depository Trust Company (DTC) in the United States, the Japanese Securities Depository Center (JASDEC) in Japan, and SIX SIS AG in Switzerland are further examples of CSDs. See Max Wirth, ‘The History of Banking in Germany and Austria-Hungary’ in Editor of the Journal of Commerce and Commercial Bulletin, *A History of Banking in all the Leading Nations* (volume 4, The Journal of Commerce and Commercial Bulletin, New York 1896) 122–125. However, it is important to underscore that there is no ICSD that specialises in the settlement of securities transactions as well as in the safekeeping and asset servicing of these securities for the entire OHADA region; there are only national CSDs such as the *Caisse autonome d’amortissement* (which is the CSD in Cameroon) or the *Banque Centrale du Congo* (which is the CSD in the Democratic Republic of the Congo).

¹⁴⁴ See in contrast Arionna Pretto-Sakmann (*supra* n 141) 49-49.

The “pyramidal structure of the intermediated system”¹⁴⁵ may be depicted as follows:

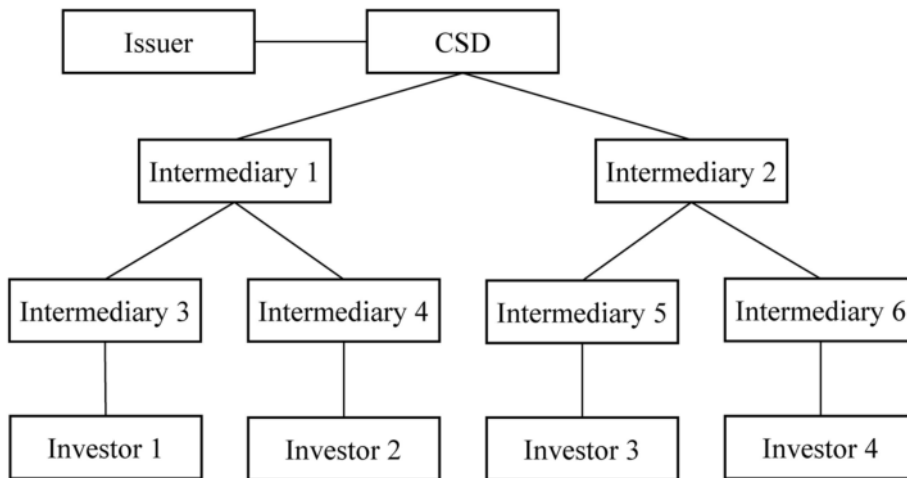


Figure 2: Intermediated Securities Holding Chain with Three Intermediaries

2. Regional and National Legislative Developments in Respect of the Law of Securities

a) Status Quaestionis under OHADA Law

(1) Revision of Uniform Acts at the OHADA Level

OHADA law has attempted to adapt its provisions to developments in the commercial and financial practice described above. In this regard, it is noteworthy that, even before the 2014 revision of the Uniform Act on Commercial Companies, the 1998 version did not totally foreclose the use of intermediated securities. Indeed, in respect of the transferability of securities issued by companies launching a public issue (*sociétés faisant appel à l'épargne publique*), Article 764 2° of the 1998 version of the Uniform Act on Commercial Companies provided that, besides the procedures laid out in Article 764 1°, both registered and bearer securities could be represented by registration in an account opened in the name of their proprietor and held either by the issuing company or a financial intermediary approved by the minister in charge of the economy and finance. In such a case, Article 764 2° provided that the transfer had to

¹⁴⁵ Simon Schwarz, *Globaler Effektenhandel* (Mohr Siebeck, Tübingen 2016) 30. See also Charles W. Mooney Jr., 'Beyond Intermediation: A New (FinTech) Model for Securities Holding Infrastructures' (2019) Faculty Scholarship at Penn Law 2098, available at <https://scholarship.law.upenn.edu/faculty_scholarship/2098> (accessed 4 January 2021), who proposes a “New Platform System” (hereinafter referred to as NPS) for the direct holding of securities that would connect issuers and investors and also connect both with trading and settlement systems.

take place from one account to another. *Pougoué, Nguebou-Toukam, and Anoukaha's* commentary on the provision in Article 764 2°) of the 1998 version reads: "In public limited companies launching a public issue, beside the traditional mechanisms, the transfer of securities can also occur through transfer from account to account. This is made possible through the dematerialisation of the securities representing the rights of the shareholder."¹⁴⁶ Thus, under the provisions in Article 764 2°) of the Uniform Act on Commercial Companies, the direct holding system was the main system for holding and transferring securities; however, the Uniform Act exceptionally allowed some public limited companies to also issue intermediated securities.

Moreover, to address the difficulties resulting from the use of paper certificates and to cope with the developments in commercial practice in the OHADA region, the 2014 revision of the Uniform Act on Commercial Companies introduced a new provision on how securities of public limited companies (*sociétés anonymes*, hereinafter referred to as SA)¹⁴⁷ and the simplified limited company (*société par actions simplifiée*, hereinafter referred to as SAS)¹⁴⁸ must be held and traded. Article 744-1 of the Uniform Act on Commercial Companies provides:

"Securities, whatever their form, must be recorded in an account in the name of their owner. They are transmitted by transfer from one account to another.

The transfer of ownership of securities results from the registration of the securities in the securities account of the purchaser.

¹⁴⁶ Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds) (*supra* n 40) 606.

¹⁴⁷ The SA is governed by Articles 385 to 852 of the Uniform Act on Commercial Companies. The SA or public limited company is defined in Article 385 as a company in which shareholders are only liable for the company debts to the extent of their contributions and in which the rights of the shareholders are represented by shares. An SA can have a single shareholder (Fatimata Meman, 'La société unipersonnelle dans le droit des affaires de l'OHADA: une œuvre (législation) à parfaire' (2014) 868 *Penant: revue trimestrielle de droit africain* 312). The SA must have capital of at least 10 million CFA. If the SA makes public issues (*appel public à l'épargne*), it must have capital of at least 100 million CFA.

¹⁴⁸ Governed by §§ 853-1 to 853-23 of the Uniform Act on Commercial Companies, the SAS is a new type of company introduced after the 2014 revision of the UACC. Under Article 853-1 of the Uniform Act, an SAS is a simplified public limited company formed by one or more shareholders; its articles of association freely regulate the organisation and operation of the company subject to the mandatory rules of the Uniform Act. Shareholders of an SAS are liable for the company's debts only to the extent of their contributions; their rights are represented by shares. Like the SA and the private limited company (*société à responsabilité limitée*, hereinafter referred to as SARL), an SAS can have a single shareholder. The articles of association freely determine the amount of the stated capital and the nominal value of the shares. Insofar as they are compatible with the specific provisions applicable to the SAS, the rules on the SA apply to the SAS, with the exception of Articles 387(1), 414 to 561, 690, and 751 to 753 of the Uniform Act on Commercial Companies.

In the event of transfer of securities admitted to the operations of a central depository or delivered in a payment and delivery system approved by the competent authority of each State party, such registration is done on the date and under the conditions prescribed by the competent market authority.

In other cases, such registration is made on the date fixed by the agreement between the parties and notified to the issuing company.”

Unlike Article 764 2°) of the 1998 version of the Uniform Act on Commercial Companies, Article 744-1 of the Uniform Act on Commercial Companies establishes three techniques to address the problems deriving from the direct holding system: centralisation, immobilisation, and dematerialisation. The securities or the global note are then held by a central depository, which holds them for one or more intermediaries who hold them either for other intermediaries or for investors (centralisation, subsection (ii)). Another technique is the dematerialisation of securities, such that the root title is no longer a piece of paper or the company’s register but rather an electronic entry on a central operator’s books (dematerialisation, subsection (iii)).¹⁴⁹

(2) Centralisation and Immobilisation of Securities

Centralisation refers to concentrating the bookkeeping of dematerialised securities and safekeeping of immobilised securities through CSDs.¹⁵⁰ Since the 2014 revision of the Uniform Act on Company Law, the centralisation of intermediated securities has been mandatory under Article 744-1 of the Uniform Act on Commercial Companies. Indeed, to reduce the movement of physical securities in the marketplace and to facilitate book-entry transfers, Article 744-1 of the Uniform Act on Commercial Companies organises the placement into a CSD of certificates or other documents of title evidencing ownership of financial instruments. Consequently, upon purchase of shares, an investor does not receive a physical certificate and is not required to physically deliver a certificate upon selling the shares. Moreover, as per Article 744-1 of the Uniform Act on Commercial Companies, financial intermediaries must deposit their customers’ stock certificates with a central depository, which then becomes the record holder of the shares represented by the deposit stock certificates.¹⁵¹

The immobilisation of securities alleviates the share transaction process of the burden which arose from the necessity of physically delivering paper certificates.¹⁵² Yet the Uniform Act on Commercial Companies does not deal with

¹⁴⁹ Louise Gullifer (*supra* n 131) 2.

¹⁵⁰ Christophe Bernasconi & Harry C. Sigman (*supra* n 139) 1195; Dorothee Einsele (*supra* n 138) 21; Simon Schwarz (*supra* n 145) 29, 62 et seq.

¹⁵¹ Katsuro Kanzaki, ‘Immobilisation of Stock Certificates: The Position of the Beneficial Shareholder’ (1981) 3 *Journal of Comparative Corporate Law and Securities Regulation* 115, 115–116.

¹⁵² Christophe Bernasconi & Harry C. Sigman (*supra* n 139) 1195.

the disadvantageous collateral effects which can derive from immobilisation. First, it does not address the fact that immobilisation makes communication between company issuers and their shareholders more circuitous due to the interposing of intermediaries and the depository. If the intermediary fails to transmit communications from the issuer to its shareholders in a timely manner, shareholder rights (including the right to vote at shareholders' meetings) might be impinged upon. In addition, if it was to vote on behalf of beneficial shareholders against or without their voting instructions, the intermediary could exercise undue influence over the affairs of the issuers. Secondly, the immobilisation system makes the share record of issuers somewhat uninformative as to the identity of the true shareholders. Indeed, it is difficult for companies to discover their true beneficial shareholders from the share record it keeps.

(3) Dematerialisation of Securities

Dematerialisation refers to the complete elimination of paper certificates as a representation of securities.¹⁵³ Under Article 744-1 of the Uniform Act on Commercial Companies, securities of SAs and SASs can no longer be in the form of paper certificates. Rather, they must be recorded in a securities account on behalf of the owner of the securities. Consequently, the dematerialisation of securities is generalised and imposed on all SA and SAS securities alike. In the former direct holding system, the transfer of bearer securities occurred through physical delivery of the paper certificates (Article 764 1°) of the Uniform Act on Commercial Companies), but under Article 744-1 of the Uniform Act on Commercial Companies the transfer of securities can occur only through a transfer from account to account.

b) The New Act on the Dematerialisation of Securities under the Law of Cameroon

(1) Presentation of the New Act on the Dematerialisation of Securities

Since the Uniform Act on Commercial Companies does not determine the practical modalities of the dematerialisation of securities, the national legislator may complement the OHADA provisions with domestic rules. In 2014, Cameroon adopted the Act n° 2014/007 of 23 April 2014 on the Modalities

¹⁵³ In comparison, France introduced a fully dematerialised system by adopting Article 94-II of the Finance Law for 1982 (*Loi de finances pour 1982*) (Law n° 81-1160 of 30 December 1981); Article 94-II entered into force on 3 November 1984. Many government securities in the United States have been dematerialised for several decades. Nevertheless, most corporate securities continue to be issued in certificated form. See Roy Goode, Hideki Kanda & Karl Kreuzer, *Explanatory Report on the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (Hague Securities Convention)* (2nd edition, Permanent Bureau, The Hague 2017) s Int-21.

for the Dematerialisation of Securities¹⁵⁴ (hereinafter referred to as Act n° 2014/007), which applies to all listed or unlisted securities issued by public or private entities operating in the Republic of Cameroon or subject to its legislation (Article 1(3) of Act n° 2014/007).¹⁵⁵ Under Article 8 of Act n°2014/007, all securities issued in Cameroon or subject to Cameroonian law must be recorded in a securities account. Therefore, the dematerialisation of securities is mandatory for all securities¹⁵⁶ issued in Cameroon or subject to Cameroonian law. Under Article 1(2) of Act n° 2014/007, the dematerialisation of securities operates by substituting the physical securities certificates in favour of registration in electronic form in a securities account. Article 2 of Act n° 2014/007 defines the term “securities account” as an account where the securities are listed and where all transactions relating to such securities are carried out, including transfer, administration, management, and custody.

(2) Modalities for the Dematerialisation of Securities

As per Article 3(1) of Act n°2014/007, the dematerialisation of securities occurs through registering them in an account with the issuer or an account keeper on behalf of their owners.¹⁵⁷ The issuer or intermediary must issue to the owner a confirmation indicating the number of securities held. The confirmation (*attestation de titre*) must contain the following elements:

- (i) The code of the securities’ owner;
- (ii) The identification of the securities’ owner and its address;
- (iii) The value code (International Securities Identification Number, hereinafter referred to as ISIN);¹⁵⁸
- (iv) The indication of the interest rate and maturity for the bonds;

¹⁵⁴ *Loi n° 2014/007 du 23 avril 2014 sur les modalités de dématérialisation des valeurs mobilières au Cameroun*. Act n° 2014/007 is available at <<http://www.leapahead.cm/fr/ench/legislations/cameroon/dematerialisations/dematerialisation-des-valeurs-mobilieres/Loi-2014-007-Sur-La-Dematerialisation-Des-Valeurs-Mobilieres-Cameroun.html>> (accessed 4 January 2021).

¹⁵⁵ As of January 2021, no other OHADA countries have adopted comprehensive complementary provisions regarding the dematerialisation of securities.

¹⁵⁶ The term “security” (*valeur mobilière*) is defined in Article 2 of Act n° 2014/007 as a representation of participation (a share) or a claim (an obligation) issued by public or private legal entities, which is transferable by registration in account and which gives access, directly or indirectly, to a quota of capital of the issuing legal person or to a general right of claim over its assets or the rights attached thereto.

¹⁵⁷ Under Article 2 of Act n° 2014/007, an account holder is an investment company in securities or a credit institution, commonly designated as an “Investment Service Provider” (*Prestataire de Services d’Investissement*), which has received a license from the Financial and Capital Market Commission (*Commission des Marchés Financiers*, hereinafter referred to as FCMC) to provide investment services (in charge of trading in dematerialised securities). See Article 7 of Act n°2014/007.

- (v) The category of assets;
- (vi) The securities debit;
- (vii) The securities credit; and
- (viii) The date of the last update.

As soon as they are registered in the account, the securities are centralised with the *Caisse autonome d'amortissement* (hereinafter referred to as CAA), which is the CSD in Cameroon. The dematerialisation of the securities must be carried out by the issuer (Articles 4 and 9 of Act n°2014/007). Under Articles 13 and 14 of Act n°2014/007, companies had until no later than two years after the promulgation of the Act to dematerialise their securities under the supervision of the FCMC.

The global dematerialisation of securities in Cameroon under Act n°2014/007 can be described as in the figure on the next page.

B. Basic Structure of OHADA's Indirect Holding System Compared to Existing Models of Intermediated Systems

I. Introduction

So far there is no international uniform legal approach for the intermediated system. Indeed, different jurisdictions have dealt with the issues arising from intermediation in a variety of ways. Each jurisdiction follows its own intermediated securities holding model.¹⁵⁹ However, at a very broad level, the different intermediated securities holding models can be boiled down to five general categories: individual ownership (II), co-ownership (III), trust (IV), security entitlement (V), and contractual models (VI). Moreover, when it comes to the identification of the investor, a distinction is made between transparent and non-transparent systems (VII). The following section lays out the basic structure of the indirect holding system in the OHADA region. Understanding this basic structure will have a bearing on the conflict of laws analysis, particularly when it comes to its compatibility with the rules of the Hague Securities Convention.¹⁶⁰

¹⁵⁸ The ISIN Code is an international identification number assigned by the Central Depository to securities (shares, bonds, etc.) at the time of issue. The ISIN code is a twelve-character international alphanumeric code assigned to each security whose first two letters identify the country in which the value was issued (for example: CM0000035113). This is the code used by the Central Depository to identify the securities.

¹⁵⁹ Christophe Bernasconi & Harry C. Sigman (*supra* n 139) 1195. *See also* Simon Schwarz (*supra* n 145) 38, who distinguishes transparent from transparent intermediated systems.

¹⁶⁰ *See* part III, chapter 4, section C, subsection III.5 of this thesis.

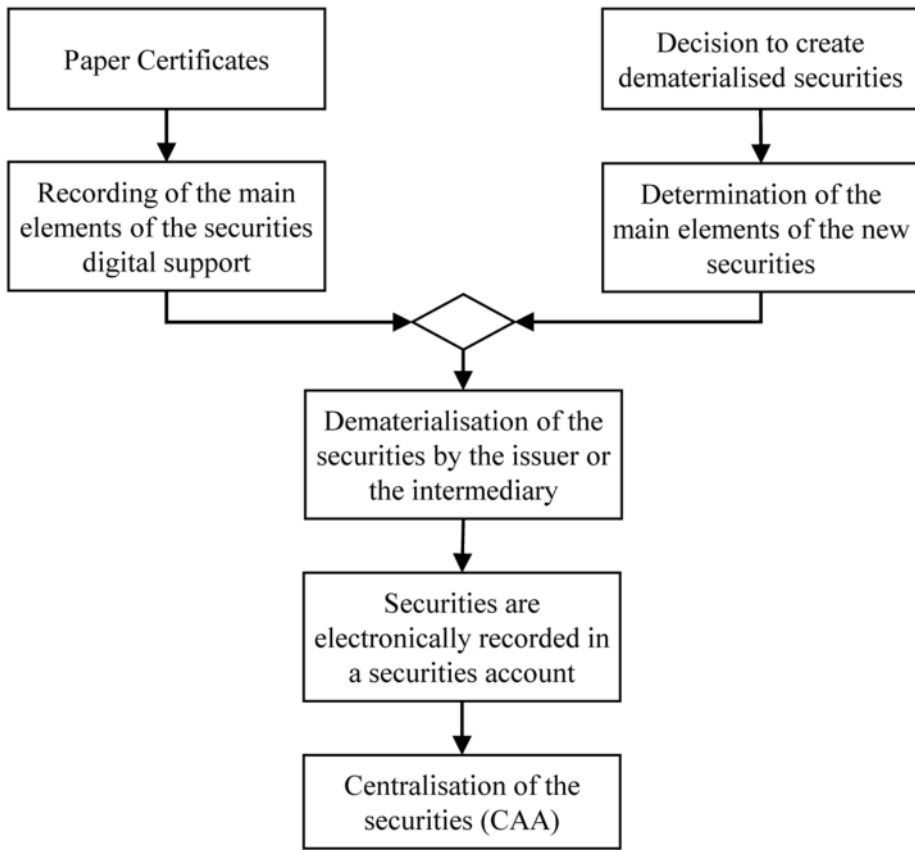


Figure 3: Global Dematerialisation of Securities in Cameroon under Act n° 2014/007

II. The Individual Ownership Model

Under this model, the intermediaries (including the CSD) have no interest in the securities, which are deemed to be located directly in a securities account of the investor. Only the investor has full and individual ownership over the securities. Intermediaries can only have rights over an investor’s securities in specific, exceptional situations where a security interest is provided to an intermediary.¹⁶¹ It is only through its own securities account with its intermediary – and not through any other intermediary – that the investor can access its securities.

For instance, under OHADA law, where securities are recorded by way of book entries at the CSD, the CSD acts only as a register for the issuer and for other participants acting on behalf of the issuer. The intermediaries (including the CSD) have no interest in the securities. Since investors are the sole owners of the securities, they have the right to require a new recording of those securities in their names in case the CSD or any other intermediary becomes insolvent.¹⁶²

¹⁶¹ That situation is envisaged in Article 152 second sentence of the Uniform Act on Security Interests, which contemplates a situation in which a securities account is given in pledge by the account holder to its intermediary.

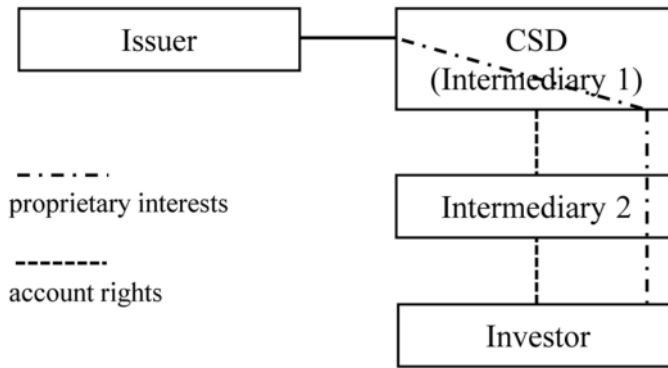


Figure 4: Individual Ownership Model

III. The Co-Ownership Model

Under the co-ownership model, the issuer deposits the securities with the CSD in the form of a global certificate. The securities are then credited by the CSD to the securities accounts of its participants, which are typically investors or banks acting as intermediaries on behalf of other intermediaries. Under this model, each investor has a co-ownership which corresponds to its holding of a pool of securities held by the CSD. The investor accesses its securities through its intermediary. Because of the pooling of securities, it is impossible for the CSD or any other intermediary above the investor’s intermediary to identify a particular investor’s specific holdings. And since neither the CSD nor the other intermediaries own the securities, the investor’s securities will not be part of the insolvency estate in the event of an insolvency of the CSD or any other intermediary. The investor may exercise and, when necessary, enforce the rights attached to the securities. Countries such as Austria, Germany, and other civil law jurisdictions apply the co-ownership model. OHADA does not follow this model.

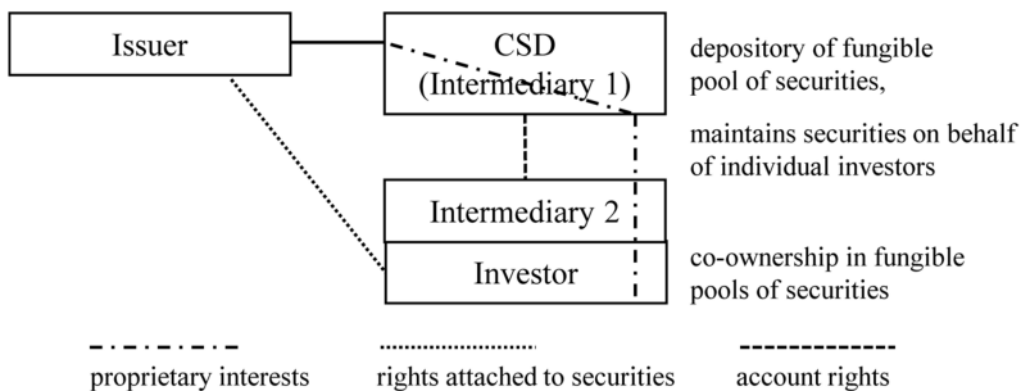


Figure 5: Co-ownership Model

¹⁶² As noted *infra* (subsection VII), some systems that follow the individual ownership model are so-called transparent systems.

IV. The Trust Model

Under the trust model, the CSD is provided with the issuer's securities for safe-keeping and acts as the issuer's register. It has no legal interest in the securities. The legal owners of the securities – whether held for themselves or for in the name of their clients – are the CSD's participants and are generally other intermediaries such as banks and other financial institutions.¹⁶³ From the moment those intermediaries credit those securities to the accounts of their account holders, they become trustees for the account holders, who are regarded as beneficiaries. As in the previous models, it is only through their relevant intermediaries¹⁶⁴ that investors can access their securities. The trust model is applied notably in Australia, England and Wales, and Ireland. OHADA law does not follow this model.

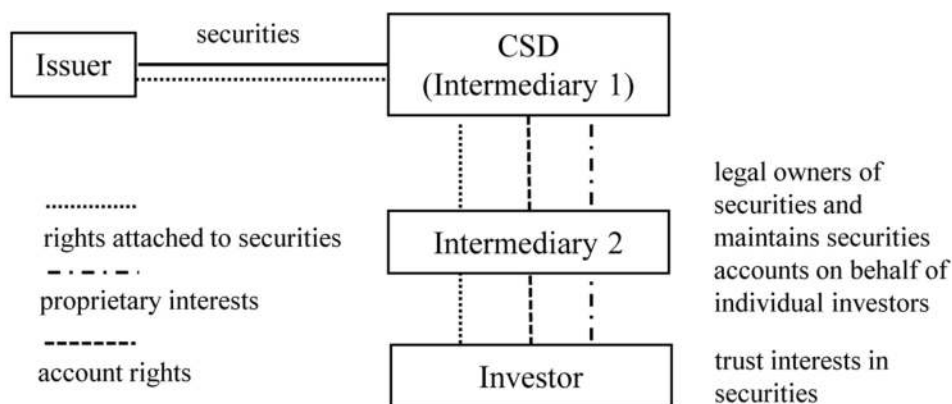


Figure 6: Trust Model

V. The Security Entitlement Model

In the security entitlement model, each securities account holder has a security entitlement against its relevant intermediary. The security entitlement encompasses a *sui generis* bundle of rights which the account holder has over the asset maintained with the intermediary and against the intermediary. In other words, there are security entitlement holders at each tier of the intermediated securities holding chain below the CSD.

The entitlement holder may not exercise economic or other rights to the financial asset directly against the issuer.¹⁶⁵ Nevertheless, the intermediary is obliged to obtain and pass on to the entitlement holder the rights which are

¹⁶³ UNIDROIT, *UNIDROIT Legislative Guide on Intermediated Securities, Implementing the Principles and Rules of the Geneva Securities Convention* (UNIDROIT, Rome 2017) s 45.

¹⁶⁴ "Relevant intermediary" means the intermediary that maintains the securities account for the account holder (see Article 1(1)(g) of the Hague Securities Convention).

¹⁶⁵ UNIDROIT (*supra* n 163) s 47.

attached to the securities. Further, the intermediary must exercise such rights on behalf of the entitlement holder. As to the investors at the end of the holding chain, it is only through their relevant intermediary rather than through any others in the chain that they can access their securities. In case of insolvency of an intermediary, the account holder is protected because security entitlements are mingled with the estate of the intermediary.

The security entitlement model is applied notably in Canada and the United States of America. OHADA law does not follow this model.

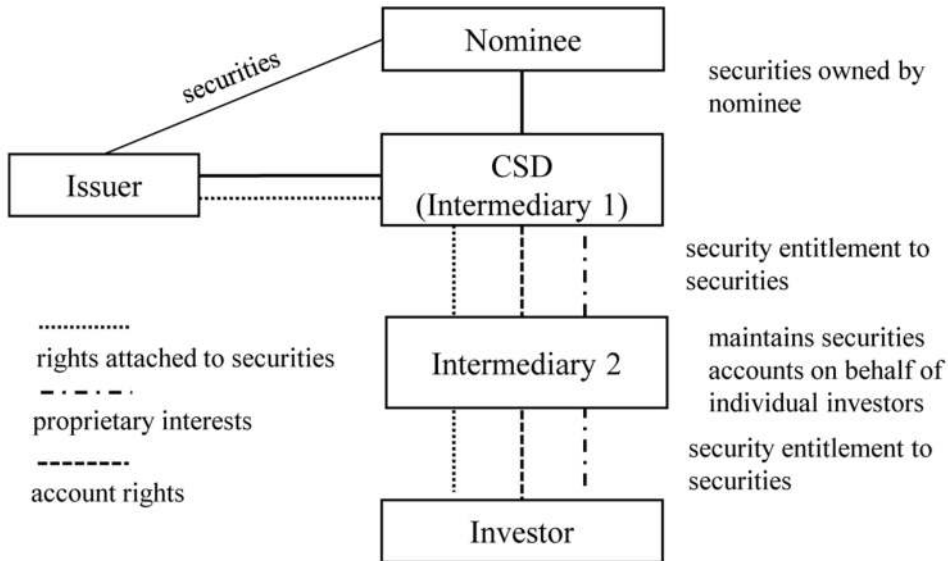


Figure 7: Security Entitlement Model

VI. The Contractual Model

Under this model, the investors do not acquire property interests in the securities. Instead, they acquire contractual rights vis-à-vis the relevant intermediary. In the contractual model, the whole holding chain from the CSD to the final investor consists of a network of bilateral contracts. The CSD appears in the issuer's book as the registered holder. Therefore, the rights and benefits are passed on through the holding chain from one intermediary to another and down to the investor.

The legal framework on various issues (such as the consequences for the rights of an investor if an intermediary becomes insolvent) is set out in the terms and conditions of the relevant contracts between participants. Nevertheless, domestic insolvency law usually governs to a significant extent the investor's rights and claims vis-à-vis the estates of the intermediary.¹⁶⁶ Under this model, protecting investors or insolvent remote intermediaries is critical,

¹⁶⁶ UNIDROIT (*supra* n 163) s 50.

as an investor’s contractual rights alone do not provide sufficient protection in the event of an intermediary’s insolvency.

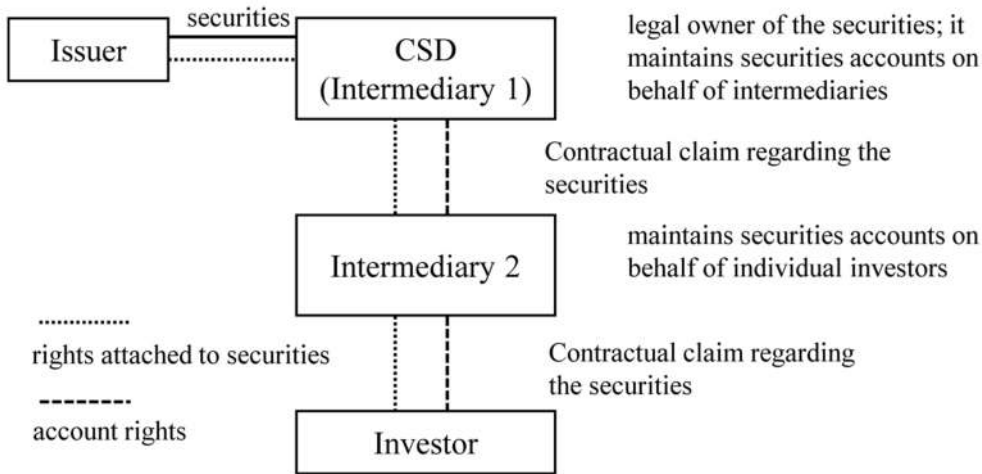


Figure 8: Contractual Model

VII. Identifying the Investor: Transparent and Non-transparent Systems

1. Introduction

Some systems are known as “transparent.” In these, the holdings of a specific investor are known to or can be identified by the CSD directly. This is because the responsibility for maintaining a securities account is divided between the CSD and other account operators.¹⁶⁷ Presented below are three categories of transparent systems. What they have in common is that investors and their individual holdings are identified at the CSD level.

The three categories of transparent systems are:

- Those in which the investor’s holdings are held in an account with the CSD;
- Those in which the holdings of the investor are identified in an intermediary’s account with the CSD; and
- Those in which the holdings of an investor are held by an intermediary in an omnibus account at the CSD and account information is registered on a regular basis.

In non-transparent systems, the investor’s interests in the securities are identified not at the level of the CSD¹⁶⁸ but rather at the level of the relevant inter-

¹⁶⁷ Thomas Keijser & Charles W. Mooney, Jr., ‘Intermediated Securities Holding Systems Revisited: A View Through the Prism of Transparency’ in Louise Gullifer & Jennifer Payne (eds), *Intermediation and Beyond* (Hart Publishing, Oxford 2019) 309, 331–335.

¹⁶⁸ Simon Schwarz (*supra* n 145) 38.

mediary.¹⁶⁹ In addition, some systems are considered “mixed,” one part being transparent and another non-transparent.¹⁷⁰

2. Transparent Systems in Which the Holdings are Held in an Account with the CSD

In such systems, the CSD maintains separate accounts for each investor, and the intermediaries merely operate them. Hence, the intermediaries serve in the capacity of “technical interface” between the CSD and the investor.

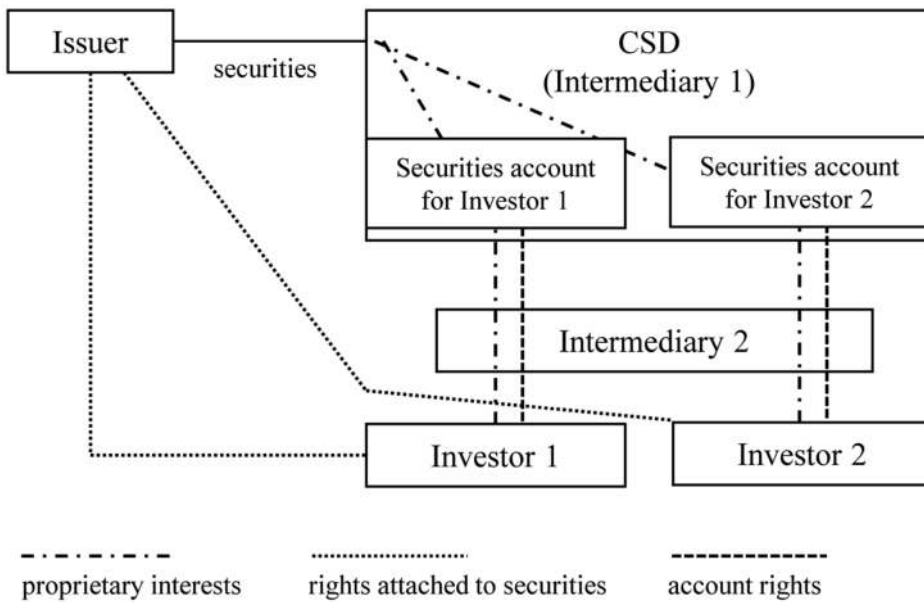


Figure 9: Transparent Systems in Which the Holdings are Held in an Account with the CSD

3. Transparent Systems in Which the Holdings of the Investor are Identified in an Intermediary Account with the CSD

In such a system, the CSD maintains accounts on behalf of the intermediaries. Each of the intermediary’s clients is allocated a sub-account to reflect the client’s holding.

¹⁶⁹ UNIDROIT (*supra* n 163) s 52; Simon Schwarz (*supra* n 145) 38.

¹⁷⁰ Moreover, cross-border holding chains which originate in a transparent system are mixed. Indeed, once it reaches across a border and becomes an international one, such a holding chain ceases to be transparent. See UNIDROIT (*supra* n 163) s 53.

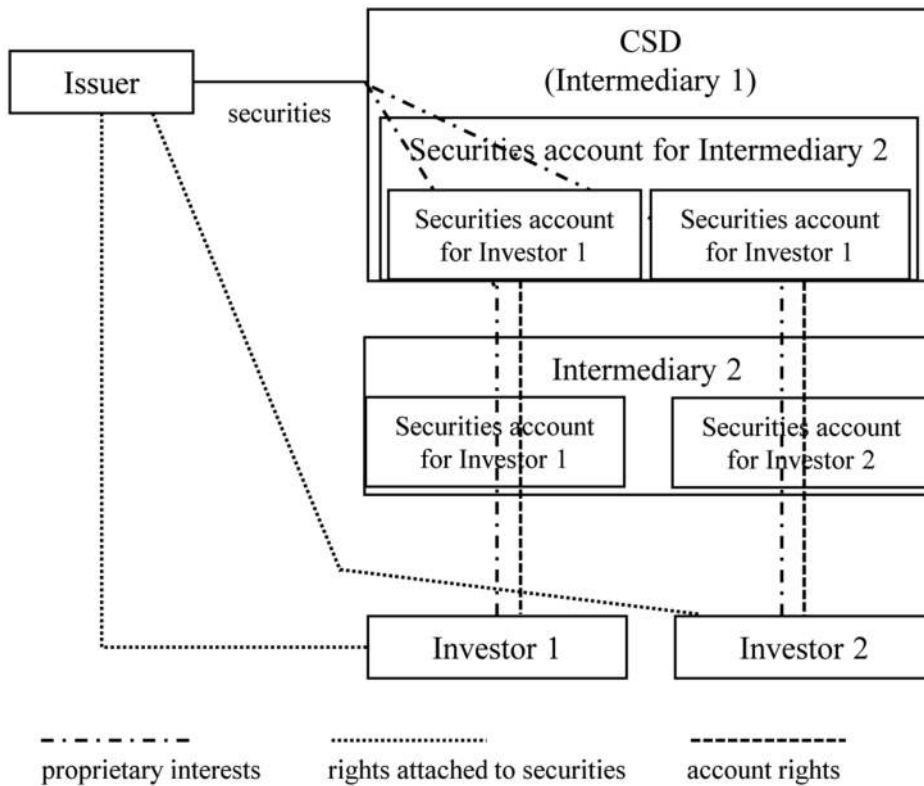


Figure 10: Transparent Systems in Which the Holdings of the Investor Are Identified in an Intermediary Account with the CSD

4. Transparent Systems in Which an Investor's Holdings are Held by an Intermediary in an Omnibus Account at the CSD

In such a system, the CSD maintains an omnibus account in the name of the intermediaries, which in turn maintain separate accounts for each of their clients. Continuous or regular consolidation takes place between the CSD and the intermediaries regarding information on those separate accounts. This enables the CSD to exactly determine what the clients hold.

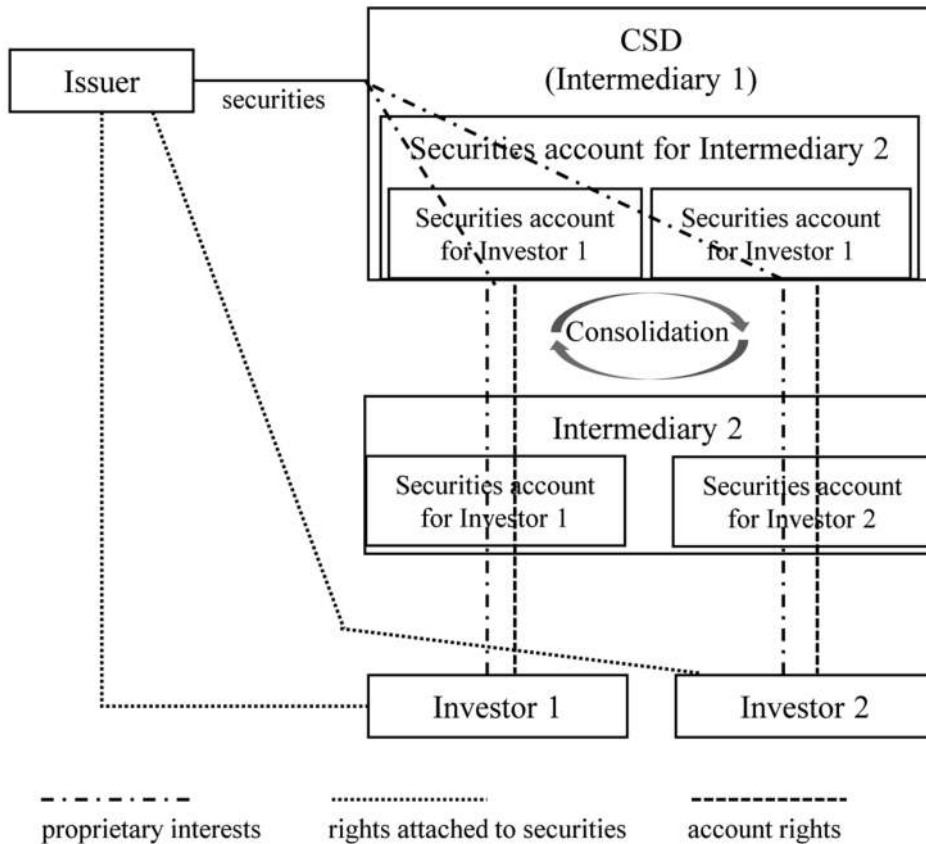


Figure 11: Transparent Systems in Which an Investor's Holdings are Held by an Intermediary in an Omnibus Account at the CSD and the Account Information is Registered on a Regular Basis

C. Summary and Evaluation

Traditionally, securities in the OHADA region were exclusively held, traded, and settled in a “direct holding system”. In such a system, owners of securities had a direct relationship with the issuer.

However, since the direct holding system depended on the movement of paper certificates, the physical exchange of certificates made transfers of securities labour-intensive, time-consuming, expensive, and even risky. Moreover, physical certificates are less secure than electronic book-entry as they are vulnerable to loss, theft, acts of God, etc.

Because of these disadvantages, and thanks to recent technological developments, the transfer and holding of securities in the OHADA region no longer relies heavily on pen and paper, and investors no longer hold securities certificates themselves. An investor's interests in the underlying securities are instead recorded in the books of an intermediary such as a bank or a securities firm. In turn, that intermediary records its interest with another intermediary, and so on up the chain until the intermediary either is recorded as the regis-

tered owner on the books of the issuer or the issuer's official record holder, or until one arrives at an intermediary who holds the certificates or other documents of title representing the securities. This creates a pyramid structure which involves a chain and a hierarchy of intermediaries.

As to the basic structure of the intermediated system in the OHADA region, OHADA follows an individual ownership model; the intermediaries (including the CSD) have no interest in the securities (unless of course such an interest is granted to them), and the securities are deemed to be directly located in the investor's securities account. Only the investor has full and individual ownership over the securities.

However, the law of most OHADA member states except for Cameroon has yet to catch up with these developments. At the OHADA level, a 2010 revision of the Uniform Act on Security Interests and a 2014 revision of the Uniform Act on Commercial Companies attempted to address the legal issues resulting from the emergence of the intermediated system, more particularly from the use of intermediated securities as collateral (Articles 146 et seq of the Uniform Act on Security Interests).

Part II

Reports on National, Regional, and International Substantive Law Rules in Respect of Security Interests in Intermediated Securities

Chapter 1: The Pledge of Securities Accounts under the OHADA Uniform Act on Security Interests

A. Introduction: Relevance of the 2010 Revision of the Uniform Act on Security Interests

Articles 64 et seq of the 1997 version of the Uniform Act on Security Interests contained provisions organising the pledge of securities.¹ These provisions were complemented by Articles 322, 747, 773, and 773 of the 1997 version of the Uniform Act on Commercial Companies and by Articles 44 and 45 of the Uniform Act on General Commercial Law. However, with the dematerialisation of securities in the OHADA region,² the rules in Articles 64 et seq of the Uniform Act on Security Interests and the traditional general rules of pledge³ became inadequate. Therefore, a revision of the Uniform Act on Security Interests⁴ adopted by the Council of Ministers on 15 December 2010 introduced

¹ In the revised version of the same Uniform Act, these provisions are found in Articles 140 et seq. The 1997 version is available at <<http://www.ohada.com/actes-uniformes/458/uniform-act-on-security-interests.html>> (accessed 4 January 2021). The revised version of the Uniform Act of 15 December 2010 is available at <<http://www.ohada.com/actes-uniformes/938/acte-uniforme-revise-portant-organisation-des-suretes.html>> (accessed 4 January 2021).

² See part II, chapter 2 of this thesis.

³ For more details on the traditional rules of pledge, see Articles 92 et seq and 140 et seq of the Uniform Act on Security Interests. See also Dalé Hélène Labitey, ‘Quelles sûretés réelles pour l’OHADA?’ (2011) 6 *Revue Congolaise des Affaires* 37. On the discrepancy of the traditional rules of pledge in the intermediated system, see Stéphane Mouy & Hubert de Vauplane, ‘La réforme du nantissement des titres dématérialisés’ (1996) *Banque et Droit* 3.

⁴ For more details on the revised Uniform Act on Security Interests, see Pierre Crocq, ‘Les grandes orientations du projet de réforme de l’Acte uniforme portant organisation des sûretés’ (2010) 197 *Droit et patrimoine* 78; Boubacar S. Diarra, ‘Les innovations introduites dans l’Acte uniforme portant organisation des sûretés’ (2011) 5 *Revue de droit uniforme africain*, Dossier spécial “Révision de l’Acte uniforme OHADA portant organisa-

the pledge of intangible properties including securities accounts. Article 126 of the Uniform Act on Security Interests determines the intangible assets that can be pledged; they are, “notably”,⁵ receivables, bank accounts, rights of partners, securities and financial instruments accounts, and intellectual property rights. The pledge of securities accounts is a new type of pledge governed by Articles 146 et seq of the Uniform Act on Security Interests and by additional provisions of the Uniform Act on Commercial Companies (Articles 747, 764, 772, 773, and 773-1).⁶ It is an adaptation of the rules of traditional pledges to intermediated securities and allows active use of the pledged securities account while protecting the interests of the collateral taker.

The following sections analyse the definition of the pledge of securities accounts (B), the relationship between the provisions of the various Uniform Acts that apply to the pledge of securities accounts (C), the constitution of a pledge of a securities account (D), the basis of the pledge (E), the right to use the intermediated securities recorded in the pledged securities account (F), and the realisation of the pledge (G).

B. Scope of Application of Articles 146 et seq of the Uniform Act on Security Interests

I. Definition of the Pledge of Securities Accounts

1. Limited Material Scope

Article 146 of the Uniform Act on Security Interests defines a pledge of securities accounts as an agreement by which the collateral provider assigns as

tion des sûretés” 3; Jean-Jacques Lecat & Pierre Marly, *Le nouveau droit des sûretés* (Editions Francis Lefebvre, Paris 2011); Gaston Kenfack Douajni, ‘Les nouvelles sûretés introduites dans l’Acte uniforme sur les sûretés adopté le 15 décembre 2010’ (2011) *Revue de l’ERSUMA* 81, 81–82; Moussa Samba, ‘La révision des sûretés personnelles en droit OHADA’ (2011) 5 *Revue de Droit Uniforme Africain* 8, 8; Kouakou Mathurin Brou, ‘Le nouvel Acte uniforme portant organisation des sûretés et l’accès au crédit dans l’espace OHADA’ (2012) 1 *Juris Ohada* 3.

⁵ The use of the word “notably” in Article 126 of the Uniform Act on Security Interests indicates that the list in that provision is not exhaustive. See *La Financière du Burkina v Ouedraogo Fatimata & Centre Hospitalier Universitaire Yalgado Ouedraogo* [2006] Tribunal de Grande Instance de Ouagadougou, judgment n° 130/06 of 22 March 2006, Ohada.com/Ohadata J-07-134; *Financière du Burkina v Ouedraogo Fatimata & Centre Hospitalier Universitaire Yalgado Ouedraogo* [2007] Cour d’appel de Ouagadougou, Chambre commerciale, judgment n° 053 of 15 March 2007, Ohada.com/Ohadata J-09-52. See also Joseph Issa-Sayegh in Joseph Issa-Sayegh, Paul-Gérard Pougué & Filiga Michel Sawadogo (eds), *OHADA: Traité et Actes Uniformes Commentés et annotés* (Juriscope, Poitiers 2014) 920.

⁶ In respect of the relationship between the provisions of the different Uniform Acts applying to the pledge of securities accounts, see section C below.

collateral for an obligation all the securities and other financial securities appearing in its account.⁷ It is worth noting that the formulation *nantissement de compte-titres* is modelled after Ordinance n° 2009-15 of 8 January 2009 on Financial Instruments⁸ as well as after Article L. 211-20 of the Monetary and Financial Code under French law.⁹ The Uniform Act on Security Interests regulates the “pledge” (*nantissement*) of securities accounts. Unlike the Geneva Securities Convention, the fifth chapter of which deals with “collateral transactions” and “collateral agreements”¹⁰ in respect of intermediated securities in general, Articles 146 et seq of the Uniform Act on Security Interests deal only with the pledge of securities accounts. In other words, pledges of securities accounts are the only collateral transaction on intermediated securities that the Uniform Act on Security Interests specifically regulates. Hence, the material scope of Articles 146 et seq does not include other types of collateral agreements on intermediated securities such as title transfer collateral arrangements, in which full ownership is transferred to the collateral taker.¹¹

⁷ The original French version of the provision reads: “Le nantissement d’un compte de titres financiers est la convention par laquelle le constituant affecte en garantie d’une obligation l’ensemble des valeurs mobilières et autres titres financiers figurant dans ce compte.”

⁸ *Ordonnance n° 2009-15 du 8 janvier 2009 relative aux instruments financiers*, available at <<https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000020052506>> (accessed 4 January 2021).

⁹ Note that the Ordinance of 8 January 2009 was complemented by the Decree n° 2009-297 of 16 March 2009 which replaced the provisions in Articles D. 431-1 et seq with Articles D. 211-10 et seq of the Monetary and Financial Code. For more information on the legislative evolution under French law of rules in respect of the pledge of securities accounts, see Jean-François Adelle, ‘Le régime du nantissement de compte d’instruments financiers se modernise’ (2005) 830 *Option finance* 34; Franck Auckenthaler, ‘Le gage de comptes d’instruments financiers après l’ordonnance du 24 février 2005’ (2005) *JCP éd.* 1728; David Robine, ‘La réforme du gage de compte d’instruments financiers par l’ordonnance n° 2005-171 du 24 février 2005’ (2005) *Bull. Joly Bourse* 400; Pierre-Grégoire Marly, ‘De quelques avatars du gage de compte d’instruments financiers (À propos de l’ordonnance du 24 février 2005 sur les contrats de garantie financière)’ (2005) *Banque et Droit* 32.

¹⁰ See Article 31(1) of the Geneva Securities Convention, which sets out the material scope of Chapter V of the Geneva Securities Convention. Under that provision, Chapter V of the Convention applies to “collateral agreements”, which include both security and title transfer collateral agreements. See also Article 31(3)(a) of the Geneva Securities Convention, which defines a collateral agreement as “a security collateral agreement or a title transfer collateral agreement”.

¹¹ Note that under Article 31(3)(c) of the Geneva Securities Convention, “title transfer collateral agreement” means an agreement, including an agreement providing for the sale and repurchase of securities, between a collateral provider and a collateral taker providing (in whatever terms) for the transfer of full ownership of intermediated securities by the collateral provider to the collateral taker for the purpose of securing or otherwise covering

2. Pledges of “Securities Accounts” rather than of “Intermediated Securities”

Moreover, it is important to note that Article 146 of the Uniform Act on Security Interests deals with pledges of “securities accounts” rather than of “intermediated securities”. Therefore, under Articles 146 of the Uniform Act on Security Interests it is not possible to provide intermediated securities *per se* as collateral directly.¹² Rather, it is only the securities account as a whole which may be given as collateral; the intermediated securities are given as collateral only indirectly. Like both Ordinance n° 2009-15 of 8 January 2009 on Financial Instruments¹³ and Article L. 211-20 of the Monetary and Financial Code under French law, the Uniform Act on Security Interests does not define the concept of a “securities account”, and that concept is likewise neither defined nor used in the Uniform Act on Commercial Companies. By comparison, the Hague Securities Convention defines a “securities account” as “an account maintained by an intermediary to which securities may be credited or debited” (Article 1(b)). Under the Geneva Securities Convention, a “securities account” is “an account maintained by an intermediary to which securities¹⁴ may be credited or debited” (Article 1(c)). Hence, it may be contended that the term “securities account” in the Uniform Act on Security Interests should be broadly interpreted to include any form of record of entitlement and transfers at any level from the lowest-level account holder up to a CSD or an ICSD. When applying Articles 146 et seq of the Uniform Act on Security Interests, it is immaterial whether the securities account is governed by an oral or a written agreement; nevertheless, it is more likely that the securities account will be governed by a written agreement.¹⁵

the performance of relevant obligations. Under OHADA law, title transfer collateral agreements are regulated in the Uniform Act on Security Interests, Articles 79 et seq. *See* Joseph Issa-Sayegh, ‘La mise en gage des comptes bancaires’ (2006) 5 *Revue de droit des affaires internationales* 697, 699.

¹² *See* in comparison Simon Schwarz, *Globaler Effektenhandel* (Mohr Siebeck, Tübingen 2016) 402–404.

¹³ Ordonnance n° 2009-15 du 8 janvier 2009 relative aux instruments financiers, available at <<https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000020052506>> (accessed 4 January 2021).

¹⁴ Under Article 1(a) of the Geneva Securities Convention, “securities” are shares, bonds, or other financial instruments or financial assets (other than cash) that are capable of being credited to a securities account and of being acquired and disposed of according to the provisions of the Convention. This definition is similar to that in Article 1(a) of the Hague Securities Convention.

¹⁵ *See* Article 5(2) of the Hague Securities Convention, which envisages the possibility of an account without an account agreement. Such is the case for instance with a Nordic CSD that is an intermediary according to Article 1(4) of the Hague Securities Convention and that maintains securities accounts governed not by an account agreement but by law

II. Relationship between the Provisions of the Different Uniform Acts applying to the Pledge of Securities Accounts

1. Provisions applying to the Pledge of Securities

Under OHADA law, pledges not only of securities accounts but of securities in general are governed by several provisions enshrined in the Uniform Act on Security Interests and in the Uniform Act on Commercial Companies:¹⁶

- (i) Articles 322, 747, 772, 773, and 773-1 of the Uniform Act on Commercial Companies (in connection with Article 764 of the same Uniform Act); and
- (ii) Articles 146 et seq of the Uniform Act on Security Interests.

It is worth mentioning that there are provisions in the Uniform Act on Collective Proceedings for the Clearing of Debts which provide that pledges and collateral transactions are unenforceable against the body of creditors during preventive settlement and bankruptcy proceedings.¹⁷

2. Prevalence of the Uniform Act on Security Interests

Since the aforementioned Uniform Acts all contain provisions on pledges of securities, the following passage aims to determine which one will ultimately govern each of the various legal issues that may arise in respect of a pledge of a securities account. In its 1997 version, Article 747 of the Uniform Act on Commercial Companies¹⁸ contained provisions regarding how pledges of securities are constituted.¹⁹ However, since this type of collateral was later included in the 2010 revision of the Uniform Act on Security Interests (Articles 146 et seq), the 2014 revision of the Uniform Act on Commercial Com-

and by the rules of the CSD (Roy Goode, Hideki Kanda & Karl Kreuzer, *Explanatory Report on the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (Hague Securities Convention)* (2nd edition, Permanent Bureau, The Hague 2017) ss 1-7 and 5-7. Under OHADA law, since there are no specific provisions in the Uniform Act on Commercial Companies or in the Uniform Act on Security Interests in respect of securities accounts, nothing prevents the parties from entering into an oral securities account agreement. But this is very unlikely in financial markets in the OHADA region.

¹⁶ The contents of these provisions are analyzed *infra*.

¹⁷ See for instance Articles 9(3), 18(2), 68(5), 149, and 167(5) of the Uniform Act on Bankruptcy Proceedings.

¹⁸ The 1997 version of the Uniform Act on Commercial Companies is available at <<http://www.ohada.com/actes-uniformes/98/acte-uniforme-relatif-au-droit-des-societes-commerciales-et-du-groupement-d-interet-economique.html>> (accessed 4 January 2021).

¹⁹ Joseph Issa-Sayegh in Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds) (*supra* n 5) 602.

panies²⁰ modified this act's Article 747 to provide that pledges of securities recorded in an account are constituted under provisions of the Uniform Act on Security Interests. Pursuant to the new provision of Article 747 of the Uniform Act on Commercial Companies, Articles 146 to 150 of the Uniform Act on Security Interests prevail over the provisions of other Uniform Acts:

“Subject to the provisions of Articles 772 and 773 hereinafter, the pledge of securities recorded in an account shall be instituted in accordance with the provisions of the uniform Act on security interests.

The enforcement of pledge of the financial instruments account shall be carried out, for securities other than financial instruments admitted to trading on a regulated stock exchange, in accordance with the provisions of Articles 104 and 105 of the uniform Act on security interests.”

Nevertheless, Articles 772 to 773-1 of the Uniform Act on Commercial Companies complement Articles 146 and 147 of the Uniform Act on Security Interests in situations where the pledge of the securities is subject to approval by the other shareholders. Indeed, the shareholder must inform the company of its plan to pledge its securities (Article 773 of the Uniform Act on Commercial Companies); if the company agrees to the pledge of shares, such an agreement entails the consent of the collateral taker in the event of the realisation of the pledge by way of appropriation by the collateral taker (Article 772 of the Uniform Act on Commercial Companies).²¹ This provision is important, since it usefully complements Article 147 of the Uniform Act on Security Interests in case the pledged securities account contains securities that are subject to an approval clause. This specific aspect is further analysed *infra*.²²

The following table sums up the relationship between the provisions in respect of the pledge of securities accounts under the Uniform Act on Security Interests, the Uniform Act on Commercial Companies, and the Uniform Act on Collective Proceedings for the Clearing of Debts.

²⁰ The 2014 revision of the Uniform Act on Commercial Companies can be found at <<http://www.ohada.com/actes-uniformes/1299/uniform-act-on-commercial-companies-and-the-economic-interest-group.html>> (accessed 4 January 2021).

²¹ Nevertheless, it is worth mentioning that Article 772 of the Uniform Act on Commercial Companies allows the company to avoid the realisation of the pledged securities by repurchasing them and reducing its capital.

²² Subsection D.I.1.c of this chapter.

Table 4: Provisions on Pledges of Securities Accounts under different Uniform Acts

Issues	Uniform Act on Security Interests	Uniform Act on Commercial Companies	Uniform Act on Collective Proceedings for the Clearing of Debts
<p><i>General Rule: Articles 146 et seq. of the Uniform Act on Security Interests prevail (see Article 747 of the Uniform Act on the Law of Commercial Companies)</i></p>			
Constitution of the pledge	Articles 146 and 147 (in conjunction with Articles 149 and 150)	<p>This Uniform Act complements the Uniform Act on Security Interests in two situations:</p> <p><i>a) If the securities are subject to an approval clause:</i></p> <p>Articles 322, 765, 772, 773, and 773-1; and</p> <p><i>b) Company taking its own shares as collateral:</i> Article 642 (in connection with Article 640)</p>	—
Basis of the pledge	Articles 148 and 150	—	—
Right of use	Article 151	—	—
Enforcement	Articles 152, 153, 154, and 155 (in connection with Articles 104 and 105)	<p>See Article 747(2), which refers to Articles 104 and 105 of the Uniform on Security Interests</p>	—
Unenforceable acts against the body of creditors in a bankruptcy proceeding against the account holder	—	—	Article 68 (in connection with Article 67)

C. *How a Pledge of a Securities Account is Constituted*

I. *Requirement of a Declaration establishing the Pledge*

1. *The Declaration establishing the Pledge*

Article 147(1) of the Uniform Act on Security Interests requires a declaration to establish a pledge of a securities account; the pledge of a securities account is established “[...] between the parties and vis-à-vis the issuer of the intermediated securities and third parties by a declaration dated and signed by the account holder.”²³ Article 147(1) of the Uniform Act on Security Interests reflects the provision contained in Article 747(1) first sentence of the 1997 version of the Uniform Act on Commercial Companies:

“Subject to the provisions of Articles 772 and 773 of this Uniform Act, the pledging (*sic*) of transferable securities put on account shall be carried out, with respect to both the issuing corporate body and third parties, by a statement dated and signed by the holder of the securities. The statement shall contain the amount of money due as well as the amount and nature of the securities pledged.”

The provision in Article 147(1) of the Uniform Act on Security Interests is liable to the criticism that it implies that a pledge of a securities account can be established solely by the declaration of the account holder. However, the declaration *per se* cannot suffice in order to create a pledge; the declaration must be preceded by the formation of a pledge agreement.²⁴ As mentioned above, Article 147 of the Uniform Act on Security Interests is modelled on French law, more particularly on the French Ordinance n° 2009-15 of 8 January 2009 on Financial Instruments²⁵ and on Article L. 211-20 of the French Monetary and Financial Code. Before the adoption of Article L. 211-20 of the Monetary and Financial Code, the Cour de cassation had decided that the declaration establishing a pledge of a securities account foreseen in Article 29 of the Law of 3 January 1983²⁶ was not to be interpreted as a requirement for the validity of the pledge; the Cour de cassation indicated instead that the declaration only aims to inform the intermediary, the issuer, or any other third party about that a

²³ The original version in French reads: “Le nantissement de comptes de titres financiers est constitué, tant entre les parties qu’à l’égard de la personne morale émettrice et des tiers, par une déclaration datée et signée par le titulaire du compte.” See also Articles 65 and 141 of the Uniform Act on Security Interests.

²⁴ Alain Couret et al, *Droit financier* (2nd edition, Dalloz, Paris 2012) s 1182.

²⁵ Ordonnance n° 2009-15 du 8 janvier 2009 relative aux instruments financiers, available at <<https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000020052506>> (accessed 4 January 2021).

²⁶ Law of 3 January 1983 on the development of investments, the protection of savings, and the accounting system of certain securities (*Loi n° 83-1 relative au développement des investissements, la protection de l’épargne et l’inscription en compte des valeurs mobilières*).

pledge has been constituted and therefore to limit the powers of the account holder over the pledged securities account.²⁷ This rationale is also reflected in the formulation in the 1997 version of Article 747 of the Uniform Act on Commercial Companies, which provided that the pledge of intermediated securities “shall be carried out, *with respect to both the issuing corporate body and third parties*,²⁸ by a statement dated and signed by the holder of the securities.” Articles 147(1) of the Uniform Act on Security Interests and L. 211-20 of the Monetary and Financial Code are both reversals of this decision of the Cour de cassation; but like Article L. 211-20 of the Monetary and Financial Code under French law, the formulation in the original French version of Article 147 of the Uniform Act on Security Interests indicates nevertheless that the declaration establishing the pledge of a securities account is a prerequisite to the validity and to third-party effectiveness:

“Le nantissement de comptes de titres financiers est *constitué, tant entre les parties qu’à l’égard de la personne morale émettrice et des tiers* [my emphasis], par une déclaration datée et signée par le titulaire du compte.”

Moreover, it is important to note that under OHADA law, the Uniform Act on Security Interests does not require that the pledge of securities accounts be registered in order for it to be effective against third parties.²⁹

2. Elements to Be Included in the Declaration establishing the Pledge

a) Date of the Declaration

Article 147(1) of the Uniform Act on Security Interests provides that the declaration establishing the pledge must include the date on which it was made. The date is important for determining the moment from which the account holder’s rights in the pledged securities are subject to limitations. More importantly, the date of the declaration allows a determination of whether the pledge was established *in tempore suspect*.³⁰ Pursuant to Article 68(5) of the

²⁷ Com. 7 March 1995, Bull. civ. IV n° 73, JCP E 1995, II, n° 695, note H. Hovasse. See also Alain Couret et al (*supra* n 24) s 1182.

²⁸ My emphasis.

²⁹ See in comparison Article 143 of the same Uniform Act regarding a pledge of members’ rights and securities.

³⁰ Articles 34 and 67 of the Uniform Act on Collective Proceedings for the Clearing of Debts define the suspect period as the period beginning from the date of cessation of payment and ending on the date of the decision to initiate the reorganisation or assets liquidation proceedings. See Michel Sawadogo Filiga, ‘L’application judiciaire du droit des procédures collectives en Afrique francophone à partir de l’exemple du Burkina Faso’ (1994) 26 *Revue burkinabé de droit* 191, 203–205. See also Trib. Rég. hors classe de Niamey, judgment n° 544 of 7 December 2005; TPI de 1^{ère} classe de Cotonou, 2^{ème} Chambre Commerciale, judgment of 18 November 2010; Tribunal de première instance de 1^{ère} classe de Lomé, judgment n° 157 of 22 January 2010.

Uniform Act on Collective Proceedings for the Clearing of Debts, any conventional pledge aimed at securing a debt previously contracted is unenforceable against the body of the creditors if it is executed during the suspect period.³¹ Additionally, the date of the declaration plays a crucial role if the debtor provides the same securities account in pledge to subsequent creditors. To determine priority among such competing interests, Article 226 of the Uniform Act on Security Interests determines the order of distribution of proceeds from the liquidation of movable assets. Under Article 226 4^o) of that Uniform Act, priority among pledgee creditors is determined based on the dates on which respective pledges became effective vis-à-vis third parties.³²

Given the importance of including the date on the declaration establishing the pledge of a securities account, it is surprising that Article 147(1) of the Uniform Act on Security Interests leaves open how the date of the declaration should be indicated: Is it the date the declaration is established or the date it was received by the intermediary?³³ So far no cases have addressed this question under OHADA law. In comparison, the latter option is preferred under French law since the declaration is aimed primarily at informing third parties of the existence of the pledge of a securities account.³⁴ Conversely, the wording of Article 147(1) of the Uniform Act on Security Interests seems to indicate that the date to be included on the declaration is the date it was established rather than the date it was received by the intermediary.

It is important to note that Article 147(1) of the Uniform Act on Security Interests does not indicate a legal sanction should the date not be included in the declaration. Article 147(1) does not indicate that a declaration which does not indicate the date is void. But the second paragraph of Article 147 by contrast does declare declarations void which do not mention any of the elements specified there: the name of the creditor, the debtor, the grantor of the pledge, the number and nature of the financial instruments given in pledge, the elements allowing the individualisation of the secured debt, its evaluation, its duration and term, and the means of identifying the special pledged account. Therefore, it may be submitted that a declaration which does not indicate the date would not be void under Article 147(1) of the Uniform Act on Security Interests.

³¹ Nevertheless, such a pledge can be enforceable against the body of creditors only if it replaces a prior security interest of a nature and a term that is at least equivalent or if it is granted in execution of a previous agreement.

³² Joseph Issa-Sayegh in Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds) (*supra* n 5) 971. It is important to note that the order of distribution between the pledged creditors is subject to the exercise of a right of retention or of an exclusive right to the payment (Article 226 first sentence of the Uniform Act on Security Interests). *See also* Article 107 of the same Uniform Act.

³³ This was also not specified in the 1997 version of Article 747 of the Uniform Act on Commercial Companies.

³⁴ *See* Alain Couret et al (*supra* n 24) s 1184.

Nevertheless, such a declaration would not be binding vis-à-vis third parties.³⁵ So far, no cases have addressed this question under OHADA law either.

b) Other Elements to Be Included in the Declaration

As mentioned above, Article 147(2) of the Uniform Act on Security Interests requires that the declaration establishing the pledge of a securities account be signed by the account holder and encompass the following elements (besides the date):

- (i) The name of the creditor, the debtor, and the grantor of the pledge;
- (ii) The number and nature of the financial instruments given in pledge;
- (iii) Elements allowing the individualisation of the secured debt, its evaluation, its duration, and its term; and
- (iv) Elements to identify of the special pledged account.³⁶

In comparison, the French Monetary and Financial Code on which Articles 146 et seq of the Uniform Act on Security Interests are modelled does not provide a sanction should a declaration not contain one or all the elements foreseen in Article D. 211-10. These elements are:

- (i) The denomination “Declaration of pledge of a securities account”;
- (ii) An indication that the declaration is subject to the provisions in Article L. 211-20;
- (iii) The name or denomination as well as the addresses of the collateral provider and the collateral taker, or if the collateral taker is an entity, its registered office;
- (iv) The amount of the secured debt or elements that allow that debt to be determined;
- (v) Elements allowing the special account to be identified as foreseen in Article L. 211-10(II);
- (vi) The nature and number of financial instruments initially recorded in the pledged securities account.

If a declaration does not contain one or all the elements foreseen in Article D. 211-10, then French law applies the solution adopted for the *bordereau Dailly*³⁷: the absence, inaccuracy, or ambiguity of any of the required indica-

³⁵ The same solution is applied in French law based on the rules of the *bordereau Dailly* (Com. 9 April 1991, Bull civ. IV n 121; RTD com. 1991, 421, obs. M. Cabrillac & B. Teysié). For more information on the *bordereau Dailly* under French law, see *infra* n 37.

³⁶ See in comparison Article D. 211-10 of the French Monetary and Financial Code; see also Mathieu Dubertret, ‘Note sur la partie réglementaire de la réforme du droit des titres’ (2009) Dalloz 797, 797–798.

³⁷ The *bordereau Dailly* is a simplified mechanism of assignment of pledges of commercial receivables (“créances commerciales”). Named after the French senator who sponsored

tions merely makes the declaration unenforceable against third parties.³⁸ Conversely, Article 147(2) of the Uniform Act on Security Interests declares void a declaration that does not indicate one or all the elements specified above.³⁹ It is worth noting that Article 147(2) of the Uniform Act on Security Interests is quite similar to Article 141 of the same act, which relates to partnership rights and transferable securities.⁴⁰ In 2008, applying OHADA law, the Cour d'appel du Littoral in Cameroon decided that a declaration of pledge that does not contain *all* the elements required in Article 141 of the Uniform Act on Security Interests (Article 64 in the 1997 version of the same act) is void.⁴¹ Article 147(2) of the Uniform Act on Security Interests is therefore consistent with OHADA case law and similar provisions on that subject.

the bill introducing the measure, the *cession Dailly* is effected by the signing of a specific document (the advice note or *bordereau*) whereby a creditor (the assignor) transfers ownership of the receivables it holds on one of the debtors (the assigned debtor), a public or private body, to one or more credit institutions (the assignee) by way of security or purchase (*es-compte*). The purpose of the *bordereau Dailly* is to help French companies, particularly with respect to exports, by facilitating the assignment of receivables and their enforceability against third parties, which can be effected through the mere signing of a slip by the beneficiary credit institution without resorting to the formalities of assignment or a pledge of receivables (which entail notifying the debtor through a process server or acceptance in a notarial deed). For more details on the *bordereau Dailly*, see Jean François Adelle, 'La cession de créance Dailly et l'exportation (the Dailly assignment of receivables and the exports)' (2004) 2 RDAI/IBLJ 218; John D. Crothers, Mathilde Bonnet & Julien Brusau Cuello, 'Cession de créances "Dailly" dans les opérations PPP: régime juridique et pratique dans les opérations PPP' (2011) 5 RDAI/IBLJ 497; Philippe Billot, 'Sécuritisation à la française' (1989) 8 International Financial Law Review 12, 13; Pierre Lastencuse, 'France Eases Restrictions on Collateral and Netting' (2005) 24 International Financial Law Review 43, 44; Clothilde Dimat & Jonathan Souffir, 'French Securitizers Wait in Vain for Insolvency Reform' (2004) 23 International Financial Law Review 17; Gilles Saint Marc, 'A New French Landmark' (2013) 32 International Financial Law Review 49, 50.

³⁸ The same solution is applied in French law based on the rules on the *bordereau Dailly* (Com. 9 April 1991, Bull civ. IV n 121; RTD com. 1991, 421, obs. M. Cabrillac & B. Teyssié).

³⁹ Joseph Issa-Sayegh in Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds) (*supra* n 5) 929.

⁴⁰ Article 141 of the Uniform Act on Security Interests provides: "On pain of nullity, the pledge of the rights of partners and securities shall be recorded in a written document containing the following particulars: 1°) the designation of the creditor, the debtor and the grantor of the pledge if the latter is not the debtor; 2°) the registered office and the registration number in the Register of Commerce and Securities of the legal entity issuing the rights of partners and securities; 3°) the number and the way to determine the latter and, where applicable, the numbers of the pledged instruments; 4°) elements enabling the individualisation of the secured debt as well as its amount and evaluation, its duration and maturity date."

⁴¹ *Mr. Bibehe Alphonse Joseph v Commercial Bank of Cameroon* [2008] Cour d'appel du Littoral, judgment n° 111 of 1 September 2008, Ohada.com/Ohadata J-09-128.

II. The Requirement of a Prior Contract

It has been mentioned above that Article 147 of the Uniform Act on Security Interests requires only that a declaration be made by the account holder in order to constitute a pledge of a securities account. However, it is critical to explore whether a prior contract – more particularly, a pledge agreement – is also required for the valid constitution of such a pledge. The wording of Article 147 of the Uniform Act on Security Interests seems to indicate that no prior contract is required. Nevertheless, despite the absence of such a requirement of a prior contract there, it is difficult to conceive that a pledge should be established *solely* by a unilateral declaration of the account holder. Therefore, based on how a pledge of a securities account is defined in Article 146 of the Uniform Act on Security Interests, it can be concluded that the declaration mentioned in Article 147 of the same act must be preceded by a contract between the collateral provider and the collateral taker. Furthermore, it can be inferred that such a contract must specify the essential elements of the pledge and the rules in respect of the use or management of the pledged security account.⁴²

D. Basis of the Pledge

I. The Contents of the Securities Account

1. Intermediated Securities located in the Securities Account

a) Financial Instruments recorded in the Pledged Securities Account

The pledge of a securities account covers all financial instruments initially deposited therein (Article 148(1) first sentence of the Uniform Act on Security Interests). It also includes securities that subsequently substitute or complement those instruments that were initially deposited (Article 148(1) second sentence of the Uniform Act on Security Interests). As stated before, the Uniform Act on Security Interests focuses on the *securities account*.⁴³ Therefore, any financial instrument recorded in the securities account at or subsequent to the moment the pledge is constituted is part of the basis of the pledge. Article 148 of the Uniform Act on Security Interests does not list every type of financial instrument that can be recorded in a pledged securities account;⁴⁴ it

⁴² See in comparison Philippe Simler & Philippe Delebecque, *Droit civil. Les sûretés. La publicité foncière* (Paris, Dalloz 2009) s 662.

⁴³ For another interpretation, see Gauthier Blanluet, ‘La cession d’actions nanties’ (1999) 11 *Receuil Dalloz* 109, s 1, who contends that the “basis of the pledge is composed of the financial instruments, and not by the securities account where they are located.”

⁴⁴ See also Article 744 of the Uniform Act on Commercial Companies; Article L. 211-20 of the French Monetary and Financial Code, which, unlike Article L. 431-4, does not indicate a list of all types of financial instruments that can be recorded in the pledged securities account.

only refers to financial instruments (*titres financiers*), which include debt securities and capital securities issued by corporations. However, commercial paper, treasury bills, and shares of mutual funds are generally not considered instruments that can be included in a pledged securities account.⁴⁵

b) Inalienable Securities

The term “financial instrument” in Articles 146, 147, 148, 151, 152, and 154 2°) of the Uniform Act on Security Interests extends to securities issued by corporations. However, the transferability of certain securities may be limited by the Articles of association of the company whose securities are given as a pledge. Indeed, notwithstanding the principle of free transferability of shares stated in Article 764 of the Uniform Act on Commercial Companies, Article 765-1 of the same act provides that the transfer of shares can be restricted by an inalienability clause.⁴⁶ Hence, it is important to explore whether securities subject to an inalienability clause pursuant to Article 765-1 of the Uniform Act on Commercial Companies can be recorded in a pledged securities account and therefore be part of the basis of the pledge.

Neither the Uniform Act on Security Interests nor the Uniform Act on Commercial Companies addresses this issue, and neither the CCJA nor the national courts have rendered any decision regarding this question yet. In comparison with French law, on which the Uniform Act on Security Interests is modelled, *Magnier and Bouteiller*⁴⁷ contend that an inalienable financial instrument may not be given as a pledge even if its inalienability is only temporary. In contrast, again under French law, the Cour de cassation rendered a decision on 30 September 2008 whereby inalienable securities may be given

⁴⁵ Under French law, see Article L. 211-1, II of the Monetary and Financial Code which indicates what can be regarded as financial instruments; Alain Couret et al (*supra* n 24) s 1190.

⁴⁶ Under Article 765-1 of the Uniform Act on Commercial Companies, inalienability clauses are valid only where they set a prohibition of a period shorter than or equal to ten years and where they are justified by a serious and legitimate reason. For more details on inalienability clauses under OHADA law, see Benoît Le Bars, *Droit des sociétés et de l'arbitrage international. Pratique en droit de l'OHADA* (Joly, Paris 2011) 193–194; Benoît Le Bars & Boris Martor, ‘Management et financement de la société anonyme’ (2004) Supplément n° 5 à la Semaine juridique n° 44 du 28 octobre 2004 12. See also Paul-Gérard Pougoué, Josette Nguebou-Toukam & François Anoukaha in Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds) (*supra* n 5) 607, who indicate that the provision in Article 765 of the Uniform Act on Commercial Companies is intended to prevent a takeover of companies located in the OHADA region by foreign investors.

⁴⁷ Véronique Magnier, ‘Le nantissement d’actions indisponibles’ (2002) RTD com. 433. See also Patrice Bouteiller, ‘La remise en garantie de l’épargne salariale’ (2000) JCP E 352.

in pledge if the inalienability is temporary.⁴⁸ One may also contend however that there is no provision under OHADA law that prevents parties from pledging financial securities that would remain inalienable after the term of the secured debt expires. In such a situation, the collateral taker will be protected by its right of retention pursuant to Article 67 of the Uniform Act on Security Interests. But in such a case, the collateral taker will nevertheless have to await the end of the financial instrument's inalienability period in order to realise the pledge.

c) Securities Whose Transfer is Subject to an Approval Clause

Another difficulty might arise if the securities recorded in the pledged account are subject to an approval clause. Under Article 765(1) of the Uniform Act on Commercial Companies, the Articles of association or the agreements referred to in Article 2-1 of the same act⁴⁹ may subject the transfer of certain shares to prior authorisation by an organ of the company (usually the board of directors) or a third party.⁵⁰ If the securities recorded in the pledged securities account are subject to such an approval agreement, it is relevant to refer to Article 772 of the Uniform Act on Commercial Companies, which provides:

“Where the company has given its consent to a proposed pledge of shares, such consent shall mean approval of the assignee in case of a mandatory enforcement of the pledged shares, unless the company prefers to repurchase these shares without delay to reduce its capital. The shares pledge plan shall be enforceable against the company only if it has been approved by the structure designated for that purpose by the Articles of association to grant approval to shares transfer.”⁵¹

Finally, it is worth noting that even if it does not clearly state that rule,⁵² Article 772 of the Uniform Act on Commercial Companies implies that if a pledge of shares is subject to an approval agreement, the company must be consulted

⁴⁸ Com. 30 September 2008, *Bull.* IV, n° 165; RD banc. fin. 2008, comm. 33, note Bonneau and comm. 171, note Cerles. *See also* Claude Ferry, ‘Portée des clauses d’inaliénabilité ayant pour objet des actions’ (2010) *Droit des sociétés*, étude 12; Daniel Fasquelle, ‘Le nantissement de valeurs mobilières’ (1995) *RTD com.* 1; Cristian Balan, ‘Inalienability Clause’ (2017) 2 *Revista Romana de Drept al Afacerilor* 209. *See also* Civ. 1^{ère}, 9 October 1985, *Bull.* I, n° 252.

⁴⁹ Bakary Diallo, Mamadou Ismaïla Konate & Bérenger Y. Meuke, ‘Gestion de crise en OHADA: anticipation conventionnelle et statutaire – Gestion négociée et règlement des conflits internes’ (2009) 4 *Jurifis info* 2, 3.

⁵⁰ Note that such restrictions are subject to the conditions provided in Articles 765-1 to 771-3 of the Uniform Act on Commercial Companies. *See* Paul-Gérard Pougoué, Josette Nguebou-Toukam & François Anoukaha *in* Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds) (*supra* n 40) 606, 607.

⁵¹ This provision is similar to Article L. 228-26 of the French Code of Commerce.

⁵² *See* Alain Couret et al (*supra* n 24) s 1192, who also criticise the lack of such a clear provision in Article L. 228-26 of the French Code of Commerce.

beforehand, because the pledge exposes the company to the risk that the shares will be transferred to a third party if realised in an appropriation.

2. *Sums of Money located in the Pledged Securities Account*

Under Article 148(2) of the Uniform Act on Security Interests, the basis of the pledge also includes “any sum of money in any currency”. This provision is similar to Article 1(4)(a) of the EU’s Financial Collateral Directive, which provides that financial collateral may consist of cash⁵³ or financial instruments.⁵⁴ However, it should be underscored that the “sum of money” mentioned in Article 148(2) of the Uniform Act on Security Interests forms the basis of a pledge only in situations where it is proceeds from intermediated securities initially recorded in the pledged securities account. Consequently, no sum of money can be initially recorded in the pledged securities account, and similarly any sum of money subsequently included in a pledged securities account must derive from the financial instruments initially recorded in the pledged securities account.⁵⁵

II. *Proof of the Content of the Pledged Securities Account*

Proof of the content of the pledged securities account is established both through the requirement that the pledged securities account take the form of a special account (1) and through a certificate of pledge of a securities account established by the intermediary (2).

1. *Special Account Open in the Name of the Account Holder*

The pledged securities account must take the form of a special account opened in the name of the account holder and maintained by the issuing legal entity or a financial intermediary (Article 149 of the Uniform Act on Security Interests). This rule is similar to that in Article 747(2) of the 1997 version of the Uniform Act on the Law of Commercial Companies as well as to L. 211-20 II of the French Monetary and Financial Code.⁵⁶ Furthermore, Arti-

⁵³ Under the Financial Collateral Directive, cash refers only to money which is represented by a credit to an account or to similar claims to repayment of money (such as money market deposits), thus explicitly excluding banknotes.

⁵⁴ See also Recital 18 of the Financial Collateral Directive. The Financial Collateral Directive is analysed in detail *infra* (see part II, chapter 3, section B).

⁵⁵ Alain Couret et al (*supra* n 24) ss 1193, 1207 et seq.

⁵⁶ See Franck Auckenthaler, *Droit des marchés de capitaux* (L.G.D.J., Paris 2004) s 85. Note that unlike Article L. 211-10 II of the French Monetary and Financial Code, the Uniform Act on Security Interests does not contemplate the possibility of identifying the pledged account through “earmarking”, which allows the electronic marking of certain lines of a securities account (Alain Couret et al (*supra* n 24) s 1195). The admission of this type of identification of a pledged securities account has been established in CA Paris,

cle 150(1) of the Uniform Act on Security Interests provides that if the account is held by a person not authorised to receive funds from the public, the benefits and products referred to in Article 148 of the same act must be registered as credited to a special account opened in the name of the pledged account holder on the books of an institution authorised to receive such funds. In that case, the collateral taker may upon request to the intermediary obtain a certificate listing any currency credited to such account as of the date of the request. Further, it is worth noting that the transfer of financial instruments to the pledged securities account is not required *ad validitatem*; in other words, it is not a requirement for the validity of the pledge but rather merely serves to establish the elements that constitute the basis of the pledge.

2. *The Certificate of Pledge*

Article 148 of the Uniform Act on Security Interests provides that on a mere request, the collateral taker may obtain from the intermediary a certificate of pledge that sets forth the inventory of the securities and any sums of money in any currency recorded in the pledged securities account as of the date the certificate was issued.⁵⁷ The wording of Article 148 indicates that the issuance of a certificate of pledge is optional. Therefore, it is not a condition for the validity of the pledge but has informative and probative value only.⁵⁸

The Uniform Act on Security Interests does not contemplate a situation in which it is established after the fact that the inventory was not accurate. However, if that were to occur and if the intermediary were responsible for the inaccuracy of the inventory, the collateral taker would have the right to claim compensation from the intermediary.⁵⁹ Further, it is worth noting that the certificate of pledge is a confirmation that the intermediary has duly received the declaration establishing the pledge.

E. *Evolution of the Pledged Securities Account*

I. *Introduction*

The value of the pledged securities account will generally evolve after the pledge is constituted. Indeed, the intermediated securities and other financial instruments recorded in the pledged securities account can yield benefits and products. Article 148(1) of the Uniform Act on Security Interests specifically

25 November 2003, *RD banc. fin.* 2004, 407, obs. Cerles. Further, see in comparison Simon Schwarz (*supra* n 12) 414–416.

⁵⁷ See also Article 747(3) of the 1997 version of the Uniform Act on Commercial Companies.

⁵⁸ Marc Billiau, Jacques Mestre & Emmanuel Putman, *Traité de droit civil (sous la direction de J. Ghestin): droit spécial des sûretés réelles* (L.G.D.J, Paris 1996) s 946.

⁵⁹ Alain Couret et al (*supra* n 24) s 1197.

incorporates such benefits and products into the basis of the pledge along with any financial instruments that are substituted for those initially deposited in the pledged securities account.⁶⁰ However, it is worth examining whether the collateral taker and the collateral provider can agree to exclude from the basis of the pledge such benefits, products, and substituted financial instruments.

II. Inclusion of Products and Benefits deriving from the Pledged Securities Account

Pursuant to Article 148(1) of the Uniform Act on Security Interests, the basis of the pledge includes all the fruits and benefits which derive from the securities and other financial instruments recorded in the pledged securities account. This rule is an expression of the general principle of *accessorium sequitur principale*. Moreover, it is worth noting that Article 144 of the Uniform Act on Security Interests also provides that the secured creditor is entitled to “reap benefits from shares and pledged transferable securities” (Article 144 of the Uniform Act on Security Interests). However, unlike Article 148 of the Uniform Act on Security Interests, Article 144 of the same act requires a prior agreement of the parties.

The original French model for Article 148(1) of the Uniform Act on Security Interests⁶¹ uses the words *fruits* (which is translated into “benefits” in the English version of the act⁶²) and *produits* (which is translated into “products” in the English version). The French term *fruits* is defined in civil law as “periodic products that a thing provides without alteration or substantial diminution of its substance”⁶³. Applied to intermediated securities, this definition covers dividends and interest generated by the securities recorded in the pledged securities account. As to the term “product”, it refers to “[...] what a thing provides without periodicity or with a substantial alteration of its substance.”⁶⁴ In the context of intermediated securities, this definition refers, for instance, to free shares.⁶⁵

⁶⁰ The formulation in Article 148 of the Uniform Act on Security Interest is similar to that in Article L. 211-20 I of the French Monetary and Financial Code.

⁶¹ The original French version of that provision is available at <<http://www.ohada.com/actes-uniformes/938/973/sous-section-2-nantissement-de-comptes-de-titres-financiers.html>> (accessed 4 January 2021).

⁶² The English version of that provision is available at <<http://www.ohada.com/actes-uniformes/938/973/sous-section-2-nantissement-de-comptes-de-titres-financiers.html>> (accessed 4 January 2021).

⁶³ “Produits périodiques qu’une chose fournit sans altération ni diminution sensible de sa substance” (Philippe Malaurie & Laurent Aynès, *Droit civil. Les biens* (4th edition, Défrémois, Paris 2010) s 160).

⁶⁴ “Une chose sans périodicité ou avec une altération sensible de sa substance” (François Terré & Philippe Simler, *Droit civil. Les biens* (8th edition, Dalloz, Paris 2010) s 15).

Article 148(1) of the Uniform Act on Security Interests is modelled on Article L. 211-20 I of the French Monetary and Financial Code. Under French law prior to the Act n° 96-597 of 2 July 1996, the inclusion of benefits and products required not only a prior agreement to this effect between the collateral taker and the collateral provider but also the constitution of a specific cash collateral (a so-called *gage-espèce*⁶⁶). Since this cumbersome requirement was repealed in 1996⁶⁷ so that products and benefits which derive from the securities and other financial instruments recorded in the pledged securities account are now automatically included in the basis of the pledge.⁶⁸

If the pledge is converted, such products and benefits in any currency are directly transferred to the collateral taker, who then owns them outright (Article 154 1° of the Uniform Act on Security Interests). Consequently, the collateral taker has a vested interest in assuring that the amount of such products and benefits is high. This explains why it can stipulate that the collateral giver always vote in favour of decisions that result in the distribution of products and benefits.⁶⁹

III. Substituted Securities

1. “New” Securities

Article 148(1) of the Uniform Act on Security Interests provides that securities substituted for those initially located in the pledged securities account are incorporated into the basis of the pledge.⁷⁰ Such substitution of securities can follow changes in the issuer’s circumstances: from a merger, demerger, or

⁶⁵ See Articles 626-1 et seq of the Uniform Act on Commercial Companies. See also Achille Sunkam Kamdem & Gaël Nguefack Donzeu, ‘L’attribution d’actions gratuites aux salariés en droit des sociétés commerciales OHADA’ (2017) 22 3 Uniform Law Review 580, 580–593.

⁶⁶ Under French law, the *gage-espèce* is a collateral agreement that relies on the delivery to the creditor of a sum of money to secure an obligation (Stéphan Alamowitch, *Le gage-espèces* (Petites Affiches, Paris 1994) 4–5).

⁶⁷ This requirement was removed by the *Loi n° 96-597 du 2 juillet 1996 de modernisation des activités financières*, available at <<https://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000000193847&categorieLien=id>> (accessed 4 January 2021).

⁶⁸ Alain Couret et al (*supra* n 24) s 1203. See also Articles 102 and 106 of the Uniform Act on Security Interests; Joseph Issa-Sayegh, ‘La liberté contractuelle dans le droit des sûretés OHADA’ (2005) 851 Penant: revue trimestrielle de droit africain 150, 176. However, as analysed *infra* (see subsection E.III.1 of this chapter), it is important to explore whether the parties can, despite the provision in Article 148 of the Uniform Act on Security Interests, determine in their agreement that products and benefits are not to be included into the basis of the pledge.

⁶⁹ Alain Couret et al (*supra* n 24) s 1207.

⁷⁰ This provision is also similar to that in Article L. 211-20 I of the French Monetary and Financial Code.

transformation operation at the issuing company, for instance.⁷¹ Nevertheless, subrogation under Article 148(1) of the Uniform Act on Security Interests is only possible if the “new” securities can be recorded in a securities account. Assume for instance that the securities initially deposited in the pledged securities account were issued by a public limited company that is then transformed into a type of entity that cannot issue securities, such as a partnership. In such a case, there would be no substitution of securities under Article 148(1) of the Uniform Act on Security Interests.⁷² Furthermore, Article 148(2) of the Uniform Act on Security Interests provides that financial instruments and any sums of money listed in the pledged account subsequent to the date of the constituent declaration of the pledge are deemed to have been remitted on the date of such declaration.⁷³

2. Sums of Money resulting from the Sale of Securities located in the Pledged Account

Article 148 of the Uniform Act on Security Interests does not clearly indicate whether the basis of the pledge also includes proceeds from the sale of the pledged securities. Article 148(1) states only that the basis of the pledge includes sums of money that are “benefits” or “products” of the securities recorded in the pledged securities account. Nevertheless, Article 148(1) of the Uniform Act on Security Interests uses a very broad formulation: “Financial instruments initially deposited in the pledged account, those that are substituted to them or complement them *in any way whatsoever* [my emphasis] as well as their benefits and products shall be included in the basis of the pledge”. The words “in any way whatsoever” (*de quelque manière que ce soit*) indicate that sums of money obtained from the sale of the pledged securities are included in the basis of the pledge. Moreover, the rationale of Article 148(1) is to preserve the value of the collateral on which the collateral taker relies. Consequently, it would be detrimental to the collateral taker if the proceeds from the sale of securities initially located in the pledged account were not included in the basis of the pledge. Based on the same rationale, if such sums of money were used to purchase new securities, the newly purchased securities would also be included in the basis of the pledge.⁷⁴

⁷¹ See Articles 189 to 199 as well as 670 to 693 of the Uniform Act on Commercial Companies.

⁷² In such a situation, OHADA law does not impose any sanction on the collateral provider who would vote in favour of such a transformation of the company. Under French law, such a collateral provider can be criminally liable under Article 314-5 of the French Criminal Code.

⁷³ See a similar solution in Article L. 211-20 of the French Monetary and Financial Code.

⁷⁴ Alain Couret et al (*supra* n 24) s 1211.

Because of the growth in virtual currencies, in particular Bitcoin, it is worth examining whether a virtual currency falls within the definition of “cash” for the purposes of Article 148, beginning with whether a virtual currency is “any currency money” as per Article 148(2). The act itself is silent on this question, and so far neither the CCJA nor the national courts have developed any case law on point. From a legal view point, money is essentially characterised by its denomination, by reference to a currency or a unit of account determined by the law of the State where it is generally accepted as a measure of value and a medium of exchange.⁷⁵ It typically involves a central bank or monetary authority responsible for issuing the currency.⁷⁶ A virtual currency is a digital representation of value which two parties may agree to use in some circumstances as an alternative means of payment. It is not issued by the central bank of a sovereign state, nor is it governed by any legal system as its *lex monetae*. There is no mandatory law which requires that one accept a virtual currency in payment of a debt.⁷⁷ Virtual currencies do not have the same characteristics as legal tender. Therefore, it is very unlikely any OHADA court (including the CCJA) would treat them as “cash” for the purposes of the Uniform Act on Security Interests.

F. Right to Use the Intermediated Securities recorded in the Pledged Securities Account

I. Right of Use

1. Scope of the Right of Use under Article 151(1) First SENTENCE of the Uniform Act on Security Interests

Article 151(1) first sentence of the Uniform Act on Security Interests allows the collateral taker and the holder of the pledged account to determine, in the pledge agreement, the conditions under which the latter may dispose of the financial instruments and any sums of money in that account.⁷⁸ If the collateral taker is not the intermediary maintaining the securities account and has authorised the account holder to dispose of securities and any currency in the

⁷⁵ Geoffrey Yeowart et al, *Yeowart and Parsons on the Law of Financial Collateral* (Edward Elgar, Cheltenham 2016) s 3.22.

⁷⁶ For instance, under Congolese law, see the *Banque Centrale du Congo* (as per Article 7 first sentence of *Loi n° 005-2002 relative à la constitution, à l'organisation et au fonctionnement de la Banque centrale du Congo*, J.O.RDC., n° spécial, 22 May 2002, 58).

⁷⁷ In Europe for instance, the European Central Bank (ECB) has indicated that virtual currencies are not to be regarded as full money from an economic view point or as money or currency from a legal perspective (European Central Bank, *Virtual Currency Schemes – A Further Analysis* (Frankfurt am Main 2015) 23–25, 32–33).

⁷⁸ See in comparison under the European Financial Collateral Directive Joanna Benjamin, Madeleine Yates & Gerald Montagu, *The Law of Global Custody* (2nd edition, Butterworths, London 2002) 64–65.

pledged account, the account holder and the collateral taker must inform the intermediary in writing of the terms of such authorisation. Under Article 151(2) of the Uniform Act on Security Interests, the intermediary is not allowed to derogate from instructions it has received without the authorisation of the collateral taker. If it were to violate these instructions, the intermediary would incur liability.

Article 151 of the Uniform Act on Security Interests radically differs from Article 34 of the Geneva Securities Convention. Indeed, Article 34 of the Geneva Securities Convention envisages a general right of disposal for the collateral taker under a security collateral agreement while Article 151 of the Uniform Act on Security Interests allows use of the collateral securities by the collateral provider rather than the collateral taker.⁷⁹ This can be explained by the fact that the provision enshrined in Article 151 derives from the notion of *nantissement*, which is in essence non-possessory.⁸⁰ This means that the debtor or collateral provider retains possession of the collateral. Consequently, and unlike Article 97(1) of the Uniform Act on Security Interests, Articles 146 et seq of the same act do not require that the pledged asset be delivered to the collateral taker or to an agreed-upon third party in order for the pledge to be enforceable against third parties. If a securities account is pledged, the collateral provider retains possession of the intermediated securities located in the pledged securities account. Hence, any right of use by the collateral taker under the Uniform Act on Security Interests is impossible because the collateral provider retains possession of the pledged securities account and of the securities located therein.

2. *Absence of Provisions in Respect of the Replacement of the Used Collateral Securities*

As mentioned above, the collateral provider may be authorised to use the collateral securities: it may sell them, lend them, and even use them as collateral or make other, similar dispositions. However, unlike the Geneva Securi-

⁷⁹ If the right is exercised, Article 34(2) of the Geneva Securities Convention provides that the collateral taker is obligated to transfer replacement collateral to the collateral provider.

⁸⁰ Akuété Pedro Santos & Jean Yado Toé, *OHADA: Droit commercial général* (Bruxelles, Bruylant 2002) s 241. For more details on the difference between *gage*, *gage sans dépossession*, and *nantissement* under OHADA law, see Mamadou Ismaïla Konate, 'La consécration des sûretés spécifiques OHADA: réserve de propriété, droit de rétention, cession de créances' (2010) 197 *Droit et Patrimoine* 1, 2; François Anoukaha, 'Le droit des sûretés dans l'Acte uniforme OHADA' (1998) 33 *Presses Universitaires de Yaoundé* 1, 17–18. See also Ulrich Drobnig & Ole Böger, *Proprietary Security in Movable Assets* (Sellier European Law Publishers, München 2015) 205, who aptly note that "non-possessory security is the sign-mark of modern systems of secured credit."

ties Convention,⁸¹ Article 151 of the Uniform Act on Security Interests contains no provision regulating the replacement of the used securities. Yet the collateral taker may suffer a loss if the collateral provider does not replace the collateral securities before an enforcement event occurs or if the value of the replacement collateral is inferior to that of the original collateral securities. Hence a provision requiring that the collateral provider replace any collateral securities it later uses would further protect the collateral taker. It is also important to highlight that such an obligation would be subject to Article 148 of the Uniform Act on Securities Interests.

This may be illustrated by the following scenario. Assume Lender granted a credit line to Borrower, who received an advance of 300. The parties agreed that repayment of the advance of 300 is due on T+120. As collateral for the sums advanced in this line of credit, Borrower grants to Lender a pledge of Borrower's securities account, which is maintained by IM. The portfolio of pledged securities encompasses bonds issued by X and shares issued by Y and Z in equal proportion, for a total value of 320. Under the collateral agreement, Borrower has the right to use the securities located in the account. Assume further that on T+45, Borrower sells some of the shares in the pledged account to Buyer for 280 in overall value.

No later than T+120, Borrower must, pursuant to the collateral agreement, return equivalent securities to the pledged securities account, and once equivalent securities are returned to the account, they will serve as collateral as if there had been no interruption in holding the pledged securities. The collateral agreement lays down how equivalent securities are to be returned. However, it may occur that Borrower fails to return equivalent securities to the pledged securities account by T+120. The Uniform Act on Security Interests does not address this issue, but Article 102 of the act, which applies to the pledge of goods of a fungible nature, suggests that Lender will not have a right to pursue (*droit de suite*) any third-party purchaser of the collateral securities. Indeed, in the case of a non-possessory pledge of goods of a fungible nature, Article 102 provides that if the collateral taker allows the collateral provider to use the pledged goods, such authorisation equates to a waiver of the right to pursue (*droit de suite*) third-party purchasers of the pledged goods. The same solution could apply by analogy⁸² to pledges of securities accounts. The collateral taker (in our illustration, Lender), in allowing the collateral provider (Borrower) to use the collateral securities account, in effect waived its *droit de suite* against any third party. Conversely, if the collateral taker had not allowed the collateral provider to use the collateral securi-

⁸¹ Articles 33(2) and 34 of the Geneva Securities Convention.

⁸² As to the concept of fungibility in regard to intangible property, see Roy Goode, 'Are Intangible Assets Fungible?' (2003) Lloyd's Maritime and Commercial Law Quarterly 379.

ties, it would retain a *droit de suite* against any third party purchaser of the collateral securities.⁸³

II. *Right of Retention*

1. *Scope of the Right of Retention*

The collateral taker has a right of retention in the financial instruments and in any sums of money in any currency recorded in the securities account.⁸⁴ This provision is modelled on Article L. 211-20 IV of the French Monetary and Financial Code. This provision plays a significant role in French law. The French Cour de cassation had previously denied collateral takers any right of retention in intangible property except when embodied in a material instrument over which the right of retention could be exercised.⁸⁵ As indicated in Article 151(1) second sentence of the Uniform Act on Security Interests, the collateral taker has a right of retention “in all cases” (*en toute hypothèse*). This means that the provisions of the pledge agreement are immaterial when it comes to the existence and extent of the right of retention. Compared to the right of use, which requires an agreement between the collateral taker and the collateral provider (or the holder of a securities account given as collateral), this is a major difference⁸⁶ the reason for which lies in Article 151’s imperative to protect the collateral taker.

Indeed, since the collateral provider keeps possession of the securities account given as collateral (Articles 146, 148, and 149 of the Uniform Act on Security Interests), allowing the collateral provider to use the securities account may affect the position of the collateral taker: If the collateral provider loses the collateral securities, the collateral taker may be left only with a contractual claim until the collateral taker provides “replacement collateral”

⁸³ The Uniform Act on Security Interests does not address the protection of a *bona fide* purchaser. As per Article 99 and 102 of the same Uniform Act, the collateral taker may exercise its *droit de suite* against any party, even a *bona fide* purchaser.

⁸⁴ Article 151(1) second sentence of the Uniform Act on Security Interests in connection with Articles 67 to 70 and 226(1) of the same Uniform Act. On the legal nature of the right of retention, see Nicole Catala-Franjou, ‘De la nature juridique du droit de rétention’ (1967) 65 RTD civ. 1967 9, who argues that the right of retention is a personal right. However, courts have regarded the right of retention as a right *in rem* (Cass. civ. 1^{er}, 7 January 1992, JCP 1992 II, 21971; RTD civ. 1992, 586).

⁸⁵ Civ. 25 January 1904, DP 1904.1.601, note Lasson. See also CA Paris, 22 November 1970, D. 1974. 93, note Malaurie. However, see also Com. 7 April 1998, Bull. Civ. IV, n° 123; D. aff., 1998, 959. See also Cass. com., 19 February 1958, Bull. Civ. III, n°82; 1^{ère} civ., 17 June 1969, JCP 1970, II, 16162; Fernand Derrida, ‘La dématérialisation du droit de rétention’ in Pierre Voirin (ed), *Mélanges offerts à Monsieur le Professeur Pierre Voirin* (LGDJ, Paris 1966) s 27.

⁸⁶ This provision is similar to that in Article 34 of the Geneva Securities Convention.

pursuant to Article 148 of the act.⁸⁷ Hence, it is crucial that the collateral taker expressly allow the collateral provider to use the collateral securities. Conversely, under the Geneva Securities Convention, it is not the collateral provider but rather the collateral taker who may find itself in possession of the collateral securities (Article 34(2) of the Convention), in which case the exercise of the right of use may affect the position of the collateral provider. Therefore, the Geneva Securities Convention and the Uniform Act on Security Interests both require that the collateral provider agree to the collateral taker exercising the right of use in the collateral securities.

The recognition of a right of retention in favour of the collateral taker simplifies the realisation of the pledge, in particular if the collateral provider faces an insolvency procedure. Article 226 of the Uniform Act on Security Interests governs priority among different collateral takers with competing interests.⁸⁸ Under the first paragraph of Article 226, a collateral taker which has exercised its right of retention under Article 72 of the Uniform Act on Security Interests will be paid before all other creditors. Therefore, the right of retention gives a clear advantage vis-à-vis other competing collateral takers and creditors.

2. *The Relationship between the Right of Retention and the Right of Use*

It is mentioned above that Article 151 of the Uniform Act on Security Interests enshrines the notion of *nantissement*, which is in essence a non-possessory interest.⁸⁹ This means that in pledging a securities account, the collateral provider retains possession of the account and the intermediated securities located therein. It is therefore utterly surprising that Article 151(1) second sentence provides that the collateral taker “benefits, *in any case* [my emphasis], from a right of retention on the financial instruments and any currency money in the account.” Under Article 72 of the act, the right of retention implies that the collateral taker has either ownership or possession of the collateral. The right of retention also means that the secured creditor declines to return the pledged property as long as the secured obligation is not discharged.

⁸⁷ See also Article 102 of the Uniform Act on Securities Interests. In comparison with the Geneva Securities Convention, see Hideki Kanda et al, *Official Commentary on the Unidroit Convention on Substantive Rules for Intermediated Securities* (Oxford University Press, Oxford 2012) s 34-1.

⁸⁸ See Joseph Issa-Sayegh in Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds) (*supra* n 5) 970–972; Mathurin Brou Kouakou, ‘Le droit de rétention en droit ivoirien: conditions d’exercice et prérogatives du rétenteur à propos de l’affaire Société SATA Mali c/ Société Incart FIAT’ (2006) Etudes offertes au professeur Joseph Issa-Sayegh AIDD 90. For more details on the new rules governing the right of retention under the revised Uniform Act on Security Interests, see Mamadou Ismaïla Konate (*supra* n 80) 1, 7.

⁸⁹ Akuété Pedro Santos & Jean Yado Toé (*supra* n 80) s 241; François Anoukaha (*supra* n 80) 17–18.

This is perfectly illustrated in Article 99 of the Uniform Act on Security Interests, which provides that if the secured creditor has possession of the pledge, it may, subject to Article 107(2),⁹⁰ exercise its *right of retention* in the pledged property until the secured obligation is discharged. Yet pursuant to Articles 146, 148, 149, and 151(1) first sentence of the same act, the taker of a securities account as collateral neither owns nor possesses it or the securities located therein. Article 149 provides: “The pledged account shall take the form of a special account *open in the name of the [account] holder* [my emphasis] and maintained by the issuing legal entity or a financial intermediary.” Hence, since the collateral taker has neither ownership of nor possession of the collateral securities account and the securities located therein, it is hard to envisage a right of retention in that case.⁹¹

G. Realisation of the Pledge

I. Introduction

Should it come to an enforcement event,⁹² the Uniform Act on Security Interests contains provisions that eliminate obstacles to enforcement which might arise under the domestic law of the Member States (III).⁹³ However, the realisation of the pledge must be preceded by a formal notice which the collateral taker must send to the debtor (II).

II. Formal Notice

In the case of a debt that is due and certain, the collateral taker may realise the pledge within eight days or once any other deadline previously agreed upon

⁹⁰ Article 107(2) of the Uniform Act on Security Interests addresses the situation in which an asset given as a nonpossessory pledge later becomes the subject of a possessory pledge. In that case, the preferential right of the first secured creditor is enforceable against the subsequent secured creditor if the first pledge was regularly registered with the RCCM. Moreover, the preferential right of the first creditor also prevails over the right of retention of the subsequent creditor.

⁹¹ *Contra*: Jacques Mestre, Emmanuel Putman & Marc Billiau, *Droit civil, droit spécial des sûretés réelles* (LGDJ, Paris 1996) s 948. If the collateral giver is insolvent, the collateral taker is still protected under Articles 131 and 162 of the Uniform Act on Collective Proceedings for the Clearing of Debts.

⁹² Note that unlike the Geneva Securities Convention, the Uniform Act on Security Interests does not provide a definition of an “enforcement event”. See in comparison Article 31(3)(h) of the Geneva Securities Convention, which defines an enforcement event, in relation to a collateral agreement, as “an event of default or other event on the occurrence of which, under the terms of that collateral agreement or by the operation of law, the collateral taker is entitled to realise the collateral securities or a close-out netting provision may be operated”.

⁹³ See in comparison Article 33 of the Geneva Securities Convention.

with the account holder has passed. However, the collateral taker must first send a formal notice to the debtor, which must be hand-delivered or sent by registered mail. It is important to underscore that Article 152 of the Uniform Act on Security Interests requires that the notice be formally sent to the debtor rather than the collateral provider, as it may indeed occur that they are not one and the same. In that case, formal notice must also be sent to the holder of the pledged account if it is not the debtor.⁹⁴ In addition, the collateral taker must also send formal notice to the intermediary if the intermediary is not the collateral taker (Article 152 of the Uniform Act on Security Interests).⁹⁵ Under Article 153, the formal notice must contain the following indications:

- (i) “Due to non-payment, the pledge may be realised by the creditor within eight days or upon the expiry of any time limit previously agreed with the pledged account holder”; and
- (ii) “The pledged account holder may, until the expiry of the time limit mentioned above, communicate to the account custodian the order in which the sums or financial instruments will be allocated in full ownership or sold, as the creditor chooses”.⁹⁶

Pursuant to Article 153, any notice that does not contain these two elements is void and would result in it being impossible to realise the pledge; in other words, there can be no realisation of the pledge of a securities account without a prior formal notice that is established and delivered pursuant to Articles 152 and 153 of the Uniform Act on Security Interests.⁹⁷ The provision in Article 153 is modelled on Article D. 211-11 of the French Monetary and Financial Code. The Cour de cassation had to specify whether a formal notice that does not contain one or all the required elements could nevertheless be considered as valid under French law if it is established that the collateral provider was not prejudiced by the irregularity of the formal notice (*pas de nullité sans grief*⁹⁸). In other words, is it necessary for the collateral provider to prove the existence of an actual harm caused by the irregularity of the notice? On 28 March 2006, the Cour de cassation indicated that the indica-

⁹⁴ See in comparison Article L. 211-20 V (1) of the French Monetary and Financial Code.

⁹⁵ Joseph Issa-Sayegh in Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds) (*supra* n 5) 931.

⁹⁶ See in comparison Article D. 211-11 of the French Monetary and Financial Code.

⁹⁷ In comparison, the establishment and delivery of a formal notice prior to the realisation of the pledge of a securities account is also required under French law. See Article D. 211-11 of the Monetary and Financial Code; Com. 18 November 2008, Bull. civ., n° 196; RD banc. fin. 2009, n° 1 comm. 25 note Cerles and comm. 34 note Bonneau; JCP2009 I, n° 150, s 22.

⁹⁸ Article 114 of the French Code of Civil Procedure.

tions required by Article D. 211-11 of the Monetary and Financial Code⁹⁹ related not to *how* the formal notice should be sent but rather to *what* the formal notice should *comprise*.¹⁰⁰ The Cour de cassation concluded therefore that the collateral provider does not have to show any harm caused by irregularities in the formal notice since such irregularities affected the formal notice *per se* rather than the effectiveness of the notice to the collateral provider or any other relevant party.¹⁰¹

III. Enforcement

1. Introduction

If the formal notice is valid under Article 153 of the Uniform Act on Security Interests, the collateral taker may realise the pledge after the expiration of the period specified in Article 152 first sentence, which is either eight days or at the expiration of any other period agreed upon by the collateral taker and the account holder. It is important to highlight that Article 152 first sentence does not clearly specify whether the collateral taker should realise the pledge *within* or *at the expiration* of the eight-day period; indeed, here is a discrepancy between the English and French versions of Article 152 first sentence of the Uniform Act on Security Interests. Indeed, the French version reads:

“Le créancier nanti [...] peut [...] réaliser le nantissement *huit jours* [...] *après mise en demeure du débiteur* [my emphasis] remise en mains propres ou adressée par courrier recommandé.”

Conversely, the English version of the same excerpt reads:

“The secured creditor [...] may [...] realise the pledge *within eight days* [...] *after a formal notice of the debtor* [my emphasis] has been hand-delivered or sent by registered mail.”

Under the French version of Article 152 first sentence, the collateral taker may realise the pledge only after the expiration of a period of eight days *after* the formal notice has been hand-delivered or sent. However, under the English version of the same provision, the realisation must occur *within* the period of eight days following the delivery of the formal notice. Adding to the confusion is the provision in Article 153 1°) regarding the elements which the formal notice must contain: “Due to non-payment, the pledge may be realised by the creditor *within eight days* [my emphasis] or upon the expiry of any time limit previously agreed with the pledged account holder.” The provision

⁹⁹ In 2006, the provision was found in Article D. 431-2 of the Monetary and Financial Code. This provision is similar to that in Article 153 of the Uniform Act on Security Interests.

¹⁰⁰ Com. 28 March 2006, Bull. civ. IV, n° 83; Bull. Joly Bourse 2006, 328, note Marotte and Robine; D. 2006. 1046, obs. Lienhard.

¹⁰¹ Alain Couret et al (*supra* n 24) s 1224.

in the French version is more satisfactory since it is in line with Articles 91 and 104 of the Uniform Act on Security Interests, which both provide that the collateral taker may realise the collateral *after* the expiration of an eight-day period following the delivery of the formal notice.

If a collateral taker that is not an intermediary deems that the conditions for the realisation of the pledge are met, it must request, in writing, that the intermediary proceed with the realisation as prescribed in Article 154 of the Uniform Act on Security Interests. Article 154¹⁰² specifies that realisation entails appropriating any sum of money recorded in the pledged account,¹⁰³ selling the intermediated securities recorded in the account (2), and appropriating the intermediated securities recorded in the account (3).¹⁰⁴

2. Realisation by Selling the Intermediated Securities

Under Article 154 of the Uniform Act on Security Interests, a collateral taker may realise the pledge by selling the intermediated securities credited to the pledged securities account. Indeed, this provision allows the collateral taker to sell the intermediated securities recorded in the account and be paid by applying the net proceeds of the sale towards the amount due. Hence, the proceeds of the sale are applied in discharge of the secured debt.¹⁰⁵ If the amount of the net proceeds of the sale surpasses the amount of the pledged debt, the surplus would have to be repaid to the account holder. The Uniform Act on Security Interests does not require prior court approval for the realisation of the pledged securities account, nor does it impose on the collateral taker an obligation to sell the securities at the price most advantageous to the debtor or within the shortest possible time, given the market and the volume of the transactions.

¹⁰² See in comparison Article D. 211-12 of the French Monetary and Financial Code. See also Article L. 211-20 V (2) of the French Monetary and Financial Code and L. 521-3 of the French Commercial Code.

¹⁰³ In case the pledged securities account also contains any sum of money in any currency, the realisation occurs directly through transfer of full ownership to the collateral taker (Article 154(1) 1° of the Uniform Act on Security Interests).

¹⁰⁴ It is important to note that the Uniform Act on Security Interests does not confirm the availability of close-out netting. See in comparison Article 33(1)(b) and (2) of the Geneva Securities Convention. For a definition of “close-out netting” under the Geneva Securities Convention, see Article 31(3)(j) of the Convention. In an enforcement event, there therefore is no requirement for the operation of a close-out netting provision unless otherwise provided in the collateral agreement.

¹⁰⁵ This provision is similar to Article 33(1)(a)(i) of the Geneva Securities Convention, which is to be read in conjunction with paragraph 3 of the same provision.

3. Realisation by Appropriating the Intermediated Securities recorded in the Pledged Securities Account

The second way to realise the pledge of a securities account under Article 154 of the Uniform Act on Security Interests is by *appropriation* of the intermediated securities recorded in it. Unlike Article 33(1)(a)(ii) of the Geneva Securities Convention, Article 154 2° of the Uniform Act on Security Interests does not require both parties' consent to appropriation by the collateral taker of the intermediated securities. Article 154 2° only indicates that it is the collateral taker who determines the amount of intermediated securities it will appropriate. Realisation of the pledge by appropriation of the intermediated securities affects the position of the collateral provider in the sense that it may lose its proprietary interest. This study therefore suggests that realisation of the pledge by appropriation of the intermediated securities recorded in the pledged securities account be permitted only with the consent of the parties, and only if the parties have specified a basis on which the intermediated securities are to be valued. As with realisation by sale of the pledged securities account, the estimated value of the intermediated securities recorded in the pledged account agreement must be applied in and towards the discharge of the secured obligation. If, in applying the valuation methods which the collateral taker and the collateral provider agreed upon, the estimated value of the intermediated securities recorded in the pledged account agreement exceeds the amount of the secured obligation, the surplus will have to be reimbursed to the collateral provider.

H. Summary and Evaluation

1. Following the dematerialisation of securities and the emergence of an intermediated securities holding system in the OHADA region, the traditional general rules of pledge and the rules in Articles 64 et seq of the Uniform Act on Security Interests had become inadequate. Consequently, the Council of Ministers adopted a revision of the Uniform Act on Security Interests on 15 December 2010. The revision introduced *inter alia* the pledge securities accounts (*nantissement de comptes-titres*), a new type of pledge governed by Articles 146 et seq of the Uniform Act on Security Interests and additionally by provisions of the Uniform Act on Commercial Companies (Articles 747, 764, 772, 773, and 773-1).
2. Article 146 of the Uniform Act on Security Interests defines a pledge of securities accounts as an agreement by which the collateral provider assigns as collateral for an obligation all the securities and other financial positions in its account. It is important to underscore that the provisions in Articles 146 et seq of the Uniform Act on Security Interests are modelled on Ordinance n° 2009-15 of 8 January 2009 on Financial Instru-

ments and Article L. 211-20 of the Monetary and Financial Code under French law.

3. Article 147(1) of the Uniform Act on Security Interests requires a declaration in order to establish a pledge of a securities account. From a private international law perspective, it is worth noting that any choice of law made by the intermediary and the account holder/collateral provider in the account agreement of the account now pledged as security is not among the elements to be stated in the declaration establishing the pledge. This aspect will play a material role in the analysis of the primary rule of the Hague Securities Convention, under which the applicable law is that of the state expressly agreed upon by the parties to govern the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law (*see* chapter 4 of part III of this thesis).
4. Although the wording of Article 147 of the Uniform Act on Security Interests seems to indicate that no prior contract is required in order to establish a pledge of a securities account, it may be inferred from the definition of a pledge of securities accounts in Articles 146 et seq of the Uniform Act on Security Interests that such a prior agreement must precede the declaration mentioned in Article 147. The prior agreement will be analysed from a private international law perspective under section V of part III of this thesis. That section examines whether the collateral taker and the collateral provider may choose the law applicable to the proprietary aspects of their agreement.
5. The Uniform Acts on Security Interests focuses on the *securities account*. Therefore, any financial instrument recorded in the securities account at the time the pledge is constituted or anytime thereafter is part of the basis of the pledge. But the Uniform Act on Security Interests and the Uniform Act on Commercial Companies do not address whether securities subject to an inalienability clause pursuant to Article 765-1 of the Uniform Act on Commercial Companies can be recorded in a pledged securities account and thus be part of the basis of the pledge. Moreover, Articles of association or the agreements referred to in Article 2-1 of the Uniform Act on Commercial Companies may make the transfer of certain shares subject to prior authorisation by an organ of the company (usually the board of directors) or by a third party (Articles 765(1) and 772 of the Uniform Act on Commercial Companies).
6. Article 148(2) of the Uniform Act on Security Interests includes as part of the basis of the pledge “any sum of money in any currency” in situations where such a sum represents proceeds from the intermediated securities initially recorded in the pledged securities account.
7. Under Article 149 of the Uniform Act on Security Interests, the pledged securities account must take the form of a special account opened in the

name of the account holder and maintained by the issuing legal entity or by a financial intermediary. This substantive law rule has an important impact on the interpretation of the primary rule of the Hague Securities Convention in the specific context of OHADA law (*see* chapters IV and VI of part III of this thesis): it represents a starting-off point from which this thesis proposes an interpretation of the Hague Securities Convention that allows the applicable law to be determined by reference to the collateral provider's intermediary.

8. As per Article 148(1) of the Uniform Act on Security Interests as well as per the general principle of *accessorium sequitur principale*, the basis of the pledge includes all the benefits and fruits which derive from the securities and other financial instruments recorded in the pledged securities account. It also includes any securities substituted for those initially located in the pledged securities account.
9. Article 151(1) first sentence of the Uniform Act on Security Interests allows the collateral taker and the collateral provider (the holder of the pledged account) to determine in the pledge agreement the conditions under which the latter may dispose of the financial instruments and any sums of money in the account. However, since the collateral provider retains possession of the intermediated securities located in the pledged securities account, Article 151 of the Uniform Act on Security Interests allows the collateral securities to be used by the collateral provider and not by the collateral taker. This provision derives from the notion of *nantissement*, which is by essence non-possessory.
10. In the occurrence of an enforcement event, the collateral taker may realise the pledge by way of sale or appropriation of the intermediated securities located in the pledged securities account. Moreover, under Article 154(1)^{1°} of the Uniform Act on Security Interests, the pledge may be realised by way of appropriation of any sum of money in any currency located in the pledged securities account.

Chapter 2: Security Interests in Intermediated Securities under the Geneva Securities Convention

A. Presentation of the Geneva Securities Convention

I. The Geneva Securities Convention

The UNIDROIT¹⁰⁶ Convention on Substantive Rules for Intermediated Securities (also known as the Geneva Securities Convention) is an international instrument created to improve the legal framework for holding, transferring, and collateralising intermediated securities. At the outset of the project, UNIDROIT convened a Study Group which first met in September 2002. In August 2003, the group's provisional response was released for public discussion in a position paper:

“The issues at stake can be divided into two categories:

- The first category is internal soundness, which comprises issues relating to the key features which any structure for the holding and transfer of securities through intermediaries must possess if it is to be regarded as sound, bearing in mind in particular the objectives of investor protection and efficiency.
- The second category is compatibility, which comprises issues affecting the ability of different legal systems to connect successfully where securities are held or transferred across national borders.

A harmonised rule should be regarded as appropriate if, but only if, it is clearly required to reduce legal or systemic risk or to promote market efficiency. This approach recognises that, desirable though it may be in principle to achieve harmonised rules, in practice this is a complex and difficult process that requires both technical and political consensus. The difficulty of achieving this, particularly within a reasonable timeframe, strongly argues in favour of a restrictive approach to the scope of harmonisation. Furthermore, a functional approach should be adopted, that is, one which uses language which is as neutral as possible, and which formulates rules by reference to their results.”¹⁰⁷

¹⁰⁶ UNIDROIT, the International Institute for the Unification of Private Law (*Institut International pour l'Unification du Droit Privé*) was established in 1926 as an auxiliary organ of the League of Nations. In 1940, it was re-established as an independent intergovernmental organisation after the dissolution of the League to study needs and methods for modernising, harmonising, and coordinating private and commercial law among Member States and between states and groups of states. It currently has 63 Member States. To achieve this purpose, UNIDROIT formulates uniform law instruments, rules, and principles. Essentially, UNIDROIT has a three-tiered structure composed of a Secretariat, a Governing Council, and a General Assembly.

¹⁰⁷ UNIDROIT 2003 – Study LXXVIII – Doc. 8, 5–6. It is worth noting that the whole process up to the adoption of the Geneva Securities Convention was guided by these core principles (Luc Thévenoz, ‘The Geneva Securities Convention: Objectives, History and Guiding Principles’ in Pierre-Henry Conac, Ulrich Segna & Luc Thévenoz, *Intermediated Securities – The Impact of the Geneva Securities Convention and the Future European Legislation* (Cambridge University Press, Cambridge 2013) 13).

On 23 December 2004, the UNIDROIT Secretariat¹⁰⁸ submitted for consideration the first version of the preliminary draft Convention¹⁰⁹ and a set of explanatory notes¹¹⁰ to the Governments of UNIDROIT Member States. That preliminary draft Convention was the basis for a negotiation process that started in May 2005 at the first session of a body called the Committee of Governmental Experts (hereinafter referred to as CGE) in Rome.¹¹¹ In March 2006, the CGE held a second session during which the draft was further improved.¹¹² After a third session in Rome in November 2006, a revised text of the preliminary draft Convention and a report of the session were issued.¹¹³ Finally, from 21 to 25 March 2007, the CGE held a fourth session which resulted in a new text of the preliminary draft Convention and a new report on the session.¹¹⁴ The negotiations involved a total of 39 UNIDROIT Member States, two non-member states, and seventeen organisations.¹¹⁵

At the end of its fourth session, the CGE reached the conclusion that the text of the draft Convention was ready to be submitted to a diplomatic conference, whereupon the Governing Council of UNIDROIT¹¹⁶ examined it and authorised its transmission. The Diplomatic Conference held its first session in Geneva from 1 to 12 September 2008 where it resolved several outstanding issues and completed the draft Convention with a preamble, transitional rules, and final provisions. It held a second and final session in Geneva from 5 to 9 October 2009 that culminated in the adoption of the UNIDROIT Convention on Substantive Rules for Intermediated Securities.

II. Objectives and Guiding Principles of the Geneva Securities Convention

The Geneva Securities Convention aims at harmonising substantive rules for intermediated securities, which are defined as “securities credited to a securi-

¹⁰⁸ The Secretariat is the executive organ of UNIDROIT. It encompasses a Secretary General (who is appointed by the Governing Council) and a small team of international civil servants and supporting staff.

¹⁰⁹ UNIDROIT 2004 – Study LXXVIII – Doc. 18.

¹¹⁰ UNIDROIT 2004 – Study LXXVIII – Doc. 19.

¹¹¹ For the Report of the session and the resulting text of the preliminary draft Convention, see UNIDROIT 2005 – Study LXXVIII – Docs. 23 rev. and 24.

¹¹² See UNIDROIT 2006 – Study LXXVIII- Docs. 42 and 43.

¹¹³ UNIDROIT 2007 – Study LXXVIII – Docs. 57 and 58.

¹¹⁴ See UNIDROIT 2007 – Study LXXVIII – Docs. 94 and 95.

¹¹⁵ It is important to note that during the negotiations and the session of the CGE, market participants played a significant role as observers.

¹¹⁶ The UNIDROIT Governing Council is responsible for supervising all policy aspects of the means by which the statutory objectives of UNIDROIT are to be attained. More particularly, it supervises the way in which the UNIDROIT Secretariat carries out the work program designed by the Council. It is comprised of the president of UNIDROIT (who is appointed by the government of Italy) and twenty-five elected members.

ties account or rights or interest in securities resulting from the credit of securities to a securities account” (Article 1(b) of the Geneva Securities Convention).¹¹⁷ For instance, Chapter V of the Convention aims to harmonise the substantive rules for collateralising intermediated securities. Such a harmonisation is needed not only because of the differences between national and regional rules but also because of the existence of different market standards.¹¹⁸ The Geneva Securities Convention has three fundamental objectives: to protect the rights of investors, to preserve the integrity of the intermediated holding system, and to achieve cross-border compatibility between legal systems. Nevertheless, the depth and the breadth of the Convention’s provisions is narrower than these three objectives; the way most of its provisions are formulated, they read like principles expressed more in terms of a result to be achieved rather than of prescriptions determining how to achieve such a result. This can be explained by many factors.

First, the global intermediated system constitutes a complex network involving as many different systems as there are jurisdictions and markets. Each system has its own legal, technological, and commercial elements which heavily depend on the way each system evolved and on the fundamental doctrines of property underpinning its evolution. Hence, the rights resulting from the immobilisation or dematerialisation of securities credited to securities accounts are characterised differently from system to system.¹¹⁹ An instru-

¹¹⁷ The Geneva Securities Convention operates regardless of how the securities were issued (certificated securities, jumbo certificate, or fully dematerialised securities) as long as the securities are kept within the intermediated system (Luc Thévenoz (*supra* n 107) 17).

¹¹⁸ The limited scope of this study does not allow an exhaustive listing of all relevant market standard documentation. However, a few are noteworthy: repo agreements are generally documented under a PSA/ISMA (now SIFMA/ICMA) Global Master Repurchase Agreement (hereinafter referred to as GMRA). There is also a standard agreement for securities lending agreements (the Global Master Securities Lending Agreement, herein after referred to as GMSLA). The GMSLA followed on earlier agreements such as the Master Equity & Fixel Interest Stock Lending Agreement (hereinafter referred to as MEFISLA), the Overseas Securities Lender’s Agreement (hereinafter referred to as OSLA) and the Master Gilt Edged Stock Lending Agreement (hereinafter referred to as MGESLA). Moreover, ISDA has developed standard documentation for derivatives and related agreements in the form of a Master Agreement. For details and references on each standard documentation, see Thomas Keijser, Guy Morton & Marcel Peeters, ‘Financial Collateral: From Private to Regulatory Law Reform’ in Thomas Keijser, *Transnational Securities Law* (Oxford University Press, Oxford 2014) ss 2.03 and 2.04.

¹¹⁹ See Philipp Paech, ‘Market Needs a Paradigm – Breaking Up the Thinking on EU Securities Law’ in Pierre-Henry Conac, Ulrich Segna & Luc Thévenoz, *Intermediated Securities – The Impact of the Geneva Securities Convention and the Future European Legislation* (Cambridge University Press, Cambridge 2013) 22 et seq; Luc Thévenoz, ‘Intermediated Securities, Legal Risk, and the International Harmonization of Commercial Law’ (2008) 13 *Stanford Journal of Law, Business & Finance* 384.

ment seeking to harmonise the law of intermediated securities was not to interfere with basic national doctrines of property law, which explains the *functional approach* of the Geneva Securities Convention.¹²⁰ Indeed, unlike the OHADA Uniform Acts,¹²¹ the provisions of the Geneva Securities Convention avoid legal notions as much as possible; rather, they are drafted to refer to facts and results. For instance, though the Convention's rules revolve around the notion that intermediated securities are the property of investors, they omit the word "property" almost entirely.

Secondly, given the complexity of the Convention's subject matter, it became obvious during the process of elaborating its provisions that "less is more"¹²². For instance, it was apparent that a full harmonisation of the validity requirements for book entries would be impossible. Consequently, intermediaries are required to act only on instruction from account holders or as authorised by law. Further, the Convention emphatically provides that no further step is necessary to make an acquisition of securities effective against third parties than being credited to an account or designated in a book entry (Articles 9 and 10 of the Geneva Securities Convention). Further requirements are left to the applicable non-Convention law.¹²³ This is the Convention's minimalist approach, which prevents it from achieving any significant degree of harmonisation.¹²⁴ Indeed, unlike the Uniform Acts,¹²⁵ the Geneva Securities Convention does not provide a uniform set of rules intended to apply irrespective of the law governing a given securities account, so even if it were universally adopted, it would not eliminate the need for conflict of laws rules to determine what law applies to *in rem* rights in respect of intermediated securities.¹²⁶

The Geneva Securities Convention encompasses only substantive rules. Any reference to "non-Convention law"¹²⁷ or the "applicable law" does not purport

¹²⁰ See the sixth recital to the preamble of the Geneva Securities Convention; Jürgen Than 'Der funktionale Ansatz in der UNIDROIT Geneva Securities Convention vom 9. Oktober 2009' in Stephan Grundmann et al (eds), *Festschrift für Klaus J. Hopt zum 70. Geburtstag am 24. August 2010: Unternehmen, Markt und Verantwortung* (De Gruyter, Berlin 2010) 233–234.

¹²¹ See part I, chapter 1, section D.I. of this thesis.

¹²² Luc Thévenoz (*supra* n 107) 19.

¹²³ "Non-Convention law" means the law in force in the Contracting State referred to in Article 2 of the Convention, other than the provisions of the Convention (Article 1(m) of the Geneva Securities Convention).

¹²⁴ Thomas Keijser, Guy Morton & Marcel Peeters (*supra* n 118) s 2.15.

¹²⁵ See part I, chapter 1, section D.I. of this thesis.

¹²⁶ This aspect is paramount for the conflict of laws analysis of this thesis, particularly its discussion of what is called the "substantive law solution" (*see* chapter 5 of part III of this thesis).

¹²⁷ Under Article 1(m) of the Geneva Securities Convention, "non-Convention law" means the law in force in the Contracting State referred to in Article 2, other than the

to designate which law (besides the Convention) should govern any particular issue.¹²⁸ Interestingly, during its elaboration process, it was noted that states party to the Convention would not be required to adopt the Hague Securities Convention. Therefore, to provide the greatest legal certainty and fulfil the expectations of the parties to a transaction involving intermediated securities, it was suggested that the Convention include a conflict of laws provision stating that determining which jurisdiction's laws are to apply is governed by the Hague Securities Convention regardless of whether a nation had ratified that convention.¹²⁹ Ratifying the Geneva Securities Convention would then have bound Contracting States to the rules of the Hague Securities Convention. But no such provision was ever incorporated into the Geneva Securities Convention.

III. Current Status of the Geneva Securities Convention

As of January 2021, the Geneva Securities Convention has not yet entered into force. For it to do so requires at least three ratifications (Article 42(1) of the Convention). Pursuant to Article 48(1) of the Convention, instruments of ratification, acceptance, approval, or accession must be deposited with UNIDROIT. Neither OHADA nor any of its Member States have signed the Convention; its only signatory as of January 2021 is Bangladesh.¹³⁰

In this regard, it is worth examining whether OHADA possesses the competence to accede to the Geneva Securities Convention pursuant to the OHADA Treaty. There is no provision in the OHADA Treaty which addresses the competence of OHADA to join an international treaty, and so far it has not done so. Conversely, Article 41 of the Geneva Securities Convention provides that a regional economic integration organisation (REIO) that is constituted by sovereign states and that has competence over certain matters governed by the Convention may sign, accept, approve, or accede to the Convention. Under Article 2 of the OHADA Treaty, OHADA has competence not only over the issues covered by the general part of the Geneva Security Convention (company law, insolvency law, etc.) but also over the specific matters in Chapter V of the Convention (security interests over intermediated securities).¹³¹

provisions of the Convention. On this topic, see particularly Francisco J. Garcimartín Alférez, 'The Geneva Convention on Intermediated Securities: A Conflict-of-Laws Approach' (2010) 15 *Uniform Law Review* 751.

¹²⁸ Luc Thévenoz (*supra* n 107) 17.

¹²⁹ Valerie Combs, 'The Law of Intermediated Securities: U.C.C. versus UNIDROIT' (2006) 58 *Alabama Law Review* 399, 414.

¹³⁰ The status of the Geneva Securities Convention is available at <<https://www.unidroit.org/status>> (accessed 4 January 2021).

¹³¹ As to the potential accession of the European Union to the Geneva Securities Convention, see Alan Rosas, 'The Status in EU Law of International Agreements Concluded by EU Member States' (2011) 34(5) *Fordham International Law Journal* 1304; Hans Van Loon & Andrea Schulz, 'The European Community and the Hague Conference on Private

*B. Scope of Application of Chapter V of the Geneva Securities Convention**I. Introduction*

Chapter V of the Geneva Securities Convention¹³² encompasses specific rules regarding collateral transactions in intermediated securities. Most of these rules were modelled on the European Financial Collateral Directive. The Geneva Securities Convention allows Contracting States to make declarations to opt out of all or part of Chapter V of the Geneva Securities Convention.¹³³ As per Article 31, which determines the scope of Chapter V, the rules enshrined there constitute a minimum harmonisation standard to which the Contracting States may add additional rules for the protection of collateral takers.¹³⁴

II. Personal Scope

Like all the provisions of the Convention, Chapter V of the Geneva Securities Convention takes as its starting point a broad personal scope. Unlike the Financial Collateral Directive, which contains a list of the types of entities to which it applies,¹³⁵ the Geneva Securities Convention (like OHADA's Uniform Act on Security Interests) is unlimited in its scope of personal application, applying in principle to both natural and legal persons involved in financial collateral arrangements. In this regard, the Convention is analogous to the Uniform Act on Security Interests. However, unlike the latter, Article 38(2)(a) of the Geneva Securities Convention leaves it to the Contracting States to exclude natural persons from its scope.

International Law' in Bernd Martenczuk & Servaas van Thiel (eds), *Justice, Liberty, Security: New Challenges for EU External Relations* (VUBPRESS, Brussels 2008) 257–299.

¹³² This section is entitled “Special Provisions in Relation to Collateral Transactions” and encompasses eight articles (Articles 31 to 38). See Hideki Kanda et al (*supra* n 87) ss 31-1 to 38-11.

¹³³ Such declarations must be in accordance with Articles 38 and 36(2) of the Geneva Securities Convention.

¹³⁴ Valerie Combs (*supra* n 129) 412; Herbert Kronke, ‘Das Genfer UNIDROIT-Übereinkommen über materiellrechtliche Normen für intermediärverwahrte Wertpapiere und die Reform des deutschen Depotrechts’ (2010) WM 1625, 1635; Michel Deschamps, ‘The Geneva Securities Convention – Selected Issues Left to Law Outside the Convention’ (2010) Uniform Law Review 703, 704. Nevertheless, Contracting States are not allowed to limit the protection of the collateral taker set out in Chapter V of the Geneva Securities Convention.

¹³⁵ For instance, the Financial Collateral Directive does not apply to natural persons (Article 1(2)(d) and (e) of the Financial Collateral Directive: “a person[,] other than a natural person”).

III. Material Scope

1. Types of Collateral

Under Article 31(1) of the Geneva Securities Convention, the material scope of Chapter V encompasses collateral agreements under which interests in intermediated securities are granted as collateral.¹³⁶ The provisions of the Convention presuppose that each Contracting State has an intermediary holding system¹³⁷ and apply irrespective of the legal design of these systems.¹³⁸ Since the Geneva Securities Convention focuses solely on intermediated securities, it does not apply to non-intermediary securities, which are securities physically held by an investor through certificates or registered in the investor's name with the issuer.¹³⁹ Chapter V also does not apply to cash. Further, although the Convention does not explicitly provide that credit claims are excluded, one may nevertheless contend that the Convention does not apply to credit claims inasmuch as they do not fulfil the Convention's two fundamental criteria for qualifying as securities. Indeed, under Article 1(b) of the Convention, "intermediated securities" are defined as "securities credited to a securities account or rights or interests in securities resulting from the credit of securities to a securities account."¹⁴⁰ Article 1(a) defines term "securities" as "any shares, bonds or other financial instruments or financial assets (other than cash) which are capable of being credited to a securities account and of being acquired and disposed of in accordance with the provisions of this Convention."

This definition in Article 1(a) limits the material scope of the Convention. The first functional criteria for qualifying as securities under Article 1(1)(a) and (b) is that securities be capable of being credited to a securities account, a criterion that limits the material scope of Chapter V to securities which can be held and traded in the form of book entries. The second criterion is that securities be capable of acquisition and disposition in accordance with the Convention. This requirement relates to the methods specified for that purpose in Article 11 (debit and credit) and Article 12 (automatic perfection in

¹³⁶ See also Article 31(3)(b), (c), and (e) of the Geneva Securities Convention.

¹³⁷ Hideki Kanda et al (*supra* n 87) s 29-14.

¹³⁸ Christophe Bernasconi & Thomas Keijser, 'The Hague and Geneva Securities Conventions: A Modern and Global Legal Regime for Intermediated Securities' (2012) *Uniform Law Review* 17(3) 549, 556. As to the different basic structure of indirect holding systems, see part I, chapter 2, subsection B of this thesis.

¹³⁹ Michel Deschamps (*supra* n 134) 1-25. As indicated *infra* (part II, chapter 3, subsection B.III of this thesis), the scope of application of the Financial Collateral Directive is broader than that of Chapter V of the Geneva Securities Convention. Indeed, the Financial Collateral Directive covers not only intermediated securities but also non-intermediated securities, credit claims, and cash provided as collateral.

¹⁴⁰ Hideki Kanda et al (*supra* n 87) s 1-15.

favour of the relevant intermediary, designating entry, and control agreement) of the Convention.¹⁴¹ These two requirements determine what financial assets can be regarded as “securities”.

It may be inferred from the official commentary to the Convention that Chapter V is applicable to “both tradable and non-tradable securities”.¹⁴² But under Article 1(a) of the Geneva Securities Convention, the securities must be “capable of [...] being acquired and disposed of”; those are aspects of tradability. Either way, pursuant to Article 38(2)(b) of the Convention, Contracting States may invoke the opt-out clause to exclude from the material scope of Chapter V intermediated securities that are not permitted to be traded on an exchange or in a regulated market.¹⁴³

2. *Relevant Obligations*

Under Article 31(3)(d) of the Geneva Securities Convention, “relevant obligations” are “any existing, future or contingent obligations of a collateral provider or another person”. Therefore, Chapter V of the Geneva Securities Convention contains no limitation as it does not seem to exclude any type of such obligations.¹⁴⁴ Indeed, it covers obligations irrespective of when they arose (*ratione temporis*) and allows collateral providers to secure obligations of third parties (*ratione personae*).¹⁴⁵ But for better adaptability to different national policies, the Convention leaves it to the discretion of the Contracting States to declare that Chapter V of the Convention will not govern collateral arrangements in respect of specific categories of relevant obligations (Article 38(2)(c) of the Geneva Securities Convention). By contrast, both the Uniform Act on Security Interests and the Financial Collateral Directive apply to any relevant obligations, without restriction as to when they were generated (whether present, actual, or existing; future or prospective; or contingent) who their debtors are (including persons other than the collateral provider). For example, Article 2(1)(f)(iii) of the Financial Collateral Directive explicitly includes relevant obligations of a specified class or kind arising from time to time; there is no mention of obligations of such a kind in Article 31(3)(d) of the Geneva Securities Convention. But this textual difference

¹⁴¹ Thomas Keijser, Maria Kyrkousi & Andreas Bakanos, ‘Financial Collateral: The Legal Framework of the European Union and UNIDROIT Compared’ (2014) 19 *Uniform Law Review* 429, 437.

¹⁴² Hideki Kanda et al (*supra* n 87) s 38-10.

¹⁴³ Changmin Chun, *Cross-Border Transactions of Intermediated Securities: A Comparative Analysis in Substantive Law and Private International Law* (Springer, Heidelberg 2012) 101. As to the meaning of the term “exchange or regulated market” under the Geneva Securities Convention, see Hideki Kanda et al (*supra* n 87) s 29-14.

¹⁴⁴ Thomas Keijser, Maria Kyrkousi & Andreas Bakanos (*supra* 262) 440.

¹⁴⁵ Hideki Kanda et al (*supra* n 87) ss 31-23, 31-24.

still does not give rise to problems as either provision is open to any kind of relevant obligations.¹⁴⁶ And unlike the Financial Collateral Directive, which requires relevant obligations to be performed by “cash settlement and/or delivery of financial instruments”¹⁴⁷, neither the Geneva Securities Convention nor the Uniform Act on Security Interests requires relevant obligations to be performed in a particular manner.

C. Recognition of Title Transfer Collateral Agreements

I. History of the Provision in Article 32 of the Geneva Securities Convention

The provision in Article 32 of the Geneva Securities Convention regarding recognition of title transfer agreements was added during the third session of the Committee of Governmental Experts (CGE). Originally, this provision also encompassed a second paragraph regarding the enforcement of title transfer collateral agreements by close-out netting.¹⁴⁸ The importance of the Convention recognising title transfer collateral agreements was first highlighted by the International Swaps and Derivatives Association (hereinafter referred to as ISDA).¹⁴⁹ The fourth session of the CGE did not substantively modify the provision.¹⁵⁰ The paragraph regarding enforcement of title transfer collateral agreements was incorporated into Article 33 (on enforcement) during the first session of the Diplomatic Conference, which by the end of its final session had not changed the provision in Article 32.

II. Analysis of Article 32 of the Geneva Securities Convention

Article 32 of the Geneva Securities Convention aims to eliminate the risk that a repurchase, securities lending, or derivative transaction, or any other transfer in the form of a title transfer, would not be respected and would instead be re-characterised as the grant of a security interest.¹⁵¹ Article 32 avoids this

¹⁴⁶ Changmin Chun (*supra* n 143) 143.

¹⁴⁷ Article 2(1)(e) of the Financial Collateral Directive.

¹⁴⁸ See UNIDROIT 2006 – Study LXXVIII – Doc. 57, Appendix 1, 18; UNIDROIT 2007 – Study LXXVIII – Doc. 58, ss 123–127 and 185.

¹⁴⁹ See UNIDROIT 2006 – Study LXXVIII – Doc. 47. See also earlier submissions by ISDA, such as UNIDROIT 2004 Study LXXVIII – Doc. 16, s 1; UNIDROIT 2005 – Study LXXVIII – Doc. 20, 8–11.

¹⁵⁰ Doc. 94, Appendix 1, 16.

¹⁵¹ Hideki Kanda et al (*supra* n 87) s 32-5. In case of such a re-characterisation, the failure to understand the steps required by the law governing security interests could have significant adverse consequences. In the context of the financial markets, many of these steps are cumbersome and formalistic. It is noteworthy that the Geneva Securities Convention has eliminated some of these (*see* Articles 11(2) and 12(2) of the Geneva Securities Convention).

risk by providing that Contracting States must allow a “transfer of full ownership” to be effective under a title transfer collateral agreement. Consequently, a Contracting State is obliged to give effect to a collateral taker’s full ownership under a title transfer collateral agreement. Moreover, it must be read in conjunction with Article 33(2), under which the secured obligation and the collateral taker’s obligation to return equivalent collateral under the terms of a title transfer collateral agreement may both be subject to a close-out netting provision.¹⁵²

D. Enforcement under Article 33 of the Geneva Securities Convention

I. History of Article 33 of the Geneva Securities Convention

From the start, the scope of the Geneva Securities Convention has encompassed the issue of enforcement or realisation of interests.¹⁵³ The issue features in the first preliminary drafts produced by the UNIDROIT Study Group.¹⁵⁴ A small substantive change was made to the enforcement provision during the first session of the CGE. Indeed, there was an initial attempt to simplify Article 33(2) of the Convention in respect of the types of secured obligations; a commercially reasonable manner of enforcement was no longer a requirement or a Convention standard but was instead made optional for the Contracting States.¹⁵⁵

The provision in Article 33 of the Convention was also changed during the second session of the CGE: parts of the first two paragraphs, which until then were part of the enforcement provision, were deleted and incorporated into the provision on scope and interpretation. In addition, during the second CGE session a provision on enforcement was taken out of the right-of-use provision and moved to the enforcement provision.¹⁵⁶ There was no substantive change to the enforcement provision during the fourth session of the CGE.¹⁵⁷ Further, the current text of Article 33(2) of the Convention, which until then was a part of Article 32 on title transfer collateral agreements, was added to the enforcement provision. The final session of the Diplomatic Conference made no changes to Article 33.

¹⁵² Hideki Kanda et al (*supra* n 87) s 32-7.

¹⁵³ UNIDROIT 2002 – Study LXXVIII – Doc. 1, s 12.

¹⁵⁴ UNIDROIT 2004 – Study LXXVIII – Doc. 13, 12–13; Study LXXVIII – Doc. 18, 11–12. For the Study Group’s explanatory notes to the initial enforcement provision, see UNIDROIT 2004 – Study LXXVIII – Doc. 19, 35.

¹⁵⁵ UNIDROIT 2005 – Study LXXVIII – Doc. 24, Appendix 1, 16–17; UNIDROIT 2005 – Study LXXVIII – Doc. 23 rev., ss 170–174 and 194.

¹⁵⁶ UNIDROIT 2006 – Study LXXVIII – Doc. 57, Appendix 1, 18–19; UNIDROIT 2007 – Study LXXVIII – Doc. 58, ss 115–117, 123–127 and 186.

¹⁵⁷ Hideki Kanda et al (*supra* n 87) s 33-8.

II. Analysis of the Enforcement Provision in the Geneva Securities Convention

1. Overview of the Realisation Methods

Article 33 of the Geneva Securities Convention is aimed at determining the collateral taker's rights in an enforcement event¹⁵⁸ and at eliminating obstacles to enforcement which might arise under national legislation, specifically with respect to insolvency proceedings. Under Article 33, a collateral taker has three different methods by which it can realise or otherwise enforce its interests in collateral securities.

First, the collateral taker may sell or appropriate the collateral securities. If the collateral taker chooses to sell securities given under a security collateral agreement, the net proceeds are applied to discharge the relevant obligations. Secondly the collateral taker may appropriate the collateral securities as its own property. In that case, the value of the collateral securities is applied in and towards the discharge of, or set off against, the relevant obligations.¹⁵⁹ However, Article 33(1)(a)(ii) of the Convention allows appropriation as an enforcement method only if it has been agreed upon in the collateral agreement. Further, the Convention requires that the agreement indicate the basis for the determining the value of the collateral securities for this purpose. Thirdly, a collateral taker may realise or enforce its interests in collateral securities by invoking a close-out netting provision (Article 33(1)(b) of the Geneva Securities Convention). Article 33(2) provides that upon the occurrence of an enforcement event, the relevant obligations of a collateral provider and the collateral taker's obligation to transfer equivalent collateral may be subject to a close-out netting provision.¹⁶⁰ In addition, Article 33(3) is aimed at ensuring that enforcement takes place in an efficient and timely manner; Article 33(3)(b) for instance provides that the commencement or continuation of an insolvency proceeding in respect of the collateral provider or collateral taker is no impediment to enforcement.¹⁶¹

¹⁵⁸ Under Article 31(3)(h) of the Geneva Securities Convention, "enforcement event" means, in relation to a collateral agreement, an event of default or other event on the occurrence of which, under the terms of that collateral agreement or by the operation of law, the collateral taker is entitled to realise the collateral securities or a close-out netting provision may be operated.

¹⁵⁹ Hideki Kanda et al (*supra* n 87) s 33-1.

¹⁶⁰ Article 33(2) of the Geneva Securities Convention, which is further elaborated in Article 33(1)(b), applies to both title transfer and security collateral agreements.

¹⁶¹ This includes the operation of a close-out netting provision. See Hideki Kanda et al (*supra* n 87) s 33-3.

2. *Realisation by way of Sale of the Collateral Securities*

Under Article 33(1)(a)(i) of the Geneva Securities Convention, the collateral taker may sell the collateral securities and be paid by applying the net proceeds of the sale towards the amounts due; the proceeds of the sale are applied “towards the discharge of the relevant obligation” (Article 33(1)(a)(i) of the Geneva Securities Convention).¹⁶² In the event the net proceeds surpass the amount of the secured debt, the surplus will have to be repaid to the collateral provider. Article 33 does not require prior court approval in order to realise the collateral securities.¹⁶³ However, Article 35 allows non-Convention law to introduce (for instance) an *a posteriori* control mechanism to ensure that the collateral taker have made an effort to sell the securities at a price most advantageous to the debtor and within the most reasonable time given the relevant market and the transaction volume.

3. *Realisation by Appropriation*

As a manner of realisation, Article 33(1)(a)(ii) of the Geneva Securities Convention allows the appropriation of the collateral securities only if the parties have given their consent and have specified the basis on which the collateral securities are to be valued.¹⁶⁴ As with realisation by sale of the collateral securities, the value of the collateral securities is to be applied in and towards the discharge of the secured obligation. Consequently, if in applying the valuation methods chosen by the collateral taker and the collateral provider the estimated value of the collateral securities is higher than the amount of the secured obligation, the surplus will have to be paid to the collateral provider.¹⁶⁵

4. *Close-Out Netting*

Unlike Article 154 of the Uniform Act on Security Interests, Article 33(2) of the Geneva Securities Convention provides that if an enforcement event occurs while any obligation of the collateral taker to deliver equivalent collateral under a collateral agreement remains outstanding, that and the other relevant obligations may be the subject of a close-out netting provision. This provision of the Convention relates to the effectiveness of a close-out netting provision in very specific cases in which the occurrence of an enforcement event precedes performance by the collateral taker of its obligation to transfer an equivalent collateral pursuant to the terms of the collateral agreement;

¹⁶² This provision is similar to that in Article 154 1° of the Uniform Act on Security Interests.

¹⁶³ See Hideki Kanda et al (*supra* n 87) s 33-19.

¹⁶⁴ In comparison, Article 154 2° of the Uniform Act on Security Interests does not require an agreement between the collateral taker and the collateral provider on that issue.

¹⁶⁵ Hideki Kanda et al (*supra* n 87) s 33-15.

more particularly, it refers to two scenarios. The first scenario is the popular, intrinsic close-out netting method of enforcing a title transfer collateral agreement; the second scenario pertains to cases in which the collateral provider has allowed the collateral taker to use the collateral securities on the condition that it return equivalent collateral no later than by the time the secured obligation is discharged.¹⁶⁶ In that situation, Article 33(2) allows a close-out netting provision to be triggered in order to offset the risk borne by the collateral provider in respect of the collateral taker.¹⁶⁷

5. *Obstacles to the Realisation of the Collateral in Some Jurisdictions*

Article 33(3) of the Geneva Securities Convention aims at avoiding potential obstacles to realising collateral in some jurisdictions. Hence, it complements Article 33(1) in respect of the scope of the collateral taker's rights under the terms of a security collateral agreement¹⁶⁸ or pursuant to a close-out netting provision in a security or title transfer collateral agreement.¹⁶⁹ The scope of Article 33(3) of the Convention is determined in its introductory part. Indeed, when it comes to realising collateral securities, Article 33(3) covers not only securities given under the terms of a title transfer collateral agreement but also those given under the terms of a security collateral agreement. Likewise, Article 33(3) applies to the operation of close-out netting provisions as these are defined in Article 31(3)(j).

Article 33(3)(a) of the Convention sets out a default rule whose application is triggered if the parties to the collateral agreement do not provide otherwise and do not limit the rights of the collateral taker. Under the default rule, the collateral securities may be realised¹⁷⁰ without prior notification to the debtor (or collateral provider, if different) on the secured obligation without prior approval by a court, public ministerial officer, or other person. Moreover, there is no requirement that the realisation be conducted by public auction or in any other prescribed manner (Article 33(3)(a)(i) to (iii) of the Geneva Securities Convention). Thus, Article 33(3)(a)(i) to (iii) eliminates the traditional formalism of some national laws¹⁷¹ in respect of realising collateral securities and of close-out netting.¹⁷²

¹⁶⁶ This scenario is to be read in conjunction with Article 34 of the Geneva Securities Convention as regards the right to use collateral securities. *See* Hideki Kanda et al (*supra* n 87) ss 34-1 et seq.

¹⁶⁷ Hideki Kanda et al (*supra* n 87) s 33-18.

¹⁶⁸ For a definition of the term "security collateral agreement", *see* Article 33(1)(a) of the Geneva Securities Convention.

¹⁶⁹ *See* Article 33(1)(b) of the Geneva Securities Convention.

¹⁷⁰ The realisation of collateral securities must be done according to the methods prescribed in Article 33(1) of the Geneva Securities Convention.

In addition, under Article 33(3)(b) collateral securities can be realised and close-out netting implemented even if insolvency proceedings have been initiated¹⁷³ that affect the collateral taker or the collateral provider.¹⁷⁴ If the collateral provider is different from the debtor on the secured obligation, an insolvency proceeding with respect to the debtor would not ordinarily affect the collateral taker's rights; in such a case, the collateral would not be part of the insolvency estate.

E. Right to Use Collateral Securities under Article 34 of the Geneva Securities Convention

I. History of Article 34 of the Geneva Securities Convention

The right to use collateral securities has been within the scope of the Geneva Securities Convention from the start of its drafting¹⁷⁵ and was featured in the first preliminary drafts produced by the Study Group.¹⁷⁶ The CGE determined at its first session the kind of securities or other assets a collateral taker would be obligated to transfer to the collateral provider upon exercising the right to use.¹⁷⁷ At its second session, the CGE envisaged that the Convention should include a right of use that would arise automatically upon crediting of securities to the account of a collateral taker. The paragraph in respect of the right of use and enforcement was included in the article on enforcement.¹⁷⁸ At its third ses-

¹⁷¹ For instance, for the realisation of the collateral securities Articles 152 and 153 of the Uniform Act on Security Interests require a prior notification (*mise en demeure*) to the debtor of the secured obligation. It is only eight days (or any other period agreed upon by the collateral taker and the account holder) after such *mise en demeure* that the collateral taker may realise the collateral securities. Moreover, it is important to note that Article 153 of the same Uniform Act indicates the formulation of the *mise en demeure*. Any prior notification which does not use the precise language contained in Article 153 of the Uniform Act on Security Interests is void (*see* Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds) (*supra* n 5) 931).

¹⁷² *See* Articles 152 and 153 of the OHADA Uniform Act on Security Interests.

¹⁷³ Under the definition in Article 1(h) of the Geneva Securities Convention, the term “insolvency proceeding” includes a reorganisation as well as a liquidation.

¹⁷⁴ Nevertheless, the application of any substantive or procedural rule of law applicable by virtue of an insolvency proceeding (*see* for instance Article 14(2) of the Geneva Securities Convention) is not affected by Article 33(3)(b) of the Geneva Securities Convention, subject to the other provisions of the Convention, such as the disapplication of zero-hour rules under Articles 36 and 37.

¹⁷⁵ UNIDROIT 2002 – Study LXXVIII – Doc. 1, Sections 10 and 11.

¹⁷⁶ UNIDROIT 2004 – Study LXXVIII – Doc. 13, 13; UNIDROIT 2004 – Study LXXVIII – Doc. 18, 12–13. For the Study Group's explanatory notes to the initial provision on the right to use collateral securities, *see* UNIDROIT 2004 – Study LXXVIII – Doc. 19, 35–36.

¹⁷⁷ UNIDROIT 2005 – Study LXXVIII – Doc. 24, Appendix 1, 17.

¹⁷⁸ *See* UNIDROIT 2006 – Study – LXXVIII – Doc. 42, Appendix 1, 18; Study LXXVIII – Doc. 43, ss 149–154.

sion, the CGE amended the provision to remove the automatic right of use it had inserted during the second session and to make clear that the provision related to security collateral agreements only. Moreover, it added a new definition of “equivalent collateral” that simplified the right-to-use provision.¹⁷⁹ No substantive changes were made to the provision at the CGE’s fourth session.¹⁸⁰ The provision did undergo significant changes during the first session of the Diplomatic Conference, including deletion of the square brackets in the then-current draft of Article 34(2) and addition of the notion of “replacement collateral” as well as the words “or the non-Convention law” at the end of the current version of Article 34(4) of the Geneva Securities Convention.¹⁸¹

II. Analysis of Article 34 of the Geneva Securities Convention

1. Use of Collateral Securities

Pursuant to Article 34 of the Geneva Securities Convention, the parties to a security collateral agreement may agree to derogate from the general prohibition against the collateral taker disposing of the assets given as collateral. In other words, the collateral taker may sell the securities given as collateral, lend them, or even use them as collateral or make similar dispositions.¹⁸² The general right in Article 34 to use collateral securities is aimed at enhancing market liquidity by ensuring that securities given as collateral remain available in the marketplace. But the Convention nevertheless requires that such a right be authorised by the collateral agreement since its exercise would affect the position of the collateral provider. Indeed, the collateral provider may lose its (proprietary) interest in the collateral securities under non-Convention law and be left only with a contractual claim until the collateral taker provides “replacement collateral”.¹⁸³

However, as stated in the tenth recital to the preamble to the Convention, the Convention does not limit or otherwise affect the powers of Contracting States to regulate, supervise, or oversee the holding and disposition of inter-

¹⁷⁹ See UNIDROIT 2007 – Study LXXVIII – Doc. 58, ss 118–120 and 187.

¹⁸⁰ See UNIDROIT 2007 – Study LXXVIII – Doc. 94, Appendix 1, 17.

¹⁸¹ Hideki Kanda et al (*supra* n 87) s 34-11. See in comparison under European law Joanna Benjamin, Madeleine Yates & Gerald Montagu (*supra* n 78) 64–65.

¹⁸² In comparison, Article 151(1) of the Uniform Act on Security Interests also regulates the right to use the collateral securities account. However, unlike Article 34 of the Geneva Securities Convention, such right is contemplated for the collateral provider, not the collateral taker. This provision under OHADA law derives from the concept of *nantissement*, which implies that the collateral provider withholds the possession of the collateral. Hence, *nantissement* of the securities account under Articles 146 et seq of the Uniform Act on Security Interests means that the account holder withholds the possession of its securities and may, if the parties agree thereto, continue to use them.

¹⁸³ Hideki Kanda et al (*supra* n 87) s 34-1.

mediated securities or any other matters expressly covered by the Convention except insofar as such regulation, supervision, or oversight would contravene the provisions of this Convention. Hence, Contracting States still have the regulatory power, for the purposes of investor protection or to address excess liquidity in the market, to impose permanent or temporary limits on the right of use.

2. *Replacement of the Used Collateral Securities*

Under Article 34(2) of the Geneva Securities Convention, the collateral taker has an obligation to transfer replacement collateral to the collateral provider. This obligation arises the moment the right of use is exercised and is to be discharged no later than the moment the relevant obligations are discharged. Replacement collateral can be “equivalent collateral”¹⁸⁴. Moreover, the collateral agreement may provide that the collateral taker must transfer “other assets”¹⁸⁵ under certain circumstances, such as if securities of the same description are no longer available because of a takeover or merger of the issuing company. The Official Commentary indicates that securities issued by the merged or acquiring company, government bonds, or cash may be considered to be “other assets”.¹⁸⁶

Article 33(2) of the Convention applies if an enforcement event occurs while any obligation of the collateral taker to deliver replacement collateral under a collateral agreement remains outstanding. In such a situation, the obligation of the collateral taker to deliver replacement collateral as well as the relevant obligations may both be subject to a close-out netting provision. Thus, the collateral provider may suffer a loss if the value of the outstanding replacement collateral surpasses that of the relevant obligations. This can be presented by the following illustration. Assume Lender granted a credit line to Borrower, and Borrower received an advance of 100. The parties agreed that the repayment of the advance of 100 is due on T+90. As collateral for the sums advanced in this line of credit, Borrower grants to Lender a pledge of securities credited to Borrower’s securities account which is maintained by IM. The portfolio of the pledged securities encompasses bonds issued by Issuer X and shares issued by Issuers Y and Z in equal proportion for the value of 120. Under the collateral agreement, the creditor/pledgee has the right to use the pledged securities. The collateral agreement sets forth how equivalent securities must be returned. Assume further that on T+25, Lender uses the pledged securities consisting of shares valued at 80, lending them to one of its customers. At the latest on T+90, Lender must, pursuant to the

¹⁸⁴ Article 31(3)(i) defines “equivalent collateral” as securities of the same description as collateral securities.

¹⁸⁵ See Article 34(2) of the Geneva Securities Convention.

¹⁸⁶ Hideki Kanda et al (*supra* n 87) s 34-3.

collateral agreement, return equivalent securities to Borrower. Once equivalent securities are returned to Borrower's securities account, they will serve as collateral as if there had been no interruption in respect of the pledged securities. However, if Lender fails to return equivalent securities to Borrower's account by T+90, then the value of the collateral, as estimated based on a close-out netting provision in the collateral agreement, will be set off against the credit extended by Lender, *i.e.*, the advance of 100. Suppose Lender disposed of all the securities valued at 120 on T+25 and fails to return equivalent securities. In such a case, Borrower is left with a contractual net claim of 20 (after 100 is netted out).

If the collateral taker transfers the collateral securities before the relevant obligations have been fully discharged (Article 34(2) of the Geneva Securities Convention), its rights regarding such securities are upheld. Under Article 34(3)(a) of the Convention, replacement collateral acquired or identified by the collateral taker before the relevant obligations have been fully discharged are, in the same manner as the original collateral securities, subject to an interest under the relevant security collateral agreement. In addition, the relevant security collateral agreement also applies to the securities in all other respects (Article 34(3)(b) of the Geneva Securities Convention).¹⁸⁷ These provisions are aimed at preventing claims that the replaced security collateral was new that and a security interest in it had become effective upon delivery – for example, for the purpose of determining the priority of such an interest.¹⁸⁸

3. *Protecting the Collateral Taker's Rights*

Article 34(4) of the Geneva Securities Convention indicates that the collateral taker's rights under the security agreement or under non-Convention law are not rendered unenforceable or invalid due to its exercising the right of use. Thus, the collateral taker would retain its rights even if it temporarily no longer held the securities initially given as collateral. This means that provisions of national legislation requiring that collateralised assets must remain in the possession of the collateral taker, a person designated by the parties, or a third party for this purpose are overridden by the Geneva Securities Convention.¹⁸⁹

¹⁸⁷ This means, for instance, that the collateral taker may exercise its right of use with respect to collateral securities which had been transferred under Article 34(2) of the Geneva Securities Convention.

¹⁸⁸ Hideki Kanda et al (*supra* n 87) s 34-16.

¹⁸⁹ Note that under Article 35 of the Geneva Securities Convention, non-Convention law may empower courts to exercise *a posteriori* control of the conditions for valuing the collateral and the secured obligations: "Articles 33 and 34 do not affect any requirement of the non-Convention law to the effect that the realisation or valuation of collateral securities or the calculation of any obligations must be conducted in a commercially reasonable manner."

F. Top-Up or Substitution of Collateral

I. General Overview and History of the Top-Up Rule in Article 36 of the Geneva Securities Convention

A collateral agreement may contain provisions for “top-up” or substitution of collateral. “Top-up” refers to cases where one of the parties to a collateral agreement provides additional collateral or returns excess collateral to ensure a balance between the parties’ outstanding obligations when price fluctuations in the financial market affect the value of the collateral or the amount of the relevant obligations (Article 36(1)(a)(i) of the Geneva Securities Convention). Similarly, an obligation to transfer top-up collateral may also occur as a result of a change in credit ratings (Article 36(1)(a)(ii)) or any other circumstance mentioned in the collateral agreement (Article 36(1)(a)(iii)). A substitution of collateral occurs when one of the parties to a collateral agreement exercises its right to withdraw collateral securities or other assets and to substitute for them other securities or assets of substantially the same value.¹⁹⁰

As to the historical development of that provision, it is worth noting that a first version of the top-up or substitution of collateral provision was devised by the Study Group.¹⁹¹ During its first session, the CGE then developed a first draft with the three types of instances that allow the provision of top-up collateral as currently set out in Article 36(1)(a)(i) to (iii)¹⁹² and at its second session improved the text regarding providing top-up collateral upon a change of credit rating, adding an objective criteria and opt-out clause.¹⁹³ No substantive change was made to the provision at the fourth session of the CGE or the Diplomatic Conference.

II. Analysis of Top-Up Rule in Article 36 of the Geneva Securities Convention

1. Rule Number 1: Top-Up

a) Introduction

The application of this rule is subject to the existence of a collateral agreement¹⁹⁴ in place before the top-up collateral is delivered. Further, the top-up rule in Article 36 of the Geneva Securities Convention applies only if the

¹⁹⁰ Hideki Kanda et al (*supra* n 87) ss 36-1, 36-2.

¹⁹¹ UNIDROIT 2004 – Study LXXVIII – Doc. 18, 13. For the Study Group’s explanatory notes on this provision, *see* UNIDROIT 2004 – Study LXXVIII – Doc. 19, 36.

¹⁹² UNIDROIT 2005 – Study LXXVIII – Doc. 23 rev., s 117 and Study LXXVIII – Doc. 24, Appendix 1, 18.

¹⁹³ UNIDROIT 2006 – Study LXXVIII – Doc. 57, Appendix 1, 20 and UNIDROIT 2007 – Study LXXVIII – Doc. 58, ss 121 and 189.

¹⁹⁴ *See* Article 31(3)(a) of the Geneva Securities Convention.

additional collateral is delivered in performance of an obligation to do so in the collateral agreement. It should be highlighted that Article 36 only applies to “additional” collateral,¹⁹⁵ so if a lender wishes collateral to secure a loan which was originally unsecured, Article 36 does not apply.¹⁹⁶ In addition, even if the collateral is additional, Article 36 is triggered only if *one* of the three following conditions is fulfilled:

The additional collateral is delivered to take account of changes in the value of the collateral delivered under the collateral agreement or in the amount of the relevant obligations (the situation provided in Article 36(1)(a)(i) of the Geneva Securities Convention);

The additional collateral is delivered to take account of any circumstances giving rise to an increase in the credit risk incurred by the collateral taker as determined by reference to objective criteria relating to the creditworthiness, financial performance, or financial condition of the collateral provider or other person by whom the relevant obligations are owed (the situation provided in Article 36(1)(a)(ii)); or

The additional collateral is delivered in circumstances other than those mentioned in Article 36(1)(a)(i) and (ii), provided that the collateral agreement includes the obligation to do so and non-Convention law permits it (the situation provided in Article 36(1)(a)(iii)).

b) The Situation provided in Article 36(1)(a)(i) of the Geneva Securities Convention

Article 36(1)(a)(i) of the Geneva Securities Convention addresses the situation in which the additional collateral is delivered to take account of changes in the value of the collateral delivered under the collateral agreement or in the amount of the relevant obligations. Changes in the value of the original collateral are determined by comparing the value at the time the collateral was delivered to its value at the time the top-up obligation is incurred. Article 36 applies only to the additional collateral delivered in order to take account of this change, as illustrated by the following fact pattern.

Assume for instance that Lender loaned USD 600,000 to Borrower. The collateral securities originally received by Lender are shares in Company X, incorporated in State Z. These original collateral securities are worth USD 900,000. Assume further that the value of the shares later fell to USD 700,000. Pursuant to the collateral agreement, if the value of the collateral falls 20% or more, then additional collateral must be delivered. Borrower consequently delivers additional collateral valued at USD 200,000. Arti-

¹⁹⁵ Hideki Kanda et al (*supra* n 87) s 36-11.

¹⁹⁶ This would be the case even in a situation where the original loan agreement stipulated, for instance, that if the credit rating of the borrower dropped, the borrower would have to give collateral.

cle 36(1)(a)(i) would apply to this delivery of additional collateral. However, if the drop in value was only USD 100,000 instead, then the delivery of additional collateral would not be covered by Article 36(1)(a)(i) of the Geneva Securities Convention: the fall in value would be less than 20%; so there would be no obligation under the collateral agreement to deliver additional collateral.

Article 36(1)(a)(i) of the Convention also covers situations in which there is a change in the “relevant obligations” though the original collateral has not changed in value. Under Article 31(3)(a) to (d), the term “relevant obligations” must be construed as covering the obligations secured by the collateral agreement and not obligations under an unsecured loan agreement.¹⁹⁷ The value of the relevant obligation is to be considered in relation to the value of the collateral securing the obligations; for example, if both the collateral and the relevant obligations are denominated in the same currency, the value of the obligations in the context of Article would not be affected by changes in that currency’s exchange rate. For instance, in the fact pattern mentioned above, assume the US dollar rises against the euro. This would lead to no change in the value of the underlying obligation compared to the collateral, since both the collateral and the relevant obligations are valued in US dollars. However, if the loan was not in US dollars but in euros instead, a rise in the euro against the US dollar would increase the value of the loan, justifying the delivery of additional collateral under Article 36(1)(a)(i) provided that the collateral agreement stipulates that the borrower must do so.

The relevant obligations and the rules of Article 36(1)(a)(i) in respect of changes in the value of the collateral may apply simultaneously. However, it might occur that the value of the collateral decreases while that of the relevant obligations increases. In such a case, Article 36(1)(a)(i) would apply to the additional collateral given under the collateral agreement in order to cover the amount of these changes in value.¹⁹⁸

c) The Situation provided in Article 36(1)(a)(ii) of the Geneva Securities Convention

Article 36(1)(a)(ii) of the Geneva Securities Convention deals with the type of situation in which additional collateral is delivered to take account of any circumstances giving rise to an increase in the credit risk incurred by the collateral taker as determined by reference to objective criteria relating to the

¹⁹⁷ Hideki Kanda et al (*supra* n 87) s 36-15.

¹⁹⁸ The Geneva Securities Convention allows a Contracting State to declare that Chapter V (including Article 36) of the Convention will not apply at all (Article 38(1)), or that Chapter V will not apply to certain market participants, types of relevant obligations, or securities (Article 38(2)). Nevertheless, a Contracting State is not allowed to declare that only Article 36(1)(a)(i) will not apply (Article 36(2)).

creditworthiness, financial performance, or financial condition of the collateral provider or other person by whom the relevant obligations are owed. Unlike Article 36(1)(a)(i) of the Convention, which focuses on the value of the collateral and the secured obligations, Article 36(1)(a)(ii) focuses on the general financial condition of the collateral provider (or of the borrower, if different). Article 36(1)(a)(ii) only applies if the collateral agreement stipulates that the collateral provider must deliver additional collateral in such a situation. Moreover, the assessment of increased credit risk must be guided by objective criteria with respect to creditworthiness, financial performance, or the financial condition of the collateral provider or other person by whom the relevant obligations are owed.

A change in the credit rating of the collateral provider, for example, could be regarded as an objective criterion under Article 36(1)(a)(ii) of the Geneva Securities Convention provided that an independent agency makes such rating. A decrease in the annual income of the collateral provider or its equity would also be covered by Article 36(1)(a)(ii). If the collateral provider is a listed company, Article 36(1)(a)(ii) would also apply to a change in its share price since the value of a company reflects its financial situation. However, Article 36(1)(a)(ii) does not apply to subjective criteria. For instance, if under the collateral agreement the collateral provider must deliver additional collateral when the collateral taker itself considers there to have been a change in the collateral provider's financial situation, Article 36(1)(a)(ii) will not apply. For Article 36(1)(a)(ii) to apply, the circumstances must specifically relate to the collateral provider or to another person by whom the relevant obligations are owed. To give another example, it also does not apply to situations in which a collateral agreement obliges the collateral provider to deliver additional collateral if a central bank raises interest rates.

The Geneva Securities Convention allows Contracting States to make declarations whereby Article 36(1)(a)(ii) will not apply (Article 36(2) of the Convention). A deteriorating general financial condition at a company may be a prelude to insolvency. Article 36(2) of the Geneva Securities Convention takes into consideration the possibility that a Contracting State may consider it undesirable to protect the position of one who has provided collateral in that circumstance, particularly in light of rules such as those in respect of avoidance or preferential treatment to defraud other creditors.

d) The Situation provided in Article 36(1)(a)(iii) of the Geneva Securities Convention

Article 36(1)(a)(iii) refers to situations in which additional collateral is delivered in circumstances other than those mentioned in Article 36(1)(a)(i) and (ii) provided that the collateral agreement contains an obligation to do so and it is permitted by non-Convention law. It protects the delivery of additional

collateral in any circumstances other than those in points (i) and (ii) against the timing claw back rule in insolvency law. However, such circumstances must be specified in the collateral agreement and permitted under non-Convention law. All the provisions of Article 36(1) of the Convention override insolvency law to the extent that Article 36(1)(a)(iii) overrides the pure timing claw back rule.¹⁹⁹

2. *Rule Number 2: Substitution*

Article 36(1)(b) of the Geneva Securities Convention applies to situations where the collateral agreement allows the collateral provider to substitute collateral. If a right of substitution is agreed upon subsequently to the original agreement, Article 36(1)(b) would still apply since the subsequent agreement can be regarded as an amendment that forms part of the collateral agreement. Article 36(1)(b) is limited in scope to substitutions of collateral securities as defined in Article 31(3)(e) of the Convention.²⁰⁰ It also applies to assets in addition to collateral securities or of substantially the same value.²⁰¹ However, for Article 36(1)(b) of the Convention to apply, the collateral agreement must, by definition, include securities.²⁰² If no securities are given as collateral prior to the substitution, Article 36(1)(b) of the Geneva Securities Convention would therefore not apply for lack of a basis in a collateral agreement.

Substitution occurs when a party delivers collateral securities or other assets of substantially the same value. How it is determined whether assets are of the same value depends on the collateral agreement and the applicable law. Article 36(1)(b) of the Convention does not prescribe a valuation method for substituted or substituting collateral; the basis for determining such method must lie in the collateral agreement and the applicable law. Moreover, Article 36(1)(b) contains no obligation that the collateral provider deliver the substituting collateral to the collateral taker before withdrawing the substituted collateral; in case of, for example, a system failure or time-zone differences in cross-border flows of securities, delivery can be later. Subject to limits set by the applicable law, the collateral agreement determines whether such a difference in timing is allowed.

3. *Scope of Protection*

Additional (top-up) collateral covered by Article 36(1)(a)(i) of the Geneva Securities Convention or substitute collateral covered by Article 36(1)(a)(ii)

¹⁹⁹ Hideki Kanda et al (*supra* n 87) ss 36-10 and 36-21.

²⁰⁰ Under Article 31(3)(e) of the Geneva Securities Convention, the term “collateral securities” means intermediated securities delivered under a collateral agreement.

²⁰¹ Such “other assets” may encompass for instance government securities or cash.

²⁰² See Article 31(3)(a) of the Geneva Securities Convention.

is not to be regarded as invalid, reversed, or declared void on the sole basis that the collateral was delivered during a prescribed (“suspect”) period before the beginning of an insolvency proceeding with respect to the collateral provider. Similarly, these operations are not to be regarded as invalid on the sole basis that the delivery of the collateral occurred after the relevant obligations were incurred.²⁰³ Article 36 of the Convention applies to collateral delivered on the same day but before the actual commencement of insolvency proceedings and overrides any rule that deems the insolvency proceeding to have commenced at the beginning of the day.²⁰⁴

Nor is the application of Article 36 affected by automatic retroactive effects to a moment determined by reference to any order or decree, nor is it affected by any action or event that results in the beginning of insolvency proceedings.²⁰⁵ Collateral delivered after the beginning of insolvency proceedings is outside the scope of Article 36 even if the collateral taker did not know or could not have known about the insolvency proceeding.²⁰⁶ As a consequence, whatever insolvency law is applicable governs the extent to which collateral delivered after the beginning of insolvency proceedings can be invalidated or reversed.

Collateral delivered under Article 36 of the Geneva Securities Convention is protected only against invalidity, reversal, and avoidance based *solely* on the collateral having been delivered during a prescribed period before insolvency proceedings or after the relevant obligations were incurred. Thus, whatever insolvency law applies may provide for a delivery of (top-up or substitute) collateral to be avoided when the collateral taker knew or ought to have known that the collateral provider was insolvent at the time of the delivery. The applicable insolvency law may also provide that a delivery of collateral may be avoided if for instance the delivery was not an ordinary business transaction or the collateral provider and the collateral taker both belong to the same group of companies. In other words, Article 36(1) of the Geneva Securities Convention overrides pure timing claw back rules, but nothing more.

Assume, for instance, that collateral provider CP delivered collateral to collateral taker CT and that the collateral is additional (top-up) collateral pursuant to Article 36(1)(a)(i) of the Geneva Securities Convention. Assume further that four weeks later, CP entered an insolvency proceeding. Under the applicable insolvency law, any delivery of collateral that occurred during the

²⁰³ Hideki Kanda et al (*supra* n 87) s 36-27.

²⁰⁴ This is the so called “zero hour rule”.

²⁰⁵ This rule is important since in some jurisdictions, the “relating back” starts from the date on which the filing or petition was presented, not from the date on which the declaration of insolvency or the relevant order was made. *See* Article 37 of the General Securities Convention which provides a similar rule for more general situations; Hideki Kanda et al (*supra* n 87) ss 36-227, 37-1 et seq.

²⁰⁶ Hideki Kanda et al (*supra* n 87) s 36-27.

three months before the insolvency proceeding began can be avoided if it secured previously existing obligations. Moreover, under the applicable law, any delivery of collateral can be avoided, regardless when it was made, if the collateral is aimed at securing pre-existing obligations and the collateral taker had or ought to have had knowledge that the collateral provider was insolvent at time of the delivery. (Additional collateral most often is provided to secure a pre-existing obligation.) The collateral was delivered to CT in the three-month suspect period. But because the collateral is additional collateral within the scope of Article 36 of the Convention, the delivery cannot be declared void on the sole basis that it occurred during the suspect period or made in respect of antecedent debt. Article 36 will thus protect against the delivery of collateral to CT being avoided though it occurred just four weeks before CP entered insolvency proceedings. However, assume now that CP was insolvent when the additional collateral was delivered and that CT knew or ought to have known that such delivery was subject to avoidance under the applicable insolvency law. The delivery could then be avoided because CT knew or ought to have known that CP was insolvent, but still not on the sole basis that the delivered collateral pertained to an antecedent^{debt}.

III. Certain Insolvency Provisions Disapplied

Article 37 of the Geneva Securities Convention, which was added during the first session of the diplomatic conference,²⁰⁷ provides:

“If Article 36 does not apply, a collateral agreement or the delivery of collateral securities under such agreement shall not be treated as invalid, reversed or declared void solely on the basis that the agreement is entered into or the collateral securities are delivered during a prescribed period before, or on the day of but before, the commencement of an insolvency proceeding in relation to the collateral provider.”

This provision protects the collateral taker against any rule of the applicable insolvency law that would set aside dispositions and agreements on the sole basis that they were made or entered into during a prescribed period before the collateral provider entered insolvency proceedings. Like Article 36 of the Convention, Article 37 refers to events which take place “during a prescribed period before, or on the day of but before, the commencement of an insolvency proceeding in relation to the collateral provider.”²⁰⁸

Article 37 is broader in scope than Article 36. It applies to the collateral agreement as such and any delivery of collateral under the collateral agreement. In contrast, Article 36 only applies to the delivery of additional (top-

²⁰⁷ See UNIDROIT 2008 – CONF. 11 – Doc. 14, s 8 and CONF. 11- Doc. 41. The provision in Article 37 remained unchanged during the final session of the diplomatic conference.

²⁰⁸ See Hideki Kanda et al (*supra* n 87) s 36-27.

up) or substitute collateral. However, Article 37 offers a narrower scope of protection than Article 36. Both Article 36 and Article 37 protect against invalidity, reversal, and avoidance, but Article 37 of the Geneva Securities Convention protects against such actions – invalidity, reversal, or avoidance – only if brought on the sole ground that the agreement or the delivery of collateral was made within a certain period before the beginning of the insolvency proceeding. Conversely, Article 36 protects against such actions even when brought on the grounds that the delivery of collateral took place after the incurrance of the relevant obligations. This difference in the scope of protection is justified in that securing an antecedent debt is particularly relevant in the context of top-up and substitution agreements.²⁰⁹ The following fact pattern can better illustrate the provision in Article 37 of the Geneva Securities Convention.

Assume the collateral agreement between the collateral provider CP and the collateral taker CT allows CP to substitute for the collateral securities. CP makes such a substitution but at the same time obtains from CT a bigger loan against delivery of further collateral securities, most of which are delivered in the morning. CP instructs its intermediary to deliver the remaining securities later that day; but before CP's intermediary is able to carry out the instruction, an insolvency proceeding is commenced in respect of CP. Since CP's intermediary has no knowledge that insolvency proceedings have commenced in respect of CP, it delivers the remaining securities to CT, who also knows nothing of the insolvency proceedings. Assume further that under the applicable insolvency law, any collateral delivered during the month before the beginning of the insolvency proceeding is voidable if the collateral is provided to secure a pre-existing debt. Additionally, the applicable insolvency law declares invalid all transactions made on the day the insolvency proceedings commence.

In the fact pattern mentioned above, Article 36 of the Convention would protect the substitution transaction against both of the identified types of avoidance claim whereas Article 37, because of its more limited scope, would not. Indeed, CT does not enjoy the protection of Article 37 against avoidance because the avoidance claim is not lodged solely on basis that the substitute collateral was delivered during the month before the insolvency proceeding; it is also grounded in the collateral having secured a previously incurred obligation.

In the aforementioned fact pattern, the delivery of additional, “new” securities occurred on the day insolvency proceedings were commenced in respect of CP and so is invalid according to the applicable insolvency law. Nevertheless, since the first securities delivery took place in the morning, before insolvency proceedings commenced, Article 37 of the Geneva Securities Convention would protect CT against invalidity of the delivery. It is important to note that Article 36(1)(a)(i) of the Geneva Securities Convention does not

²⁰⁹ Hideki Kanda et al (*supra* n 87) s 36-6.

apply in this case, because according to Article 36 of the Convention the “new” securities are not additional collateral. And since the second delivery of “new” securities took place after the insolvency proceedings began, Article 37 and Article 36 both do not cover it.

G. Summary and Evaluation

1. Chapter V of the Geneva Securities Convention comprises specific rules in respect of collateral transactions on intermediated securities. Most of these rules were modelled on the European Financial Collateral Directive. Contracting States are allowed to make declarations to opt-out of all or part of Chapter V of the Geneva Securities Convention in accordance with Articles 38 and 36(2) of the same. Further, under Article 31 of the Convention, the rules enshrined in Chapter V constitute a minimum harmonisation standard which the Contracting States may supplement with additional rules for the protection of collateral takers.
2. Key terms used in Chapter V of the Geneva Securities Convention are defined in Article 31(1). Article 32 eliminates the risk that an agreement to transfer full title to collateral will be subsequently characterised of as a security collateral agreement. The Convention prohibits such a re-characterisation and ensures that a title transfer collateral agreement takes effect as per its terms. Article 33 sets out methods for realising or otherwise enforcing the collateral taker’s interests in collateral securities; if an enforcement event occurs, the collateral provider’s relevant obligations, as well as the collateral taker’s obligation to transfer equivalent collateral, may be subject to a close-out netting provision. Further, Article 33 of the Geneva Securities Convention provides rules that ensure that such enforcement takes place in an efficient and timely manner.
3. The “right of use” of collateral is regulated in Article 34 of the Geneva Securities Convention. This provision is aimed at enhancing market liquidity and promoting secured finance. However, Article 34 provides that the collateral agreement must authorise the collateral taker to exercise such a general right of disposal. Moreover, Article 34 obliges the collateral taker to transfer equivalent collateral to the collateral provider.
4. In case of enforcement (Article 33) or if a right of use is exercised under Article 34 of the Convention, Chapter V upholds any standard imposed by non-Convention law of commercial reasonableness for the realisation or valuation of collateral securities.
5. Many collateral agreements contain “top-up” and “substitution of collateral” provisions. Consequently, Article 36 of the Convention protects such provisions against the “timing claw back rule” in insolvency law. Article 37 provides protection similar to that of Article. However, the scope of Article 36 is limited to the particular cases of top-up and substi-

tution of collateral. Consequently, Article 37 applies only where Article 36 does not.

6. Article 38 of the Convention sets forth a number of possible declarations a Contracting State may make regarding Chapter V. A Contracting State may declare either that it will apply none or only some of the provisions contained in Chapter. If it applies only some provisions, the Contracting State may only limit the scope of Chapter V with respect to three specific issues mentioned in Article 38(2) of the Convention.
7. The Geneva Securities Convention defers so often to non-Convention law (it takes a minimalist approach) that it fails to achieve any significant degree of harmonisation. It does not provide a uniform set of rules to be applied independently of the law governing a given securities account. The Convention contains many optional provisions; however, the most important ones require that the Contracting State publicise its choice in a declaration. Hence, even if the Geneva Securities Convention were universally adopted, it would not obviate the need for conflict of laws rules regarding *in rem* rights in intermediated securities.

Chapter 3: The EU Legislation on the Collateralisation of Intermediated Securities

A. A Bird's Eye View of the EU Legislative Framework on Intermediated Securities

With the sharp rise in the volume of cross-border transactions in financial instruments, the post-trading arrangements for the functioning of an integrated financial market became paramount. The EU's effort to integrate financial markets (including the intermediated system) dates back to the 1966 publication of the Segré Report²¹⁰, which was the first pan-European initiative for the integration of European financial markets. But the European Union has still not reached the goal of market integration; the intermediated securities arena is consequently still fragmented, and there is no overall European directive on securities law. The following passage analyses Europe's initiatives designed to tackle the problems hindering integration of the European intermediated systems and surveys three important directives: the Settlement Finality Directive, the Financial Collateral Directive and the MiFID.

In a nutshell, the Settlement Finality Directive of 1998 removed a portion of the legal risk inherent in holding and settling securities held through secu-

²¹⁰ See Claudio Segré et al, *The Development of a European Capital Market Report of a Group of Experts appointed by the EEC Commission* (Brussels, 1996) 31 and 246–247 for the debates on clearing and settlement.

rities accounts; it applies *inter alia* to designated securities settlement systems, to collateral provided under the arrangements of such systems, and to the systems' participants. Article 3 of the Settlement Finality Directive protects the effectiveness and irrevocability (also referred to as "finality") of transfer orders once they are entered into such systems. Such protection applies even if one or more system participants become insolvent. Furthermore, the Settlement Finality Directive is aimed at abolishing certain insolvency rules that protect an insolvent participant's creditors by rendering invalid certain transactions executed prior to the insolvency (see Article 7). As for the Financial Collateral Directive, it aims to remove major impediments to the use of securities as collateral, particularly in a cross-border situation. It applies to collateral in the form of financial instruments and cash provided to a collateral taker under an arrangement either involving a transfer of title or security (pledge, charge, lien, etc.) The Financial Collateral Directive abolishes formalities in the creation of collateral interests (Article 3) and simplifies procedures and formalities for the enforcement of collateral in a default situation (Article 4). Additionally, it lets the parties agree to a right of use of securities provided as collateral (Article 5) and institutionalises certain market practices, namely close-out netting, top-up collateral, and substitution of collateral securities. The MiFID aims to give investment firms an effective single passport to operate across the EU and to provide a high level of investor protection. It requires Member States to further harmonise the rules for investment services and for engaging in investment activities. It also aims to establish a comprehensive regulatory framework applicable to the execution of investor transactions on exchanges or other trading systems as well as by investment firms. Lastly, the Winding-up Directive of 2001 introduced the home-state control principle for insolvencies of credit institutions with branches in other Member States. Since it provides for the recognition of set-off in case of insolvency, it encompasses some provisions that are relevant to collateral arrangements and netting.

B. The Collateralisation of Intermediated Securities under the Settlement Finality Directive

I. History of the Settlement Finality Directive

To address systemic risks related to payment systems, the Commission of the European Communities (hereinafter referred to as the Commission) proposed the Settlement Finality Directive on 30 May 1996.²¹¹ It came out of a study group established in 1993 of experts from Member States to examine the legal

²¹¹ Commission of the European Communities, *Proposal for a European Parliament and Council Directive on Settlement Finality and Collateral Security*, COM(96) 193 final.

aspects of cross-border payments.²¹² Two years later, the Settlement Finality Directive became the first European instrument partially dealing with clearing and settlement arrangements in the EU. Since the study group focused on payment systems, that was all the Commission's original proposal covered.²¹³

The Settlement Finality Directive was drafted in the mid-1990s and aimed at preparing European payment and securities settlement systems for the euro and for a more integrated market place. However, legislation and markets have developed since the time of its drafting.²¹⁴ Therefore, on 23 April 2008, the European Commission issued a proposal to amend the Settlement Finality Directive of 1998 and the Financial Collateral Directive of 2002²¹⁵ (hereinafter referred to as the Proposal). Directive 2009/44/EC of the European Parliament and of the Council Amending Directive 98/26/EC on Settlement Finality in Payment and Securities Settlement Systems and Directive 2002/47/EC on Financial Collateral Arrangements as Regards Linked Systems and Credit Claims²¹⁶ (hereinafter referred to as the Directive 2009/44/EC) was adopted on 6 May 2009.²¹⁷ The purpose of Directive 2009/44/EC is to bring the Settlement Finality Directive and the Financial Collateral Directive in line with the latest market and regulatory developments. To do so, it first extends the scope of protection of the Settlement Finality Directive to

²¹² Diego Devos, 'Legal Protection of Payment and Securities Settlement Systems and of Collateral Transactions in European Union Legislation' (2006) Seminar Paper presented in the IMF 18.

²¹³ Commission of the European Communities (*supra* n 211) 2; René Sauer, *Die Harmonisierung des Kollisions- und Sachenrechts für Wertpapierguthaben und Wertpapiersicherheiten: Hintergrund und Entwicklung gemeinschaftlicher und globaler Regelungsansätze* (Peter Lang, Frankfurt am Main 2008) 19.

²¹⁴ For instance, the MiFID entered into force in November 2007. The purpose of the MiFID is to enable investment firms, regulated markets, and multilateral trading facilities (MTFs) to choose their post-trade location. In contrast, the Code of Conduct is intended to make the user choices enshrined by MiFID not a theoretical possibility but an effective option. To do so, it notably makes it easier for service providers to gain access to and become interoperable with infrastructures in foreign markets.

²¹⁵ Proposal for a Directive of the European Parliament and of the Council amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims, COM/2008/0213 final. See also Commission of the European Communities, *Commission Staff Working Document Accompanying the Proposal for a Directive of the European Parliament and of the Council Amending the Settlement Finality Directive and the Financial Collateral Directive: Impact Assessment*, COM(2008) 213 final, SEC(2008).

²¹⁶ OJ L 146/37.

²¹⁷ Further amending legislation can be found at <https://ec.europa.eu/info/law/settlement-finality-directive-98-26-ec/amending-and-supplementary-acts/amendments_en#amending-legislation> (accessed 4 January 2021). A consolidated version of the Settlement Finality Directive can be found at <<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:01998L0026-20140917>> (accessed 4 January 2021).

night-time settlement²¹⁸ in case insolvency procedures are opened; it also extends the Directive's scope to settlements between linked²¹⁹ systems. Secondly, it broadens the scope of protection of both the Settlement Finality Directive and the Financial Collateral Directive to include new types of assets (*i.e.*, credit claims eligible for the collateralisation of central bank credit operations) in order to facilitate their use throughout the Community.²²⁰ Thirdly, it introduces some simplifications and clarifications to facilitate the application of the Financial Collateral Directive and Settlement Finality Directive.²²¹

II. System and Participants

The Settlement Finality Directive has a narrow scope of application.²²² It covers only limited payment and securities settlement systems and their par-

²¹⁸ Since the adoption of the Settlement Finality Directive, more and more systems have introduced business days that start immediately after the closing of the previous business day. Such systems provide night-time settlement services, which are designed essentially to execute bulk and retail transactions. Currently, only transfer orders carried out on the same calendar day ("day of the opening of insolvency procedures") are covered. Consequently, a strict reading of the Settlement Finality Directive could indicate that a transfer order is protected only if the batch processing is finalised before midnight. In contrast, a batch running after midnight is not protected. The purpose of the proposal is hence the elimination of uncertainty regarding the status of night-time settlement services. Accordingly, the concept of "day" should be replaced by a reference to "business day, as defined by rules of system" (European Commission, *Amendments to Settlement Finality Directive and Financial Collateral Directive: Frequently Asked Questions*, Brussels, 24 April 2008, MEMO/08/267, 3).

²¹⁹ Several linked systems have existed for a number of years. The "bridge" between Euroclear Bank and Clearstream International is the most notable one regarding securities settlement. Moreover, nearly sixty links exist between securities settlement systems.

²²⁰ The incorporation of credit claims as collateral is important since the use of a credit claim as collateral could improve market liquidity and contribute to market stability, particularly in times of market stress. *See* Changmin Chun (*supra* n 143) 130; Rolf H. Weber & Seraina Grünwald, 'Settlement Finality and Financial Collateral Directives: Ignored but Crucial in Financial Turmoil' (2009) 24 *Butterworths Journal of International Banking and Financial Law* 70, who assess the role of the Settlement Finality Directive and the Financial Collateral Directive from the perspective of the most recent financial turmoil.

²²¹ Note that the proposal encompasses no amendments to the "PRIMA" rule (Article 9(2) of the Settlement Finality Directive and Article 9(1) of the Financial Collateral Directive). No agreement has been reached in Europe on whether and to what extent Article 9 Settlement Finality Directive and Article 9 Financial Collateral Directive ought to be changed. This pertains also to whether the EU should adhere to the Hague Securities Convention. Since 2003, a proposal by the Commission to sign the Convention has been blocked. As long as no agreement has been reached among Member States about which avenue is most suitable, the Commission considers it not appropriate to bring forth any new proposals to amend Article 9 Settlement Finality Directive and Article 9 Financial Collateral Directive (European Commission (*supra* n 218) 4).

ticipants (Article 1 of the Settlement Finality Directive). Under Article 2(a) of the Settlement Finality Directive, a system means a formal arrangement:

- (i) Composed of three or more participants, excluding the operator²²³ of that system, a settlement agent,²²⁴ a central counterparty (CCP),²²⁵ a clearing house,²²⁶ or an indirect participant;
- (ii) Organised by common rules and standardised arrangements for clearing;
- (iii) Governed by the law of the Member State chosen by its participants;
- (iv) Designated as a system and notified to the European Securities and Markets Authority by the Member State whose law is applicable, after that Member State is satisfied as to the adequacy of the rules of the system;²²⁷
- (v) Operating in in any currency, which can be the euro or other currencies that the system converts one against the other (*see* Article 1(a) of the Settlement Finality Directive); and
- (vi) Not entered between interoperable systems.²²⁸

Despite these requirements, Article 2(a) of the Settlement Finality Directive provides that “[a] Member State may also on a case-by-case basis designate as a system such a formal arrangement between two participants, without counting a possible settlement agent, a possible central counterparty, a possible clearing house, or a possible indirect participant, when that Member State considers that such a designation is warranted on grounds of systemic risk”.

²²² Due to its limited scope, the Settlement Finality Directive cannot be regarded as a European general legal reform measure. *See* Thomas Keijser, Guy Morton & Marcel Peeters (*supra* n 118) s 2.08.

²²³ Pursuant to Article 2(p) of the Settlement Finality Directive, a “system operator” means the entity or entities legally responsible for the operation of a system. A system operator may also act as a settlement agent, central counterparty, or clearing house.

²²⁴ Article 2(d) of the Settlement Finality Directive defines the term “settlement agent” as “an entity providing to institutions and/or a central counterparty participating in systems, settlement accounts through which transfer orders within such systems are settled and, as the case may be, extending credit to those institutions and/or central counterparties for settlement purposes”.

²²⁵ A “central counterparty” is an entity which is interposed between the institutions in a system and which acts as the exclusive counterparty of these institutions with regard to their transfer orders (Article 2(c) of the Settlement Finality Directive).

²²⁶ Article 2(e) of the Settlement Finality Directive provides that the term “clearing house” means an entity responsible for the calculation of the net positions of institutions, a possible central counterparty and/or a possible settlement agent.

²²⁷ The adequacy qualification indicates that it is important for Member States to review and supervise their internal system rules. *See* Article 10(1)(3) of the Settlement Finality Directive; Changmin Chun (*supra* n 143) 131.

²²⁸ This last requirement was added by the Directive 2009/44/EC. Under Article 2(o) of the Settlement Finality Directive. “Interoperable systems” are two or more systems whose system operators have entered into an arrangement with one another that involves cross-system execution of transfer orders.

Under Article 2(f) of the Settlement Finality Directive, institutions, CCPs, settlement agents, clearing houses, and system operators are regarded as participants in a system. In the event of their default, participants are potential risk-carriers in a system. Article 2(b) of the Settlement Finality Directive comprises a very broad definition of the term “institution”; besides public authorities and publicly guaranteed undertakings, it covers credit institutions as listed in Article 2 and defined in Article 4(1) of the Banking Directive²²⁹; it also covers investment firms as defined in Article 4(1)(1) of the MiFID.²³⁰

Moreover, Article 2(b) of the Settlement Finality Directive also considers to be an “institution” any undertaking whose head office is outside the Community and whose functions correspond to those of the Community credit institutions or investment firms as defined in Article 4(1) of the Banking Directive and Article 4(1)(1) of the MiFID. However, to fall within the scope of the Settlement Finality Directive, these institutions must participate in a system and be responsible for discharging the financial obligations arising from transfer orders within that system (Article 2(b) of the Settlement Finality Directive). Recital 7 of the Settlement Finality Directive says a Member State may extend the scope of the Directive to its institutions which participate in a non-EU system.²³¹

The Settlement Finality Directive also sets out a legal framework for indirect participants. Article 2(f) of the Settlement Finality Directive allows Member States, for purposes of the Directive and if justified on grounds of systemic risk, to consider indirect participants to be direct participants without limiting the responsibility of the participant through which the indirect participant passes transfer orders to the system. Article 2(g) of the Settlement Finality Directive defines the term “indirect participant” as “an institution, a central counterparty, a settlement agent, a clearing house, or a system operator with a contractual relationship with a participant in a system executing transfer orders which enables the indirect participant to pass transfer orders through the system, provided that the indirect participant is known to the system operator.”

²²⁹ Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast) (OJ L 177, 30.6.2006, p. 1).

²³⁰ OJ L 145, 30 April 2004, 1. However, the institutions set out in Article 2(1) of the MiFID are excluded from the scope of the Settlement Finality Directive.

²³¹ “Whereas Member States may apply the provisions of this Directive to their domestic institutions which participate directly in third country systems and to collateral security provided in connection with participation in such systems” (recital 7 of the Settlement Finality Directive).

III. Collateral Transaction

Under Article 1(c) of the Settlement Finality Directive, its scope includes collateral security provided in connection with participation in a system or with operations of the Member States' central banks in the context of their function as central banks. Article 2(m) and Recital 9 of the Settlement Finality Directive defines "collateral security" as "all realisable assets, including, without limitations, financial collateral referred to in Article 1(4)(a) of the Financial Collateral Directive, provided under a pledge (including money provided under a pledge), a repurchase or similar agreement, or otherwise, for the purpose of securing rights and obligations potentially arising in connection with a system, or provided to central banks of the Member States or to the European Central Bank."

IV. Insolvency Proceedings and Collateral Security

1. Provisions regarding Insolvency Proceedings

Section III of the Settlement Finality Directive encompasses three general rules with respect to insolvency proceedings which are relevant for collateral security. Article 6(1) of the Settlement Finality Directive provides that "the moment insolvency proceedings open is the moment when the relevant judicial or administrative authority handed down its decision". Under Article 6(2) of the Settlement Finality Directive, the relevant judicial or administrative authority immediately must notify their decision to the appropriate authority chosen by its Member State in accordance with Article 10(1) of the same Directive. In turn, that Member State must immediately notify the European Systemic Risk Board, other Member States, and the European Supervisory Authority (the European Securities and Markets Authority, ESMA²³²). Furthermore, Article 7 of the Settlement Finality Directive provides that insolvency proceedings must not have retroactive effects on a participant's rights and obligations arising from or in connection with its participation in a system before the moment of opening of such proceedings as defined in Article 6(1) of the same Directive. This disapplication of the zero hour rule is similar to what is found in Article 37 of the Geneva Securities Convention and Article 8(1) of the Financial Collateral Directive. In addition, Article 8 of the Settlement Finality Directive provides a conflict of laws rule that says an insolvent participant's rights and obligations arising from or in connection with its participation in a system are determined by the insolvency law of the

²³² ESMA was established by Regulation (EU) n° 1095/2010 of the European Parliament and of the Council (OJ L 331, 15 December 2010, 84). It is an independent EU authority responsible for safeguarding the stability of the European Union's financial system and promoting stable and orderly financial markets. More details are available on ESMA's website <<https://www.esma.europa.eu/>> (accessed 4 January 2021).

system.²³³ Article 9(1) of the Settlement Finality Directive has the same effects as Article 8 of the Settlement Finality Directive.²³⁴

2. *Collateral Security and Legal Certainty*

In a payment and securities settlement system, the primary purpose of providing collateral is to ensure settlement in case the provider becomes insolvent. In this regard, Article 9(1) of the Settlement Finality Directive provides:

“1. The rights of a system operator or of a participant to collateral security provided to them in connection with a system or any interoperable system, and the rights of central banks of the Member States or the European Central Bank to collateral security provided to them, shall not be affected by insolvency proceedings against:

- (a) the participant (in the system concerned or in an interoperable system);
- (b) the system operator of an interoperable system which is not a participant;
- (c) a counterparty to central banks of the Member States or the European Central Bank;
- or
- (d) any third party which provided the collateral security.”

C. *Collateral Agreements on Intermediated Securities under the Financial Collateral Directive*

I. *Objectives of the Financial Collateral Directive*

The Financial Collateral Directive is aimed at establishing a minimum Community regime for providing collateral and thereby contributing to the stability and the integration of the EU financial market as well as improving cross-border competitive transactions.²³⁵ As indicated in Recital 4, the Financial Collateral Directive complements other EU instruments, such as the Settlement Finality Directive, the Insolvency Regulation²³⁶, and the Winding-up Directive; in fact, it widely applies a number of features of the Settlement Finality Directive such as the protection of collateral against invalidation under rules of insolvency law.²³⁷ Its objective is to provide a simple, speedy,

²³³ From a private international law perspective, chapter 5 of part II of this thesis explores the possibility of using the “law of the system” as the general conflict of laws rule for determining the law governing certain rights in respect of intermediated securities.

²³⁴ See also Article 10 of the Winding-up Directive.

²³⁵ Recital 3 of the Financial Collateral Directive; Geoffrey Yeowart et al (*supra* n 75) s 1.01; Christoph Keller, ‘Die EG-Richtlinie 98/26 vom 19.5.1998 über die Wirksamkeit von Abrechnungen in Zahlungs- sowie Wertpapierliefer- und -abrechnungssystemen und ihre Umsetzung in Deutschland’ (2000) WM 1269, 1269–1270; Gulenay Rusen, ‘Financial Collateral Arrangements’ (2007) 2 *Journal of International Commercial Law and Technology* 250, 251.

²³⁶ Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (OJ L 160 1).

²³⁷ See particularly Article 9(1) of the Settlement Finality Directive.

effective, and uniform means of enforcing security in financial instruments, credits claims, and cash throughout the European Union.²³⁸ To do so, it requires EU Member States to disapply certain rules of national insolvency law that hinder the realisation of financial collateral in a collateral provider becomes insolvent.²³⁹ Furthermore, the Financial Collateral Directive takes aim at formality requirements and rules that hinder the creation²⁴⁰ and enforcement²⁴¹ of rights to collateral imposed by national law.²⁴² In addition, the Financial Collateral Directive aims to recognise risk-management measures, such as the right of use, close-out netting, top-ups, and substitutions, that financial markets frequently use.²⁴³

II. History of the Financial Collateral Directive

1. Preparatory Work

At the outset of the work on the Financial Collateral Directive, the EU Commission published a “Communication to the European Parliament and the Council” on 11 July 1999 (the Action Plan).²⁴⁴ The Action Plan identified fresh priorities for a single financial market and indicated that work on implementing the Settlement and Finality Directive showed the importance of common rules for collateral pledged to payment and securities systems. More particularly, the Action Plan read:

“Priority should be given to further progress in the field of collateral beyond this field. The mutual acceptance and enforceability of cross-border collateral is indispensable for the stability of the EU financial system and for a cost-effective and integrated securities set-

²³⁸ Geoffrey Yeowart et al (*supra* n 75) s 1.01.

²³⁹ See Article 8 of the Financial Collateral Directive.

²⁴⁰ See Article 3 of the Financial Collateral Directive.

²⁴¹ Article 4 of the Financial Collateral Directive.

²⁴² These hinderances include for instance the re-characterisation risk, formal requirements, cumbersome enforcement procedures, and some insolvency rules (Gulenay Rusen (*supra* n 235) 251; Changmin Chun (*supra* n 143) 139).

²⁴³ In comparison with the Geneva Securities Convention, see Article 34 of the Geneva Securities Convention (right of use), Article 36 of the Geneva Securities Convention (top-up and substitution of collateral), and Article 33(1)(b), (2), (3) of the Geneva Securities Convention (close-out netting). As to the OHADA Uniform Act on Security Interests, see Article 151(1) first sentence of the Uniform Act on Security Interests (right of use). Unlike the Geneva Securities Convention and the Financial Collateral Directive, the OHADA Uniform Act on Security Interests does not contain provisions on top-up and close-out netting; Klaus M. Löber & Ewa Klima, ‘The Implementation of Directive 2002/47 on Financial Collateral Arrangements’ (2006) 21:4 JIBLR 203, 204.

²⁴⁴ European Commission, *Implementing the Framework for Financial Market: Action Plan*, COM(1999) 232 final. See recital 2 of the Financial Collateral Directive. In addition, it is worth noting that the Action Plan can be used to interpret the Financial Collateral Directive. See Geoffrey Yeowart et al (*supra* n 75) s 1-29.

tlement structure. At present, these conditions are not fulfilled: there is a higher risk of invalidation of cross-border collateral arrangements and uncertainty as regards enforceability should the collateral provider become insolvent. If such difficulties are not resolved, cross-border securities transactions will be subject to higher costs and risks.²⁴⁵

One of the priorities of the Action Plan was the drafting and adoption of a directive on cross-border use of collateral. In the autumn of 1999, the Commission created the Forum Group on Collateral, which encompassed legal and market experts from across the European Union.²⁴⁶ Assisted by the Forum Group and based on work carried out notably by the International Swaps and Derivatives Association (ISDA)²⁴⁷, the Commission released to relevant bodies for consultation a working document on collateral in June 2000²⁴⁸ (the Working Document). The annexures of the Working Document included papers prepared by members of the Forum Group and one by the European Financial Markets Lawyers Group, EFMLG.²⁴⁹

The Working Document confirmed that an EU Directive on cross-border use of collateral was needed for many reasons:

- (i) There had been a substantial increase in the use of collateral to support cross-border payments;
- (ii) The Settlement Finality Directive offered very limited legal protection for the use of cross-border collateral to support financial transactions in the European Monetary Union;
- (iii) The risk that cross-border uses of collateral would be invalidated was higher than for domestic uses, resulting in legal uncertainty and, ultimately, in unnecessary systemic risk to the financial market;
- (iv) The administrative burden related to cross-border use of collateral was hindering the integration of EU financial market; and

²⁴⁵ European Commission (*supra* n 244) 6.

²⁴⁶ Erica Johansson, *Property Rights in Investment Securities and the Doctrine of Specificity* (Springer, London 2009) 11.

²⁴⁷ ISDA, 'ISDA 1999 Collateral Review' (ISDA, New York 1999) available at <<https://www.isdadocs.org/press/pdf/colrev99.pdf>> (accessed 4 January 2021). See also ISDA, 'ISDA Collateral Survey 2000' (ISDA, New York 2000), available at <<https://www.isdadocs.org/press/pdf/collsvy2000.pdf>> (accessed 4 January 2021); EFMLG, *Proposal for an EU Directive on Collateralisation* (June 2000); EFMLG, *Statement on Proposal for a Directive on Financial Collateral Arrangements* COM(2001) 168.

²⁴⁸ Commission of the European Communities, *Working Document on Collateral from the Commission to Relevant Bodies for Consultation*, C4/PN D (2000). See also *Explanatory Memorandum of the Proposal for a Directive of the European Parliament and of the Council on Financial Collateral Arrangements*, COM/2001/0168 final (OJ C 180E, 26.6.2001, 312–318); Diego Devos, *Current Development in Monetary and Financial Law* (International Monetary Fund, Washington DC 2008) 541.

²⁴⁹ The EFMLG was created in 1999 by the ECB. It had reached similar conclusions on the need for new legislation.

- (v) The proposed directive aimed at improving the functioning and the stability of European financial markets.²⁵⁰

2. Adoption and Implementation

On 30 March 2001, the EU Commission completed its first draft proposal for a directive the final version of which was adopted fifteen months later on 6 June 2002. Pursuant to its Article 12, the Financial Collateral Directive entered into force on 27 June 2002. Because it gives Member States some discretion in implementing its provisions, it provides for a minimum of harmonisation.²⁵¹ EFMLG released a report on its implementation in 2006.²⁵²

The EFMLG report indicated that the Financial Collateral Directive had been implemented in various ways; in some Member States, including Austria,²⁵³ Belgium,²⁵⁴ Czech Republic,²⁵⁵ Cyprus,²⁵⁶ Denmark,²⁵⁷ Estonia,²⁵⁸

²⁵⁰ Commission of the European Communities (*supra* n 248) 3. See particularly Annex A (at 1) to the Working Document *Position Paper on the Taking of Securities as Collateral in the European Union* by Guy Morton and Richard Potok: In modern securities and financial markets, there is an increase of global, multi-tiered, dematerialised, electronic holding and record systems. Settlement time frames have diminished, while the effective length of each business day has increased. Moreover, there is a continuous increase of the velocity and quantity of transactions. Many practices, such as those in respect of the issuance and trading of securities and the securitisation of assets, have made great strides. Nevertheless, current patterns of securities holding require greater certainty, predictability, and flexibility in the legal principles applying to the taking of collateral. Modern financial markets also demand prompt liquidation of the positions of a bankrupt party as market fluctuations in the securities markets lead to an inordinate risk that the insolvency of one party could trigger the insolvencies of others who carry accounts for that party, which would affect the integrity of those markets.

²⁵¹ For instance, Member States were allowed to extend the Financial Collateral Directive's protection beyond the scope set out in the Directive. As an illustration, the definition of "financial instrument" in Article 2(1)(e) of the Financial Collateral Directive contains a non-exhaustive list of financial instruments such as shares, bonds, warrants, units in funds, and money market instruments. This definition is a mere outline; the final interpretation and form may be determined by the Member States.

²⁵² European Financial Market Lawyers Group, *Survey on the Implementation of Directive 2002/47/EC on Financial Collateral Arrangements*, March 2006 (hereinafter referred to as the EFMLG Report). The EFMLG Report is available at <http://www.efmlg.org/Docs/Documents/2006%20March%20-%20EFMLG%20report%20on%20the%20survey%20on%20the%20implementation%20of%20Directive%202002_47_EC%20on%20Financial%20Collateral%20Arrangements.pdf> (accessed 4 January 2021).

²⁵³ *Finanzsicherheitengesetz* published on 16 December 2003; BGBl I 2003/117.

²⁵⁴ Law of 15 December 2004 on Financial Collateral (*Loi relative aux sûretés financières et portant des dispositions fiscales diverses en matière de conventions constitutives de sûreté réelle et de prêts portant sur des instruments financiers*), published and entered into force on 1 February 2005; Belgian Official Gazette of 1 February 2005.

Finland,²⁵⁹ Germany,²⁶⁰ Greece,²⁶¹ Hungary,²⁶² Latvia,²⁶³ Lithuania,²⁶⁴ Luxembourg,²⁶⁵ the Netherlands,²⁶⁶ Poland,²⁶⁷ Slovakia,²⁶⁸ Slovenia,²⁶⁹ and Swe-

²⁵⁵ Law on the Supplementary Supervision of Banks, Savings and Credit Cooperatives, Electronic Money Institutions, Insurance Undertakings, and Investment Firms in a Financial Conglomerate, entered into force on 29 September 2005, implementing the Collateral Directive; <<http://www.mvcr.cz/sbirka/2005/sb132-05.pdf>> (accessed 4 January 2021).

²⁵⁶ Law on Financial Collateral Arrangements of 2004. Official Gazette of the Republic n° 3823 of 19 March 2004, Appendix 1(I) 511–520 (Law 43(I)/2004), entered into force on 1 May 2004.

²⁵⁷ Amendment to the Law on Trading in Securities that entered into force on 1 January 2004.

²⁵⁸ Law amending the Law on Property, Law on the Central Register for Securities, Law on Credit Institutions, Law on Insurance Activities, Law on Bankruptcy, Law on Obligations, Law on Private International Law and Law on the Securities Market, passed by the Estonian Parliament on 22 April 2004 and entered into force on 1 May 2004.

²⁵⁹ Law on Financial Collateral approved by the Finnish Parliament in December 2003; new legislation entered into force on 1 February 2004.

²⁶⁰ Law of 5 April 2004 Transposing Directive 2002/47/EC of 6 June 2002 on Financial Collateral Arrangements and Amending the Mortgage Bank Act and Other Laws (*Gesetz zur Umsetzung der Richtlinie 2002/47/EG vom 6. Juni 2002 über Finanzsicherheiten und zur Änderung des Hypothekbankgesetzes und anderer Gesetze vom 5. April 2004*), entered into force on 9 April 2004; BGBl I of 8 April 2004, 502.

²⁶¹ Implementing Law 3301/12004, published on 9 December 2004 and entered into force on 23 December 2004; Official Gazette Vol. A Issue 263.

²⁶² Law XXVII of 2004 on the codification modification of certain financial legislative acts, which modified the Civil Code, the Law on bankruptcy and liquidation and the Law on private international law, adopted by Parliament on 19 April 2004 and Law XLVIII of 2004, which amended the Capital Market Act, adopted by Parliament on 2 June 2004.

²⁶³ Law on financial collateral adopted by the Parliament on 21 April 2005, entered into force on 25 May 2005; Latvijas Vestnesis (11 May 2005). Simultaneous amendments to the Law on the Insolvency of Undertakings and Companies (adopted on 17 March 2005) and amendments to the Law on Commercial Pledges (21 April 2005) necessary in order to ensure the application of the Law on Financial Collateral, already entered into force.

²⁶⁴ Law n° IX-2127 on the Financial Collateral Arrangements adopted by Lithuania's Seimas on 15 April 2004 and entered into force on 1 May 2004; Valstybės žinios, n° 61-2183, 2004.

²⁶⁵ *Loi du 5 août 2005 sur les contrats de garantie financière* adopted on 12 July 2005 and entered into force on 19 August 2005; <<http://www.legilux.public.lu/leg/a/archives/2005/1281608/1281608.pdf>> (accessed 4 January 2021).

²⁶⁶ The Law implementing the Collateral Directive (*Wet tot uitvoering van Richtlijn nr. 2002/47/EG betreffende financiëlezekerheidsvereenkomsten*) was adopted by the Second Chamber of the Dutch Parliament on 23 December 2005.

²⁶⁷ Law on Financial Collateral entered into force on 1 May 2004.

²⁶⁸ Law n° 7/2005 on Bankruptcy and Reconstruction, together with Law No 566/2001 on Securities and Investment Services, Law No 483/2001 on Banks, Law No 510/2002 on Payment Systems.

²⁶⁹ Law on Financial Collateral of 22 April 2004, entered into force on 1 May 2004.

den,²⁷⁰ it was implemented in the form of a law; implementation in other Member States, such as France,²⁷¹ Italy,²⁷² Portugal,²⁷³ and Spain,²⁷⁴ had been in the form of an executive order (either a decree or an ordinance). Another group of Member States, including Ireland,²⁷⁵ Malta,²⁷⁶ and the United Kingdom,²⁷⁷ implemented the Financial Collateral Directive in the form of a regulation.²⁷⁸ It is important to add that Bulgaria²⁷⁹ and Croatia²⁸⁰ implemented the Directive into law after the EFMLG completed its report. As for Romania,²⁸¹ it implemented the Directive in the form of an ordinance approved by a law.

²⁷⁰ The Swedish Parliament decided on the Government's legislative report and proposal on financial collateral (prop. 2004/05:30), the legislative amendments entered into force on 1 May 2005.

²⁷¹ Law n° 2004-1343 of 9 December 2004 on the Simplification of Law (as published in the Journal Officiel of 10 December) authorising the French Government to adopt an Ordinance implementing the Collateral Directive and simplifying certain collateral procedures. The Ordinance was adopted on 24 February 2005 and published in the Journal Officiel of 25 February 2005. Further aspects are addressed by the Law on financial security of 1 August 2003 implementing Article 7 of the Collateral Directive.

²⁷² Legislative Decree n° 170 of 21 May 2004, entered into force on 30 July 2004. *See also Implementation of Directive 2002/47/47/EC on Financial Collateral Arrangements (Attuazione della direttiva 2002/47/47/CE in materia di contratti di garanzia finanziaria)*, Gazzetta Ufficiale della Repubblica Italiana, n° 164, 15 July 2004, 11–14.

²⁷³ Decree-Law n° 105/2004 of 8 May 2004.

²⁷⁴ On 11 March 2005, the Government adopted Royal Decree-Law 5/2005 Introducing Urgent Reforms to Increase Productivity. It entered into force 15 March 2005. The Royal Decree-Law amends Law 24/1988 on the Securities Market and Other Regulations in order to: (i) implement the Prospectus Directive (2003/71/EC); (ii) implement the Collateral Directive (2002/47/EC); and (iii) introduce some modifications to the energy sector and to the law on public procurement.

²⁷⁵ European Communities (Financial Collateral Arrangements) Regulations 2004 of 9 January 2004 (S.I. n° 1 of 2004). Amending Regulations were adopted on 8 March 2004 (S.I. n° 89 of 2004).

²⁷⁶ The Minister of Finance has adopted Financial Collateral Arrangements Regulations, 2004 (L.N. 177 of 2004), pursuant to the powers delegated under the Set-off and Netting on Insolvency Act, Chapter 456 of the Laws of Malta. They entered into force on 1 May 2004.

²⁷⁷ Financial Collateral Arrangements (n° 2) Regulations 2003. SI 2003/3226, entered into force on 26 December 2003.

²⁷⁸ *See Annex entitled National Transposition Measures Concerning the Financial Collateral Directive.*

²⁷⁹ Financial Collateral Contracts Act; Държавен вестник n° 68; 22 August 2006.

²⁸⁰ Financial Insurance Act (Narodne Novine, n° 76/07); the Act amending the Financial Insurance Act (Narodne Novine, n° 59/12).

²⁸¹ Order n° 9/2004 on Certain Financial Guarantee Contracts, Monitorul Oficial al României, n° 78, 30 January 2004, 4–8; Law approving Government Order n° 9/2004 on Certain Financial Guarantee Contracts (Monitorul Oficial al României, n° 508, 7 June 2004, 1–2).

In addition, some Member States (including Cyprus, Estonia, Finland, Greece, Ireland, Italy, Lithuania, Malta, Portugal, Slovenia, and the United Kingdom) have implemented the Financial Collateral Directive in the form of a single act; others, such as Belgium, Czech Republic, Denmark, Germany, France, Hungary, the Netherlands, Slovakia, Spain, and Sweden, have implemented it by amending existing provisions of or integrating new provisions into existing national legislation. Three Member States (Austria, Latvia, and Poland) have combined both methods. Further, some Member States, including Cyprus, Ireland, Malta, and the United Kingdom, have implemented the Financial Collateral Directive verbatim.²⁸²

3. *Amendments*

In 2008, the Commission released a proposal for a new directive to amend the Financial Collateral Directive and the Settlement Finality Directive. The goal was to adapt these two directives to the latest market and regulatory developments by extending the scope of the Financial Collateral Directive to protect a new type of asset (credit claims eligible for the collateralisation of central bank credit operations) and to facilitate its use throughout the European Union. Moreover, several simplifications and clarifications were proposed to facilitate application of the Financial Collateral Directive.²⁸³ The Commission also noted that some Member States, including France, Germany, Spain, Austria, and the Netherlands, had recognised credit claims as collateral. This necessitated a harmonisation to create a level playing field among central banks and to stimulate cross-border use of collateral.²⁸⁴ As mentioned above, the Financial Collateral Directive was amended in 2009.²⁸⁵

²⁸² European Financial Market Lawyers Group (*supra* n 252) 10.

²⁸³ Explanatory Memorandum to the Proposal for a Directive to Amend the Settlement Finality Directive and Financial Collateral Directive, 17 March 2008, 2.

²⁸⁴ Explanatory Memorandum (*supra* n 283) 2. Unlike cash or financial instruments, credit claims are not fungible from the view point of the Commission. Therefore, it was not appropriate for the right of use contained in Article 5 of the Financial Collateral Directive to govern credit claims. Indeed, at the end of the transaction, the collateral taker could not return equivalent collateral to the collateral provider.

²⁸⁵ See Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims (Text with EEA relevance) (OJ L 146, 10.6.2009, 37–43).

III. Scope of Application

1. Personal Scope

a) History of the Provision in Article 1(2) of the Financial Collateral Directive

During the process of elaborating the Financial Collateral Directive, the first question was whether it should only apply to collateral arrangements between financial institutions or instead be broader in scope.²⁸⁶ The originally proposed directive was narrow in its personal scope.²⁸⁷ Its Article 2(4) required that both the collateral taker and the collateral provider be:

- (i) A public authority or a central bank;
- (ii) A financial institution under prudential supervision; or
- (iii) A person other than a natural person whose capital base exceeds EUR 100 million or whose gross assets exceed EUR 1000 million, at the time where financial collateral is actually delivered, according to the most recently prepared account published within a period no greater than two years prior to that time.

The monetary thresholds were subject to many criticisms and later abolished, allowing all companies to benefit from the Directive, as long as their counterparty was a financial institution.²⁸⁸

In addition, the Commission contended that the scope of the Directive should not be extended to natural persons since they are normally absent from the wholesale markets.²⁸⁹ The Commission also thought including natural persons might increase consumer related issues outside the main focus of the Directive.²⁹⁰

b) Description of the Personal Scope of Application of the Directive

Unlike Articles 146 et seq of the OHADA Uniform Act on Security Interests, which is not limited in personal scope, the Financial Collateral Directive applies if collateral taker and collateral provider both belong to one of the following categories:

²⁸⁶ Geoffrey Yeowart et al (*supra* n 75) s 1.33.

²⁸⁷ Proposal for a Directive of the European Parliament and of the Council on financial collateral arrangements, COM/2001/0168 final, OJ C 180E, 26.6.2001, 312–318.

²⁸⁸ Diego Devos (*supra* n 212) 39 for further discussion on this matter.

²⁸⁹ Commission of the European Communities (*supra* n 248) 9.

²⁹⁰ Geoffrey Yeowart et al (*supra* n 75) s 1.37.

- a. A public authority;²⁹¹
- b. A central bank, the European Central Bank, the Bank for International Settlements, a multilateral development bank as defined in Article 1(19) of Directive 2000/12/EC of the European Parliament and of the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions,²⁹² the International Monetary Funds, and the European Investment Bank;
- c. A financial institution subject to prudential supervision;²⁹³
- d. A central counterparty, settlement agent, or clearing house, as defined respectively in Article 2(c), (d) and (e) of Directive 98/26/EC;²⁹⁴ or
- e. A person other than a natural person, including unincorporated firms and partnerships, provided that the other party is an institution as defined in Article 1(2)(a) to (d) of the Financial Collateral Directive.²⁹⁵

The way the Directive's personal scope is implemented differs from one Member State to another. Indeed, some Member States opted for a broader

²⁹¹ Article 1(2)(a) of the Financial Collateral Directive excludes publicly guaranteed undertakings unless they fall under Article 1(2)(b) to (e) of the Financial Collateral Directive. Moreover, the term "public authority" in Article 1(2) of the Financial Collateral Directive includes (i) public sector bodies of Member States charged with or intervening in the management of public debt and (ii) public sector bodies of Member States authorised to hold accounts for customers.

²⁹² OJ L 126, 26 May 2000, 1. Directive as amended by Directive 2000/28/EC (OJ L 275, 27 October 2000, 37).

²⁹³ This includes: (i) a credit institution as defined in Article 1(1) of Directive 2000/12/EC, including the institutions listed in Article 2(3) of that Directive; (ii) an investment firm as defined in Article 1(2) of Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (OJ L 141, 11 June 1993, 27); (iii) a financial institution as defined in Article 1(5) of Directive 2000/12/EC; (iv) an insurance undertaking as defined in Article 1(a) of Council Directive 92/49/EEC of 18 June 1992 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Direct Insurance Other than Life Assurance (OJ L 228, 11 August 1992, 1) and a life assurance undertaking as defined in Article 1(a) of Council Directive 92/96/EEC of 10 November 1992 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Direct Life Assurance (OJ L 360, 9 December 1992, 1); (v) an undertaking for collective investment in transferable securities (UCITS) as defined in Article 1(2) of Council Directive 85/611/EEC of 20 December 1985 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS) (OJ L 375, 31 December 1985, 3); (vi) a management company as defined in Article 1a(2) of Directive 85/611/EEC.

²⁹⁴ This includes similar institutions regulated under national law acting in option and derivative markets to the extent not covered by Directive 98/26/EC, and a person, other than a natural person, who acts in a trust or representative capacity on behalf of any one or more persons that include any bondholders or holders of other forms of securitised debt or any institution as defined in Article 1(2) (a) to (d) of the Financial Collateral Directive.

²⁹⁵ Gulenay Rusen (*supra* n 235) 251.

scope than what it set out in the Financial Collateral Directive; for instance, Belgium included natural persons in all but title transfer transactions; under Estonian law, the collateral taker can be a private person; in Italy, the Directive's personal scope was extended to cover transactions involving non-profit organisations, political parties, trade unions, and associations. Similarly, in Spain the other party can even be a private person if one of the parties is a financial or governmental institution as listed in Article 1(2)(a) to (d) of the Directive. In Luxembourg, the Directive's personal scope has been extended to cover transactions between two corporate entities.

The Financial Collateral Directive in Article 1(3) first sentence nevertheless provides an opt-out mechanism whereby a Member State may exclude from the scope of the Directive financial collateral arrangements one of the parties to which is other than a natural person, perhaps an unincorporated firm or partnership (Article 1(2)(e) of the Directive). A Member State that makes use of this option must inform the Commission, which must then inform the other Member States of the fact (Article 1(3) second sentence of the Financial Collateral Directive). This opt-out mechanism was a compromise: some Member States had expressed concerns that the principle of *paritas creditorum* (the equal treatment of creditors) would be eroded otherwise.

Some Member States have indeed opted out under Article 1(3) of the Financial Collateral Directive. The EFMLG report²⁹⁶ divides them into three groups:

- (i) Full opt-out: Austria;
- (ii) Partial opt-out: Czech Republic (only certain-sized businesses, in terms of assets, turnover, and capital, are covered; if a party to a collateral arrangement is an investment firm, an insurance undertaking, or a fund management company, the other party must be a credit institution or a public entity); Slovenia (exclusion of associations and civil law legal persons); Sweden (limitation to financial agents regarding the possibility to re-pledge assets); and
- (iii) Diversified opt-out: France (excludes cash collateral provided or received by businesses) and Germany (includes transactions between two corporate entities but partial opt-out if the collateral provider is a business; only covered is financial collateral used to secure specifically defined financial obligations; long-term cash loans to businesses are thus mainly excluded).

Other Member States have not opted out and have included persons other than natural persons as well as unincorporated firms provided that the other party is a financial institution. The Member States that have taken this ap-

²⁹⁶ European Financial Market Lawyers Group (*supra* n 252) 10, 11.

proach are Cyprus, Greece, Hungary, Ireland, Latvia, Lithuania, Malta, the Netherlands, Poland, Portugal, and Slovakia.

2. *Material Scope*

The material scope of the Financial Collateral Directive originally included collateral provided in the form of both cash and financial instruments.²⁹⁷ In 2009, following the ECB's 2007 decision to make credit claims eligible to serve as collateral in Eurosystem credit operations, its scope was extended to include collateral in the form of credit claims.²⁹⁸ The Financial Collateral Directive now covers bilateral collateral arrangements consisting of title transfer financial collateral arrangements and security financial collateral arrangements (collectively, SCAs) between a collateral taker and a collateral provider. Article 2(1)(a) of the Financial Collateral Directive defines an SCA as "an arrangement under which a collateral provider provides financial collateral by way of security in favour of, or to, a collateral taker, and where the full ownership of the financial collateral remains with the collateral provider when the security right is established". As to title transfer financial collateral arrangements, Article 2(1)(b) of the Financial Collateral Directive defines them as arrangements "including repurchase agreements, under which a collateral provider transfers full ownership of financial collateral to a collateral taker for the purpose of securing or otherwise covering the performance of relevant financial obligations."

The definitions of these terms, title transfer financial collateral arrangements and SCAs, are essentially similar to those in the Geneva Securities Convention.²⁹⁹ Indeed, Article 31(3)(b) of the Geneva Securities Convention defines the term "security collateral agreement" as "an agreement between a collateral provider and a collateral taker providing (in whatever terms) for the grant of an interest other than full ownership in intermediated securities for the purpose of securing the performance of relevant obligations." Under Article 31(3)(c) of the Geneva Securities Convention, a "title transfer collateral agreement" is "an agreement, including one for the sale and repurchase of securities, between a collateral provider and a collateral taker providing (in whatever terms) for the transfer of full ownership of intermediated securities by the collateral provider to the collateral taker for the purpose of securing or otherwise covering the performance of relevant obligations."³⁰⁰ However, unlike Chapter V of the Geneva Securities Convention, whose scope is limited to intermediated securities used as collateral unless explicitly specified

²⁹⁷ Thomas Keijser, Guy Morton & Marcel Peeters (*supra* n 118) s 2.11.

²⁹⁸ See recital (5) of Directive 2009/44/EC (OJ 2009 L146/37).

²⁹⁹ Changmin Chun (*supra* n 143) 140.

³⁰⁰ For more details on the definition of these terms under the Geneva Securities Convention, see Hideki Kanda et al (*supra* n 87) ss 31-20 et seq.

otherwise, as in Article 34 and 36 of the Geneva Securities Convention,³⁰¹ the Financial Collateral Directive also applies to cash, credit claims,³⁰² and financial instruments³⁰³ used as collateral (Article 1(4)(a) of the Financial Collateral Directive).

In respect of cash, it is widely used as collateral in financial markets:

“Cash collateral arrangements may involve either a deposit with a right of set-off against the secured obligations or some form of pledge. The latter case often arises in practice from the use of cash in substitutions for securities – for example where securities are held in a pledged account with a third party such as a central securities depository and the pledgor is permitted to substitute cash for securities. In these cases, the pledge of cash parallels the pledge of securities collateral – indeed the pledged cash may even be credited to the same account. The pledgor should therefore retain ownership of the pledged cash. Otherwise, were the pledgee to go bankrupt, the pledgor cash would belong to the bankruptcy estate even though it was held by a third party. [...] It appears that pledges of cash may be analysed in a number of ways. The pledge may be regarded as attaching to the account in which the cash is deposited, to the debt claim or right arising from the deposit or to the deposited cash itself. In some jurisdictions it is also possible to create an irregular pledge, under which title to the deposited cash passes to the pledgee and which therefore in some respect resembles a deposit and set-off arrangement.”³⁰⁴

In light of the above, cash was included into the material scope of the Financial Collateral Directive. It is defined in Article 2(1)(d) of the Financial Col-

³⁰¹ Article 35(1) of the Geneva Securities Convention; Hideki Kanda et al (*supra* n 87) s 31-15.

³⁰² Credit claims are pecuniary claims deriving from an agreement through which a credit institution as per the Banking Directive grants credits in the form of a loan. During the process of elaborating the Financial Collateral Directive, the ECB proposed including all types of assets that were eligible for Eurosystem credit operations, such as credit claims in the form of bank loans. The ECB was of the view that it would promote efficient cross-border use of all assets eligible for European credit operations (*see* European Central Bank, *Opinion of 13 June 2001 on the Proposed Directive on Financial Collateral Arrangements, at the Request of the Council of the European Union Concerning a Proposal for a Directive of the European Parliament and of the Council on Financial Collateral Arrangements* (CON/2001/13)).

³⁰³ Financial instruments are shares in companies and other securities equivalent to shares in companies, bonds and other forms of debt instruments if these are negotiable on the capital market, and any other securities which are normally dealt in and which give the right to acquire any such shares, bonds, or other securities by subscription, purchase, or exchange or which give rise to a cash settlement (excluding instruments of payment), including units in collective investment undertakings, money market instruments, and claims relating to or rights in or in respect of any of the foregoing (Article 2(1)(e) of the Financial Collateral Directive). This definition encompasses nearly all debt and equity instruments in the capital market, including security entitlements. *See* Changmin Chun (*supra* n 143) 141. On bank notes which may be “financial instruments”, *see* Geoffrey Yeowart et al (*supra* n 75) s 3.19 and fn 22.

³⁰⁴ Commission of the European Communities (*supra* n 248) 14.

lateral Directive as “money credited to an account in any currency, or similar claims for the repayment of money, such as money market deposits”. Initially, the proposed Directive did not encompass a definition of the word “cash”; it was added only later, to apply to money credited to an account and to claims for the repayment of money, including money market deposits. However, this definition does not cover banknotes, *i.e.*, physical notes and coins, as it was thought unnecessary to include these in the material scope of the Financial Collateral Directive.³⁰⁵ Moreover, note that the ECB has indicated its view that virtual currencies can be regarded neither as full money from an economic perspective nor as money or currency from a legal perspective.³⁰⁶

Furthermore, the significance of collateral in the market for repo and reverse repo transactions was acknowledged. A 2001 report prepared by the Committee on the Global Financial System Working Group on Collateral contains a useful description of this market:

“A repo is the sale and subsequent repurchase of securities at a specified date and price. As repos have a ‘cash leg’ and a ‘securities leg’, collateral is an inherent part of such transactions. Repos are employed to finance and hedge dealer positions and to create short-term assets with low credit risk, underlining the either ‘cash-driven’ or ‘security driven’ character of the transactions.”³⁰⁷

The Commission also noted that repos mainly relate to bonds, especially governments bonds, and to some extent to equities; it therefore seemed clear that these kinds of assets could be covered.³⁰⁸ Further, during the elaboration process of the Financial Collateral Directive, the Commission contemplated extending the material scope of the Directive to other financial assets such as receivables, simple debt claims, and letters of credit but concluded that it would be preferable to deal with receivables etc. entirely separately since receivable financing was a separate financing technique with its own specific issues.³⁰⁹

Article 1(4)(b) of the Financial Collateral Directive contains an opt-out clause that enables a Member State to “exclude from the scope of the Directive financial collateral consisting of the collateral provider’s own shares, shares in affiliated undertakings within the meaning of the Directive on con-

³⁰⁵ See recital 18 of the Financial Collateral Directive and Statement of the Council’s reasons attached to the Common Position (EC) n° 32/2002 adopted by the Council on 5 March 2002, 22.

³⁰⁶ European Central Bank, *Virtual Currency Schemes – A Further Analysis* (February 2015) 25 and 32–33. See also Financial Action Task Force, *Report on Virtual Currencies: Key Definitions and Potential AML/CFT Risks* (June 2014).

³⁰⁷ Bank for International Settlements, *Collateral in Wholesale Financial Markets* (Basel 2001) 6.

³⁰⁸ Commission of the European Communities (*supra* n 248) 10.

³⁰⁹ See Geoffrey Yeowart et al (*supra* n 75) s 1.43.

solidated accounts,^[310] and shares in undertakings whose exclusive purpose is to own means of production that are essential for the collateral provider's business or to own real property."³¹¹ The Member States which opted out under Article 1(4)(b) of the Financial Collateral Directive can be classified as follows:

- (i) Full opt-out: Denmark;
- (ii) Partial opt-out: Germany³¹², Ireland, and Sweden;
- (iii) No opt-out: Austria, Belgium, Cyprus, Czech Republic, Estonia, Finland, France, Greece, Hungary, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Slovenia, Slovakia, Spain, and the United Kingdom.³¹³

In 2009, Article 1(4) of the Financial Collateral Directive was amended³¹⁴ to include a paragraph c that enables a Member State to exclude from the scope of application of the Directive credit claims where the debtor is a consumer as defined in Article 3(a) of Directive on credit agreements for consumers³¹⁵ or a micro or small enterprise as defined in Article 1 and Article 2(2) and (3) of the Annex to Commission Recommendation 2003/361/EC of 6 May 2003 concerning the definition of micro, small, and medium-sized enterprises.³¹⁶ Nevertheless, the opt-out does not apply where the collateral taker or the collateral provider of such credit claims is one of the institutions³¹⁷ referred to under Article 1(2)(b) of the Financial Collateral Directive (last sentence of

³¹⁰ Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated account (OJ L 193, 18.7.1983, 1). This directive as last amended by Directive 2001/65/EC of the European Parliament and of the Council (OJ L 283, 27.10.2001, 28).

³¹¹ See Article 38(2)(b) of the Geneva Securities Convention which provides that a Contracting State may make a declaration not to apply Chapter V of the Convention to intermediated securities which are not permitted to be traded on an exchange or regulated market. Article 38(2)(b) of the Geneva Securities Convention is to be read together with the definition of "collateral securities" in Article 31(3)(e) of the same Convention, which includes both tradable and non-tradable securities. See Hideki Kanda et al (*supra* n 87) s 38-10.

³¹² If the collateral giver is a business, the use of its own assets or the use of affiliates' shares is excluded from the range of usable collateral.

³¹³ Note that France included claims and several types of rights provided that they are assignable.

³¹⁴ Article 2(4)(d) of the Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims (OJ L 146, 10.6.2009, 37-43).

³¹⁵ Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on Credit Agreements for Consumers (OJ L 133, 22.5.2008, 66).

³¹⁶ OJ L 124, 20.5.2003, 36.

³¹⁷ Such institutions are, for instance, central banks, the ECB, the BIS, etc.

Article 1(4)(c) of the Financial Collateral Directive).³¹⁸ In view of the importance of cash collateral, the Commission concluded that it was desirable that the Directive should recognise pledges of cash as valid. Provided that valid pledges of cash were possible, the Commission concluded that it did not seem necessary to mandate a specific form of pledge or to require Member States to adopt a common analysis.³¹⁹

During the elaboration process of the Financial Collateral Directive, the European Parliament thought furthermore that it was important to specify that for financial collateral to fall within the scope of the Directive, there had to be dispossession of the collateral. Hence, a definition of the word “provision” was suggested such that “provided” would mean that the financial collateral has to be delivered, transferred, registered, held, or otherwise designated so as to be in the possession of or under the control of the collateral taker or of a person acting on its behalf. With minor modification, the suggested wording was adopted as Article 2(2) of the Financial Collateral Directive.³²⁰ The Commission accepted the requirement of dispossession, underscoring that the compromise reached between the Commission and the European Parliament on the proposed Financial Collateral Directive was aimed at:

“[...] providing a balance between market efficiency, which is the reason behind the exclusion of formal acts, and the safety of the parties to the arrangement and third parties, thereby avoiding, *inter alia*, the risk of fraud. This balance is achieved by the fact that the scope of the Directive only covers those financial collateral arrangements which provide for some dispossession, as set out in Articles 1(5) and 2(2), and where the provision of the financial collateral can be evidenced in writing or in a durable medium, as set out in Articles 1(5) and 2(3), ensuring thereby the traceability of the collateral.”³²¹

Against this background, pursuant to Articles 1(5) and 3(2) of the Financial Collateral Directive,³²² the Directive only applies to financial collateral once

³¹⁸ Of all the European Member States, only Denmark has exercised the opt-out provision in Article 1(4)(b) of the Financial Collateral Directive. See Klaus M. Löber & Ewa Klima (*supra* n 243) 208–209.

³¹⁹ Geoffrey Yeowart et al (*supra* n 75) s 1.63.

³²⁰ European Parliament, Report of 23 November 2001 on the proposal for a European Parliament and Council directive on financial collateral arrangements (COM (2001) 168, 7).

³²¹ Commission Position (EC) n° 52/2002, Statement of the Commission’s Reasons, 23. The Financial Collateral Directive is intended to provide a balance between market efficiency and the safety of the parties to the arrangement and third parties. To achieve this balance, the scope of the Financial Collateral Directive includes only those financial collateral arrangements which are “provided”, meaning which provide for some form of dispossession and which can be evidenced in writing or in a durable medium. See Recitals 10 and 11 of the Financial Collateral Directive. See also Geoffrey Yeowart et al (*supra* n 75) s 4.03.

³²² These articles must be read together with Article 2(2) of the Financial Collateral Directive.

it has been provided and if that provision can be evidenced in writing or in a legally equivalent manner. Under the Financial Collateral Directive, the term “writing” includes recording by electronic means and any other durable medium (Article 2(3) of the Financial Collateral Directive).³²³ As per the second sentence of Article 1(5) of the Financial Collateral Directive, “[t]he evidencing of the provision of financial collateral must allow for the identification of the financial collateral to which it applies. For this purpose, it is sufficient to prove that the book entry securities collateral^[324] has been credited to, or forms a credit in, the relevant account and that the cash collateral has been credited to, or forms a credit in, a designated account”.

As mentioned above, Article 2(2) of the Financial Collateral Directive determines the meaning of the financial collateral being “provided” or the “provision” of financial collateral. Indeed, these terms refer to the financial collateral being delivered, transferred, held, registered, or otherwise designated so as to be in the possession or under the control of the collateral taker or of a person acting on the collateral taker’s behalf. Any right of substitution or to withdraw excess financial collateral in favour of the collateral provider does not prejudice the financial collateral having been provided to the collateral taker as mentioned in the Financial Collateral Directive.

IV. Formal Requirements and Enforcement

Differences between the Member States in respect of the formal requirements for collateral arrangements have hampered the harmonisation of the European international financial market.³²⁵ To limit the administrative burdens for parties, the Financial Collateral Directive is aimed at minimising the different formal requirements.³²⁶ Recital 9 of the Financial Collateral Directive notes that to limit the administrative burdens for parties using financial collateral under the scope of the Financial Collateral Directive, “the only perfection requirement which national law may impose in respect of financial collateral should be that the financial collateral is delivered, transferred, held, registered or otherwise designated so as to be in the possession or under the control of the collateral taker or of a person acting on the collateral taker’s behalf while

³²³ It should be noted that such a writing requirement is not contemplated in the Geneva Securities Convention.

³²⁴ Under Article 2(1)(g) of the Financial Collateral Directive, “book entry securities collateral” means financial collateral provided under a financial collateral arrangement which consists of financial instruments title to which is evidenced by entries in a register or account maintained by or on behalf of an intermediary.

³²⁵ Gulenay Rusen (*supra* n 235) 252.

³²⁶ Hallgrímur Asgeirsson, ‘Financial Collateral Arrangements’ (2003) Monetary Bulletin 88, 89.

not excluding collateral techniques where the collateral provider is allowed to substitute collateral or to withdraw excess collateral.”

Moreover, the Financial Collateral Directive recites:

“For the same reasons, the creation, validity, perfection, enforceability or admissibility in evidence of a financial collateral arrangement, or the provision of financial collateral under a financial collateral arrangement, should not be made dependent on the performance of any formal act such as the execution of any document in a specific form or in a particular manner, the making of any filing with an official or public body or registration in a public register, advertisement in a newspaper or journal, in an official register or publication or in any other matter, notification to a public officer or the provision of evidence in a particular form as to the date of execution of a document or instrument, the amount of the relevant financial obligations or any other matter.”

Under Article 3(1) of the Financial Collateral Directive, Member States are not allowed to “[...] require that the creation, validity, perfection, enforceability, or admissibility in evidence of a financial collateral arrangement of the provision of financial collateral under a financial collateral arrangement be dependent on the performance of any formal act”.³²⁷ The Financial Collateral Directive provides some examples of “formal acts”: under Article 3, a formal act is the “registration in a public register” (Recital 10 of the Financial Collateral Directive).³²⁸

The Commission reached the conclusion that the Financial Collateral Directive should allow the collateral taker to liquidate the collateral speedily and with minimum formalities. Not allowing a rapid liquidation of the collateral could significantly impair the value of the collateral to the collateral taker, who in turn might not be able to fulfil its obligations vis-à-vis other counterparties. Hence, the collateral taker should be able to realise the collateral without any special requirement such as sale at public auction or in any prescribed manner or a notice of intention to sell approved or issued by a public authority.³²⁹ Allowing for rapid realisation of collateral helps reduce systemic risk by limiting the overall market disruption caused by an insolvency, so the Financial Collateral Directive ensures financial collateral arrangements can be enforced without cumbersome realisation procedures such as

³²⁷ As indicated above, the Financial Collateral Directive applies to financial collateral only if it has been provided, if that provision can be evidenced in writing, and where the financial collateral arrangement can be evidenced in writing or in a legally equivalent manner (Article 3(2) of the Financial Collateral Directive).

³²⁸ See Under English law Regulations 4(4) and 5 of the FCARs which, in respect of a security financial collateral arrangement or any change created otherwise that derives from a security collateral arrangement, disapply the rules of the Companies Act of 2006 addressing the registration of the Company Registry of mortgages or charges created by UK companies.

³²⁹ Commission of the European Communities (*supra* n 248) 16.

court approval, public auction, prior notice, or the elapse of an additional time period (Article 4 of the Financial Collateral Directive).³³⁰

Further, Article 4(2) of the Financial Collateral Directive allows the enforcement of the collateral by way of appropriation. It should be noted that the original version of the Directive did not contain a provision allowing securities to be realised by appropriation.³³¹ Nevertheless, the ECB recommended that the Commission consider allowing a collateral taker to appropriate the collateral in case of an enforcement event provided that the creditor is not unduly enriched.³³² Furthermore, the Committee on Economic and Monetary Affairs of the European Parliament (hereinafter referred to as the Committee) formulated amendments to the Directive to allow appropriation where the parties have agreed, in the collateral agreement, on terms and a valuation method. The Committee highlighted that realising the collateral by sale during a period of instability in the financial markets might not be in the best interest of the collateral taker.³³³

Against this background, Article 4(1)(a) of the Financial Collateral Directive allows the collateral taker to realise the collateral by means of appropriation. Article 4(2) specifies that appropriation is possible only if “(a) this has been agreed by the parties in the security financial collateral arrangement; and (b) the parties have agreed in the security financial collateral arrangement on the valuation of the financial instruments.” It was feared that introducing appropriation as a means of enforcement only with respect to financial collateral arrangements could lead to legal uncertainty in some Member States where this legal technique was unknown. Therefore, an option was included in the Financial Collateral Directive to allow Member States not to recognise this technique if they did not allow appropriation when the Directive entered into force.³³⁴ Indeed, Article 4(3) provided that “Member States which do not allow appropriation on 27 June 2002 are not obliged to recognise it. If they make use of this option, Member States shall inform the Commission which in turn shall inform the other Member States thereof.” The EFMLG report indicated not only that all Member States recognised appropriation when implementing the Collateral Directive but also that no implementation problems were identified.³³⁵ Hence, the 2009 amendment of the Financial Collateral Directive removed this option (Article 2(7)(c) of Directive 2009/44/EC). Additionally, Article 4(5) provides that Member States must ensure that a financial collateral arrangement can take effect in accordance with its terms

³³⁰ See also Article 33 of the Geneva Securities Convention.

³³¹ Geoffrey Yeowart et al (*supra* n 75) s 1.70.

³³² European Central Bank (*supra* n 302) s 13.

³³³ European Parliament (*supra* n 320) 12.

³³⁴ Geoffrey Yeowart et al (*supra* n 75) s 1.71.

³³⁵ European Financial Market Lawyers Group (*supra* n 252) 14.

notwithstanding the commencement or continuation of winding-up proceedings or reorganisation measures in respect of the collateral provider or collateral taker.

V. Right of Use

1. The Right of Use throughout the Elaboration Process of the Financial Collateral Directive

During the process of elaborating the Financial Collateral Directive, the use of pledged collateral by the collateral taker in accordance with the terms of the collateral agreement triggered a robust discussion within the Forum Group.³³⁶ The EFMLG indicated that such use could be difficult under the legal systems of most Member States; it would constitute a radical departure from the basic principles of the laws governing the pledging of assets.

“The issue is that the re-use is not consistent with the basic concept of pledge in most Member States (where the debtor providing the assets as collateral nonetheless remains the owner of the collateral, subject to the pledge in favour of the creditor). Thus, the creditor cannot freely use the pledged securities in question. This is not the case where the transfer of title is utilised (and explains why there is pressure to use the transfer of title). The inability to transfer or pledge the relevant securities severely limits the range and type of transactions on offer to participants in market.”³³⁷

However, the Commission was of the view that allowing a collateral taker to use the financial collateral would increase liquidity in the market and enable investors to buy or sell securities easily and at a fair price.³³⁸ It was proposed that the right of use be subject to an obligation to deliver equivalent securities once the loan is repaid.³³⁹ Moreover, the Commission perceived two additional advantages in use of collateral: First, both collateral taker and collateral provider could benefit from the right of use the collateral; indeed, the collateral taker stands to gain financially from it and consequently could offer better financing terms to the collateral provider. Secondly, a right of use

³³⁶ Commission of the European Communities (*supra* n 248) Annex B, 6. For more details on the right of use of financial collateral under the Financial Collateral Directive, see also Geoffrey Yeowart et al (*supra* n 75) ss 11.01 et seq.

³³⁷ Commission of the European Communities (*supra* n 248) Annex F, 11.

³³⁸ As mentioned above, it was concluded during the process of elaborating the Financial Collateral Directive that allowing a right of use of the collateral in the Directive was regarded as of critical importance where the collateral taker provided a general securities financing facility and participated actively in the securities and derivatives markets (Commission of the European Communities (*supra* n 248) Annex B, 6).

³³⁹ Commission of the European Communities (*supra* n 248) Annex F, 10. Later, the same reason would be mentioned for the inclusion of the provision of the right of use of collateral in the Geneva Securities Convention (Article 34). See Hideki Kanda et al (*supra* n 87) ss 34-1 et seq.

would lead to a clearer choice between title transfer and security structures. Moreover, a security interest combined with a right of use would allow the collateral provider to determine the extent to which it is willing to incur a credit exposure to the collateral taker. Against this background, the Commission concluded that it would be preferable to include a right of use of the collateral in the Financial Collateral Directive but require parties to define it contractually; this would ensure that only securities with a value not exceeding that of the secured liabilities could be used.³⁴⁰

2. Description of the Right of Use under Article 5 of the Financial Collateral Directive

Under Article 5 of the Financial Collateral Directive, “[t]he collateral taker is entitled to exercise a right of use in relation to financial collateral provided under the security financial collateral arrangement.”³⁴¹ In case a collateral taker exercises a right of use, it has thereby the “obligation to transfer equivalent collateral to replace the original financial collateral at the latest on the due date for the performance of the relevant financial obligations covered by the security financial collateral arrangement” (Article 5(2) of the Financial Collateral Directive). Alternatively, on the due date for the performance of the relevant financial obligations, the collateral taker has two options: It can either transfer equivalent collateral or set off the value of the equivalent collateral against or apply it in discharge of the relevant financial obligations, if and to the extent that the terms of a security financial collateral arrangement so provide (Article 5(2) of the Financial Collateral Directive).³⁴²

It is important to recall that under Article 34(2) of the Geneva Securities Convention, a collateral taker who has exercised a right of use incurs an obligation to replace the original collateral securities by delivering to the collateral provider equivalent collateral *no later than the discharge of the relevant obligations*. In contrast, the Financial Collateral Directive provides that a collateral taker who exercises a right of use incurs the obligation to deliver equivalent collateral to replace the original financial collateral *at the latest on the due date* for the performance of the relevant financial obligations (Article 5(2) of the Financial Collateral Directive). Compared to the phrase “at the latest on due date”, the formulation “the discharge of the relevant obligations” gives more time to the collateral taker, since the actual discharge of the

³⁴⁰ Commission of the European Communities (*supra* n 248) 12.

³⁴¹ See Article 34 of the Geneva Securities Convention; Hideki Kanda et al (*supra* n 87) s 34-1.

³⁴² If an enforcement event occurs while an obligation described in Article 5(2)(1) of the Financial Collateral Directive remains outstanding, the obligation may be the subject of a close-out netting provision (Article 5(5) of the Financial Collateral Directive).

relevant obligations may not occur on the due date and instead be postponed such that it does not take place when the relevant obligations mature.³⁴³

Further, Article 5(3) of the Directive provides that the security financial collateral agreement to which the original financial collateral was subject also applies to equivalent collateral transferred in discharge of an obligation as described in Article 5(1) and (2). In addition, the equivalent collateral is to be treated as having been provided under the security financial collateral arrangement at the same time as the original financial collateral was first provided. However, the use of financial collateral by the collateral taker according to Article 5 does not render invalid or unenforceable the collateral taker's rights under the security financial collateral arrangement in relation to financial collateral it transfers in discharge of an obligation as described in Article 5(2).³⁴⁴

As part of the evaluation process, the Commission revisited the right of use in 2006.³⁴⁵ It reached the conclusion that no change was necessary at that stage; when it was introduced, the right of use was a novelty for many Member States, and according to the EFMLG report, all Member States except Germany introduced specific provisions in their national legislation allowing a right of use in accordance with the Financial Collateral Directive.³⁴⁶ Nevertheless, all Member States had accepted in their legal systems that a collateral taker had a right of use to the extent provided by the collateral arrangement.³⁴⁷ Some Member States, including Austria, Cyprus, Greece, Ireland, Latvia, Malta, and the United Kingdom, have enacted Article 5 verbatim.

VI. Recognition of Title Transfer Financial Collateral Arrangements

The Financial Collateral Directive removes the risk of re-characterisation by ensuring that title transfer financial collateral arrangements are valid and

³⁴³ During the final session of the Diplomatic Conference to adopt the Geneva Securities Convention, the EU Commission submitted that the use of the wording “no later than the discharge of the relevant obligation” introduced an element of uncertainty and suggested replacing it with the words “not later than the due date”. But this assertion was not accepted. See the comments submitted by the EU Commission on this subject in UNIDROIT 2009 Conf. 11/2 – Doc. 18 (24 August 2009) s 19.

³⁴⁴ See Article 2(8) of Directive 2009/44/EC of 6 May 2009.

³⁴⁵ Commission of the European Communities, *Report from the Commission to the Council and the European Parliament: Evaluation Report on the Financial Collateral Arrangements Directive (2002/47/EC)*, Brussels, 20 December 2006, COM(2006) 833 final, 9. See Article 10 of the Financial Collateral Directive that provides: “Not later than 27 December 2006, the Commission shall present a report to the European Parliament and the Council on the application of this Directive, in particular on the application of Article 1(3), Article 4(3) and Article 5, accompanied where appropriate by proposals for its revision.”

³⁴⁶ European Financial Market Lawyers Group (*supra* n 252) 15.

³⁴⁷ Commission of the European Communities (*supra* n 345) 10.

effective.³⁴⁸ Article 6(1) of the Financial Collateral Directive provides that Member States are to ensure that a title transfer financial collateral arrangement can take effect in accordance with its terms. The Directive also provides that the obligation may be subject to close-out netting if enforced while any obligation of the collateral taker to transfer equivalent collateral under a title transfer financial collateral arrangement remains outstanding (Article 6(2) of the Financial Collateral Directive).

VII. Recognition of Close-Out Netting Provisions

During the process of elaborating the Financial Collateral Directive, the Commission acknowledged the importance of netting for managing and limiting risk exposure. Hence, it concluded that where netting forms part of a collateral agreement, it should be protected. Indeed, the Commission explained that “close-out” netting is the form of netting particularly linked to collateral arrangements.³⁴⁹ Under close-out netting, there is an acceleration, termination, or replacement of the obligations of both parties with by one party’s obligation to pay the other a single net amount that represents the difference between the estimated current values of both their obligations. Although the Commission feared that “close-out” netting provisions might conflict with the insolvency law of some jurisdictions that do not allow or restrict insolvency set-off, it concluded that the Directive should affirm their validity given their importance for title transfer and repo arrangements.³⁵⁰

Article 7(1)(a) of the Directive recognises close-out netting provisions in spite of the commencement or continuation of winding-up proceedings or reorganisation measures with respect to the collateral provider and/or the collateral taker. Similarly, Article 7(1)(b) ensures that a close-out netting provision can take effect according to its terms despite any purported assign-

³⁴⁸ Article 6 of the Financial Collateral Directive. See also Article 32 of the Geneva Securities Convention; Hideki Kanda et al (*supra* n 87) s 32-1.

³⁴⁹ Under Article 2(1)(n) of the Financial Collateral Directive, a close-out netting provision is “a provision of a financial collateral arrangement, or of an arrangement of which a financial collateral arrangement forms part, or, in the absence of any such provision, any statutory rule by which, on the occurrence of an enforcement event, whether through the operation of netting or set-off or otherwise: (i) the obligations of the parties are accelerated so as to be immediately due and expressed as an obligation to pay an amount representing their estimated current value, or are terminated and replaced by an obligation to pay such an amount; and/or (ii) an account is taken of what is due from each party to the other in respect of such obligations, and a net sum equal to the balance of the account is payable by the party from whom the larger amount is due to the other party.” This definition of close-out netting provisions excludes “walkaway” clauses under which a defaulting party forfeits any amount due or credit arising in its favour as a result of close-out. See Geoffrey Yeoward et al (*supra* n 75) s 1.60, fn 59.

³⁵⁰ Commission of the European Communities (*supra* n 248) 13.

ment, judicial, other attachment, or other disposition of or in respect of such rights.³⁵¹ Moreover, unless otherwise provided by the parties, a close-out netting provision may not be subject to cumbersome procedures or requirements such as prior notice, court approval, public auction, or the elapse of an additional time period (Articles 7(2) and 4(4) of the Financial Collateral Directive).

With respect to the implementation of Article 7 of the Directive in the Member States, the EFMLG report highlighted that close-out netting is recognised within all Member States except Estonia as a contractual or statutory arrangement which accelerates the parties' mutual obligations upon the occurrence of an enforcement event.³⁵²

VIII. Certain Insolvency Provisions Disapplied

One of the greatest advantages that the Financial Collateral Directive offers to collateral takers is the possibility of swiftly enforcing financial collateral arrangements without interference from the insolvency laws of the Member States. The Financial Collateral Directive recites:

“In order to improve the legal certainty of financial collateral arrangements, Member States should ensure that certain provisions of insolvency law do not apply to such arrangements, in particular, those that would inhibit the effective realisation of financial collateral or cast doubt on the validity of current techniques such as bilateral close-out netting, the provision of additional collateral in the form of top-up collateral and substitution of collateral.”

Furthermore, Article 8(1) of the Financial Collateral Directive provides:

“1. Member States shall ensure that a financial collateral arrangement, as well as the provision of financial collateral under such arrangement, may not be declared invalid or void or be reversed on the sole basis that the financial collateral arrangement has come into existence, or the financial collateral has been provided:

- (a) on the day of the commencement of winding-up proceedings or reorganisation measures, but prior to the order or decree making that commencement; or
- (b) in a prescribed period prior to, and defined by reference to, the commencement of such proceedings or measures or by reference to the making of any order or decree or the taking of any other action or occurrence of any other event in the course of such proceedings or measures.”

A financial collateral arrangement or a relevant financial obligation is legally enforceable and binding on third parties if it has come into existence, or financial collateral has been provided on the day of, but after the moment of the commencement of, winding-up proceedings or reorganisation measures. In such a case, the collateral taker will have to prove that it was not aware,

³⁵¹ Article 33(3) of the Geneva Securities Convention.

³⁵² European Financial Market Lawyers Group (*supra* n 252) 15.

nor should have been aware, of the commencement of such proceedings or measures (Article 8(2) of the Financial Collateral Directive).

IX. Top-Up and Substitutions

The Commission recognised the importance of top-up collateral for the limitation of counterparty risk. Top-up collateral allowed market participants to limit their mutual credit exposure to reflect changes in the market values of collateral. It also allowed regulated participants to obtain favourable regulatory capital treatment.³⁵³ It was typically done by “market-to-market” calculations.³⁵⁴ Although the Commission concluded that such arrangements were sound market practices favoured by regulators, it was decided that the Directive should not protect instances of top-up collateral based on the deterioration of the collateral provider’s credit rating.³⁵⁵

With respect to substitution, the Commission noted that a collateral provider that provides a portfolio of securities often wishes to withdraw specific securities and replace them with other securities of equivalent value and so to continue to trade in the securities that were provided as collateral. But the Commission was of the view that this kind of substitution might result legally in the creation of a new pledge in some jurisdictions and thus in a repetition of all necessary formalities or the beginning of a new “suspect period”³⁵⁶. It might also lead to the pledge being accorded lower priority in an insolvency of the collateral provider unless the collateral taker had retained a right to prevent it. Nevertheless, the Commission concluded:

“In the event of the insolvency of the collateral provider, should the substitution have occurred during the ‘suspect period’, there may be additional vulnerability under insolvency law even though economically no new collateral has been provided. A clear statutory regime confirming the validity of substitution of collateral should be provided in the Directive. Consequently, the Directive should confirm that substitutive collateral is to be treated as provided at the time when the original collateral was provided.”³⁵⁷

Against this background, Article 8(3) of the Financial Collateral Directive provides:

³⁵³ Commission of the European Communities (*supra* n 248) Annex A, 12, fn 15.

³⁵⁴ Geoffrey Yeowart et al (*supra* n 75) ss 1.23, 1.66.

³⁵⁵ See in comparison Article 36(1) of the Geneva Securities Convention, which protects top-up collateral based on the deterioration of the collateral provider’s credit rating.

³⁵⁶ “Suspect period” means the period which runs from the date on which the debtor ceases payments. Suspect periods are in place for instance in Italy and Spain (*see* Article 9(2) n° 4 Legge Fallimentare and Article 10 n° 1 Ley Concursal). *See* also Horst Eidenmüller, ‘Abuse of Law in the Context of European Insolvency Law’ (2009) ECFR 15; Gerrit Hölzle, ‘Wege in die Restschuldbefreiung und Schuldenerlass im Exil – Oder: Lohnt die Flucht nach Frankreich wirklich?’ (2007) Zeitschrift für Verbraucher- und Privatinsolvenzrecht 1, 4.

³⁵⁷ Commission of the European Communities (*supra* n 248) 12.

“3. Where a financial collateral arrangement contains:

- (a) an obligation to provide financial collateral or additional financial collateral in order to take account of changes in the value of the financial collateral or in the amount of the relevant financial obligations, or
- (b) a right to withdraw financial collateral on providing, by way of substitution or exchange, financial collateral of substantially the same value,

Member States shall ensure that the provision of financial collateral, additional financial collateral or substitute or replacement financial collateral under such an obligation or right shall not be treated as invalid or reversed or declared void on the sole basis that:

- (i) such provision was made on the day of the commencement of winding-up proceedings or reorganisation measures, but prior to the order or decree making that commencement or in a prescribed period prior to, and defined by reference to, the commencement of winding-up proceedings or reorganisation measures or by reference to the making of any order or decree or the taking of any other action or occurrence of any other event in the course of such proceedings or measures; and/or
- (ii) the relevant financial obligations were incurred prior to the date of the provision of the financial collateral, additional financial collateral or substitute or replacement financial collateral.”³⁵⁸

Here it is worth recalling that the Geneva Securities Convention indicates three instances when a top-up collateral can be triggered in accordance with the collateral agreement:

- “[...] (i) in order to take account of changes in the value of the collateral delivered under the collateral agreement or in the amount of the relevant obligations;
- (ii) in order to take account of any circumstances giving rise to an increase in the credit risk incurred by the collateral taker as determined by reference to objective criteria relating to the creditworthiness, financial performance or financial condition of the collateral provider or other person by whom the relevant obligations are owed; or
- (iii) to the extent permitted by the non-Convention law, in any other circumstances specified in the collateral agreement [...]”³⁵⁹

Only in one of these three cases do the parties possibly have recourse to top-up collateral. But the Financial Collateral Directive by contrast simply provides for the situation that changes will occur in the value of the financial collateral or in the amount of the relevant financial obligations (Article 8(3)(a) of the Financial Collateral Directive). The situation contemplated in Article 8(3)(a) of the Financial Collateral Directive is similar only to the first case in Article 36(1)(i) of the Geneva Securities Convention.³⁶⁰

³⁵⁸ The Financial Collateral Directive leaves unaffected the general rules of national insolvency law in relation to the voidance of transactions entered into during the prescribed period referred to in Article 8(1)(b) and in Article 3(i) of the Financial Collateral Directive.

³⁵⁹ Article 36(1) of the Geneva Securities Convention.

³⁶⁰ Note that in case a Contracting State opts-out of the second case under the Geneva Securities Convention, the result will be somewhat similar to that of Article 8(3)(a) of the Financial Collateral Directive. Nevertheless, under Article 36(1)(iii) of the Geneva Securities

D. Summary and Evaluation

1. The European Union's first relevant legal reform in respect of the collateralisation of intermediated securities was the Settlement Finality Directive. It included some features which were later widely applied in the Financial Collateral Directive, such as the protection of collateral against invalidation under rules of insolvency law (Article 9 of the Settlement Finality Directive). However, the Settlement Finality Directive was not a *general* legal reform; its scope was narrowly aimed at payment and settlement systems.
2. The aim of the Financial Collateral Directive is to remove major obstacles to cross-border use of collateral, to limit administrative burdens and cumbersome procedures, and to create a simple legal framework regarding financial collateral.
3. In respect of personal scope, the Financial Collateral Directive applies if the collateral taker and the collateral provider belong to one of the following categories: public sector entities (except publicly guaranteed undertakings), central banks and international financial institutions, supervised financial institutions, central counterparties, settlement agents, and clearing houses. It can also apply to corporate entities provided that the other party is one of the aforementioned types of entity, but Member States may opt out of this inclusion. The material scope of the Financial Collateral Directive covers financial collateral in the form of financial instruments and cash. Financial instruments are shares in companies, bonds, and other forms of debt instruments if they are negotiable on the market.
4. Under the Financial Collateral Directive, Member States are prohibited from imposing any formalities and administrative procedures (such as registration requirements, notification requirements, notarial deeds, public announcements, or other formal certification) in respect of the creation, validity, perfection, enforceability, or admissibility in evidence of financial collateral arrangements or the provision of financial collateral under such arrangement (Article 3 of the Financial Collateral Directive).
5. In an enforcement event, realisation of security financial collateral arrangements will be possible through sale or appropriation (if agreed) of the financial instruments and through set-off, or application in discharge, of the relevant financial obligation. This requires no court authorisation, prior notice, waiting period, or public auction (Article 4 of the Financial Collateral Directive).
6. The Financial Collateral Directive recognises a right of use of pledged collateral, defined as a contractually agreed right of the collateral taker to

ties Convention, the collateral agreement may still provide further cases to the extent the non-Convention law admits. See Changmin Chun (*supra* n 143) 143–144.

use (meaning for instance to sell, pledge on, or lend) collateral it has been given under a security financial collateral agreement. It can use the collateral as if it were the full owner, but if it exercises the right, it incurs an obligation to transfer back equivalent collateral which, once transferred back, will be treated as if it were original financial collateral. Such an obligation to return the used collateral can be subject to a close-out netting provision. In addition, since such use may affect the legal position of an investor holding securities, the parties to the collateral agreement must expressly agree to the right of use (Article 5 of the Financial Collateral Directive).

7. The Financial Collateral Directive also contains provisions that protect financial collateral arrangements from the effects of insolvency proceedings. The validity of such arrangements is protected even if insolvency proceedings are open against one of the parties to the transaction (Articles 4(5) and 8 of the Financial Collateral Directive).
8. Close-out netting arrangements, whether statutory or contractual, are expressly recognised in Article 7 of the Financial Collateral Directive, and under Article 8 certain, typical risk control elements that are inherent in collateral arrangements (*i.e.*, the substitution of assets or asset-price related mark-to-market practices) are protected.

Chapter 4: Collateralisation of Intermediated Securities under the Law in the United States

A. General Overview

I. Introduction

Except for debt securities related to the federal government,³⁶¹ the intermediated system in the United States is mainly³⁶² organised by Part 5 of Article 8

³⁶¹ Federal government debt securities, including treasury bonds, bills, and notes are governed by Treasury Reserve Automated Debt Entry System Regulations (hereinafter referred to as TRADES Regulations), which took effect as of 1 January 1997. For more information on federal debt securities, see the website of Treasury Direct: <<https://www.treasurydirect.gov/tdhome.htm>> (accessed 4 January 2021). For more details on TRADES Regulation, see Sandra M. Rocks, Penelope L. Christophorou & Gottlieb Cleary, 'Memorandum Regarding the 1994 Uniform Version of Article 8 of the Uniform Commercial Code and the Federal Book-Entry Regulations (with Addendum Regarding Investment Property Changes Under Article 9)' (2002) SG085 ALI-ABA 143, 166–170. See also Dorothee Einsele, *Wertpapierrecht als Schuldrecht: Funktionsverlust von Effektenurkunden im internationalen Rechtsverkehr* (Mohr Siebeck, Tübingen 2015) 378.

³⁶² UCC Article 8 deals with some aspects of the rights of securities holders against issuers. Yet that relationship is primarily governed by the law of corporations, securities, and contract. Likewise, although UCC Article 8 addresses some aspects of the rights and duties

and by further provisions of Article 9 of the Uniform Commercial Code³⁶³ (UCC). On one hand, UCC Article 8 addresses issues of investment securities: its first part covers several definitions and concepts, including claim, control, choice of law, clearing corporation, and security intermediaries. Part 2 of UCC Article 8 determines issuance of securities and issuer; Part 3 specifies transfer of certificated and uncertificated securities; Part 4 of UCC Article 8 addresses the registration of transfer; Part 5 of UCC Article 8 provides innovative rules on the intermediated system in the United States. Article 9 of the UCC, on the other hand, deals with secured transactions and was significantly revised in 1998.³⁶⁴

II. Historical Evolution

1. History of UCC Article 8

a) The 1962 Version of UCC Article 8

The 1962 version of UCC Article 8 was widely adopted.³⁶⁵ It contained the concept of book-entry transfers of securities and had some limited provisions

of those who transfer securities, it does not cover the law of contracts applying to the purchase or sale of securities. See Notes on Scope of Article 8 in the Prefatory Note to 1994 Official Text of UCC Article 8 (Cynthia Lee Starnes).

³⁶³ The Uniform Commercial Code is not a statutory law. In addition, it is not a “Code” in the civil-law sense, meaning that it is not a comprehensive enactment covering every situation cognisable by the law. Rather, it is a model law open for adoption by the states and an integrated statute relating to commercial transactions. As of January 2021, all 50 states, the District of Columbia, Puerto Rico, and the US Virgin Islands have adopted the UCC. The UCC is a joint project of the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI). For a history of the UCC, see Soia Mentschikoff, ‘The Uniform Commercial Code: An Experiment in Democracy in Drafting’ (1950) 36 *American Bar Association Journal* 419; Walker D. Malcolm, ‘The Uniform Commercial Code in the United States’ (1963) 12 *International & Comparative Law Quarterly* 226; Robert Braucher, ‘The Legislative History of the Uniform Commercial Code’ (1958) 58 *Columbia Law Review* 798; Randall D. Guynn & James Steven Rogers, ‘United States (New York)’ in Richard Potok, *Cross-Border Collateral: Legal Risks and the Conflict of Laws* (Butterworths, London 2002) 603.

³⁶⁴ See Jean Wegman Burns, ‘New Article 9 of the UCC: The Good, the Bad, and the Ugly’ (2002) 1 *University of Illinois Law Review* 29; Harry C. Sigman & Eva-Maria Kieninger, ‘Introduction’ in Harry C. Sigman & Eva-Maria Kieninger (eds), *Cross-Border Security over Tangibles* (Sellier, München 2007) 36–53; Terry M. Anderson, Marianne B. Culhane & Catherine Lee Wilson, ‘Attachment and Perfection of Security Interests Under Revised Article 9: A “Nuts and Bolts” Primer’ (2001) 9 *American Bankruptcy Institute Law Review* 179; Steven L. Schwarcz, ‘The Impact on Securitization of Revised UCC Article 9’ (2000) 74 *Chicago-Kent Law Review* 947.

³⁶⁵ Russel A. Hakes, ‘UCC Article 8: Will the Indirect Holding of Securities Survive the Light of Day?’ (2002) 35 *Loyola of Los Angeles Law Review* 661, 667; Martin J.

on intermediated securities.³⁶⁶ Its main assumption was that the key elements in the securities holding system were possession and delivery of physical certificates.³⁶⁷ Indeed, possession of certificates traditionally evidenced ownership of securities, and because the paper stock certificate was tangible evidence of the holder's rights, it seemed logical to apply traditional concepts of property law. Ownership changes were realised via delivery of certificates,³⁶⁸ a very slow and labour-intensive process. Because of surging volumes of securities transactions on the NYSE, by the late 1960s the stock market had to close one day a week simply to settle all the trades.³⁶⁹ It seems an obvious solution to eliminate paper certificates and simply have each issuer register its shareholders on its books. The intermediated system therefore gained importance and was being widely utilised by the late 1960s.³⁷⁰

b) The 1977 Version of UCC Article 8

During the 1970s, considerable attention was aimed at establishing legal rules in respect of securities transfers that would allow securities ownership to be evidenced by electronic records maintained by issuers.³⁷¹ Consequently, the revision effort that led to the 1977 amendments to UCC Article 8 sought to develop rules governing "uncertificated securities". At the time, it was assumed that the problems within the securities trading market resulted from too

Aronstein, 'The New/Old Law of Securities Transfer: Calling a "Spade" a "Heart, Diamond, Club or the Like"' (1990) 12 *Cardozo Law Review* 429, 430.

³⁶⁶ See for instance §§ 9-320 and 8-313(1). For more information on prior versions of §§ 9-313 and their drafting history, see Charles W. Mooney, Jr., 'Beyond Negotiability: A New Model for Transfer and Pledge of Interests in Securities Controlled by Intermediaries' (1990) 12 *Cardozo Law Review* 306, 415–427.

³⁶⁷ Everette L. Martin, 'An Arkansas Practitioner's Guide to Perfecting Security Interests in Securities, Brokerage Accounts, and Other Forms of Investment Property Under Revised Article 8 and Amended Article 9' (1996) 19 *University of Arkansas at Little Rock Law Journal* 1, 2.

³⁶⁸ Prefatory Note of UCC Article, Part I. A. This probably resulted from the influence of the materialisation theory which permeated the US in the late nineteenth century. For more information on the materialisation in the US, see Egon Guttman & Thomas P. Lemke, 'The Transfer of Securities in Organized Markets: A Comparative Study of Clearing Agencies in the United States of America, Britain and Canada' (1981) 19 *Osgoode Hall Law Journal* 400, 401–407; Grant Gilmore, 'The Commercial Doctrine of Good Faith Purchase' (1954) *Yale Law Journal* 1057.

³⁶⁹ Everette L. Martin (*supra* n 367) 3.

³⁷⁰ Russel A. Hakes (*supra* n 365) 668; Egon Guttman, 'Investment Securities Law: New Federal and State Developments and their Effect on Article 8' (1992) 24 *Uniform Commercial Code Law Journal* 307, reprinted in *Commercial Law Annual* 1993, 453.

³⁷¹ See for instance Richard B. Smith, 'A Piece of Paper' (1970) 25 *Business Lawyer* 923; Richard B. Smith, 'A Piece of Paper Revisited' (1971) 26 *Business Lawyer* 1769.

much paperwork, which could be reduced using uncertificated security.³⁷² Consequently, to tackle the problems arising from paper-centred securities transfer processing the 1977 version of UCC Article 8 introduced the concept of uncertificated securities.³⁷³ However, rather than constituting a wholesale revision reflecting true conditions in the marketplace,³⁷⁴ the 1977 amendments only gave UCC Article 8 a facelift and did not seek a comprehensive modernisation; and inasmuch as the 1977 revision of UCC Article 8 intended to develop rules for a practice that had not yet developed, it was entirely sensible to adopt an approach of fundamental conservatism. The amendments retained the structure and organisation of the existing law in respect of certificated securities in every way, merely adding new provisions concerning uncertificated securities. This led to a structure in which virtually all provisions of UCC Article 8 encompassed separate but parallel rules: one set for certificated securities and another for uncertificated securities. But as *Rogers* noted, there were difficulties in applying such rules to uncertificated securities:

“Old Article 8 was drafted in light of the transaction patterns of the paper-based system of securities transfers by physical delivery of certificates. The focus and organization of the statutory language itself, the content and emphasis of the accompanying official comments, and the available secondary literature discussing the statute all bespeak the paper-based origins of the statute. Thus, if one is seeking the statutory rules applicable to a securities transfer effected by physical delivery of a certificate, even a novice would have a relatively easy time finding one’s way around the statute. By contrast, although old Article 8 does contain rules that apply to the indirect holding system, these matters were added onto a statutory structure devised for entirely different sorts of transactions. Not surprisingly then,

³⁷² It was thought that changes in ownership would continue to be reflected by changes in the records of the issuer. The most significant difference would be that instead of surrendering an endorsed certificate for registration of transfer, an instruction would be sent to the issuer directing it to register the transfer (Everette L. Martin (*supra* n 367) 3, fn 12).

³⁷³ Prefatory Note at Part I. A. It is important to note that the amendments that were made to UCC Article 8 were approved in 1977. However, they were included in the 1978 official text of the UCC. For an overview of the 1977 amendments, see Martin J. Aronstein, Robert Haydock, Jr. & Donald A. Scott, ‘Article 8 is Ready’ (1980) 93 *Harvard Law Review* 889. See also Dorothee Einsele (*supra* n 361) 302–390; James Steven Rogers, ‘Policy Perspectives on Revised U.C.C. Article 8’ (1996) 43 *UCLA Law Review* 1431, 1441–1448; Jeanne Schroeder & David Gray Carlson, ‘Security Interests Under Article 8 of the Uniform Commercial Code’ (1990) 12 *Cardozo Law Review* 557.

³⁷⁴ It is worth recalling that while the *paper crunch* occurred in the late 1960s, UCC Article 8 was revised nearly a decade later. In the interim, the market had addressed this issue by developing an indirect holding system for securities whereby “delivery” is accomplished by an entry on the books. This means that a securities depository, such as DTC, would be used to hold the paper stock certificates on behalf of its members, who were primarily banks and large brokerage firms. In turn, the banks and brokerage firms would hold the securities on behalf of their customers. See Everette L. Martin (*supra* n 367) 3 for an illustration of the difference between the direct and the indirect holding system.

it is considerably more difficult even to find the provisions of old Article 8 that apply to the indirect holding system, let alone to be confident about their interpretation.”³⁷⁵

In the 1977 version of UCC Article 8, a basic rule of the intermediated system (that a person acquires a property interest when there is a credit of securities to the person’s account with an intermediary) was hidden four levels down in the complex paragraph structure of old § 8-313, in subparagraph (iii) of paragraph (d) of subsection (1). Even then, only a person with sufficient knowledge of the meaning of § 8-313(1)(d)(iii) could understand the provision.³⁷⁶

Conceptually, the amendments merely exchanged the term “delivery” for “transfer” while maintaining the same troubled rules for uncertificated securities as applied to certificated securities.³⁷⁷ The difference between the new rules introduced by the 1977 version of UCC Article 8 and the traditional system was that ownership of securities would not necessarily be evidenced by physical certificates. The 1977 version of UCC Article 8 did not take into account the characteristics of the intermediated system; it did not properly reflect practices in the securities markets whereby transfers of securities or settlements of securities trades were realised by computerised book-entries on securities accounts maintained with intermediaries rather than by registration of the transfer in records of the issuers or their transfer agents.³⁷⁸ Moreover, it led to an increase of the workload of documenting the transfer of uncertificated securities.³⁷⁹

Describing the class of concerns that the 1977 version of UCC Article 8 caused, *Reitz*³⁸⁰ notes that it was difficult to know exactly what was created by a credit to a securities account. Indeed, a credit entry in a securities account was definitely not covered by any conventional definition of “security”. In addition, *Reitz* notes that it was unknown how the rights of account holders related to the issuers, the depositaries, or the intermediary firms located on other tiers of the intermediated system; it was unknown whether and if so just how an account holder could lose its rights to another who claimed ownership over what the account holder had. Furthermore, it was difficult to determine the legal consequences for an account holder whose intermediary had made a credit entry but did not maintain a comparable position with its upper-tier intermediary.

³⁷⁵ James Steven Rogers (*supra* n 373) 1448.

³⁷⁶ James Steven Rogers (*supra* n 373) 1448.

³⁷⁷ Jeanne L. Schroeder, ‘Is Article 8 Finally Ready This Time? The Radical Reform of Secured Lending on Wall Street’ (1994) 3 *Columbia Business Law Review* 291, 312–315. The responsibility of the 1977 Drafting Committee was solely to create a scheme for the transfer of uncertificated securities while leaving the rules on certificated securities intact (Uniform Commercial Code, 2C U.L.A. 39, Prefatory Note (Supp.1996)).

³⁷⁸ Changmin Chun (*supra* n 143) 200.

³⁷⁹ Jeanne L. Schroeder (*supra* n 377) 333–334, who evaluates the 1977 version of UCC Article 8 as a “disaster” (at 303).

³⁸⁰ Curtis R. Reitz, ‘Reflections on the Drafting of the 1994 Revision of Article 8 of the US Uniform Commercial Code’ (2005) 10 *Uniform Law Review* 357, 359–360.

Another cause of the novel and uncertain relationship between an intermediary and its account holder under the 1977 version of UCC Article 8 was that the problem of innocent acquisition of intermediated securities was not recognised.³⁸¹ § 8-313(2) of the 1977 version provided that “[i]f a security so held is part of a fungible bulk, as in the circumstances specified in paragraphs (d)(ii) and d(iii) of subsection (1), the purchaser is the owner of a proportionate property interest in the fungible bulk.” And yet official comment 4 to § 8-313 indicated:

“Unless specific securities are separately identified as belonging to the purchaser, he cannot become a bona fide purchaser [...]. If bona fide purchaser status were given to those whose securities are held as part of a fungible bulk, there would be a possibility of inconsistent claims between two or more bona fide purchasers, since if the bulk should prove to be smaller than was expected, the claim of one or both must be compromised.”³⁸²

It was only after the October 1987 stock market crash or “market break”³⁸³ that a wholesale amendment of UCC Article 8 was undertaken. On 19 October 1987,³⁸⁴ stock markets around the world crashed, shedding a huge amount of value in a very short time. The Dow Jones Industrial Average³⁸⁵ fell 508 points, or 22.6%, on a record volume of 604 million shares per day.³⁸⁶ Afterwards, market participants and regulators realised the importance of a well-

³⁸¹ See also Charles W. Mooney, Jr. (*supra* n 366) 330–342, 349–379.

³⁸² It is important to note that the same comment made an exception to this principle of non-recognition of innocent acquisition. Innocent acquisition was acknowledged in case of intermediated securities held by a clearing corporation. Indeed, clearing corporations hold only for others’ accounts. Hence, the possibility of innocent acquisition is very small. See Jeanne L. Schroeder (*supra* n 377) 334–349; James Steven Rogers (*supra* n 373) 1467–1968. In spite of the official comment to the 1977 version of UCC Article 8, courts often acknowledged investors’ innocent acquisition. For more details on the courts’ interpretation of UCC Article 8, Section 8-313(2) of the 1977 version of UCC Article 8, see Jeanne L. Schroeder (*supra* n 377) 451–461.

³⁸³ Charles W. Mooney, Jr., ‘The Roles of Individuals in UCC Reform: Is the Uniform Law Process a Potted Plant? The Case of Revised UCC Article 8’ (2002) 27 Oklahoma City University law review 553, 562. For more details on the October 1987 stock market crash, see generally Andrew M. Klein, ‘The October 1987 Market Crash’ (1988) 619 *PLI/Corp* 79.

³⁸⁴ This date would be later known in finance as “black Monday” (see for instance Ryan McKeon & Jeffry M. Netter, ‘What Caused the 1987 Stock Market Crash and Lessons for the 2008 Crash’ (2009) 8 *Review of Accounting and Finance* 123).

³⁸⁵ The Dow Jones Industrial Average (or DJIA, the Industrial Average, the Dow Jones, the Dow Jones Industrial, DJI, the Dow 30, or simply the Dow) is an index that shows how 30 large publicly owned companies based in the United States have traded during a standard trading session in the stock market (Arthur O’Sullivan & Steven M. Sheffrin, *Economics: Principles in Action* (Pearson Prentice Hall, New Jersey 2003) 290).

³⁸⁶ Joel Seligman (*supra* n 135) 589–593.

organised clearing and settlement system.³⁸⁷ On 18 March 1988, President Ronald Reagan signed Executive Order 12631, which created the Working Group on Financial Markets (also called the President’s Working Group on Financial Markets).³⁸⁸ The Working Group on Financial Markets was established to provide a coordinating framework for consideration, resolution, recommendation, and action on the issues raised by the market break in 1987. Indeed, Section 2 of Executive Order 12631 provided:

“(a) Recognizing the goals of enhancing the integrity, efficiency, orderliness, and competitiveness of our Nation’s financial markets and maintaining investor confidence, the Working Group shall identify and consider:

- (1) the major issues raised by the numerous studies on the events in the financial markets surrounding October 19, 1987, and any of those recommendations that have the potential to achieve the goals noted above; and
 - (2) the actions, including governmental actions under existing laws and regulations (such as policy coordination and contingency planning), that are appropriate to carry out these recommendations.
- (b) The Working Group shall consult, as appropriate, with representatives of the various exchanges, clearinghouses, self-regulatory bodies, and with major market participants to determine private sector solutions wherever possible.
- (c) The Working Group shall report to the President initially within 60 days (and periodically thereafter) on its progress and, if appropriate, its views on any recommended legislative changes.”

In May 1988 the Working Group on Financial Markets issued an interim report on its progress, actions, and recommendations.³⁸⁹ It recommended that federal legislation be considered to deal with the transfer and pledge of “options” and “certificated and uncertificated stock”. The report underscored a prevailing nonuniformity: a substantial number of states had not adopted the 1977 official text of UCC Article 8.³⁹⁰ The following month, David S. Ruder, the chairman of the Securities and Exchange Commission (SEC), sent a letter to the president and the leadership of Congress enclosing a draft of proposed legislation³⁹¹ to allow the SEC, upon making certain findings of necessity, to promulgate

³⁸⁷ Note that *Mooney* considers that the amendments to UCC Article 8 were triggered by several failures of government securities dealers in the early 1980s which resulted in losses to investors such as secured lenders (Charles W. Mooney, Jr., (*supra* n 383) 559 and 562).

³⁸⁸ This Executive Order is available on the website of the US National Archives at <<https://www.archives.gov/federal-register/codification/executive-order/12631.html>> (accessed 4 January 2021).

³⁸⁹ Interim Report of The Working Group on Financial Markets, Submitted to The President of the United States (May 1988). The report is available at <<https://ia800301.us.archive.org/3/items/interimreportofw00unit/interimreportofw00unit.pdf>> (accessed 4 January 2021).

³⁹⁰ Interim Report of The Working Group on Financial Markets, Submitted to The President of the United States (May 1988) 15–16.

³⁹¹ Letter from David S. Ruder to The Honorable George Bush (23 June 1988).

regulations governing “the transfer of certificated or uncertificated securities or limited interests (including security interests) therein”. Nevertheless, government or agency securities such as the treasury securities covered by book-entry treasury regulations were not to be governed by that legislation.³⁹² Two weeks later, congressman Edward J. Markey introduced the “Securities Market Reform Act of 1988” (the Markey Bill).³⁹³ The proposed legislation would have given the SEC the power to issue regulations on the private law of transfers and pledges of securities along lines it had proposed.

In October 1988, SEC chairman Ruder sent a letter to David E. Nelson, the chair of the ABA section on business law, in which he explained that SEC staff had been working with the Subcommittee on Investment Securities on the possibility of establishing an SEC advisory committee. However, the staff concluded that “the rigidities inherent in federal advisory committees would not be conducive to creative study of this critical area.”³⁹⁴ Ruder therefore suggested that the ABA “consider sponsoring an expert ad hoc committee that can study the issues and develop intelligent and workable solutions.”³⁹⁵ The ABA Advisory Committee thus established an informal task force or drafting group to prepare a report with recommendations accompanied by substantive discussion.³⁹⁶

It is worth noting that in 1989 at the international level, during these developments in the United States, the Group of Thirty³⁹⁷ released a report which “propose[d] standards for clearance and settlement that [could] be set and maintained by national corporate securities markets to reduce the risks and costs”.³⁹⁸ The nine recommendations were:

³⁹² Letter from David S. Ruder to The Honorable George Bush (23 June 1988), proposing to add a new subsection (f) to § 17A of the Securities Exchange Act of 1934.

³⁹³ H.R. 4997, 100th Cong. (1998).

³⁹⁴ Letter from David S. Ruder to David E. Nelson (October 25, 1988).

³⁹⁵ Letter from David S. Ruder to David E. Nelson (October 25, 1988).

³⁹⁶ This informal group consisted of Professor Charles W. Mooney, Jr., Professor Emeritus Martin Aronstein, Professor Egon Guttman, Jonathan Kallman, (SEC), Robert C. Mendelson, Ernest Patrikis (New York Fed), and Richard B. Smith. The group had no chair. However, most of the drafting was done by Kallman, Mendelson, and Professor Charles W. Mooney, Jr. The informal group was sometimes supplemented by other interested members of the ABA Advisory Committee or observers. See Charles W. Mooney, Jr. (*supra* n 383) 565.

³⁹⁷ Established in 1978, the Group of Thirty is a private, non-profit, international body composed of very senior representatives of the private and public sectors and academia. Its purpose is to deepen understanding of international economic and financial issues. It also aims to explore the international repercussions of decisions taken in the public and private sectors.

³⁹⁸ See Group of Thirty, *Clearance and Settlement Systems in the World's Securities Markets* (1989) 1. The report is available at <http://group30.org/images/uploads/publications/G30_ClearanceSettlement1988.pdf> (accessed 4 January 2021).

- (i) Recommendation 1: By 1990, all comparisons of trades between direct market participants (*i.e.*, brokers, broker/dealers, and other exchange members) [had to] be accomplished by trade date plus 1 (T+1);
- (ii) Recommendation 2: Indirect market participants (such as institutional investors, or any trading counterparties which are not broker/dealers) [had to], by 1992, be members of a trade comparison system which achieves positive affirmation of trade details;
- (iii) Recommendation 3: Each country [had to] have an effective and fully developed central securities depository, organised and managed to encourage the broadest possible industry participation (directly and indirectly), in place by 1992;
- (iv) Recommendation 4: Each country [had to] study its market volumes and participation to determine whether a trade netting system would be beneficial in terms of reducing risk and promoting efficiency. If a netting system would be appropriate, it [had to] be implemented by 1992;
- (v) Recommendation 5, Delivery versus payment (DVP) should be employed as the method for settling all securities transactions. A DVP system should be in place by 1992;
- (vi) Recommendation 6: Payments associated with the settlement of securities transactions and the servicing of securities portfolios [had to] be made consistent across all instruments and markets by adopting the “same day” funds convention;
- (vii) Recommendation 7: A “Rolling Settlement”³⁹⁹ system [had to] be adopted by all markets. Final settlement [had to] occur on T + 3 by 1992. As an interim target, final settlement should occur on T + 5 by 1990 at the latest, save only where it hinders the achievement of T + 3 by 1992;
- (viii) Recommendation 8: Securities lending and borrowing [had to] be encouraged as a method of expediting the settlement of securities transactions. Existing regulatory and taxation barriers that inhibit the practice of lending securities [had to] be removed by 1990;
- (ix) Recommendation 9: Each country [had to] adopt the standard for securities messages developed by the International Organisation for Standardisation [ISO Standard 7775]. More particularly, countries [had to] adopt the ISIN numbering system for securities issues. These standards [had to] be universally applied by 1992.⁴⁰⁰

Of the nine recommendations contained in that report, Recommendations 5 and 8 are most relevant to the 1994 version of UCC Article 8. The policy

³⁹⁹ In a rolling system, trades settle on all business days of the week, thereby limiting the number of outstanding trades and reducing market exposure (Group of Thirty (*supra* n 398) 14).

⁴⁰⁰ Group of Thirty (*supra* n 398) 3, 5, 7, 9, 11, 13, 14, 16, and 18.

behind these recommendations of the Group of Thirty was *finality*, and it is what motivated the drafters of revised UCC Article 8. The project of revising UCC Article 8 was one of several efforts around the world to assure that the clearance and settlement system for securities trading is up to the task of processing the ever-increasing trading volumes of securities.⁴⁰¹

The ABA Advisory Committee and its drafting group met throughout 1989 and 1990 and in February 1991 issued an interim report⁴⁰² proposing *inter alia*:

“A majority of the committee believes that the better view, as a matter of policy, should be to give priority to upper-tier claimants in circumstances where a shortfall in the fungible bulk exists and two similarly situated, different-tier claimants assert an interest in the same fungible bulk. A minority of the Committee believes that the better view in these circumstances, as a matter of policy, should be to give priority to lower-tier claimants.”⁴⁰³

While the ABA Committee was at work, the United States Congress was envisaging several legislative packages to amend federal securities laws in response to the October 1987 market break and the failure of Drexel Burnham in February 1990.⁴⁰⁴ Acknowledging the need to revise the commercial law foundation of the securities holding system,⁴⁰⁵ the US Congress enacted the Market Reform Act of 1990,⁴⁰⁶ which added Section 17A(f) to the Exchange Act.⁴⁰⁷ Un-

⁴⁰¹ James Steven Rogers (*supra* n 373) 1435.

⁴⁰² American Bar Association, Section of Business Law, Interim Report of the Advisory Committee on Settlement of Market Transactions (Exposure Draft, 15 February 1991) (hereinafter Interim Report). As it turned out, that was the only formal report ever issued by the Advisory Committee on Settlement of Market Transactions. It is important to note that the report cited and discussed the following study in support of the majority view: Charles W. Mooney, Jr., (*supra* n 366) 386–397.

⁴⁰³ American Bar Association (*supra* n 402) 36.

⁴⁰⁴ On 13 February 1990, Drexel Burnham Lambert was forced into filing for Chapter 11 bankruptcy protection by the chairmen of the New York Federal Reserve and the Securities and Exchange Commission. It was the first Wall Street firm to be forced into bankruptcy since the Great Depression. See Miles Livingston & Glenn Williams, ‘Drexel Burnham Lambert’s bankruptcy and the subsequent decline in underwriter fees’ (2007) *Journal of Financial Economics* 472, 476.

⁴⁰⁵ See for instance Coordinated Clearance and Settlement Act of 1990, H.R. Rep. n° 477, 101st Cong., 2nd Sess. 6 (1990). The report indicates that “[a]nother weakness in our system revealed by the October 1987 market break is the lack of uniformity and clarity among state laws governing the transfer and pledge of securities. The lack of harmony among various state laws detracts from the liquidity of the clearance and settlement system by making it burdensome (and in some cases, impracticable) for investors to finance their payment obligations in one market by pledging the value of their positions in another market as collateral for loans.”

⁴⁰⁶ Pub. L. n° 101-432, 104 Stat. 963 (1990).

⁴⁰⁷ Section 17A(f) to the Exchange Act was similar to provisions proposed by the SEC and in the Markey Bill in 1988 (see 15 U.S.C. § 78q-1(f) (2000)).

der subsection (f), the SEC was allowed to adopt rules covering transfers of interests in securities (including limited interests such as security interests) and dealing with the rights of parties to transactions and of third parties.⁴⁰⁸

The SEC was required to establish a national system for the prompt and accurate clearance and settlement of transactions in securities other than exempt securities and US government securities that are transferred within the book-entry system of Federal Reserve banks.⁴⁰⁹ Before enacting that rule, the SEC had to take into consideration the views of a federal advisory committee and consult with the secretary of the Treasury and the Board of Governors of the Federal Reserve System. After examining the views of these entities, the SEC reached the following conclusion:

- (i) “Such rule is necessary or appropriate for the protection of investors or in the public interest and is reasonably designed to promote the prompt, accurate, and safe clearance and settlement of securities transactions”;⁴¹⁰
- (ii) “In the absence of a uniform rule, the safe and efficient operation of the national system for clearance and settlement [...] will be or is, substantially impeded”;⁴¹¹ and
- (iii) The advantages of such rules outweigh any direct or indirect impairment or diminution of the rights of investors under state law concerning transfer of securities or of limited interests in securities.⁴¹²

In case the secretary of the Treasury objected in writing to a rule that the SEC proposed, the SEC had to consider “all feasible alternatives to the proposed rule.” The SEC was not allowed to promulgate the rule unless it made “an explicit finding that the rule is the most practicable method for achieving safe and efficient operation of the national clearance and settlement system.”⁴¹³ Further, within two years after the promulgation of the rule, a state could enact a statute referring expressly to the rule and provide, prospectively, for its own law to apply regardless of any difference from the SEC rule.⁴¹⁴ Moreover, the SEC was also required to establish, within ninety days after enactment of the Market Reform Act, an advisory committee under the Federal Advisory Committee

⁴⁰⁸ 15 U.S.C. § 78q-1(f)(1) (2000). Under this provision, the SEC was allowed to preempt state commercial laws, including the Uniform Commercial Code. *See also* Charles W. Mooney, Jr. (*supra* n 383) 567.

⁴⁰⁹ 1934 Act § 17A(a)(2), 15 U.S.C.A. § 78q-1(a)(1)(A).

⁴¹⁰ 1934 Act § 17A(f)(2)(A)(i), 15 U.S.C.A. § 78q-1(f)(2)(A)(i).

⁴¹¹ 1934 Act § 17A(f)(2)(A)(ii), 15 U.S.C.A. § 78q-1(f)(2)(A)(ii).

⁴¹² 1934 Act § 17A(f)(2)(A)(iii), 15 U.S.C.A. § 78q-1(f)(2)(A)(iii).

⁴¹³ 1934 Act § 17A(f)(2)(B), 15 U.S.C.A. § 78q-1(f)(2)(B).

⁴¹⁴ 1934 Act § 17A(f)(3), 15 U.S.C.A. § 78q-1(f)(3). The state statute had to specifically refer to the Securities Exchange Act of 1934 (1934 Act) subsection and to the SEC rule promulgated thereunder.

Act.⁴¹⁵ This development did not disrupt the work of the ABA Advisory Committee. Rather, the establishment and appointment of the fifteen members of the Market Transaction Advisory Committee (MTAC), along with the SEC, the Board of Governors of the Federal Reserve System (the Fed), and the Department of Treasury (Treasury), reasonably ensured cooperation and coordination; several active participants in the ABA Advisory Committee were appointed to the MTAC.⁴¹⁶ With the first formal meeting of the MTAC on 29 October 1991, the work of the ABA Advisory Committee was complete.

And another project was well underway: Given the crisis caused by the October 1987 stock market crash and in the wake of several studies on that market crash,⁴¹⁷ the National Conference of Commissioners on Uniform State Law and the American Law Institute⁴¹⁸ established a draft committee in 1991 with Professor Curtis Reitz as its chair and Professor James Rogers as the reporter. Its purpose was to continue with the revision of UCC Article 8 and to efficiently address the issues raised by the studies and eliminate systemic risk during periods of market stress.⁴¹⁹ The first (largely organisational) meeting of the Drafting Committee was held in August 1991 during the NCCUSL annual meeting. In 1994, after three years of study and discussion, the NCCUSL and ALI approved the revised version of UCC Article 8 alongside related amendments to UCC Article 9 and to other relevant Articles.⁴²⁰

c) *The 1994 Version of UCC Article 8*

The 1994 revision of UCC Article 8 was aimed at tailoring a set of intelligible legal rules to govern contemporary securities holding practices.⁴²¹ It sets

⁴¹⁵ 15 U.S.C. § 78q-1(f)(4) (2000).

⁴¹⁶ Pursuant to Subsection (f)(4)(B), the SEC was to appoint eleven members, the Federal government two members, and Treasury two members. Active MTAC members in the ABA Advisory Committee were Charles W. Mooney, Jr., Robert Mendelson (MTAC Chair), Martin J. Aronstein, Richard B. Nesson, Sandra M. Rocks, and Robert J. Woldow. In addition, there was one member who was past president of NCCUSL, Carlyle C. Ring, Jr.

⁴¹⁷ See for instance Charles W. Mooney, Jr., Sandra M. Rocks & Robert S. Schwartz, 'An Introduction to the Revised U.C.C. Article 8 and Review of Other Recent Developments with Investment Securities' (1994) 49 *Business Lawyer* 1892; James Steven Rogers (*supra* n 373) 1445–1447.

⁴¹⁸ These two institutions are the sponsors of the Uniform Commercial Code.

⁴¹⁹ Financial Markets Law Committee, *Issue3-Property Interests in Investment Securities: Report on the Research into the 1994 Revision of Article 8 of Uniform Commercial Code* (London 2005) 5–6; James Steven Rogers (*supra* n 373) 1446–1447; Charles W. Mooney, Jr. (*supra* n 366) 559–576.

⁴²⁰ See Charles W. Mooney, Jr., Sandra M. Rocks & Robert S. Schwartz (*supra* n 417) 1891; James Steven Rogers (*supra* n 373) 1432. See also Charles W. Mooney, Jr. (*supra* n 383) 559 et seq for a personal sketch of the revisions of UCC Article 8.

⁴²¹ On 24 February 1995, Arkansas became the first state in the U.S. to adopt the 1994 Revised UCC Article 8.

ground rules for implementing transfers and resolves disputes that may arise in respect of interests in securities.⁴²² Whereas the 1962 and the 1977 versions of UCC Article 8 were in principle based on physical securities certificates, the 1994 version establishes a distinction between the direct and the indirect holding systems.⁴²³ The drafters of the 1994 revision reasoned that it is “by no means clear whether the long-term evolution will be toward decreased or increased use of direct holdings,” that developments will be determined by market and regulatory forces, and that the UCC Article 8 rules should not seek to influence that development in any specific direction. Therefore, the revised text took a “neutral position on the evolution of securities holding practices.”⁴²⁴ Accordingly, UCC Article 8 generally retains the former Article 8 provisions on the direct holding system⁴²⁵ but contains a new Part 5 which determines rules for the intermediated system; and it rendered unnecessary the complicated provisions of the 1977 text embodied in former UCC § 8-313.⁴²⁶

In respect of the indirect holding system, Part 5 of UCC Article 8 is not based on traditional property law but rather creates a new intermediated system which is, from a legal perspective, comparable to the payment system.⁴²⁷ It also introduces several new definitions and concepts, such as “securities account” and “securities entitlement”. Indeed, the old terms contained in the former versions of UCC Articles 8 and 9 were inadequate to describe paper-

⁴²² Most states have adopted the 1994 revision of UCC Article 8 along with related amendments to UCC Article 9. The Department of the Treasury has also adopted Revised UCC Article 8 for the market in Treasury securities, preempting certain provisions of the laws of any state that has not adopted Revised UCC Article 8.

⁴²³ Ruth Olson, ‘Review of Recent Developments with Revised U.C.C. Article 8 and Investment Securities’ (1995) 50 *Business Lawyer* 1542.

⁴²⁴ Learning from the mistakes of the past, the revision process aimed nevertheless to encourage market development while limiting any unforeseen constraint on the evolutionary process of the direct and indirect holding systems (U.C.C. Series (Hawkland) Special Release, Revised Article 8 Code Text & Official Comments, pt. 2, 7–8 (1995); Everette L. Martin (*supra* n 367) 9, fn 22).

⁴²⁵ UCC Series (Hawkland) Special Release, Revised Article 8 Code Text & Official Comments, pt. 2, 9–10 (1995).

⁴²⁶ It is also worth noting that the scope of UCC Article 8 includes not just securities but also financial assets; it also covers money market funds, repurchase agreements, securities lending agreements, US government securities (to the extent not preempted by federal treasury and related government agency regulations), interests in limited partnerships (if the partnership agreement opts into revised UCC Article 8 or the partnership interests are publicly traded), and other financial assets. However, it does not apply to normal bank accounts.

⁴²⁷ Charles W. Mooney, Jr. & Atsushi Kinami, ‘Transfer, Pledge, Clearance and Settlement in the Japanese and United States Government Securities Market’ (1991) 12 4 *University of Pennsylvania Journal of International Business Law* 517, 518–519; Charles W. Mooney (*supra* n 366) 403–405. For more details on the difference between the intermediated system and the payment system, see Jeanne L. Schroeder (*supra* n 379) 371–375.

less transactions within the intermediated system. Hence, the drafters had to develop novel terms and concepts. Moreover, the revision suppresses the necessity of transferring or physically delivering securities into the possession or control of the secured party in order to create an effective security interest. The only necessary elements are UCC § 9-203 (agreement, signature, the debtor's interest in the collateral, and a debt to be secured).⁴²⁸ With respect to the direct holding system, the 1994 version of UCC Article 8 largely maintains the previous 1977 version but with simplified rules.

§ 8-501 of the UCC determines what a securities account is⁴²⁹ and how security entitlements are acquired from the relevant intermediary. § 8-502 contains a limitation on adverse claims in the indirect holding system. § 8-503 it governs the property aspects of entitlements and the innocent acquisition rule. §§ 8-504 through 8-509 specify duties of the intermediary. The rights of a purchaser of a security entitlement from an entitlement holder are set forth in § 8-510, which also determines the relevant priority rules. § 8-511 addresses the priority rules among secured creditors and entitlement holders. UCC Article 8 Part 1 also sets out definitions and general rules that are essential to a proper understanding of the provisions in UCC Article 8 Part 5. § 8-110 contains choice of law rules.⁴³⁰

2. *Brief History of UCC Article 9*

a) *Pre-Article 9 Law applying to Security in Personal Property*

*Gilmore*⁴³¹ notes that UCC Article 9 is not so much a new start or a fresh approach as it is a reflection of work long since accomplished. A detail histo-

⁴²⁸ The 1994 version of UCC Article 8 does however introduce the concept of “control” to obtain a perfected security interest; the creditor must be in a position to sell the collateral without the cooperation of the debtor and apply the proceeds to the debt. This may be accomplished either by having the securities transferred into an account in its own name or by having the debtor and the securities intermediary sign an agreement that acknowledges right of the creditor to control and order the disposition of the securities (*see* UCC § 8-106). It is important to note that perfection by filing an ordinary Article 9 financing statement is an alternative to control. Perfection by filing is subordinate to perfection by control (*see* UCC § 9-328(1)). *See* section C of this chapter.

⁴²⁹ A “securities account” under Revised UCC Article 8 is: “An account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset.” The following relationships are clearly covered by the definition of a securities account: (1) between a clearing corporation and its participants; (2) between a broker and customers who leave their securities with the broker; and (3) between a bank acting as securities custodian and its customers (*see* Arkansas Code Annotated § 4-8-501(a)).

⁴³⁰ For a discussion of the conflict of laws problems that the 1994 version of UCC Article 8 attempts to solve, *see* James Steven Rogers (*supra* n 373) 1457–1460.

ry of the law governing security interests before UCC Article 9 is beyond the scope of this study. However, to put UCC Article 9 in its proper perspective, it is important to present a summary of that history. The evolution of the law relating to security in personal property reflects the development of increasingly sophisticated commercial transactions. Until the early 1980s, the pledge was the only recognised personal property security device. Attempts to create non-possessory security interests in personal property were viewed by courts as tantamount to fraud.⁴³² Following the Industrial Revolution, however, there was an increased need for credit. This forced lenders to seek recourse to personal and real property as security for loans. With the increasing use of nonpossessory security interests in personal property, courts progressively recognised the validity of both possessory and nonpossessory security interests in most types of personal property. Courts notably recognised:

- The pledge;
- The chattel mortgage;
- The conditional sale;
- The trust concept;
- The factor's lien; and
- Field warehousing.

In addition, various laws were enacted to apply to various types of security interests in personal property. Some of these statutes were modelled on acts proposed and drafted by the NCCUSL.⁴³³ In the late 1930s, many lawyers, judges, business people, and academics were concerned about a lack of uniformity in the state statutory law that governed security interests in personal property, with much uncertainty for persons involved in interstate business. Thus, efforts were put into a comprehensive re-examination of state laws applying to commercial transactions in general and to security interests in particular.⁴³⁴

b) The 1962 Version of UCC Article 9

Although several states adopted the UCC between 1957 and 1961,⁴³⁵ many were still adopting numerous non-uniform amendments to it. To discourage

⁴³¹ Grant Gilmore, *Security Interests in Personal Property* (Little, Brown & Company, Boston 1965) 290.

⁴³² Richard F. Duncan, William H. Lyons & Catherine Lee Wilson, *The Law and Practice of Secured Transactions: Working with Article 9* (Law Journal Press, New York 2004) 1–4.

⁴³³ Such as: (i) the Uniform Trust Receipts Act; (ii) the Uniform Conditional Sales Act; (iii) the Uniform Negotiable Instruments Law; (iv) the Uniform Warehouse Receipts Act; (v) the Uniform Sales Act; and (vi) the Uniform Bill of Lading Act. However, other statutes were not modelled on any uniform model (such as the chattel mortgage acts and the factors lien acts).

⁴³⁴ Richard F. Duncan, William H. Lyons & Catherine Lee Wilson (*supra* n 432) 1–5.

non-uniform amendments, the ALI and the NCCUSL established the Permanent Editorial Board. Its purpose was to review the UCC on an ongoing basis and draft suggested amendments to ensure that the UCC was adapted to changing commercial practices. The first substantive action of the Permanent Editorial Board was to recommend that its proposed 1962 Official Text of the UCC be adopted.⁴³⁶

Article 9 as it appeared in the 1962 Official Text was a major simplification of pre-UCC personal property security law; it replaced many pre-UCC security devices with a unitary security device called a “security interest”⁴³⁷ and established a uniform body of law with a single filing system and a single terminology. Article 9 moreover departed from the past in de-linking the creation and perfection of security interests from the mere form of the transaction; instead, distinctions in that area were based on the nature of the collateral and the nature of the transaction.

c) *The Pre-1972 Official Text and the 1977 Amendments*

The 1962 version of UCC Article 9 constituted a major simplification of personal property law. Yet there were still issues it did not address. To resolve them, individual states turned once again to non-uniform amendments. In 1966, the Permanent Editorial Board launched a full review of UCC Article 9 and in 1971 presented a report recommending revisions.⁴³⁸ Though the suggested revisions did not alter the fundamental approach of UCC Article 9, they were substantial and required a complete redrafting of entire sections of Article 9.⁴³⁹ The 1972 Official Text, which was adopted by all states, was largely based on the report of the Permanent Editorial Board. In 1977, UCC

⁴³⁵ Massachusetts (in 1957); Kentucky (in 1958); Connecticut, New Hampshire, Rhode Island, Wyoming, Arkansas, Ohio, New Mexico, Illinois, Oklahoma, Georgia, New Jersey, Alaska, Michigan, and New York (in 1958). Pennsylvania substituted the 1958 Code for the 1952 Code in 1959.

⁴³⁶ The 1962 Official Text is available at <[http://www.legislature.mi.gov/\(S\(kidfh1nkkbu0ctnkr4nepqj\)\)/documents/mcl/pdf/mcl-Act-174-of-1962.pdf](http://www.legislature.mi.gov/(S(kidfh1nkkbu0ctnkr4nepqj))/documents/mcl/pdf/mcl-Act-174-of-1962.pdf)> (accessed 4 January 2021). See also The American Law Institute, *Uniform Commercial Code – 1962 Official Text with Comments* (1963). The 1962 Official Text was eventually adopted in all the states, except Louisiana.

⁴³⁷ Richard F. Duncan, William H. Lyons & Catherine Lee Wilson (*supra* n 432) 1–6.

⁴³⁸ See Permanent Editorial Board for the Uniform Commercial Code, Review Committee for Article 9 of the Uniform Commercial Code, Final Report, *Proposals for changes in Article 9 of the Uniform Commercial Code and Related Changes in Other Articles with Reasons Therefor and Comments* (25 April 1971, Philadelphia). The report is available at <<http://heinonline.org/HOL/LandingPage?handle=hein.ali/alicc0140&div=1&src=home>> (accessed 4 January 2021).

⁴³⁹ For instance, UCC § 9-103(1962), which governs the perfection of security interests in multiple state transactions, was completely redrafted in the 1972 Code.

Article 9 was amended in response to problems with negotiable stock certificates. Certain amendments were also made to UCC Article 8's provisions on the creation and perfection of security interests in uncertificated securities. Following the 1977 amendments, UCC Article 9 no longer governed those issues; but the 1994 revision of UCC Articles 8 and 9 reversed this action.⁴⁴⁰

d) The 1994 Amendments to UCC Article 9

In 1994, several provisions of UCC Article 9 were amended in connection with the revisions to UCC Article 8. As mentioned above, the 1977 version of UCC Article 8 applied to property interests in investment securities. The 1994 revisions now returned the provisions in respect of the creation and the perfection of security interests in investment securities to UCC Article 9, thereby re-establishing the structure which existed before the 1977 amendments to UCC Article 9. More particularly, § 9-106 governs the control of investment property. § 9-206 applies to security interests arising in purchase, while § 9-309 applies to security interest perfected upon attachment. § 9-312 sets out rules on perfection. §§ 9-314 and 9-328 govern perfection by control and priority, respectively.⁴⁴¹ It is important to note, however, that an account agreement concluded between an investor (or entitlement holder)⁴⁴² and its intermediary plays a significant role in practice. Indeed, UCC Article 8 gives priority to an account agreement over some provisions of UCC Article 8 regarding the intermediaries' duties.

e) The 1999 Official Text

In 1990, the Permanent Editorial Board created a committee to analyse UCC Article 9 and prepare the substance of any revision to its provisions. On 1 December 1992, the study committee issued a report which recommended several changes to UCC Article 9.⁴⁴³ In 1993, the ALI and the NCCUSL established a drafting committee which commenced its work based on the rec-

⁴⁴⁰ For a critical analysis of the 1977 amendments of UCC Article 9, see Peter F. Coogan, 'Security Interests in Investment Securities Under Revised Article 8 of the Uniform Commercial Code' (1980) 93 *Harvard Law Review* 889.

⁴⁴¹ Edward J. Janger, 'Predicting when the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom' (1998) 83 *Iowa Law Review* 569, 617–625, who addresses the possible role of industry capture in the revision process.

⁴⁴² Under UCC Article 8, there is a difference between the concepts of entitlement holders and investors. In the US intermediated system, there are security entitlements at each tier of the indirect holding chain. Hence, intermediaries at various levels of the intermediated system are entitlement holders though not investors. For more details on this question, see section B of this chapter.

⁴⁴³ See Permanent Editorial Board for the Uniform Commercial Code, *PEB Study Group Uniform Commercial Code Article 9* (December 1992).

ommendation of the study committee. It completed and submitted its work to the American Law Institute and the NCCUSL during their 1998 annual meetings, whereupon the NCCUSL and ALI approved the revisions to UCC Article 9. The revised version of UCC Article 9 (Revised Article 9) has been adopted in all states, the District of Columbia, and the US Virgin Islands. It called for a uniform effective date of 1 July 2001.⁴⁴⁴ The drafting committee inserted a provision delaying the effective date of the revision until 1 July 2001; this was intended to eliminate as many conflict of laws issues as possible.⁴⁴⁵ Revised Article 9 substantially reorganises the 1972 version: First, its scope is expanded to include many situations and issues that were previously not subject to its rules concerning attachment, perfection, and enforcement. Second, the revised version changes the provisions on filing. Third, it changes the choice of law provisions applying to perfection, the effects of perfection or non-perfection, and priority. And fourth, as an alternative to signing a piece of paper, the revised version of UCC Article 9 provides for the authentication of a record.⁴⁴⁶

B. Key Features of the Intermediated System in the US

I. Basic Structure of the Intermediated System in the US

The indirect holding system in the United States is composed of investors, intermediated securities, intermediaries, and a CSD. In this regard, the US intermediated system is similar to that of Germany and to that of the OHADA region. Nevertheless, the underlying legal framework of the indirect holding system in the US is entirely different.⁴⁴⁷ Indeed, an investor in the US indirect holding system does not hold the securities themselves but rather a new, intermediary-centred right, one that is *sui generis*, called a “security entitlement”.⁴⁴⁸ A security entitlement is not an interest in any particular security.

⁴⁴⁴ Most states adopted Revised Article 9 with its 1 July 2001 effective date. However, a tiny minority of jurisdictions had a later effective date. For instance, Connecticut had an effective date of 1 October 2001. Alabama, Florida, and Mississippi had an effective date of 1 January 2002. For an in-depth analysis of the conflict of laws issues that arose from the non-uniform effective dates, see Bradley Y. Smith, ‘New Article 9 Transition Rules’ (1999) 74 Chicago-Kent Law Review 1339, 1351–1355.

⁴⁴⁵ Richard F. Duncan, William H. Lyons & Catherine Lee Wilson (*supra* n 432) 1–9.

⁴⁴⁶ For more details on the revised version of UCC Article 9, see Darrell W. Pierce, ‘Revised Article 9 of the Uniform Commercial Code: Filing System Improvements and their Rationale’ (1998) 31 Uniform Commercial Code Law Journal 16.

⁴⁴⁷ Changmin Chun (*supra* n 143) 203.

⁴⁴⁸ Bradley Crawford ‘The Hague Prima Convention: Choice of Law to Govern Recognition of Dispositions of Book-Based Securities in Cross Border Transactions’ (2003) 38 Canadian Business Law Journal 157, 166; Richard Potok, ‘Legal Certainty for Securities Held as Collateral’ (1999) 18 International Financial Law Review 12, 13; Stephan Saager,

Rather, section 8-102(a)(17) defines a “security entitlement” as “the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5”. A person acquires a security entitlement when financial assets are credited to the entitlement holder’s account by its securities intermediary; such financial assets can be money-market funds, limited partnership interests, and other interests that might be held through a securities entitlement account. From an OHADA legal viewpoint, a security entitlement is a packaged aggregate composed of rights *in personam* with some aspects of rights *in rem*. Moreover, securities are not the underlying objects of security entitlements in the US intermediated system.

UCC Article 8’s broad definition of the concept of “financial asset”, found in § 8-102(a)(9), is:

- (i) A security;⁴⁴⁹
- (ii) An obligation of a person or a share, participation, or other interest in a person or in property or an enterprise of a person, which is, or is of a type, dealt in or traded on financial markets, or which is recognised in any area in which it is issued or dealt in as a medium for investment; or
- (iii) Any property that is held by a securities intermediary⁴⁵⁰ for another person in a securities account if the securities intermediary has expressly agreed with the other person that the property is to be treated as a financial asset under this Article.⁴⁵¹

The third test in § 8-102(a)(9) is significant: any property (including an interest in a partnership or limited liability company, a negotiable instrument under Article 3,⁴⁵² or a document of title) becomes a financial asset in case an investor

Effektengiroverkehr und internationales Privatrecht (Dunker & Humblot, Berlin 2007) 158–159; Dorothee Einsele (*supra* n 361) 305.

⁴⁴⁹ § 8-102(a)(14) defines the term “security” as “an obligation of an issuer or a share, participation, or other interest in an issuer or in property or an enterprise of an issuer: (i) which is represented by a security certificate in bearer or registered form, or the transfer of which may be registered upon books maintained for that purpose by or on behalf of the issuer; (ii) which is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations; and (iii) which: (a) is, or is of a type, dealt in or traded on securities exchanges or securities markets; or (b) is a medium for investment and by its terms expressly provides that it is a security governed by this Article.”

⁴⁵⁰ § 8-102(a)(14) defines the term “securities intermediary” as “(i) a clearing corporation; or (ii) a person, including a bank or broker, that in the ordinary course of its business maintains securities accounts for others and is acting in that capacity”.

⁴⁵¹ As context requires, the term means either the interest itself or the means by which a person’s claim to it is evidenced, including a certificated or uncertificated security, a security certificate, or a security entitlement.

⁴⁵² Under § 3-104(a), “negotiable instrument” means “an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it: (1) is payable to bearer or to order at the time it is issued or first

(or more accurately, entitlement holder) and its intermediary enter into an agreement that expressly stipulates that the property is to be treated as a financial asset.⁴⁵³ This provision reflects the liberal approach characteristic of the US intermediated system, which rests on the agreement between the relevant parties. In line with this liberal approach, there is no list of securities eligible for the intermediated system in UCC Article 8. And similarly, under the DTC rules, eligible securities are determined solely at the discretion of DTC (Rule 5(1)).

Because of the importance placed on the relationship between the intermediary and the account holder, securities accounts play a key role in the US intermediated system, and the rules regarding securities accounts are therefore positioned first in UCC Article 8 Part 5. § 8-501 defines a securities account as “an account to which a financial asset is or may be credited in accordance with an agreement under which the person maintaining the account undertakes to treat the person for whom the account is maintained as entitled to exercise the rights that comprise the financial asset.” In light of this provision, the concept of “securities account” in the US intermediated system is composed of two elements. First, a securities account is created by a consensual agreement. Second, the agreement must entitle the account holder to exercise the right which the financial asset represents. As mentioned above, a security entitlement is in essence a claim vis-à-vis the specific intermediary of an entitlement holder, so the US indirect holding system is consequently constructed “account by account” or “stage by stage”. Under § 8-501, an account holder acquires a security entitlement when a financial asset is or may be credited to its securities account; in other words, in the US intermediary system a securities entitlement regarding financial assets is created by a book-entry to a securities account.⁴⁵⁴

Moreover, the absence of a trust relationship in the definition of a securities account in UCC Article 8 is noteworthy. In the US intermediated system, a securities account is a consensual agreement that entitles the entitlement holder to exercise the rights comprising the financial asset; this definition precludes a trust relationship in which the trustee holds legal title and exercises the rights. Therefore, it is not an analysis of the nominal words of an agreement that determines whether an agreement constitutes a securities account; rather, it is

comes into possession of a holder; (2) is payable on demand or at a definite time; and (3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment of money, but the promise or order may contain (i) an undertaking or power to give, maintain, or protect collateral to secure payment, (ii) an authorisation or power to the holder to confess judgment or realise on or dispose of collateral, or (iii) a waiver of the benefit of any law intended for the advantage or protection of an obligor.”

⁴⁵³ Note also that under § 8-103(e), an option or similar obligation issued by a clearing corporation to its participants is not a security, though it is a financial asset.

⁴⁵⁴ Changmin Chun (*supra* n 143) 204.

whether the application of Part 5 of UCC Article 8 is consistent with the expectations of the parties and with the objectives of UCC Article 8.⁴⁵⁵

As mentioned above, the US intermediary system makes a distinction between an “entitlement holder” and an “account holder”.⁴⁵⁶ § 8-102(a)(7) defines the term “entitlement holder” as a person identified in the records of a securities intermediary as the person having a security entitlement against the securities intermediary. If a person acquires a security entitlement by virtue of § 8-501(b)(2) or (3), that person is the entitlement holder. This means that an entitlement holder is any person whose interest in a financial asset is not registered on the books of the pertinent issuer.⁴⁵⁷ In other words, an entitlement holder is a party that holds a security entitlement created in the securities account through its intermediary. However, an entitlement holder is not necessarily an “ultimate investor”; accordingly, the relevant intermediary of the entitlement holder may be an entitlement holder vis-à-vis its upper-tier intermediary, which in turn can be an entitlement holder vis-à-vis a further upper-tier intermediary. The existence of different layers in the US indirect holding system is a result of the “securities account” and “security entitlement” concepts found in UCC Article 8 Part 5. The only situation where there can be a singular entitlement holder in the US indirect holding system is when a participant in the CSD, *i.e.*, the Depository Trust Company (DTC), is the ultimate investor.

As noted above, in the US intermediated system the different tiers of an indirect holding chain are insulated from one another. An entitlement holder has a relationship solely with its intermediary; it has no relationship with other intermediaries or with the issuer of the asset. Consequently, a creditor can only lodge a claim against its debtor’s intermediary. Under § 8-112(c), “the interest of a debtor in a security entitlement may be reached by a creditor only by legal process upon the securities intermediary with which the debtor’s securities account is maintained, except as otherwise provided in subsection (d)”⁴⁵⁸. Therefore, except for an extremely rare case in § 8-503(d),⁴⁵⁹ an upper-tier attachment is systematically prohibited in the US intermediated system.

⁴⁵⁵ Russel A. Hakes (*supra* n 365) 680.

⁴⁵⁶ See Article 1(e) of the Geneva Securities Convention and Article 1(1)(d) of the Hague Securities Convention, which both use the concept of “account holder”.

⁴⁵⁷ Francis J. Facciolo, ‘Father Knows Best: Revised Article 8 and the Individual Investor’ (2000) 27 Florida State University Law Review 615, 623. The 1994 version of UCC Article 8 expressly abandons all tracing rules (*see* Jeanne L. Schroeder (*supra* n 377) 332–334 (describing netting of trades as leading to impossibility of tracing, both as related to § 8-313(2))).

⁴⁵⁸ Under § 8-112(d), “[t]he interest of a debtor in a certificated security for which the certificate is in the possession of a secured party, or in an uncertificated security registered in the name of a secured party, or a security entitlement maintained in the name of a secured party, may be reached by a creditor by legal process upon the secured party.”

⁴⁵⁹ § 8-503(d) provides: “An entitlement holder’s property interest with respect to a particular financial asset under subsection (a) may be enforced against a purchaser of the

The definition of a securities intermediary in § 8-102(a)(14) indicates that the US indirect holding system, unlike the German intermediated system, does not require an intermediary to be regulated or engaged in a banking or brokerage business. Whether an entity maintains a securities account for others and acts in that capacity is the most crucial element.⁴⁶⁰ As defined in § 3(a)(23) of the Securities Exchange Act (SEA), a clearing corporation is a clearing agency under the federal securities law registered with the Securities Exchange Commission (SEC). A clearing corporation can also be any other entity which provides clearance or settlement services as long as its activities as such are governed by a federal or state governmental authority (§ 8-102(a)(5)).⁴⁶¹ In the US intermediated system, the DTC⁴⁶² is the CSD. For most securities traded in US securities markets, the National Securities Clearing Corporation (NSCC)⁴⁶³ is the central counterparty.

If an entity issues global certificates, all transfers are made through book-entry. If the securities are not issued in book-entry-only form, they can be registered or withdrawn on behalf of the intermediaries, investors, or others. The relationship between a transfer agent (issuer) and the DTC plays a key role in the registration and withdrawal process. Under the Fast Automated Securities Transfer (FAST)⁴⁶⁴ program, the DTC enters into agreements with transfer agents whereby securities are registered in the name of the nominee of the

financial asset or interest therein only if: (1) insolvency proceedings have been initiated by or against the securities intermediary; (2) the securities intermediary does not have sufficient interests in the financial asset to satisfy the security entitlements of all of its entitlement holders to that financial asset; (3) the securities intermediary violated its obligations under § 8-504 by transferring the financial asset or interest therein to the purchaser; and (4) the purchaser is not protected under subsection (e).”

⁴⁶⁰ Article 1(d) of the Geneva Securities Convention and Article 1(1)(c) of the Hague Securities Convention have a similar definition of an intermediary.

⁴⁶¹ Unlike other intermediaries, clearing corporations are governed by two preferential clauses for clearing corporations under UCC Article 8. First, the rules of the clearing corporations are effective even if they contradict provisions of the UCC. These rules also affect other parties who did not agree to the rules (§ 8-111). Second, under § 8-511, if a creditor of a clearing corporation does not have sufficient financial assets, it has no priority over the entitlement holders’ claims.

⁴⁶² Established in 1973 as a successor to the business of the Central Certificate Service of the NYSE (which was established to address the paper crunch in the late 1960s), it is a limited purpose trust company which was created under New York law. In 1999, DTC became a subsidiary of DTCC with the NSCC.

⁴⁶³ Created in 1976, the NSCC provides settlement, clearing, CPP services, and a guarantee of completion for transactions for almost all broker-to-broker trades.

⁴⁶⁴ FAST was introduced in 1975. In 1976, it was approved by the SEC. *See* Securities and Exchange Commission, *Depository Trust Co.* (1976) 41 Fed. Reg. 17823, Release n° 34-12353.

DTC, *i.e.*, Cede & Co.⁴⁶⁵ Because of this relationship between the DTC and the transfer agents, the balance certificates of the securities maintained by both reflect the DTC's ownership interests. If DTC a participant requires the DTC to withdraw securities, the DTC debits the securities from that participant's account. Furthermore, the DTC instructs the relevant transfer agent to withdraw the requested securities, whereupon the transfer agent reduces the DTC's balance, issues certificates in the name of the requested person, and moreover delivers the certificates directly to that participant. The FAST program allows fast withdrawal of securities and diminishes the DTC's operational burden from maintaining securities certificates. Nevertheless, it is important to note that not all deposit-eligible registered securities come under the FAST program, which is in place only for securities designated by the DTC. Besides the FAST program, the DTC also provides the Direct Registration System (DRS) program, under which securities are registered directly in the names of the ultimate investors on the books of the shareholders managed by transfer agents.

The figure on the next page illustrates the basic structure of the US indirect holding system described above.

II. Key Features of the US Indirect Holding System

As indicated above, the relevant provisions of UCC Article 8 depart from previous rules that were based on securities certificates. First, UCC Article 8 sets forth new definitions and terms which apply only to the indirect holding system, such as security entitlement, securities account, entitlement order,⁴⁶⁶ entitlement holder, financial asset, etc. Second, the UCC provides specific rules for the indirect holding system, more particularly regarding (i) the protection of the innocent acquirer or of relevant parties such as collateral takers (§§ 8-502 & 8-510(a)), (ii) insolvency immunity as well as allocation and shortfalls (for instance in §§ 8-503(a) & (b)), and (iii) priority (for instance in §§ 8-510, 8-511 & 9-328).

⁴⁶⁵ Cede & Co. stands for "Certificate Depository and Company". It is a partnership between the DTC and employees of the DTC. This legal form was chosen to simplify the verification of signatures to the issuer. It was thought that the verification of the signature for a partnership is less difficult than a signature for a corporation: Jeanne L. Schroeder & David Gray Carlson (*supra* n 373) 561. The only purpose of Cede & Co. is the maintenance of registered ownership of securities which are deposited with the DTC (Charles W. Mooney, Jr. (*supra* n 366) 319).

⁴⁶⁶ Under § 8-102(a)(8), an entitlement order is a notification sent to an intermediary instructing transfer or redemption of a financial asset to which the entitlement holder has a security entitlement.

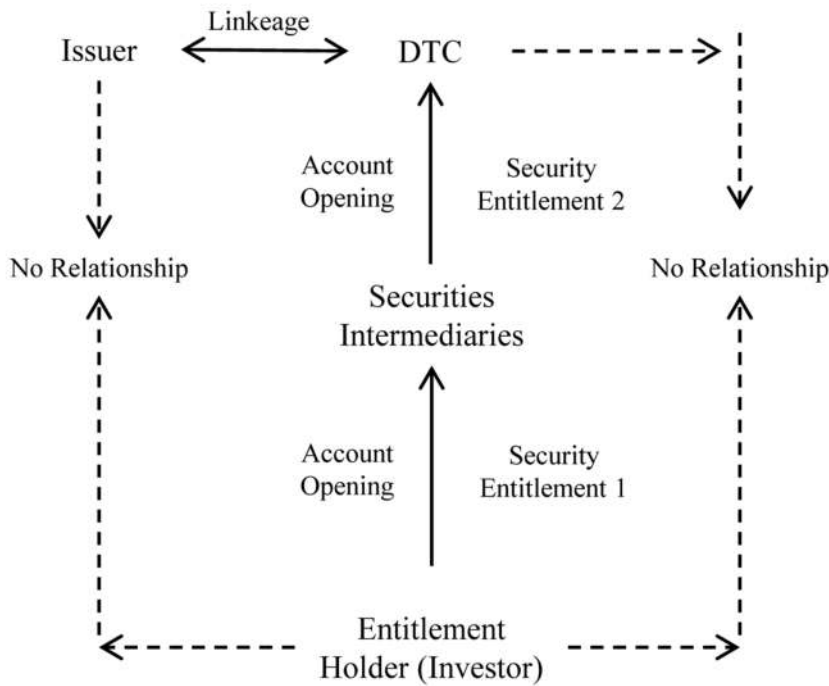


Figure 12: Basic Structure of the US Intermediated System⁴⁶⁷

Further, the US intermediary system is an intermediary-centred regime. Indeed, the relationship with the intermediary is at the centre of the US indirect holding system.⁴⁶⁸ In fact, almost all operations in that system are performed by intermediaries; consequently, the nature of a security entitlement is basically an *in personam* right, one between the account holder and the intermediary. As for attachment of the debtor's security entitlement, no upper-tier attachment is allowed in the US indirect holding system since a relationship is maintained only with the debtor's intermediary. Additionally, because of this relationship-based system and the nature of a security entitlement, all indirect holding systems are analysed stage by stage under UCC Article 8 Part 5.

However, the intermediary-centred, relationship-based approach taken by the US intermediary system has disadvantages. One is that it is too favourable vis-à-vis intermediaries: For example, if there are conflicting priority claims, §§ 8-510(d) and 9-328(3) give priority to the intermediary, as purchaser, over other purchasers who have control⁴⁶⁹ if the intermediary did not agree other-

⁴⁶⁷ Source: Changmin Chun (*supra* n 143) 208.

⁴⁶⁸ Changmin Chun (*supra* n 143) 209.

⁴⁶⁹ UCC Article 8 defines control as "the steps necessary for a transfer that will qualify the transferee for protection against adverse claims." Under UCC § 8-106(d) a transferee obtains control in the intermediated system by (i) becoming an entitlement holder; (ii) a control agreement with an intermediary; (iii) another person's obtaining of control on behalf of the transferee, or the acknowledgment that another person, who previously ac-

wise. But conversely, Article 19(4) of the Geneva Securities Convention gives priority to other persons' interests over those of the intermediary barring an express agreement. Moreover, §§ 8-504 to 8-509 determine essential duties of an intermediary. However, it is the agreement between the intermediary and its customers which primarily determines that intermediary's duties.

Due to the bargaining power intermediaries typically have, individual investors may be unable to properly protect themselves in the formulation of their rights against their intermediary. In that regard, *Facciolo* critiques the substance of the 1994 revision of UCC Article 8, pointing out that it favours institutional market participants to the detriment of consumers or individual investors.⁴⁷⁰ This negative substantive result can be partly⁴⁷¹ explained by the fact that individual investor interests were not represented during the UCC Article 8 revision process.⁴⁷² In contrast, *Mooney* points out that the US intermediary system was erected with upper- and middle-class individual investors in mind: "The individual members of the drafting committee epitomised the middle- to upper-income individuals who maintain a substantial portion of their wealth in securities accounts."⁴⁷³ It is true that this type of liberal approach, associated with broad party autonomy, can be regarded as essential to an always-evolving financial market. Yet, such an approach must be complemented by other laws such as insolvency law or securities law. UCC Article 8 Part 5 corresponds to this structure.⁴⁷⁴ Indeed, it does not encompass regulatory rules. Rather, specific provisions governing intermediary activities (such as segregation of customer property)⁴⁷⁵ are set forth in federal securities law and rules. Turning for a moment to OHADA, any UCC Article 8 inspired

quired control, has control on behalf of the purchaser. This question is further analysed under section C of this chapter.

⁴⁷⁰ Francis J. Facciolo (*supra* n 457) 618.

⁴⁷¹ The use of the word "partly" is justified because *Facciolo's* arguments seem incoherent as he notes that the participation of individual investors, even in the matter he advocates, may not suffice to protect consumers (Francis J. Facciolo (*supra* n 457) 703).

⁴⁷² Francis J. Facciolo (*supra* n 457) 618; see section A of this chapter.

⁴⁷³ Charles W. Mooney, Jr. (*supra* n 383) 580. For more criticisms of Facciolo's claims, see Charles W. Mooney, Jr. (*supra* n 383) 577–583.

⁴⁷⁴ *Mooney* explains: "Investor groups representatives believed and continue to believe that the framework of SEC regulation and SIPA protection, not 'property' rules under Article 8, are the appropriate areas of concern of investors." (Charles W. Mooney, Jr. (*supra* n 383) 579).

⁴⁷⁵ See Rule 15c3-3, 17 CFR S. 240.15c-3. For a comparative law analysis on the segregation rule, see also Ronald H. Filler, 'Ask the Professor: How Does the U.K. Client Money Rules Differ from the U.S. Customer Segregated Rules When the Custodian Firm Fails to Treat Customer Property Properly?' (2010) *The Journal of the Law of Investment & Risk Management*, "The Futures & Derivatives Law Report", Vol. 30, No. 11, NYLS Legal Studies Research Paper n° 10/11 12. See also Francis J. Facciolo (*supra* n 457) 685–688.

attempt to regulate the intermediated system under OHADA law (particularly the collateralisation of intermediated securities) should consider all the other regulatory aspects which UCC Article 8 does not encompass. According to *Schwarcz*, without comprehensive regulatory protection under federal and state law, it is doubtful that UCC Article 8 rules would favour collateral providers or consumers.⁴⁷⁶

Another important feature of the US intermediated system is the neutrality of UCC Article 8, whose rules for the direct and the indirect holding systems are similar and parallel one another. Investors can choose any holding form from one of the two systems. The rules for the indirect holding system in UCC Article 8 Part 5 apply when financial assets are credited to a securities account. The neutrality of the US intermediated system is also perceptible in respect of dematerialisation and immobilisation: Most securities, other than federal and state government securities and mutual fund securities, are issued in the form of global securities or jumbo certificates.⁴⁷⁷ After their registration under the name of Cede & Co., these securities are immobilised in the vault of the DTC.⁴⁷⁸ Consequently, the U.S indirect holding system is a system of immobilisation.⁴⁷⁹ But while the German intermediated system is not designed for dematerialised securities, the US indirect holding system is legally neutral regarding dematerialisation.⁴⁸⁰

III. Concept of Security Entitlements

1. Introduction

As mentioned *supra*, the structure for indirect securities holding in the United States involves a bundle of rights which each person or entity holds with the entity at the next higher level. These bundles of rights are “security entitlements”. Under § 8-102(a)(17), the term “security entitlement” means “the rights and property interest of an entitlement holder with respect to a financial asset specified in Part 5” of UCC Article 8. Therefore, a security entitlement is both a package of personal rights against the securities intermediary as well as an interest in the property held by the security intermediary. However, the definition in § 8-102(a)(17) does not fully grasp the concept of security enti-

⁴⁷⁶ Steven L. Schwarcz, ‘Intermediary Risk in a Global Economy’ (2001) 50 *Duke Law Journal* 1596.

⁴⁷⁷ Federal and state government securities as well as mutual funds securities, however, are issued in a dematerialised form.

⁴⁷⁸ Global securities certificates correspond to permanent global certificates in the *Depotgesetz*. See Dorothee Einsele (*supra* n 361) 13–14.

⁴⁷⁹ See David C. Donald, ‘The Rise and Effects of the Indirect Holding System – How Corporate America Ceded its Shareholders to Intermediaries’ (2007) available at SSRN: <<https://ssrn.com/abstract=1017206>> or <<http://dx.doi.org/10.2139/ssrn.1017206>>.

⁴⁸⁰ Changmin Chun (*supra* n 143) 212.

tlements. The prefatory note to UCC Article 8 indicates that the notion of security entitlements cannot be understood only from a specific provision; its meaning can be found instead in the “matrix of rules” employing the term “security entitlement”. In other words, the definition of a security entitlement derives from all the provisions of UCC Article 8 Part 5.⁴⁸¹ The following section analyses the two main aspects of a security entitlement in detail: property rights (2) and personal rights (3).

2. *The Property Rights Aspect*

a) *Pro Rata Property Interests*

A security entitlement is by nature a property right, but one that is reshaped restrictively into a proportional interest without a direct right in a specific financial asset. Under § 8-505(b), a security entitlement is a *pro rata property interest* in all interests in that financial asset held by an intermediary.⁴⁸² When and in what sequence the account holder or the relevant intermediary acquires the security entitlement or interest in the financial asset is irrelevant. To ensure the reality of the property aspect of the security entitlement, § 8-503(a) further provides that, to the extent necessary for a securities intermediary to satisfy all security entitlements with respect to a particular financial asset, all interests in that financial asset held by the securities intermediary are held by the securities intermediary for the entitlement holders, are not property of the securities intermediary, and are not subject to claims of creditors of the securities intermediary, except as otherwise provided in § 8-511.⁴⁸³

b) *Enforcement of Property Rights against Third Parties*

§ 8-503(c) contains a limitation on the property aspect of a security entitlement. Since a security entitlement is a statutory, *sui generis* package of rights, it can be exercised *solely* against the relevant intermediary; in other words, whereas a common-law property right may be exercised against any person, a security entitlement can be exercised only against the relevant intermediary despite being a form of property. This principle constitutes the recognition in law of the factual realities of the modern multi-tiered system of intermediar-

⁴⁸¹ Prefatory Note, Part II. C.

⁴⁸² This is comparable to the concept of co-ownership under German law. However, it is important to note that the German concept of co-ownership is based on the securities certificates held by the CSD. Conversely, the US concept of proportional interests does not depend on the physical certificates held by the CSD; rather, it is linked to the financial asset held by the relevant intermediary.

⁴⁸³ § 8-511 specifies rules regarding priority among security interests and entitlement holders. For more details on the relationship between §§ 9-503(a) and 8-511, see Russel A. Hakes (*supra* n 365) 775–779.

ies, in which each intermediary knows only the identity and the extent of the positions of its own account holders.⁴⁸⁴ The upper-tier intermediary has no way of knowing anything about its customer's customers; and therefore the drafters of the 1994 version of UCC Article 8 were of the opinion that the factual realities of the modern securities holding system dictated that an intermediary can only be held responsible to its own customers.

Traditionally, the rules in UCC Article 8 rested on the principal that paper certificates were a reification of the underlying right.⁴⁸⁵ For instance, a person's claim to ownership of a securities certificate was a right to a specific, identifiable physical object to be asserted against any person in possession of that physical certificate, and the only exception was when the *bona fide* rules cut off the adverse claim. Applied to the modern, indirect holding system, however, the traditional rule would significantly impair its operation. Assume for instance that JM holds securities through its intermediary Z, who in turn holds through Clearing Corporation. Suppose T has claimed some form of interest in JM's property. Can T's asserted claim be enforced directly against Clearing Corporation? Under the 1994 version of UCC Article 8, the answer is no: any claim by T affecting JM's interest, by legal process or any other means, should be directed at JM's intermediary, Z. The conceptual structure of the 1977 version of UCC Article 8 understood all relationships in the intermediated system in terms of transfer of property interests in the "security".⁴⁸⁶ Consequently, in the example of T's claim against JM, Clearing Operation is regarded as having possession of an item of property that belongs to JM; so under the 1977 version of UCC Article 8 and taking into account general property concepts and the law of creditors' rights, T was entitled to reach JM's property by process, notice, or other action directed to Clearing Corporation.⁴⁸⁷

The 1994 version of UCC Article 8's rules for the intermediated system are based on entirely different concepts. Indeed, a security entitlement is not a claim to a specific identifiable *res* but rather a bundle of rights and interests which a person has against her intermediary and its property. Hence, the US intermediary system is based on the fundamental principle that the direct intermediary of an entitlement holder *must* see to it that the entitlement holder receives all the corporate and economic rights related to the security, so an enti-

⁴⁸⁴ Stephan Saager (*supra* n 448) 158–159; Richard Potok (*supra* n 448) 13; Bradley Crawford (*supra* n 448) 166; Dorothee Einsele (*supra* n 361) 305.

⁴⁸⁵ James Steven Rogers (*supra* n 373) 1455.

⁴⁸⁶ The provision of the 1977 version of UCC Article 8 addressing creditor process provided that the interest of a person holding through an intermediary "may be reached by a creditor by legal process upon the financial intermediary on whose books the interests of the debtor appears" (UCC s 8-317(4) (1978)). In New York, where DTC is located, it was thought necessary to add special legislation to the civil procedure statutes to eliminate this potential problem (N.Y. Civ. Prac. L. & R. 5201(c)(4) (McKinney 1983)).

⁴⁸⁷ James Steven Rogers (*supra* n 373) 1456.

tlement holder can direct any claims it has to performance of obligations only against *that* intermediary. She cannot assert rights directly against other entities such as further intermediaries through which the first intermediary holds positions. In the above example of T's claim against JM, the 1994 version of UCC Article 8⁴⁸⁸ provides the following solution: JM's property interest is described as a "security entitlement". It is, therefore, a package of rights against JM's intermediary, that is Z. Since JM's property is "located" at Z, it follows, as a matter of general principle, that any effort of JM's creditors to reach or affect JM's interest by legal process or other means should be directed *only* at Z.

But there are exceptions to the principle that a security entitlement can be exercised only against the relevant intermediary. They arise in rare situations which satisfy all the requirements of §§ 9-503(d) and (e). Before attempting to assert its property rights against the purchaser of a financial asset, the entitlement holder must fulfil four separate conditions:

- (i) Under § 8-503(d)(1), insolvency proceedings must have been initiated by or against the intermediary. As a procedural issue, the insolvent intermediary's insolvency administrator⁴⁸⁹ should choose not to sue the transferee. Moreover, the account holder that is suing should not rely entirely on its rights in the intermediary's insolvency proceedings (§ 8-503(d) (sentence 2)); it is only after their conclusion that a lawsuit by the account holder can be brought. Moreover, the insolvency administrator may indeed choose to sue the transferee; then, if the insolvency administrator is able to obtain the financial asset which was wrongfully transferred, specific distribution depends on the rules of insolvency law;⁴⁹⁰
- (ii) Pursuant to § 8-503(d)(2), the intermediary must have a shortfall of a specific financial asset such that all its account holders who hold a security entitlement in the insufficiently held financial asset cannot be fully satisfied (§ 8-503(d)(2));
- (iii) § 8-503(d)(3) requires that the transfer of the financial asset from the intermediary to the transferee must have been carried out in violation of the intermediary's obligation under § 8-504;⁴⁹¹

⁴⁸⁸ UCC § 8-112(c) (1994) provides: "The interest of a debtor in a security entitlement may be reached by a creditor only by legal process upon the securities intermediary with which the debtor's securities account is maintained [...]"

⁴⁸⁹ It is important to note that § 8-503(d) uses the terms "trustee" and "liquidator", while the Hague Securities Convention and the Geneva Securities Convention both use the term "insolvency administrator".

⁴⁹⁰ For more information on shortfalls and loss sharing rules in insolvency under US law, see Changmin Chun (*supra* n 143) 243–246.

⁴⁹¹ Under § 8-504, the intermediary must maintain sufficient financial assets corresponding to all the security entitlements that the intermediary created.

- (iv) As per § 8-503(d)(4), the protection otherwise found in § 8-503(e) must not apply. Much like in a case of innocent acquisition, § 8-503(e) protects a transferee who purchased a financial asset or interest therein either by (a) giving value, (b) obtaining control, or (c) not being in collusion with the intermediary.

As mentioned above, the account holder must satisfy *all* these strict requirements in order to enforce its rights against the colluding transferee. The purpose of these conditions is to restrict entitlement holders, in most situations, to a cause of action against the securities intermediary. The rationale behind imposing such high requirements for an entitlement holder to assert its interest against a purchaser of property rights in any financial asset is that an entitlement holder should typically look only to its intermediary for performance of the obligations that constitute a securities entitlement. Unlike the common-law concepts behind the 1977 version of UCC Article 8 (which relied on claims to specific physical certificates), the 1994 version of UCC Article 8 ultimately creates a new type of property interest that is not a claim to a specific identifiable thing. Instead, it is a package of rights and interests that a person has against its intermediary and the property held by it.⁴⁹²

In addition, it is worth noting that one of the requirements under § 8-503(d)(3) is that the insolvent intermediary's must have violated its obligation to maintain sufficient financial assets. Therefore, from a procedural viewpoint, it is only after the resolution of litigation regarding the intermediary's violation of its duty under § 8-504 that the account holder will be able to enforce its property rights against the transferee. This was confirmed in the *Drage* case⁴⁹³, where the court held that a suit against the intermediary violating a duty under § 8-507(b) should be resolved before initiating a suit against the transferee under § 8-503(e).⁴⁹⁴

3. *Aspects of Personal Rights*

As mentioned above, a security entitlement is to be exercised only vis-à-vis the relevant intermediary; only exceptionally can it be exercised against a limited class of third persons under §§ 9-503(d) and 8-503(e). The following section complements the foregoing analysis of the property-like aspects of the security entitlement concept by exploring the core aspect of a security entitlement as duties of an intermediary as per §§ 9-504 through 8-509. Under § 8-504(a) sentence 1, an intermediary must promptly obtain, and thereafter

⁴⁹² Francis J. Facciolo (*supra* n 457) 624.

⁴⁹³ *Nathan W. Drage, P.C. v First Concord Securities, Ltd., et al.* [2000] Supreme Court, New York County, 184 Misc.2d 92, 707 N.Y.S.2d 782.

⁴⁹⁴ For more information on the *Drage* case, see Howard Darmstadter, 'Three Article 8 Cases' (2002) 57 *Business Lawyer* 1741, 1746–1750.

maintain, a financial asset in a quantity corresponding to the aggregate of all security entitlements it has established in favour of its entitlement holders with respect to that financial asset. The intermediary may maintain those financial assets directly or through one or more other intermediaries (§ 8-504(a) sentence 2).⁴⁹⁵ In addition, § 8-504(b) provides that an intermediary may not grant security interests in the financial assets it is obligated to maintain under § 8-504(a) on behalf of its customers. The only exception to this prohibition is if there is an agreement of the intermediary's entitlement holder.⁴⁹⁶ It is worth noting that a written pledge agreement is not required under UCC Article 8. Nor does Article 8 require such agreement to be entered every single time a security interest in a customer's securities is granted.⁴⁹⁷ However, under federal securities regulations, brokers are required to obtain *explicit consent* from their customers before encumbering customers' securities; it is a violation of federal securities law for an intermediary to encumber a customer's security interest without such consent. Moreover, SEC Rules 8c-1 and 15c2-1 allow pledges of investors' securities only for the purpose of funding loans to the investors.

If the issuer of a financial asset makes a payment or distribution, § 8-505(a) requires that the intermediary take action to obtain it. Further, § 8-505(b) obliges the intermediary to pass it through to the customers that hold security interests vis-à-vis the financial asset. But if the issuer of the financial asset becomes insolvent and cannot make the payment, the intermediary is under no duty to take measures to enforce the issuer's duty to pay. Moreover, under § 8-509(c), the obligation of a securities intermediary to perform the duties imposed by §§ 9-504 through 8-508 is subject to (i) rights of the intermediary arising out of a security interest under a security agreement with the entitlement holder or otherwise; and (ii) rights of the intermediary under another law, regulation, rule, or agreement to withhold performance of its duties as a result of unfulfilled obligations of the entitlement holder to the securities intermediary.

As mentioned above, a security entitlement is based on a relationship between the investor and the intermediary. Hence, if an investor desires to exercise its rights (such as voting rights, for instance), it may exercise them via its intermediary. This explains why § 8-506 obligates the intermediary to exercise these rights upon its customer's instruction. Subject to any specific agreement, a intermediary may fulfil this obligation by placing the customer in a position to exercise its rights directly or by exercising due care in ac-

⁴⁹⁵ It is through § 8-504(a) second sentence that the multi-tiered holding pattern is recognised in the US system.

⁴⁹⁶ The rationale behind § 8-504(b) is that an intermediary does not hold financial assets for its own purpose (Changmin Chun (*supra* n 143) 217).

⁴⁹⁷ See Article 12(1) of the *Depotgesetz*.

cordance with reasonable commercial standards. Absent instructions from its customer, the intermediary is not required to exercise rights. Furthermore, unlike Article 10(2)(e) of the Geneva Securities Convention, which imposes on the intermediary a duty to pass on to its account holders any relevant information necessary for them to exercise their rights,⁴⁹⁸ UCC Article 8 no duty on an intermediary to relay information it receives about the asset.

Moreover, the intermediary has an obligation to comply with its customers' entitlement orders. § 8-102(a)(8) defines an entitlement order as an instruction⁴⁹⁹ or direction related to disposition or redemption of securities. Though a sale order implies a disposition, an entitlement order differs from other trade orders. § 8-507(a) provides the following alternative conditions in which an intermediary is obliged to obey an entitlement order: "(1) the securities intermediary acts with respect to the duty as agreed upon by the entitlement holder and the securities intermediary; or (2) in the absence of agreement, the securities intermediary exercises due care in accordance with reasonable commercial standards to comply with the entitlement order."

Additionally, an intermediary must act pursuant its customers' instructions to change a security entitlement into another available form of holding, such as physical securities certificates if individual securities certificates are available or registration of the customer on the issuer's books if the underlying financial asset is dematerialised (§ 8-508). An intermediary satisfies the duty (i) if it acts as agreed upon with the entitlement holder or (ii) if, in the absence of agreement, it exercises due care in accordance with reasonable commercial standards to follow the direction of the entitlement holder.

Finally, § 8-506(a) provides that if the substance of a duty imposed upon an intermediary by §§ 9-504 through 8-508 is the subject of other statute, regulation, or rule, then compliance with that statute, regulation, or rule satisfies the duty. An intermediary is not required to take any action that other statutes, regulation, or rule prohibit (§ 8-509(d)). In addition, § 8-509(c) provides that the obligation of an intermediary to perform the duties imposed by §§ 9-504 through 8-508 is subject to (i) rights of the intermediary arising out of a security interest under a security agreement with the entitlement holder or otherwise; and (ii) rights of the intermediary under other law, regulation, rule, or agreement to withhold performance of its duties as a result of unfulfilled obligations of the entitlement holder to the intermediary.

⁴⁹⁸ Nevertheless, Article 10(2)(e) of the Geneva Securities Convention applies only if provided by the non-Convention law, the account agreement, or the uniform rules of a securities settlement system.

⁴⁹⁹ See § 8-102(a)(12).

C. *Perfection of Security Interests in Investment Property*

I. *Introduction*

The rules governing security interests in investment securities were considered to be among the most important in commercial law concerning investment securities. Accordingly, one of the major goals of the 1994 revision of UCC Article 8 was to ensure that the commercial law rules concerning security interests in investment securities were sufficiently simple and certain – to develop adequate rules not only for the wide variety of transactions in which securities are used as collateral, but also for arrangements that may evolve in the future.⁵⁰⁰

The 1994 version of UCC Article 8 simplified the rules governing attachment, perfection, and priority of security interests⁵⁰¹ in investment property⁵⁰². Indeed, it removed the nebulous concepts of “transfer” and “constructive possession” found in former section 8-313.⁵⁰³ Under the 1994 revision, a security interest in securities can arise the same way one in any other form of property can: by agreement between the debtor and the secured party. For the creation of an effective security interest, the 1994 version of UCC Article 8 does not require any “transfer,” “delivery,” or any similar action, physical or metaphysical.

The current version of UCC Article 8 returns to the pre-1977 structure in which the rules in respect of attachment and perfection of security interests in securities are set out in UCC Article 9.⁵⁰⁴ This constituted a reversal of the reorganisation effected by the 1977 version of UCC Article 8, under which UCC Article 8 covered the requirements for attachment and perfection of a security interest while UCC Article 9 governed (as usual) priority and other issues concerning security interests in investment securities. The goal of the drafters of the 1994 version of UCC Article 8 was to avoid disrupting the rules of UCC Article 9 by including *all* the principal rules in respect of security interests in investment property in § 9-115 of the UCC and by incorporat-

⁵⁰⁰ James Steven Rogers (*supra* n 373) 1473.

⁵⁰¹ UCC section 1-201(37) defines “security interest” as “an interest in personal property [...] which secures payment or performance of an obligation.”

⁵⁰² As mentioned above, the term “investment property” is a new general category of collateral. UCC Article 8 broadly defines it as including securities, security entitlements, securities accounts, commodity contracts, and commodity accounts. In the conforming amendments of UCC Article 9, “investment property” is specifically excluded from the definition of goods, instruments, and general intangibles. *See* Everette L. Martin (*supra* n 367) fn 3.

⁵⁰³ “[A]lthough the draftsman obviously had no quarrel with actual, physical possession, the Official Notes damn the entire idea of constructive possession and propose to expel it from this area of the law” (C995 ALI-ABA 643, 21).

⁵⁰⁴ 2C U.L.A. Revised Article 8 (1994) Investment Securities, Prefatory Note, 44 (Supp.1996); James Steven Rogers (*supra* n 373) 1473; Max Johann Lipsky, *Statutenwechsel im italienischen Sachenrecht – Auswirkungen auf den Im- und Export von Mobiliarsicherheiten* (Peter Lang, Frankfurt am Main 2011) 290.

ing additional rules to govern corresponding issues for other forms of collateral.⁵⁰⁵ Nevertheless, the general concepts, rules, and terms of the 1994 version of UCC Article 8 still govern issues that § 9-115 does not address.⁵⁰⁶

The 1994 version of UCC Article 8 introduces “investment property”, a new defined term that supplies a general collateral category to encompass investment securities and related property. The concept of investment property plays an important role in the structure of UCC Article 9, akin to the categories “instruments”, “chattel paper”, “goods”, “accounts”, and “general intangibles”. It includes interests not only in securities (whether held directly or indirectly) but also in other financial assets held through securities accounts as well as interests in commodity contracts. UCC Article 9 applies “to any transaction (regardless of its form) which is intended to create a security interest in personal property.”⁵⁰⁷

II. Attachment and Perfection

The familiar rules in § 9-203 govern attachment of a security interest in investment property, including intermediated securities. Under these rules, a security interest attaches when:

- (i) There is a written security agreement describing the collateral or the secured party takes possession;
- (ii) The debtor has rights in the collateral; and
- (iii) The secured party gives value.

The new rules on attachment of security interests in investment property involve only relatively modest adaptations of these familiar principles.⁵⁰⁸ The perfection of a security interest in investment property may occur in one of the two following ways:⁵⁰⁹

⁵⁰⁵ Everette L. Martin (*supra* n 367) 17.

⁵⁰⁶ UCC § 9-115 cmt. 1 (1994).

⁵⁰⁷ UCC § 9-102(1)(a) (1995).

⁵⁰⁸ See UCC § 9-203(1)(a) (1994); UCC § 9-115(2) (attachment of security interest in securities account or commodity account); § 9-115(3) (description of investment property in security agreement); § 9-115(6) (security interest in unendorsed registered securities by possession).

⁵⁰⁹ It is worth noting that under 1995 Louisiana Acts 884, which enacted the revised provisions of Louisiana (La.) UCC Articles 8 and 9 relative to investment securities, there was a three-year transition rule within which a lender who perfected a pre-1996 Louisiana UCC Article 8 security interest in uncertificated securities by notice to the third-party holder or issuer of the securities (old La UCC § 8-313(1)(h)) had to re-perfect its security interest either by filing a UCC-1 financing statement (Filing Perfection, La. UCC § 9-115(4)(b)), or by taking control (La. UCC § 8-106) over the investment property (Control Perfection). See La. UCC § 9-115(4)(a).

- (i) By the filing of a UCC-1 financing statement,⁵¹⁰ or
- (ii) By control.

“Control” is a new concept the drafters created to replace the common-law principles of possession and constructive possession which had led to uncertainty and confusion when applied to the intermediated system.⁵¹¹ The test to determine whether a secured party has “control” is whether the secured party is allowed to sell the collateral without further consent or action by the debtor. Amended UCC Article 9 incorporates the definition of control from § 8-106 of the UCC for certificated securities, uncertificated securities, and security entitlements. With respect to security accounts, “control” is defined in § 9-115(1)(e); the definition there is derived from the definition of control regarding security entitlements in § 8-106(d) and (e). Its location in UCC Article 9 rather than in UCC Article 8 is a consequence of technical details of the drafting structure: UCC Article 8 addresses mechanisms for transferring interests in securities and deals with creating and transferring interests in specific securities. It was thought however that it would be convenient to have, in UCC Article 9, a simple mechanism for establishing a security interest in all positions held by the debtor or in all positions held through a certain account. A collective description of a “security account” was included as one of the sub-categories of “investment property”; and against this background, the definition of “control” in UCC Article 8, which is written with an eye to security entitlements, had to be adapted to the concept of a security interest in a securities account. § 9-115(1)(e) serves that very purpose.⁵¹²

Obtaining “control” means that the secured party has ensured, given the manner in which the securities are held, that it has placed itself in a position where it can have the securities sold without further action by the debtor. The way a financial asset is held determines the specific means of obtaining “con-

⁵¹⁰ In order to perfect by filing, the secured party must also have a written security agreement (Everette L. Martin (*supra* n 367) 18. A UCC-1 financing statement is a legal form filed by a creditor to give notice that it has or may have an interest in the personal property of a debtor. It allows a creditor to “perfect” a security interest by giving public notice that there is a right to take possession of and sell certain assets for repayment of a specific debt with a certain priority (Jens Hausmann, ‘The Value of Public-Notice Filing under Uniform Commercial Code Article 9: A Comparison with the German Legal System of Securities in Personal Property’ (1996) 25 *Georgia Journal of International and Comparative Law* 427, 428). As per UCC § 9-503 and 9-504, the financing statement need only contain three pieces of information: (i) the debtor’s name and address; (ii) the creditor’s name and address, and (iii) an indication of the collateral, “whether or not it is specific, if it reasonably identifies what is described” (UCC § 9-108).

⁵¹¹ If the collateral is investment property and if the secured party obtains control pursuant to an agreement with the debtor, there is no requirement of a signed security agreement (*see* Arkansas Code Annotated § 4-9-203(1)(a)).

⁵¹² James Steven Rogers (*supra* n 373) fn 72.

trol”: possession gives the secured party control of certificated securities in bearer form.⁵¹³ Control of a certificated security in registered form can be acquired by delivery *plus* an endorsement to the purchaser in blank or registration of the certificate in the name of the secured party. Hence, if a secured party merely takes possession of a certificated security in registered form but does not take the additional steps of having the certificate endorsed or registered, it does not have “control”.⁵¹⁴

There are two means of obtaining control of uncertificated securities. One is for a secured party to obtain control by having it “delivered to the purchaser”⁵¹⁵. Under § 8-301(b) of the UCC, delivery of an uncertificated security occurs when the purchaser becomes a registered holder or when a person other than a securities intermediary either becomes the registered owner on behalf of secured party or acknowledges that it holds the uncertificated security for the secured party. The other, provided under § 8-106(c)(2) of the UCC, is for the secured party to have the issuer agree to act according to its instructions and without the registered owner’s further consent. This option allows the secured party to permit the registered owner to trade on securities positions as listed while the security interest is maintained.

Under UCC Article 8, a secured party may obtain control through an agreement with the issuer. However, there is no *requirement* that the issuer recognise the assignment even if the entitlement holder directs the securities intermediary to do so. Moreover, if the issuer does agree to recognise the secured party’s interest, it is still not *required* to confirm the existence of the agreement to another party except when requested to do so by the registered owner and pledgee.⁵¹⁶

The ways of obtaining control of a security entitlement are parallel to those used to obtain control of an uncertificated security:

- (i) Become the entitlement holder, or
- (ii) Obtain an agreement from the securities intermediary that it will follow the secured party’s instructions without further consent of the entitlement holder.

⁵¹³ §§ 8-106(a), 8-301(a). See also Arkansas Code Annotated § 4-8-106(a).

⁵¹⁴ Everette L. Martin (*supra* n 367) 21.

⁵¹⁵ UCC § 8-106(c)(1) (1994).

⁵¹⁶ UCC § 8-408 (1990).

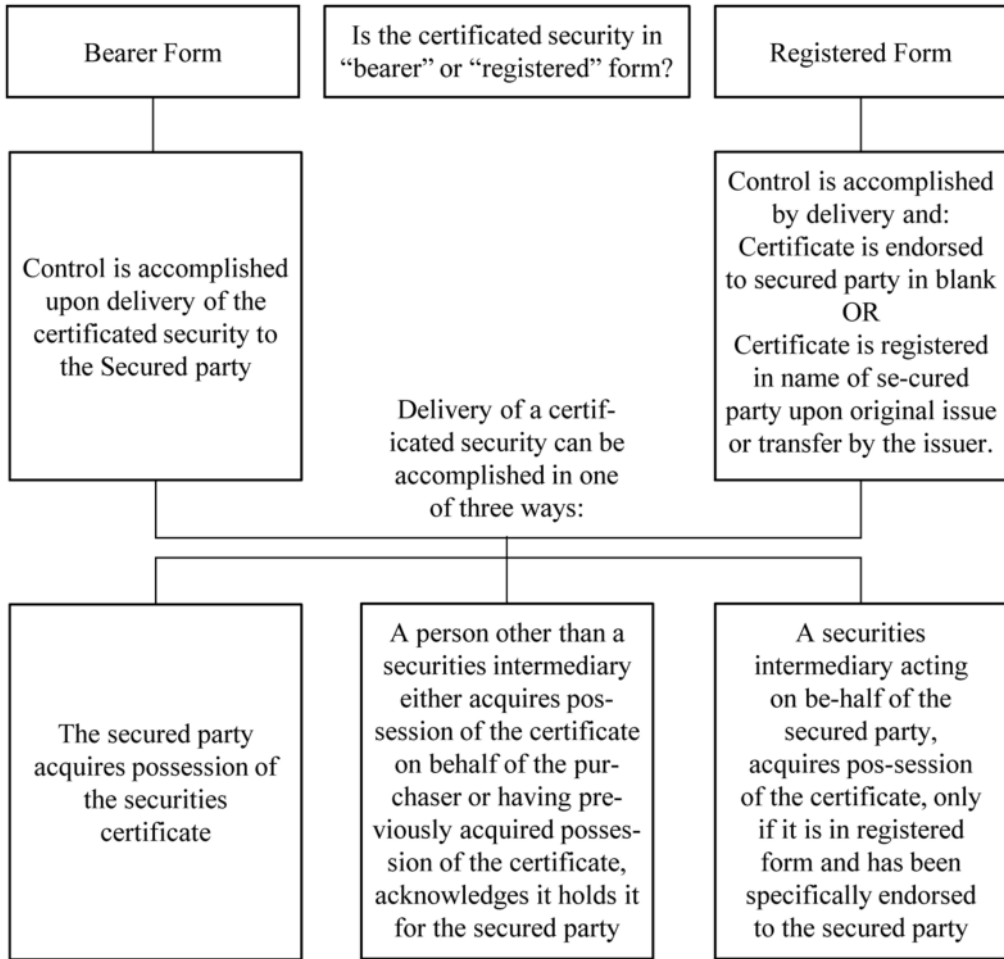


Figure 13: Method of Obtaining Control of Certificated Securities

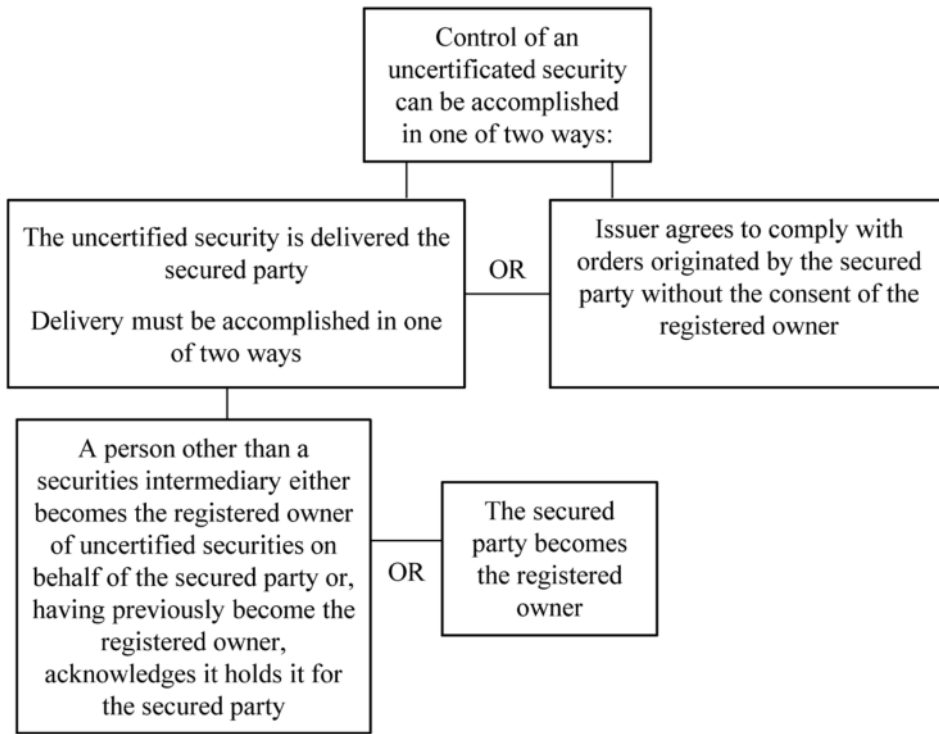


Figure 14: Methods of Obtaining Control of an Uncertificated Security⁵¹⁷

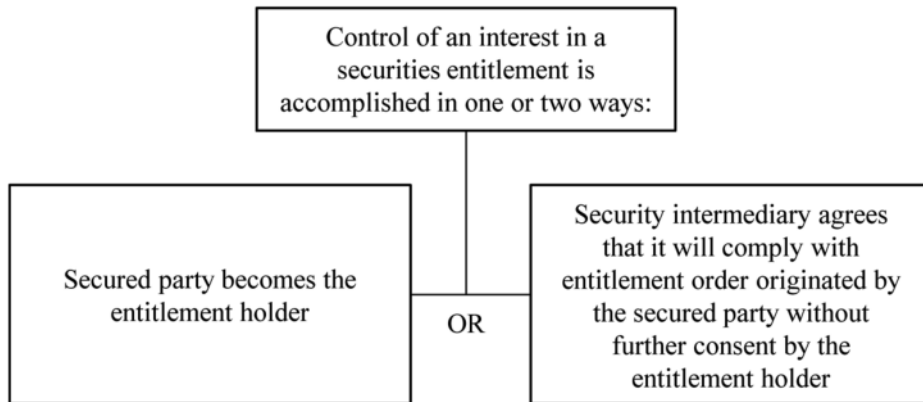


Figure 15: Methods of Obtaining Control of Security Entitlements⁵¹⁸

⁵¹⁷ Source: Everette L. Martin (*supra* n 367) 20.

⁵¹⁸ It is important to note that the securities intermediary must obtain the consent of the entitlement holder. However, entering into such an agreement is not *required*, even in the event the entitlement holder so requests.

It is important to highlight that the concept of “control” does not mean absolute and complete control, and there is no requirement that the powers held by the purchaser be exclusive.⁵¹⁹ Without losing “control” of its collateral, a secured party can permit the debtor to maintain the right to make substitutions or to direct the disposition of the security entitlement.⁵²⁰ Therefore, under § 8-106(f) of the UCC, a secured party may share control of a security entitlement with a debtor, thereby providing greater flexibility in the use of securities accounts as collateral while maintaining priority over other secured parties who do not have “control”.⁵²¹ The advantages and the disadvantages of shared control can be described as follows:

“The disadvantage of this method, obviously, is that, by giving the debtor flexibility to deal in financial assets held through a securities account, the secured party loses some of its ability to protect itself from debtor misbehaviour. This is, however, no different from the risk faced by any secured creditor who allows its debtor to retain “possession” and the power to deal in collateral (such as in a typical inventory security arrangement). Indeed, the position of a secured party perfecting a security interest in securities entitlements by “control” is somewhat better than the inventory financier who perfects by filing. This is because the agreement between the secured party and the securities intermediary could provide that the securities intermediary will obey disposition orders only if certain contractual conditions are met — [e.g.], the intermediary shall not obey a debtor’s instruction received after notice of default sent by a secured party. In other words, arrangements could be made with a securities intermediary which would provide policing functions for the secured party somewhat similar to those provided by a traditional field warehouse for ordinary goods”.⁵²²

Since an agreement with the securities intermediary requires the consent of the entitlement holder and is typically signed by the secured party, it can be regarded as a “tri-party control agreement”⁵²³. However, because of the variety of duties which over-zealous counsellors of the lender may place on securities intermediaries, they hesitate to sign tri-party control agreements.⁵²⁴ Under the 1994 version of UCC Article 8, a securities intermediary can freely decide whether to enter into such an agreement. Additionally, except for securities intermediaries and brokers, one can also perfect a security interest by filing a UCC-1 financing statement under section 9-115(4)(b). However, the secured party does not gain “control” over (meaning an ability to sell) the security only by filing a financing statement; a secured party who perfects merely by

⁵¹⁹ U.C.C. § 8-106 cmt. 7.

⁵²⁰ Jeanne L. Schroeder (*supra* n 377) 389.

⁵²¹ Everette L. Martin (*supra* n 367) 23.

⁵²² Jeanne L. Schroeder (*supra* n 377) 389.

⁵²³ Everette L. Martin (*supra* n 367) 24, 29.

⁵²⁴ See Everette L. Martin (*supra* n 367) fn 107, who contends that brokerage firms are less likely to enter into these agreements and that banks holding securities in their custodial accounts tend to be more agreeable.

filing is therefore subject to being primed by a secured party who perfected its interest by “control”.⁵²⁵

D. Priorities

A secured party’s priority is determined by the concept of “control”,⁵²⁶ the general rule being the greater the control, the higher priority the security interest will have.⁵²⁷ This rule is the statutory expression of the structural principle upon which the secured transactions rules of revised Articles 8 and 9 UCC are based.⁵²⁸ It applies as follows: Assume J seeks an advance of value from K and offers as collateral securities that K holds in such fashion that K has the power to have the securities sold without further actions by J. In such a case, K should be able to proceed without fear that J may have granted a conflicting interest to some other party.

§ 9-115(5)(a) provides that “[a] security interest of a secured party who has control over investment property has priority over a security interest of a secured party who does not have control over the investment property.”⁵²⁹ Paragraph (c) of UCC § 9-115(5) provides that unless the parties agree otherwise, a security interest granted to a debtor’s own intermediary has priority over other security interests.⁵³⁰ If two secured parties have control and neither is an intermediary, each of them has a *pro rata* interest in such investment property. The customary rule *qui prior est tempore, potior est jure* does not apply; however, the solution varies depending on whether the debtor or the secured party is an intermediary, as depicted in the following figure.

⁵²⁵ Nevertheless, if the debtor was not a securities intermediary and neither secured party had “control”, the customary rules with respect to “first in time–first in right” will apply (Everette L. Martin (*supra* n 367) 25).

⁵²⁶ Everette L. Martin (*supra* n 367) 25.

⁵²⁷ UCC § 9-115(5) (1994).

⁵²⁸ James Steven Rogers (*supra* n 373) 1477.

⁵²⁹ The rest of subsection (5) of § 9-115 addresses several matters subsidiary to the general principal embodied in the control priority rule, including establishing rules for situations where both or neither secured party has obtained control.

⁵³⁰ The text of § 9-115(5)(c) is as follows: “Except as otherwise agreed by the securities intermediary, a security interest in a security entitlement or a securities account granted to the debtor’s own securities intermediary has priority over any security interest granted by the debtor to another secured party. An analogous rule for commodity intermediaries is set out in § 9-115(5)(d): Except as otherwise agreed by the commodity intermediary, a security interest in a commodity contract or a commodity account granted to the debtor’s own commodity intermediary has priority over any security interest granted by the debtor to another secured party.” For a detailed analysis of security interests granted to a debtor’s own intermediary, see Simon Schwarz (*supra* n 12) 409.

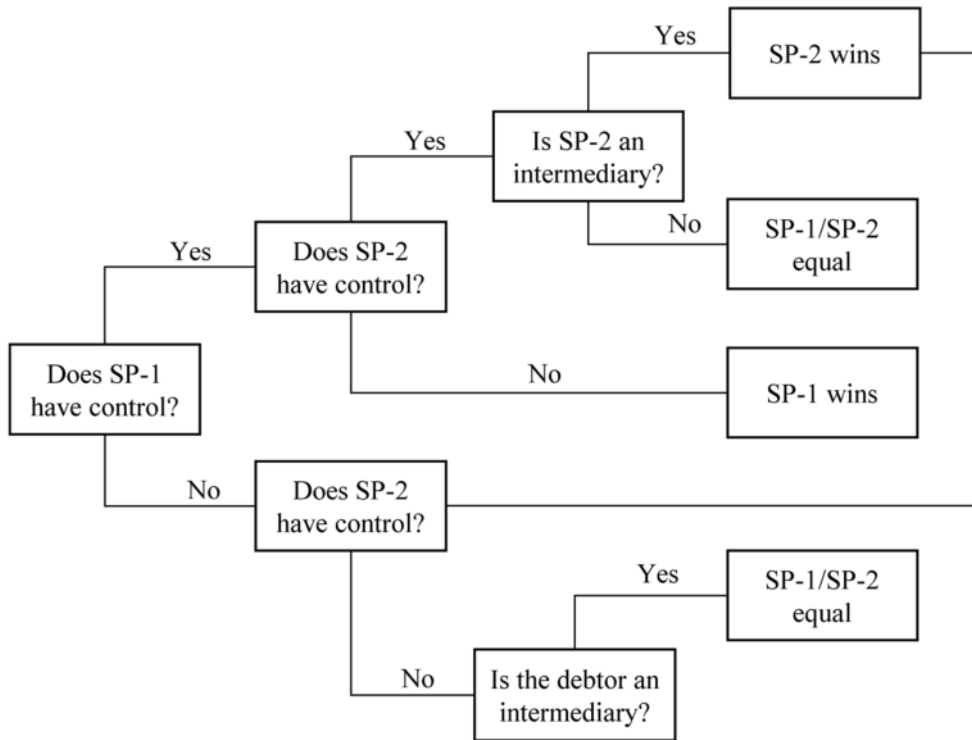


Figure 16: Priority of Security Interests in Investment Property⁵³¹

E. Summary and Evaluation

1. The intermediated system in the US is mainly organised by Part 5 of UCC Article 8 and by further provisions of UCC Article 9. In the intermediated system in the United States, an investor holds a “security entitlement”, which is not an interest in any particular security but rather is a bundle of rights and a property interest of an entitlement holder in a financial asset of a kind specified in § 8-102(a)(9). From the standpoint of OHADA law, a security entitlement amounts to a packaged aggregate composed of rights *in personam* with some characteristics of rights *in rem*.
2. Because of the importance of the intermediary relationship, the intermediary system in the United States is an intermediary-centred regime. Securities accounts consequently play a key role. They are created by a consensual agreement which must entitle the account holder to exercise certain rights. The liberal approach embodied in UCC Articles 8 and 9 as well as the importance given to the securities account and the account agreement all lay the some of the groundwork for the private international law discussion that follows in Part III of this thesis (*see* in particular Chapters III and IV of Part III). More particularly, it will be established that the Uniform Commercial Code and the Hague Securities Convention

⁵³¹ Source: Everette L. Martin (*supra* n 367) 26.

both determine the law applicable to certain rights in respect of intermediated securities by reference to the choice of law made by the account holder and its intermediary in the agreement that governs the relevant securities account.

3. In addition, since a security entitlement is in essence a claim vis-à-vis the specific intermediary of an entitlement holder, the US intermediary system is constructed “account by account” or “stage by stage”. Under § 8-501, an account holder acquires a security entitlement when a financial asset is or may be credited to its securities account. As discussed *infra* (see chapter 4 of part III of this thesis), the “stage by stage” approach embodied in UCC Articles 8 and 9 inspired the contents of both the Geneva Securities Convention and (more importantly for the subject matter of this thesis) the Hague Securities Convention.
4. The revision of UCC Article 8 was a response to concerns numerous governmental bodies and others had expressed that the structure of the prior version was inadequate for the modern book-entry system of securities holding and transfer. The 1994 version simplified the law governing attachment and perfection of security interests in investment property. It was a return to the pre-1977 structure, under which the rules on attachment and perfection of security interests in securities are set out in UCC Article 9.

Part III

Conflict of Laws Analysis

Chapter 1: The *lex rei sitae* (*lex cartae sitae*) Rule in the OHADA Region

A. General Overview of OHADA's Private International Law

I. Lesser Importance of Conflict of Laws Issues in OHADA's Legislative Agenda

As indicated *supra*,¹ OHADA is aimed at unifying business law in Africa. However, the term “business law” is very broad as it includes the regulation of various components of an economy: the legal rules in respect of credit, competition, economic actors (traders, commercial companies, trade intermediaries, etc.), goods and services, and economic activities (such as production, distribution, consumption, etc.).² Hence, Article 2 of the OHADA Treaty³ restrictively lists the areas of law which OHADA may unify. In March 2001, the OHADA Council of Ministers decided to extend the list of areas of law that could be harmonised by OHADA to include competition law, banking law, intellectual property law, contract law, and the law of evidence.⁴ Interestingly, neither the list provided in Article 2 of the OHADA Treaty nor the 2001 Decision of the OHADA Council of Ministers mentions conflict of laws issues, international jurisdiction, or the recognition and enforcement of foreign judgments. In that regard, *Oppong* aptly notes that despite decades of economic integration in Africa, none of the communities have had private

¹ See part I, chapter 1, section B of this thesis.

² Joseph Issa-Sayegh & Jacqueline Lohoues-Oble, *Harmonisation du droit des affaires* (Bruylant, Brussels 2002) ss 259–261.

³ “So as to implement the present Treaty, it is to be understood by business law regulations concerning company law, definition and classification of legal persons engaged in trade, proceeding in respect credits and recovery of debts, legal enforcement, bankruptcy, arbitration, employment law, accounting law, transportation law, sales laws, and any other matter that the Council of Ministers would unanimously decide to include [my emphasis] as falling within the definition of business law [...]”

⁴ J.O. OHADA n° 12, 2003, 6. The text of the Conclusions of the 2002 meeting of the OHADA Council of Ministers is available at <http://www.idcafrique.org/sites/default/files/journaux_officiels/12%20journal_officiel_n_12_0.pdf> (accessed 4 January 2021).

international law on their agenda.⁵ Unfortunately, this observation applies to OHADA as well. Yet the unification of private international law remains most indispensable to achieving legal certainty and predictability, in the OHADA region in particular but also in Africa in general.

The main reason behind the lack of emphasis on conflict of laws under OHADA law can be found in OHADA's unification technique itself, which leaves very little room for national law. Indeed, as mentioned above, OHADA does not harmonise business law but rather is aimed at *unifying* the various areas of law listed in Article 2 of the OHADA Treaty or unanimously determined by the OHADA Council of Ministers. This leaves virtually no room for differences among the national laws of the Member States. It would *seem*, consequently, that unifying these areas of law would relieve courts in OHADA Member States from having to cope with choice of law issues, since all the Member States apply the very same (unified) law.⁶ For example, an international sales agreement between A (a Congolese trader domiciled in Kinshasa, Democratic Republic of the Congo) and B (a Senegalese trader domiciled in Dakar, Senegal), concluded in Lomé (Togo), will be governed by Articles 234 to 302 of the Uniform Act on General Commercial Law. The courts in the OHADA region would not have to cope with conflict of laws questions since the laws of Senegal, the Democratic Republic of the Congo, Togo, or any other OHADA Member State would yield the same result.

However, this approach is ill-conceived. It does not take into account the high probability that an international situation can involve a foreign element that neither located in nor has any link to an OHADA Member State. In the same illustration given above, assume the sales agreement is concluded between A (a Congolese trader domiciled in Kinshasa) and G (a Senegalese trader domiciled in London) and concluded in Paris (France); the sales agreement relates to sardine cans to be delivered in Kinshasa (Democratic Republic of the Congo). In such a case, the courts of the OHADA Member States will not apply the Uniform Act on General Commercial Law right away. Rather, they will first and foremost resort to the conflict of laws rules first to determine which law will govern the contract.

Yet there are no uniform conflict of laws rules regarding the law applicable to contractual obligations under OHADA law in the absence of a choice of law provision in the contract.⁷ Therefore, pursuant to Article 10 of the OHADA Treaty, the conflict of laws rules of the Member States will apply,

⁵ Richard Frimpong Oppong, 'Globalization and Private International Law in Commonwealth Africa' (2014) 36 University of Arkansas at Little Rock Law Review 153.

⁶ This is further analysed in chapter 5 of this part of the thesis (the so-called "substantive law solution").

⁷ Subject to Articles 234, 235, and 236 of the Uniform Act on General Commercial Law.

and the Uniform Act on General Commercial Law will govern the sales agreement only if the conflict of laws rules of the forum point to the law of an OHADA Member State (Article 234(2) of the Uniform Act on General Commercial Law). Conversely, if the conflict of laws rules lead to the application of a non-Member State, OHADA law would not apply. This illustration demonstrates that the unification of the *substantive rules* does not eliminate the need of the unification of conflict of laws rules.

II. *Scarce Conflict of Laws Rules under OHADA Law*⁸

The foregoing critique notwithstanding, there are a few, scarce provisions which address conflict of laws issues under OHADA law in exceptional situations. These provisions are enshrined in the Uniform Act on Arbitration and the Arbitration Rules of Procedure of the CCJA. The OHADA Treaty contains provisions on international (institutional) arbitration (Articles 21 to 26 of the OHADA Treaty), and in OHADA law there are also specific private international law provisions in various Uniform Acts. For instance, OHADA recognises the principle of party autonomy in respect of choice of law in international commercial contracts, as does the legislation of all OHADA Member States.⁹ Indeed, the 2010 revision of the Uniform Act on General

⁸ As the title suggests, this section focuses solely on *conflict of laws* rules. Space will not allow an analysis of the exceptional private international law rules under OHADA in respect of international jurisdiction and of the recognition and enforcement of foreign judgments and public documents. These subjects are beyond the scope of this study. However, the following elements bear mention nonetheless: A) For more details on OHADA law provisions on international jurisdiction, *see* for instance Articles 3-1, 4-17, 15 of the Uniform Act on Collective Proceedings for the Clearing of Debts; *Brasseries du Burkina (Brakina) v La Société Locamat Sarl & Carron Charles Christian* [2006] Tribunal de Grande Instance de Ouagadougou, Judgment n° 153/2006 of 5 April 2006; B) For more details on choice of courts agreements under OHADA law, *see* Article 27 1°) of the Uniform Act on Contracts of Carriage of Goods by Road; Article 132 of the Uniform Act on General Commercial Law; *La Compagnie Delmas v Compagnie Axa Assurances Côte d'Ivoire (Ex-Union Africaine)* [2007] Supreme Court of Côte d'Ivoire, Judgment n° 204/07 of 12 April 2007, *Actualités Juridiques* n° 57 153; *Sobitraf v Banque of Africa(BOA)* [2008] Tribunal de Grande Instance de Ouagadougou (Burkina Faso), Judgment n° 074/2008 of 9 April 2008; C) In respect of recognition and enforcement of foreign judgments under OHADA law, *see* Article 27 3°) of the Uniform Act on Contracts of Carriage of Goods by Road; Article 20 of the OHADA Treaty; moreover, Article 247 et seq of the Uniform Act on Collective Proceedings for the Clearing of Debts governs the recognition of decisions to initiate and close bankruptcy proceedings issued in OHADA Member States and outside the OHADA region.

⁹ *See* for instance in the Democratic Republic of the Congo Article 11 of the Decree of 4 May 1895 (*Bulletin Officiel*, 1895, 138); in Central African Republic Article 42.1 of Law n° 65-71 of 3 June 1965 regarding the obligatory force of laws and the conflict of laws in time and space, effective on 1 July 1965; in Chad Article 70.6 of Ordinance n° 6 of

Commercial Law introduced a new provision that allows parties to an international sales agreement to choose the applicable law (Article 234(2) of the Uniform Act on General Commercial Law):¹⁰

“*Unless otherwise stipulated* [my emphasis], the commercial sale contract shall be subject to the provisions of this Book insofar as the contractors have their registered office in one of the States parties or when the rules of private international law lead to the application of the law of a State party.”

The phrase “unless otherwise stipulated” enshrines the recognition of party autonomy under OHADA law.¹¹ Before the 2010 revision of the Uniform Act on General Commercial Law, the Court of Appeal of Ouagadougou in 2009 had already recognised the parties’ ability to choose the law applicable to an international sales agreement.¹² However, the court’s decision as well as Article 243(2) of the Uniform Act on General Commercial Law is limited to

21 March 1967 for the Reform of Judicial Organisation; in the Republic of Congo Article 826 of Law n° 073/1984 of 17 October 1984; in Gabon Article 55 of the of the Civil Code; in Guinea-Bissau Article 41 of the Civil Code of Guinea-Bissau (initially enacted by the Portuguese Ordinance n° 22-869 of 4 September 1967 and renewed by Guinea-Bissau Law n° 1-73 of 27 September 1973, published in Boletim Oficial n° 1, of 4 January 1975). Note that the codifications of Burkina Faso, the Republic of the Congo (also known as Congo-Brazzaville), Senegal, and Togo are limited to matters of personal status, family law, and succession. They do not address contracts in general. Nevertheless, these codifications allow party autonomy in testaments and donations. *See* also in Burkina Faso Articles 1047–1048 of the Code of Persons and Family (Law VII 0013 of 19 November 1989, effective 4 August 1990; in Senegal Article 848 of the Family Code of Senegal (Law n° 76-61 of June 1972, Official Journal of Republic of Senegal n° 4243 of 12 August 1972, 1295); in Togo Articles 722 and 724 of the Code of Persons and Family (Law 80-16 of 31 January 1980 as revised by Law of 29 June 2012).

¹⁰ *See* Articles 202 to 288 of the earlier version of the Uniform Act on General Commercial Law. For more details on the regulation of sales agreement under the former version of the Uniform Act on General Commercial Law, *see* Akuété Pedro Santos & Jean Yado Toé, *OHADA: Droit commercial général* (Bruxelles, Bruylant 2002) para. 539.

¹¹ Article 234 of the Uniform Act on General Commercial Law does not determine whether parties can choose rules of law to govern their contract. Hence, under Article 10 of the OHADA Treaty, this question is governed by the national law of each Member State. No Member State of OHADA allows parties litigating in national courts to designate non-State law to govern their contract. Conversely, Article 15(1) first sentence of the Uniform Act on Arbitration Law allows the parties to choose not only State law, but also rules of law (*règles de droit*) to govern their arbitral proceedings. Unlike the Hague Principles on Choice of Law in International Commercial Contracts (Article 3), the Preliminary Draft does not allow parties to designate “rules of law” (*règles de droit*) to govern their contract.

¹² *Société industrielle des tubes d’acier (SITACI) SA v société française d’importation et d’exportation de produits métalliques (MISÉTAL) SA* [2009] Cour d’appel de Ouagadougou, Decision n° 025 of 15/05/2009, Ohadata J-10-211; *Eurasie-Afrique v Compagnie Internationale d’affrètement et de Transit (CIAT)* [2001] Cour d’appel de Ouagadougou, Decision n°89/2001, Ohadata J-06-64.

international commercial sales agreements, so OHADA law so far recognises party autonomy only in international commercial sales agreements falling within the scope of the Uniform Act on General Commercial Law. For all other international contracts, the parties' ability to choose the applicable law is subject to the national law of each Member State pursuant to Article 10 of the OHADA Treaty. Conversely, Article 575(1) first sentence of the Preliminary Draft establishes the parties' freedom to choose the law governing their contract: "The contract is governed by the law chosen by the parties." Unlike Article 234(2) of the Uniform Act on General Commercial Law, Article 575 of the Preliminary Draft applies to all types of international contracts, both civil and commercial.

As of January 2021, OHADA has not adopted provisions determining the law applicable to contractual obligations in the absence of a choice of law clause, and therefore, the domestic law of each Member State governs this issue pursuant to Article 10 of the OHADA Treaty. Nevertheless, the Preliminary Draft¹³ encompasses rules determining which state's law governs a contract in the absence of a choice of law by the parties: Article 576(1)(a) of the Preliminary Draft provides that a contract for the sale of goods is governed by the law of the country in which the seller has its habitual residence; Article 576(1)(b) provides that a contract for the provision of services is governed by the law of the country in which the service provider has its habitual residence. However, if it appears from all the circumstances of the case that the contract is manifestly more closely connected to a country other than the one referred to in Article 576(1) or (2) of the Preliminary Draft, the law of that country applies (Article 576(3) of the Preliminary Draft); if the applicable law cannot be determined on the basis of Article 576(1) or (2) of the Preliminary Draft, the contract is governed by the law of the country with which it has the closest connection.¹⁴

III. Lack of Conflict of Laws Provisions regarding Intermediated Securities at the OHADA Level

There is no provision among the few conflict of laws provisions in OHADA law, which are described above, that addresses the issue of the law applicable to certain rights in respect of securities held with an intermediary. And more particularly, there is no conflict of laws rule in respect of the law applicable

¹³ The genesis and the general contents of the Preliminary Draft have been analysed *supra* (part I, chapter 1, section D.I.5 of this thesis).

¹⁴ Additionally, Article 578 of the Preliminary Draft determines the law applicable to a contract entered into by the consumer for a purpose that may be regarded as extraneous to its professional activity with the professional acting in the exercise of its professional activity. Moreover, Article 580 of the Preliminary Draft determines the law applicable to individual employment contracts.

to security interests in intermediated securities. The Uniform Act on Commercial Companies and the Uniform Act on Security Interests cover only substantive law issues regarding the collateralisation of intermediated securities, so questions of what law applies to security interests in intermediated securities are governed by the national conflict of laws rules of each OHADA Member State. Indeed, Article 10 of the OHADA Treaty provides that Uniform Acts are directly applicable and of overriding force in the Member States notwithstanding any conflict with a previous or subsequently enacted municipal law. As established *supra*,¹⁵ this provision means that for any matter regulated by an instrument of OHADA, OHADA law trumps national law, and conversely any issue not regulated by OHADA law is governed by the national law of each Member State.¹⁶ It follows that since OHADA does not provide conflict of laws rules in respect of the collateralisation of intermediated securities, the question of what law applies is entirely governed by the conflict of laws provisions of each Member State.

B. The Law Applicable to Security Interests in Intermediated Securities under the National Laws of the OHADA Member States

I. The lex rei sitae Rule under the Laws of the OHADA Member States

The conflict of laws rule traditionally used in all the Member States to determine the enforceability of a pledge of securities effected in the intermediary system is the *lex rei sitae* (also referred to as the *lex cartae sitae* or the *lex situs*).¹⁷ For instance, under the law of Gabon, Article 44 of the Civil Code¹⁸ provides that tangible goods are subject to the law of the place where they are located.¹⁹ Article 45 of the Gabonese Civil Code contains a specific provision on securities, which provides:

“Transactions relating to debt securities are subject to the law of the debtor’s domicile. However, if the title is registered, the applicable law is that of the place where the register is located; if not, it is the law of the seat of the company which issued the title. In case of a bearer share, the applicable law is that of the place where the security is located at the time of the transactions.”²⁰

¹⁵ See part I, chapter 1, section D.I.3 of this thesis.

¹⁶ See Advisory Opinion n° 001/2001/EP.

¹⁷ Richard Potok, ‘Legal Certainty for Securities Held as Collateral’ (1999) 18 International Financial Law Review 12, 12.

¹⁸ *Journal Officiel de la République gabonaise*, September 1995.

¹⁹ The original version in French reads: “Les biens corporels sont soumis à la loi du lieu de leur situation.”

²⁰ The original version in French reads: “Les opérations concernant les titres de créance sont soumises à la loi du domicile du débiteur. Toutefois, si le titre est nominatif, la loi applicable est celle du lieu où se trouve le registre des transferts, à défaut, la loi du siège de

The law of the Democratic Republic of the Congo, unlike the Gabonese Civil Code, contains in Article 9 of the Decree of 4 May 1895²¹ a general conflict of laws provision which applies to all types of movable and immovable property: “Rights in both movable and immovable property are governed by the law in which such property is located”²². The law of Burkina Faso, under Articles 1002 and 1003 of the *Loi du 13 du 16 novembre 1989 portant institution et application d’un code des personnes et de la famille*²³, is vaguer as it merely refers to “the law with the closest connection” to the property.²⁴ The law of Guinea Bissau, under Article 46(1) of the *Código Civil*, provides: “The regime of ownership, property and other real rights is defined by the law of the State in whose territory things are situated.” Article 46(2) of the *Código Civil*²⁵ provides an exception in that in all matters relating to the constitution or transfer of *in rem* rights in transit, such movables are deemed to be situated in the country of destination.

In light of the above, the conflict of laws rule to determine the law applicable to *in rem* rights in respect of security interests in securities under the laws of virtually all the OHADA Member States is the *lex rei sitae*. Under this rule, the validity and the enforceability of a pledge is governed by the law of the place where the security is located.²⁶ In case of bearer securities,

l’établissement qui a émis le titre. Si le titre est au porteur ou à ordre, la loi applicable est celle du lieu où ce titre est situé au moment desdites opérations.”

²¹ B.O., 1895, 138. For more details on the applicability of the Decree of 4 May 1895, see Jean-Michel Kumbu & Justin Monsenepwo, ‘Problèmes actuels en droit international privé congolais liés à l’abrogation de l’article 915 de la loi 87-010’ (2018) 1 *Law in Africa* 52.

²² The original version in French reads: “Les droits sur les biens tant meubles qu’ immeubles sont régis par la loi où ces biens se trouvent”. See also Article 1002 of the *Loi du 13 du 16 novembre 1989 portant institution et application d’un code des personnes et de la famille* of Burkina Faso (available at <<http://data.unicef.org/wp-content/uploads/2017/12/CODE-DES-PERSONNES-ET-DE-LA-FAMILLE.pdf>> (accessed 4 January 2021)).

²³ Available at <<http://data.unicef.org/wp-content/uploads/2017/12/CODE-DES-PERSONNES-ET-DE-LA-FAMILLE.pdf>> (accessed 4 January 2021).

²⁴ Article 1002 of the *Loi du 13 du 16 novembre 1989 portant institution et application d’un code des personnes et de la famille* provides: “Sous réserve des conventions internationales, les dispositions du présent chapitre fixent le droit applicable à certains rapports juridiques privés présentant un ou plusieurs rattachements avec un ou plusieurs systèmes juridiques étrangers.” Article 1003 reads: “Les rapports juridiques visés à l’article précédent sont régis par le droit à l’égard duquel le rattachement est le plus étroit. Les règles de conflits de lois du présent chapitre doivent être considérées comme l’expression du principe général énoncé à l’alinéa premier. En cas de lacune ou d’insuffisance des dispositions du présent chapitre, le juge s’inspirera du principe énoncé à l’alinéa premier.”

²⁵ The *Código Civil* of Guinea Bissau is available at <[http://www.track.unodc.org/LegalLibrary/LegalResources/Guinea-Bissau/Laws/C%C3%B3digo%20Civil%20\(2000\).pdf](http://www.track.unodc.org/LegalLibrary/LegalResources/Guinea-Bissau/Laws/C%C3%B3digo%20Civil%20(2000).pdf)> (accessed 4 January 2021).

²⁶ Richard Potok, Guy Morton & Antoine Maffei, ‘The Legal Regime of Securities: The Need for a New Deal in Securities Law’ (2003) *Business Law International* 226, 227;

the *lex rei sitae* is generally taken to be the law of the State in which the collateral taker takes possession of the securities certificates at the time of the transfer. The *lex rei sitae* can moreover be the law of the jurisdiction in which the issuer is incorporated; this approach is more satisfactory where the certificates are regarded as representing the interests of the investor – for instance, as negotiable instruments. The *lex rei sitae* can also be the law of the State where the securities records of the issuer or its official recordholder are located at the time of transfer.²⁷ Third, the *lex rei sitae* can be the law of the jurisdiction where the collateral taker takes possession of the certificate at the time of transfer if the certificate issued in respect of a registered security is treated as representing the security (for example, if it is treated as a negotiable instrument). But regardless of the aforementioned variations, the *lex rei sitae* rule is nevertheless an adaptation to the direct holding system.²⁸

But even within the direct holding system, the *lex rei sitae* rule gives rise to severe difficulties. First, there is no uniform approach to how to determine the *situs* of the security.²⁹ Indeed, there are different strains of authority, not

Bradley Crawford (*supra* n 448) 161; Bernard Audit & Louis d'Avout, *Droit international privé* (7th edition, Economica, Paris 2013) s 740; Eric Dirix 'Belgium' in Harry C. Sigman & Eva-Maria Kieninger (eds), *Cross-Border Security over Tangibles* (Sellier, München 2007) 240; Christophe Bernasconi & Harry C. Sigman, 'The Hague Convention on Securities' (2006) 6 *Anuario Espanol de Derecho Internacional Privado* 1191, 1196–1197. Under German law, Article 43(1) EGBGB (*Gesetz zum Internationalen Privatrecht für außervertragliche Schuldverhältnisse und für Sachen* of 21 May 1999 (BGBl, 1999 I, 1026); BGH 20 March 1963 – VIII ZR 130/61, BGHZ 39, 173 (174); BGH 28 September 1994 – VI ZR 95/93, NJW 1995, 58 (59); BGH 9 May 1996 – IX ZR 244/95, NJW 1996, 2233 (2234); Arnd Goldt, *Sachenrechtliche Fragen des grenzüberschreitenden Versendungskaufs aus international-privatrechtlicher Sicht* (Duncker & Humblot, Berlin 2002) 27, 58 et seq; Ingo Scholz, *Das Problem der autonomen Auslegung des EuGVÜ* (Mohr Siebeck, Tübingen 1998) 3; Cordula Thoms, *Einzelstatut bricht Gesamtstatut: zur Auslegung der "besonderen Vorschriften" in Art. 3 Abs. 3 EGBGB* (Mohr Siebeck, Tübingen 1996) 35–36; Stephan Saager, *Effektengiroverkehr und internationales Privatrecht* (Duncker & Humblot, Berlin 2007) 110–117. See in comparison under Chinese law Huanfang Du, 'The Choice of Law for Property Rights in mainland China: Progress and Imperfection' in Jürgen Basedow & Knut B. Pißler, *Private International Law in mainland China, Taiwan and Europe* (Mohr Siebeck, Tübingen 2014) 104–106.

²⁷ See Randall D. Guynn & Nancy J. Marchand, 'Transfer of Pledge of Securities held through Depositories' in Hans van Houtte (ed), *The Law of Cross-Border Securities Transactions* (London, Sweet & Maxwell 1999) 49 and 55.

²⁸ Huanfang Du (*supra* n 26) 112; Francisco Garcimartín & Florence Guillaume, 'Conflict of Law Rules' in Thomas Keijser, *Transnational Securities Law* (Oxford University Press, Oxford 2014) s 10.06.

²⁹ Karl Kreuzer, 'Innovationen in der Haager Wertpapierkonvention' in Heinrich Menkhaus & Fumihiko Sato (eds), *Japanischer Brückenbauer zum deutschen Rechtskreis, Festschrift für Koresuke Yamauchi zum 60. Geburtstag* (Duncker & Humblot, Berlin 2006) 216; Richard Potok, Guy Morton & Antoine Maffei (*supra* n 26) 227, s 2.64; Randall D.

only in different jurisdictions but also within them, as to which factor applies to determine the *situs*. Discrepancies between the particulars of the *lex rei sitae* rule in different jurisdictions are perfectly illustrated by a survey, conducted during the process of elaborating the Hague Securities Convention by Richard Potok, of experts from twenty-eight jurisdictions.³⁰ The results indicated that in several jurisdictions there seemed to be no clear answer regarding the applicable law.³¹ And the existence of different interpretations of the *lex rei sitae* rule within the same jurisdiction is perfectly illustrated on the other hand by the English case *Macmillan Inc. v Bishopgate Investment Trust plc and others*,³² in which a three-member panel of the Court of Appeal held that ownership of shares is to be determined according to the *lex situs*. But the justices did not agree on where shares are situated for this purpose: Lord Justice Staughton supported the view that the *situs* of shares is the place of incorporation of the company although he accepted that this would not be the case if the shares were negotiable instruments; he also accepted that there might be situations in which the *lex situs* is arguably the law of the place where the register is kept.³³ Conversely, Lord Justice Auld contended that the *lex situs* of shares is the law of the jurisdiction where the share register is kept, which is often but not always the country of incorporation.³⁴ He also took the view that if shares are negotiable, the *lex situs* is where the pieces of paper constituting the negotiable instruments are at the time of transfer.³⁵ Lord Justice Aldous contended that the appropriate law to decide questions of title to property (including shares) is the *lex situs*, which is the same as the law of incorporation because:

“[...] it is not possible to decide whether a person is entitled to be included upon the register of a company as a shareholder without recourse to the company’s documents of incorporation, as interpreted according to the law of the place of incorporation.”³⁶

Guynn & Nancy J. Marchand (*supra* n 27) 62, s 3.19, who address the difficulties deriving from the existence of different applications of the *lex rei sitae* in several jurisdictions.

³⁰ See Appendix B of Preliminary Document n° 1 of November 2000, 69 et seq.

³¹ The multitude of probable and possible answers to the survey can be found in schematic form in Figure 1 (perfection of pledge) and Figure 2 (priorities) in Appendix B to Preliminary Document n° 1 of November 2000, 69–74.

³² High Court (Chancery Division) [1995] 3 All ER 747 (first instance) and Court of Appeal [1996] 1 All ER 585 (second instance). For more details on this case, see Eva-Maria Kieninger, ‘Übertragung von Gesellschaftsanteilen im englischen Internationalen Privatrecht’ (1997) IPRax 449; Adam Johnson, ‘Chapter 1: The Law Applicable to Shares’ in Hans van Houtte (ed), *The Law of Cross-Border Securities Transactions* (London, Sweet & Maxwell 1999) 22, s 1.14.

³³ [1996] 1 All E.R. 585 at 602a–b.

³⁴ [1996] 1 All E.R. 585 at 608c–d.

³⁵ [1996] 1 All E.R. 585 at 608c–d.

³⁶ [1996] 1 All E.R. 585 at 620.

Secondly, the *lex rei sitae* rule determines the law applicable to the creation, perfection, and realisation of a pledge. It also determines the law governing its effectiveness against the issuer and third parties, the priorities of a transfer of non-intermediated securities, and the validity of the transfer as between the parties. However, the law of the place where a certificate is physically held cannot govern whether the transfer is effective against the issuer; the issuer has no means of knowing the location of the certificates and ought to be able to depend on a single law to ascertain its obligations to securities holders. Thus, even in the direct holding system, the *situs* of the certificate cannot be regarded as an appropriate connecting factor to determine the law governing the effectiveness of a transfer against the issuer.³⁷ Ooi argues moreover that there is no real utility to applying the *lex rei sitae* rule to tangibles or to shares in *inter vivos* voluntary dealings; the *situs* of a share does not absolutely point to the governing law but rather leads to other connecting factors, such as the jurisdiction of incorporation, the location of the certificate, or the place of the register.³⁸

In conclusion, in spite of the aforementioned difficulties the *lex rei sitae* is better suited to a direct holding system in which the investor has a direct relationship with the issuer and ownership of the securities can be confirmed by checking the issuer's records in respect of registered securities or by ascertaining the availability of the certificates in respect of bearer securities.³⁹ The direct holding system thus generally produces clear and satisfactory results. But the *lex rei sitae* is ill-adapted to a system where the securities are held through several tiers of intermediaries who are located in different jurisdictions; indeed, here it gives rise to severe difficulties, which the next subsection examines.

II. Rejection of the *lex rei sitae* Rule and the "Look-Through Approach"

The *lex rei sitae* rule is not suitable for an intermediary system based on immobilisation and dematerialisation of securities.⁴⁰ Indeed, following the de-

³⁷ Michel Deschamps, 'The Best Rules for Non-Intermediated Securities' in Thomas Keijser, *Transnational Securities Law* (Oxford University Press, Oxford 2014) s 1.99. The best connecting factor in this case seems to be the law under which the issuer has been formed or constituted.

³⁸ Maisie Ooi, *Shares and Other Securities in the Conflict of Laws* (Oxford University Press, Oxford 2003) ss 2.43–2.57, 6.28. The *situs* is hence a mere label that masks different rules.

³⁹ Richard Potok, Guy Morton & Antoine Maffei (*supra* n 26) 227; Bradley Crawford, 'The Hague Prima Convention: Choice of Law to Govern Recognition of Dispositions of Book-Based Securities in Cross Border Transactions' (2003) 38 *Canadian Business Law Journal* 157, 161.

⁴⁰ Dorothee Einsele, *Wertpapierrecht als Schuldrecht: Funktionsverlust von Effektenurkunden im internationalen Rechtsverkehr* (Mohr Siebeck, Tübingen 1995) 464; Stephan Saager (*supra* n 26) 117, 119.

materialisation (*Entmaterialisierung*) of securities certificates, title is no longer rooted in either a piece of paper or the company's register (*Bedeutungsverlust der Wertpapierurkunde*⁴¹). And following the immobilisation of securities, a global note, representing the entire issue of securities, is held by a central depository; it in turn holds the global note for one or more intermediaries who hold either for further intermediaries or for investors.⁴² If a transaction involves a portfolio of securities located in several States, the application of the *lex rei sitae* rule would lead each security to be referred to the law of the jurisdiction where it is located with the unfortunate effect of proliferating the number of applicable laws.⁴³ Applied to the granting of a security interest in a securities account, in practice the *lex rei sitae* rule produces unmanageable results since the grantee will have to fulfil perfection requirements under all the laws governing all the securities.

Moreover, the difficulty generated by applying the *lex rei sitae* rule to the intermediary system is that it requires an approach that “looks through” the different tiers of intermediaries up to the level of the issuer or register (the so-called “look-through approach”).⁴⁴ Indeed, if intermediated securities are held through omnibus accounts or fungible accounts, an individual investor's interest is recorded only at the level of the intermediary with whom the investor has a direct relationship; in other words, there is no record of the investor's interest at the level of the issuer's register or of any intermediary for that matter, other than the one the investor has a direct relationship with.⁴⁵ Conse-

⁴¹ Dorothee Einsele (*supra* n 40) *passim*.

⁴² Roy Goode, ‘Security Entitlements as Collateral and the Conflict of Laws’ (1998) Oxford Colloquium on Collateral and Conflict of Law, Special Supplement to Butterworths Journal of International Banking and Financial Law 22, 25; Fabian Reuschle, ‘Grenzüberschreitender Effektengiroverkehr: Die Entwicklung des europäischen und internationalen Wertpapierkollisionsrechts’ (2004) 68 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 687, 711.

⁴³ Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.06; Christophe Bernasconi & Harry C. Sigman (*supra* n 26) 1196–1197; Richard Potok (*supra* n17) 12.

⁴⁴ Christophe Bernasconi, *Report on the Law Applicable to Dispositions of Securities Held Through Indirect Holding Systems* (Hague Conference on Private International Law, Preliminary Document n° 1 of November 2000) 27; Christophe Bernasconi, Richard Potok & Guy Morton, ‘General Introduction: Legal Nature of Interests in Indirectly Held Securities and Resulting Conflict of Laws Analysis’ in Richard Potok (ed), *Cross Border Collateral: Legal Risk and the Conflict of Laws* (Butterworths, London 2002) s 2.66; James Steven Rogers, ‘Of Normalcy and Anomaly: Thoughts on Choice of Law for the Indirect Holding System’ (1998) Oxford Colloquium on Collateral and Conflict of Laws, Special Supplement to Butterworths Journal of International Banking and Financial Law 47; Joanna Benjamin, Madeleine Yates & Gerald Montagu, *The Law of Global Custody* (2nd edition, Butterworths, London 2002) 80; Christophe Bernasconi & Richard Potok, ‘PRIMA Convention brings certainty to cross-border deals’ (2003) *International Financial Law Review* 11; Stephan Saager (*supra* n 26) 120.

quently, a collateral taker with a claim against the investor's interest in the securities who attempts to enforce it higher up the intermediary chain will find there is no record of the investor's interest against which the claim could be pursued.⁴⁶ Under OHADA law, the only record of the investor's interest is on the books of the investor's immediate intermediary, *i.e.*, the intermediary with whom the investor has a direct relationship.⁴⁷ It follows that the application of the "look-through approach" under OHADA law would lead to severe practical difficulties,⁴⁸ as illustrated by the following fact pattern:

Assume Paping SA is incorporated in Porto-Novo (Benin). Paping SA has 5,000,000 shares outstanding, all held through STRATE, a Central Securities Depository (CSD) incorporated in South Africa (Johannesburg). STRATE keeps the actual physical certificates representing the Paping SA shares in its vault in South Africa. Paping SA maintains a share register in Dakar (Senegal) with a registrar located there. Congolese Investor's interest in respect of 100 Paping SA shares is reflected by a book entry credited to an account entitled "Congolese Investor Securities Account" at its intermediary, Ivorian Bank, which is located and has its principal place of business in Abidjan. Ivorian Bank, in turn, holds interests corresponding to Congolese Investor's interest in respect of Paping SA shares, together with interests of other customers of French Bank, through book entries credited to an account entitled "Ivorian Bank Omnibus Customer Securities Account" on the books of French Bank. In total, for all its customers (including Congolese Investor) Ivorian Bank holds 45,000 Paping SA shares. French Bank in turn holds interests corresponding to Ivorian Bank's interests in respect of Paping SA shares, together with other participants' interests, through book entries credited to an account entitled "French Bank Omnibus Customer Securities Account" on the books of STRATE in South Africa. In total, French Bank holds for all its customers (including Ivorian Bank) 950,000 Paping SA shares. Assume further that Congolese investor wants to borrow funds from Gabonese Bank, located in Libreville, which has its securities account with Ivorian Bank, located in Abidjan. Now, finally assume that Congolese investor and

⁴⁵ Steven L. Schwarcz & Joanna Benjamin, 'Intermediary Risk in the Indirect Holding System for Securities' (2002) 12 *Duke Journal of Comparative & International Law* 309, 324; Huanfang Du (*supra* n 26) 113.

⁴⁶ See for instance under United States law, *Fidelity Partners, Inc. v First Trust Co.* [1997] U.S. Dist. Lexis 19287, n° 97 Civ. 5184, 1997, WL 752725 (S.D.N.Y., 5 December 1997).

⁴⁷ See part I, chapter 2 of this thesis.

⁴⁸ In addition, applying the *lex rei sitae* rule would contradict the principle that jurisdiction over proprietary aspects of dispositions of movable property should be broadly attributed to the jurisdiction where orders in respect of that property are capable of being enforced. See Joanna Benjamin, 'Determining the Situs of Interests in Immobilised Securities' (1998) 47 *International & Comparative Law Quarterly* 923.

Gabonese Bank enter into a loan agreement and Congolese investor provides the 100 shares of Paping SA to Gabonese Bank as collateral. This fact pattern can be depicted as follows:⁴⁹

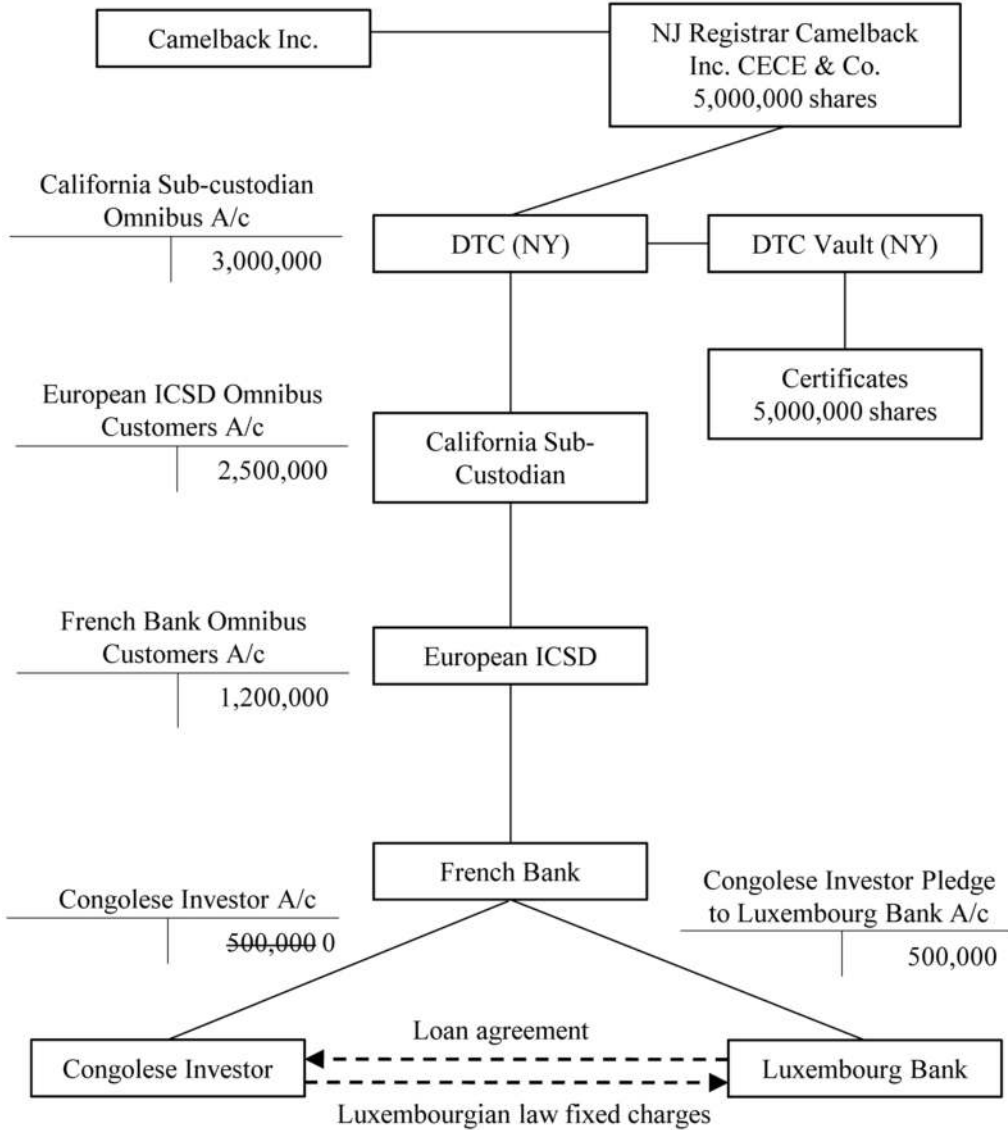


Figure 17: Look-Through Approach

Like Congolese Investor in this fact pattern, investors usually provide collateral in the form of an interest in a diversified portfolio of securities issued in several different jurisdictions. Under the “look-through approach”, the collat-

⁴⁹ For the sake of simplicity, the examples above involve only a single company’s securities. The fact pattern occurring in practice, particularly where portfolios of securities are provided as collateral, will often be much more complex.

eral taker would be compelled to satisfy the perfection requirements of several jurisdictions (Gabon, the Democratic Republic of the Congo, France, Benin, and South Africa).⁵⁰ Moreover, there is no rule under OHADA law or the domestic law of the OHADA Member States that clearly identifies the legal rule is when applying the *lex rei sitae* and the “look-through approach”. Is it the law of the place of the register, the underlying securities, or the issuer? In addition, even if the collateral taker is able to determine what the legal rule is when applying the *lex rei sitae* and the “look-through approach”, it is difficult to obtain the necessary information to ascertain how to apply that rule. For instance, if the test is the law of the place of the certificates, Gabonese Bank or Congolese Investor will find it impossible to discover where the CSD actually stores the certificates.⁵¹ In practice, the collateral taker (Gabonese Bank in this case) will likely pass the expense of investigating where the certificates reside and what the perfection requirements are on to the collateral provider (in this case, Congolese Investor).

In conclusion, the *lex rei sitae* and the “look through approach” give rise to severe practical difficulties. The legal uncertainty related to the “look-through approach” results in significant expense for market participants (particularly collateral providers) in the OHADA region since collateral takers are likely to pass the expense of investigating perfection requirements on to the collateral providers. The lack of legal predictability resulting from the “look-through” approach moreover gives rise to an element of risk which, depending on the size of the transactions involved and the importance of the relevant financial institutions, can be considered systemic.⁵²

C. Summary and Evaluation

1. Under OHADA law, there is no provision that addresses the issue of what law applies to certain rights in respect of securities held with an intermediary; pursuant to Article 10 of the OHADA Treaty, this question is therefore governed by the national laws of the Member States.

⁵⁰ See Dietrich Schefold, ‘Grenzüberschreitende Wertpapierübertragungen und Internationales Privatrecht – Zum kollisionsrechtlichen Anwendungsbereich von § 17a Depotgesetz’ (2000) IPRax 468, 470; Richard Potok & Mark Moshinsky, ‘Cross-Border Collateral: A Conceptual Framework for Choice of Law Situations’ (1998) Oxford Colloquium on Collateral and Conflict of Laws, Special Supplement to Butterworths Journal of International Banking and Financial Law 15; Stephan Saager (*supra* n 26) 120–121.

⁵¹ Christophe Bernasconi & Richard Potok (*supra* n 44) 12; James Steven Rogers (*supra* n 44) 47–51. See also Christophe Bernasconi, Richard Potok & Guy Morton (*supra* n 44) 29; Roy Goode (*supra* n 42) 25, 47, 48; Randall D. Guynn & Nancy J. Marchand (*supra* n 27) 60; Simon Schwarz, *Globaler Effektenhandel* (Mohr Siebeck, Tübingen 2016) 227.

⁵² Christophe Bernasconi (*supra* n 44) 29.

2. The traditional conflict of laws rule in every Member State to determine the enforceability of a pledge of securities effected in the intermediary system is the *lex rei sitae* (also referred to as the *lex cartae sitae* or the *lex situs*). Under the *lex rei sitae* rule, the validity and enforceability of the pledge is governed by the law of the place where the security is located.
3. While the *lex rei sitae* rule is suitable for a direct holding system, it leads to severe legal and practical difficulties when applied to the intermediary system, in which securities are immobilised and dematerialised. Indeed, in a transaction involving a portfolio of securities located in several States, the application of the *lex rei sitae* rule would lead each security to be referred to the law of the jurisdiction where it is located, with the unfortunate effect of proliferating the number of applicable laws and hence of increasing legal uncertainty.
4. This study opposes use of the *lex rei sitae* rule in the context of the indirect holding system since its application requires an approach that “looks through” the various tiers of intermediaries up to the level of the issuer or register. Indeed, as chapter 2 of part I of this thesis has established, under OHADA law an individual investor’s interest is only recorded at the level of the intermediary with whom the investor has a direct relationship. Therefore, a collateral taker with a claim against the investor’s interest in the securities who attempts to enforce that claim higher up the intermediary chain will find there is no record of the investor’s interest against which the claim could be pursued.

Chapter 2: The Place of the Relevant Intermediary Approach (PRIMA) under European Law

A. Analysis of the EU PRIMA Rule

I. Contents of the EU PRIMA Rule

The current EU *acquis* comprises provisions which determine the law applicable to proprietary effects⁵³ of cross-border transactions in intermediated securities. These provisions are enshrined in Articles of three Directives:⁵⁴

⁵³ As mentioned above, the conflict of laws rules govern two different elements of transactions in securities: (i) the proprietary element and (ii) the contractual element. Under EU law, the contractual element is regulated by the Regulation (EC) 593/2008 of 17 June 2008 on the Law Applicable to Contractual Obligations (OJ L 177, 4.7.2008, 6–16, the Rome I Regulation). However, this study concerns only the first aspect, that is, the proprietary aspects of securities transactions.

⁵⁴ Please note that this chapter will not address the personal and material scope of these directives since this question has already been addressed *supra* (see part II, chapter 3).

(i) Article 9(2) of the Settlement Finality Directive:

“Where securities (including rights in securities) are provided as collateral security to participants and/or central banks of the Member States or the future European central bank as described in paragraph 1, and their right (or that of any nominee, agent or third party acting on their behalf) with respect to the securities is legally recorded on a register, account or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State.”

(ii) Article 9(1) of the Financial Collateral Directive:

“Any question with respect to any of the matters specified in paragraph 2 arising in relation to book entry securities collateral shall be governed by the law of the country in which the relevant account is maintained. The reference to the law of a country is a reference to its domestic law, disregarding any rule under which, in deciding the relevant question, reference should be made to the law of another country.”

(iii) Article 24 of the Winding-up Directive⁵⁵

“The enforcement of proprietary rights in instruments or other rights in such instruments the existence or transfer of which presupposes their recording in a register, an account or a centralised deposit system held or located in a Member State shall be governed by the law of the Member State where the register, account, or centralised deposit system in which those rights are recorded is held or located.”

Each of these provisions designates the applicable law based on the “place of the relevant intermediary approach” (PRIMA). Indeed, in the intermediary system the records of the immediate intermediary with whom the entries effecting a pledge are made play a crucial role. Consequently, the most reasonable “location” of the pledged interest is the place of that intermediary. In lieu of looking through the various tiers of intermediaries (“look-through approach”), PRIMA stops at the level of the intermediary immediately above the parties to the pledge or transfer.⁵⁶ PRIMA has the advantage of subjecting all an investor’s interests regarding a portfolio of securities to the law of a single jurisdiction regardless of whether the issuers and the certificates evidencing such underlying securities are located in several different countries.⁵⁷ This allows the parties to a transaction to determine in advance which jurisdiction’s law applies to their rights and obligations.⁵⁸

⁵⁵ Interestingly, the chapeau of Article 24 of the Directive is: “*Lex rei sitae*”.

⁵⁶ Whether PRIMA can be considered to be an adaptation of the traditional *lex rei sitae* principle to new market realities is subject to debate. See for instance Roy Goode (*supra* n 42) 26, who contends that PRIMA should be regarded as a free-standing rule rather than an extension of the traditional *lex rei sitae* principle. See also Bradley Crawford (*supra* n 39) 169.

⁵⁷ Christophe Bernasconi (*supra* n 44) 31.

⁵⁸ Randall D. Guynn & Nancy J. Marchand (*supra* n 27) 61.

Under the PRIMA rule, the law applicable to certain questions of book-entry securities is determined by the place of the most relevant intermediary (or rather, by the place of the securities account).⁵⁹ PRIMA follows the legal principle that the law governing proprietary issues should be the law of the place where the record of title is maintained and hence where orders affecting the property can be effectively enforced.⁶⁰ In the indirect holding system, a booking in a securities account, made by an intermediary in favour of the account holder, is regularly the only booking in the entire custody chain that identifies the custody account holder as the entitled party. The nature of the indirect holding system, therefore, frequently makes it impossible to ascertain a specific investor's rights higher up in the custody chain.⁶¹ Each member of the custody chain only knows the custody account holder of accounts it maintains, so the relevant intermediary is the intermediary which has a direct relationship with the investor and which maintains its securities account.⁶² Under PRIMA, if interests in securities are credited on an intermediary's books and are then provided as collateral to the intermediary or to another customer, the law applicable to that intermediary will determine the validity and priority of the collateral taker's legal entitlement as against third parties. And if a pool of securities originating from issuers located in several different jurisdictions is given as collateral – a frequent practice – the collateral taker under the *lex rei sitae* rule would then have to satisfy the laws of the jurisdiction to which each issuer of securities is subject. In contrast, under PRIMA the collateral taker will need to satisfy the validity and priority requirements of only one jurisdiction, even in situations in which the securities are held through different jurisdictions.⁶³

⁵⁹ Pursuant to Article 9(2) of the Settlement Financial Directive, the specific issues governed by the law determined by the conflict of laws provision in Article 9(1) are: a) the legal nature and proprietary effects; b) the requirements for perfection; c) priorities; and d) the steps required for realisation.

⁶⁰ Christophe Bernasconi, 'Indirectly Held Securities: A New Venture for Hague Conference on Private International Law' in Petar Sarcevic & Paul Volken, *Yearbook of Private International Law* (Sellier, European Law Publishers, München 2009) 63, 74; Stephan Saager (*supra* n 26) 129; Richard Potok, Guy Morton & Antoine Maffei (*supra* n 26) 228.

⁶¹ See for instance § 3 Abs. 1 S. 1 DepotG under German law. See also Dorothee Einsele, 'Wertpapiere im elektronischen bankgeschäft' (2001) WM 7, 12; Theodor Heinsius, Arno Horn & Jürgen Than, *Depotgesetz – Kommentar zum Gesetz über die Verwahrung und Anschaffung von Wertpapieren vom 4. Februar 1937* (De Gruyter, Berlin 1975) § 3 s 13; Dorothee Einsele, 'Die internationalprivatrechtlichen Regelungen der Finalitätsrichtlinie und ihre Umsetzung in der Europäischen Union' (2001) WM 2415, 2423.

⁶² Stephan Saager (*supra* n 26) 130.

⁶³ Richard Potok (*supra* n 17) 12; Stephan Saager (*supra* n 26) 129.

II. Illustrations of How PRIMA Operates

To illustrate how PRIMA operates and, more particularly, which intermediary is the “relevant” one, the following discussion considers different variations on the following fact pattern:⁶⁴ A Congolese Investor⁶⁵ holds an interest in 500,000 shares of Camelback, Inc. through its intermediary, French Bank. French Bank in turn holds through European ICSD, which holds through California Subcustodian. California Subcustodian in turn holds through DTC. DTC’s nominee, Cede & Co., is recorded as the registered owner of the securities in the register maintained by NJ Registrar in New Jersey. DTC keeps the physical share certificates representing the Camelback, Inc. shares in a vault in New York.

The first three variations of this fact pattern represent a situation in which Congolese Investor seeks a loan from Luxembourg Bank, an international investment bank incorporated in Luxembourg and based in Luxembourg City. However, in the fourth and final variation, Congolese Investor seeks the loan from its intermediate intermediary, French Bank.

1. First Variation of the Fact Pattern: Collateral Provider and Collateral Taker Hold through the Same Intermediary and Collateral Is Provided by way of Pledge

In the first variation of this fact pattern, the collateral taker, Luxembourg Bank, and the collateral provider, Congolese Investor, both hold their interests in the securities through the same intermediary, French Bank. Congolese Investor pledges its interest in the Camelback, Inc. shares to Luxembourg Bank using a pledge mechanism. The contractual aspects of the pledge are governed by Luxembourgian law. As schematically depicted below, the pledge is represented on the books of French Bank as a debit to the “Congolese Investor Account” in respect of 500,000 shares of Camelback, Inc. and a corresponding credit to a “Congolese Investor Pledge to Luxembourg Bank

⁶⁴ Although the following fact pattern has been modified, it is modelled on the illustration found in Christophe Bernasconi (*supra* n 44) 14 et seq. It is important to note that the fact pattern involves shares of only a single company. However, fact patterns occur in practice which are often much more complex; the selected fact pattern reflects only the most important issues.

⁶⁵ It is important to highlight that these fact patterns involve a private investor. As analysed in the previous section, most Member States have not extended the personal scope of the Settlement Finality Directive, the Financial Collateral Directive, and the Winding-up Directive. Only few national enactments include more counterparties than the conflict of laws rules set out in these three directives. The examples provided in this section are supposed to be under the laws of the Member States which have extended the personal scope of the directives (*see* Evaluation in Annex 5 to the Impact Assessment SWD(2018)52, 119).

Account”. The pledge effects no change on the books of European ICSD, California Subcustodian, or DTC.

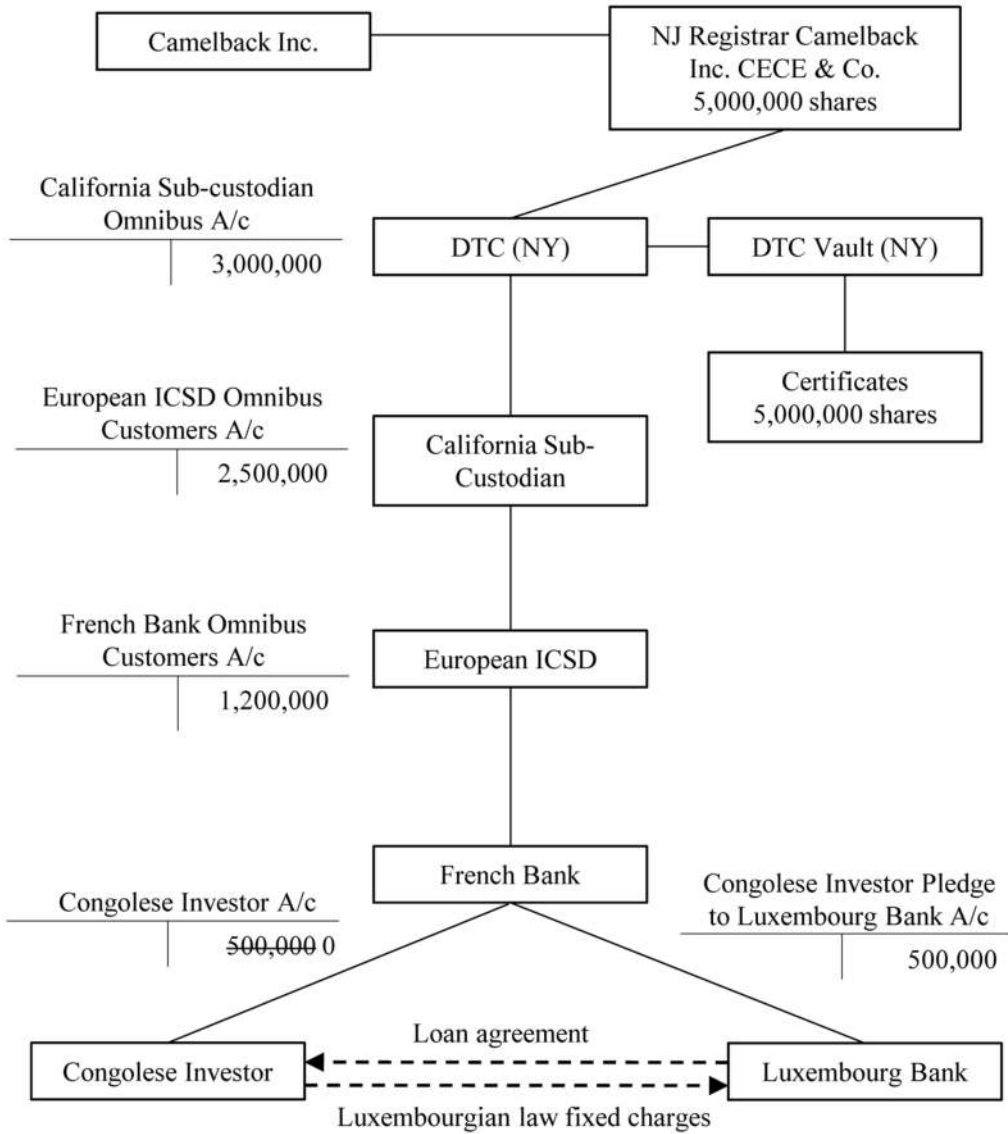


Figure 18: First Variation⁶⁶

After the pledge is executed in favour of Luxembourg Bank, Congolese Investor enters into a pledge agreement with Italian Bank, encumbering the same 500,000 Camelback, Inc. shares. Congolese Investor and Italian Bank choose Italian law to govern their agreement; under Italian law, the second pledge is valid. Assume further that Congolese Investor enters insolvency in the Demo-

⁶⁶ Source: Christophe Bernasconi (*supra* n 44) 32.

cratic Republic of the Congo. The liquidator asks the Congolese court to determine if the pledges in favour of Luxembourg Bank and Italian Bank should be treated as valid and also to indicate which pledge takes priority relative to the other. To answer these questions, the insolvency court will have to determine the law governing the proprietary aspects of the transaction.

In this variation of the fact pattern, PRIMA would lead to the application of French law as the law of the place of French Bank, the intermediary on whose books the pledge in favour of Luxembourg Bank's recorded.

2. Second Variation: Collateral Provider and Collateral Taker Hold through Different Intermediaries and Collateral Is Provided by way of Pledge

Under this variation, the collateral taker, Luxembourg Bank, holds its interest in the Camelback, Inc. securities not through French Bank but rather through Swiss Bank, which is incorporated in Switzerland and located in Zurich. In turn, Swiss Bank's account, called "Swiss Bank Omnibus Customers Account" and maintained on the books of European ICSD, contains 100,000 Camelback, Inc. shares that Swiss Bank holds for its customers.

Assume that Congolese Investor asks for a loan, and Luxembourg Bank requires that Congolese Investor move its position in Camelback, Inc. shares to Swiss Bank, the pledge to be recorded on Swiss Bank's books. For Luxembourg Bank, this transfer of the shares to the books of an intermediary which it trusts is aimed at avoiding any exposure to French Bank – or more specifically, any exposure to the possible consequences of administrative error, wrongdoing, or insolvency at French Bank. Therefore, prior to the pledge, Congolese Investor's interest in 500,000 Camelback, Inc. shares would be debited from "Congolese Investor Account" at French Bank and credited to "Congolese Investor Account" at Swiss Bank. The figure on the next page depicts this variation of the fact pattern.

As mentioned above and depicted in the figure, there is a transfer from French Bank to Swiss Bank of an interest in 500,000 shares of Camelback, Inc. that will result on one hand in the books of European ICSD showing a debit from the "French Bank Omnibus Account" (reducing that account's balance from 1,200,000 to 700,000) and on the other hand in a corresponding credit to the "Swiss Bank Omnibus Customers Account" (increasing the balance there from 100,000 to 600,000).

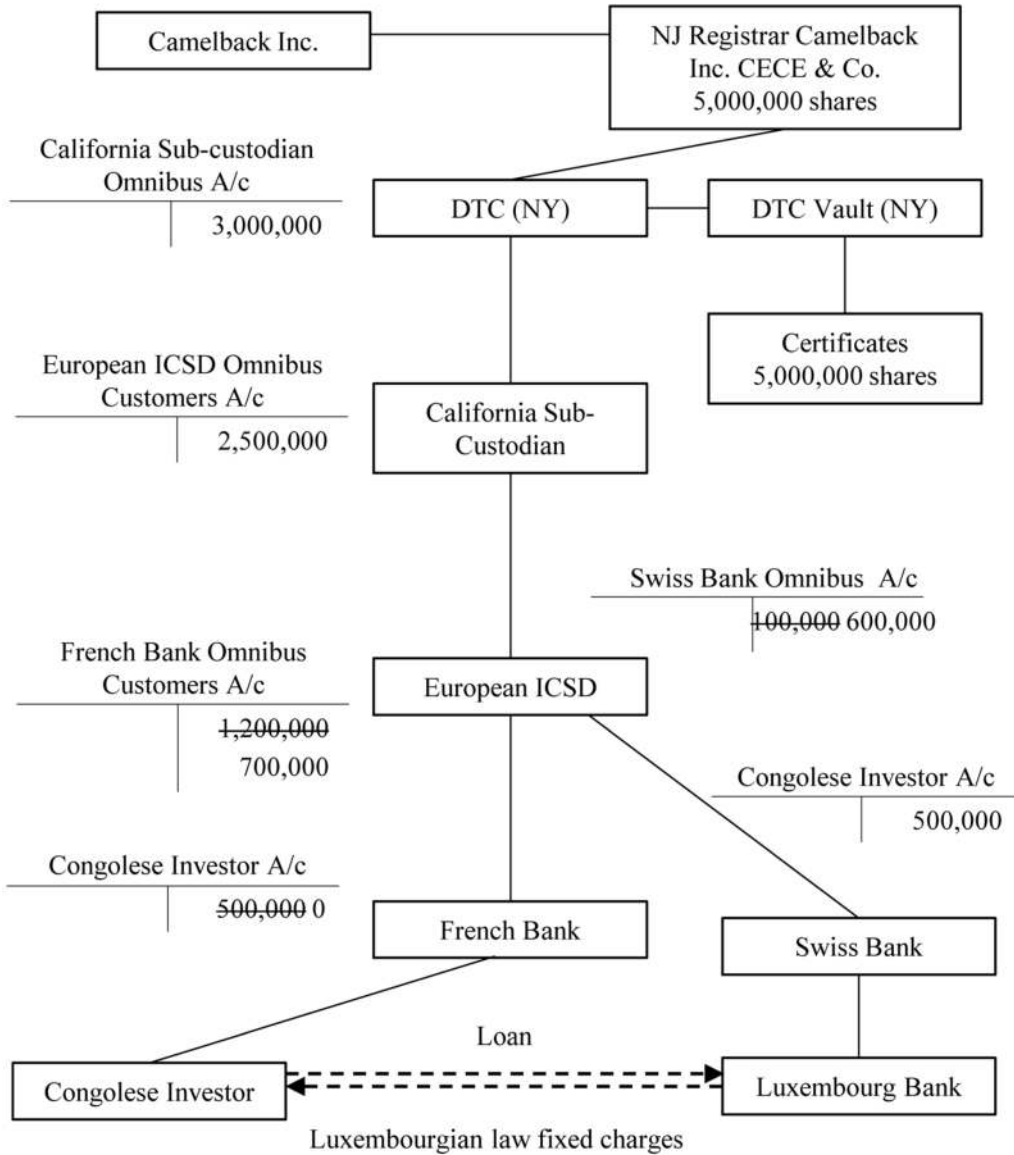


Figure 19: Second Variation⁶⁷

Congolese Investor pledges its interests in the Camelback, Inc. shares to Luxembourg Bank, and Luxembourgian law governs the contractual aspects of the pledge mechanism. As represented in the figure below, the pledge is represented on the books of the French Bank though a debit of 500,000 shares of Camelback, Inc. from “Congolese Investor Account”. It also corresponds to a credit to the new “Congolese Investor Pledge to Luxembourgian Account”.

⁶⁷ Source: Christophe Bernasconi (*supra* n 44) 32.

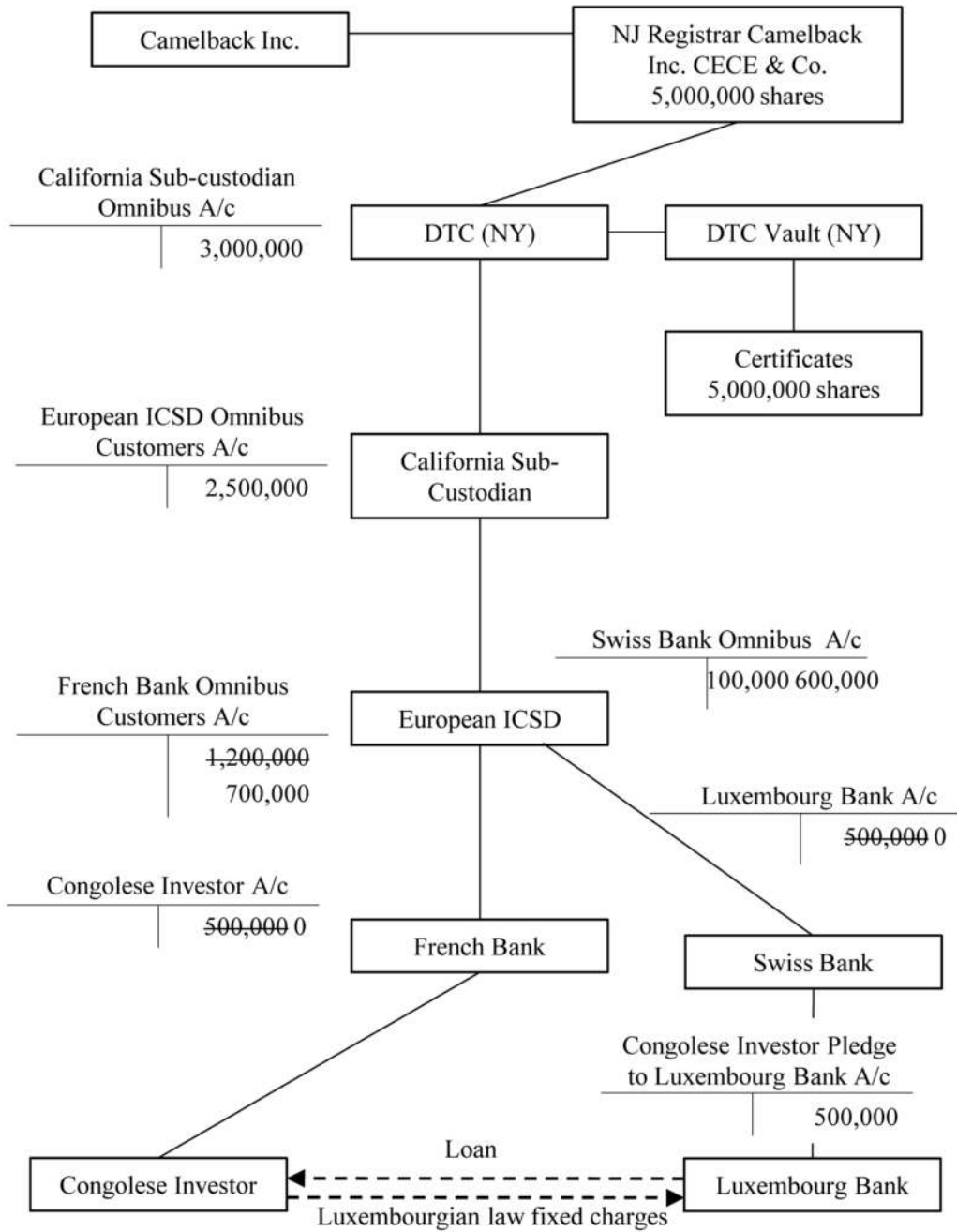


Figure 20: Second Variation (Continued)⁶⁸

After the execution of the pledge agreement in favour of Luxembourg Bank, Congolese Investor pledges the same 500,000 shares of Camelback, Inc. to Italian Bank. Congolese Investor and Italian Bank choose Italian law as the law applicable to their pledge agreement; under Italian substantive law, the

⁶⁸ Source: Christophe Bernasconi (*supra* n 44) 34.

second pledge is valid. Congolese Investor then enters insolvency in the Democratic Republic of the Congo. The liquidator petitions the Congolese court to determine whether the pledges in favour of Luxembourg Bank and Italian Bank can both be regarded as valid; and if they are, the Congolese court is asked to then rule on which pledge takes priority over the other.

For this second variation, under PRIMA Swiss law (as the law of the place of Swiss Bank, the intermediary on whose books the pledge in favour of Luxembourg Bank is recorded) would govern the proprietary issues, including whether Luxembourg Bank received a perfect interest in respect of Camelback, Inc. shares. Swiss law would also determine whether Luxembourg Bank had priority over the interest of Italian Bank.

3. Third Variation: Collateral Taker and Collateral Provider Hold through Different Intermediaries and Collateral Is Provided by way of Title Transfer

Assume the facts are the same as in the second variation, except that Congolese Investor did not use a pledge mechanism in return for a loan but rather transferred to Luxembourg Bank title to its interest in the 500,000 shares of Camelback, Inc. under Luxembourgian law with transfer-of-title documentation. According to the title transfer agreement, Luxembourg Bank must return equivalent shares once the loan is repaid.

Assume further that before the title transfer, Congolese Investor's interest in respect of the Camelback, Inc. shares is recorded as a credit to the "Congolese Investor Account" on the books of its intermediary, French Bank. The title transfer results in a debit of 500,000 shares of Camelback, Inc. to the "Congolese Investor Account" on the books of French Bank and a corresponding credit to "Luxembourg Bank Account" on the books of Luxembourg Bank's Intermediary, Swiss Bank. These transactions will also be reflected on the books of European ICSD as a debit to the "French Bank Omnibus Customers Account" (decreasing a position in Camelback, Inc. shares from 1,200,000 to 700,000) and as a corresponding credit to the "Swiss Bank Omnibus Customers Account" (increasing from 100,000 to 600,000 a position in shares of Camelback, Inc.). The pledge results in no change on the books of California Subcustodian or the DTC.

In addition, assume that after signing the transfer-of-title documentation but before completing the transfer to Luxembourg Bank (though making the appropriate book entries), Congolese Investor also pledges the same 500,000 shares of Camelback, Inc. to Italian Bank. Under Italian substantive law (chosen by Congolese Investor and Italian Bank in their pledge agreement), the pledge is valid. After Congolese Investor enters into the pledge agreement, the title transfer is completed. Lastly, suppose Congolese Investor then goes into insolvency in the Democratic Republic of the Congo. The liquidator asks the Congolese Court to determine:

- (i) Whether the pledge in favour of Italian Bank should be treated as valid,
- (ii) Whether Luxembourg Bank should be treated as having acquired a valid and competent interest, and
- (iii) In case the answers to both (i) and (ii) are yes, if the interest of Luxembourg Bank should be treated as subject to Italian Bank’s pledge.

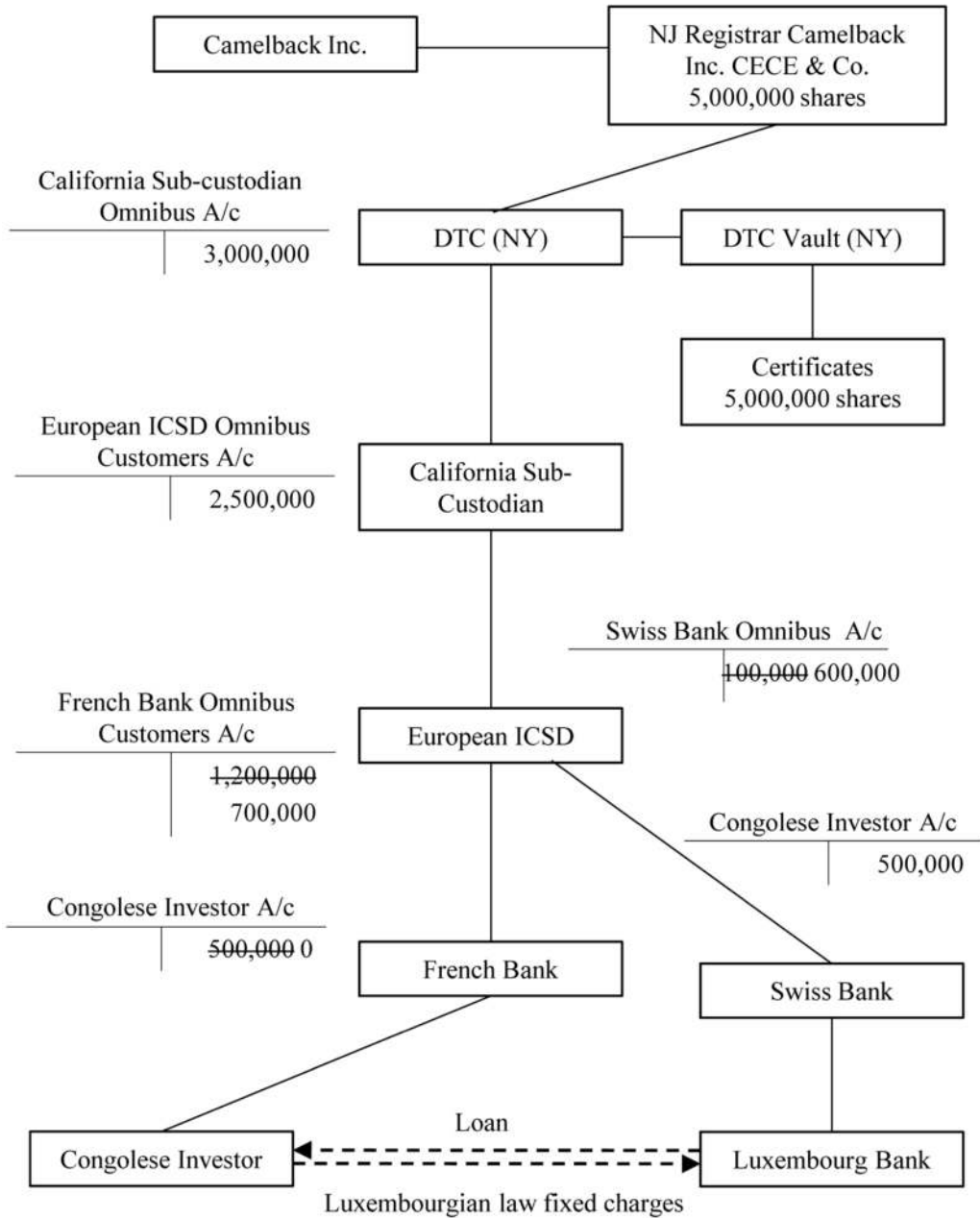


Figure 21: Third Variation⁶⁹

Compared to the two former variations, the complexity of this one lies in the fact that Congolese Investor's interest is not transferred directly to Luxembourg Bank, because Congolese Investor never holds an interest with the same intermediary as Luxembourg Bank. (This differs from the second variation, where Congolese Investor's interest is moved to Swiss Bank before the pledge to Luxembourg Bank takes effect.) Instead, this third variation has Congolese Investor instructing its intermediary, French Bank, to transfer interests forming part of French Bank's pool of customer securities held through European ICSD to Swiss Bank's pool of customer securities held through European ICSD, with Swiss Bank to credit Luxembourg Bank's account. Consequently, Congolese Investor ceases to have any interest in French Bank's (reduced) pool of customer securities, and Luxembourg Bank receives an interest in Swiss Bank's (enlarged) pool of customer securities.

Under PRIMA, the following laws will govern the proprietary aspects of the three stages of this transfer process:

- (i) Whether Luxembourg Bank acquires a valid interest in Swiss Bank's pool of customer securities is governed by Swiss law, as that is the law of the place of Swiss Bank, the intermediary on whose books interests in that pool are recorded;
- (ii) Whether Congolese Investor's interest in French Bank's pool of customer securities is validly extinguished is governed by French law, as it is the law of the place of French Bank, the intermediary on whose books Congolese Investor's interest is recorded;
- (iii) Whether the appropriate portion of French Bank's interest in European ICSD's pool of customer securities is validly transferred to Swiss Bank is governed by the law of the place of European ICSD, the intermediary on whose records both French Bank's and Swiss Bank's interests are recorded.

4. Fourth Variation: Collateral Provider Holds through Collateral Taker as Intermediary and Collateral Provided by way of Pledge

In this last variation, Congolese Investor requests that its intermediary, French Bank, make the loan in return for a pledge by Congolese Investor of its interest in respect of shares of Camelback, Inc. The contractual aspects of the pledge are governed by French law. As represented in the figure below, on the books of French Bank the pledge results in a debit of 500,000 Camelback, Inc. shares to "Congolese Investor Account" and a corresponding credit to the "Congolese Investor Pledge to French Bank Account". At the level of European ICSD, California Subcustodian, or the DTC, the pledge does not lead to any change on the books.

⁶⁹ Source: Christophe Bernasconi (*supra* n 44) 37.

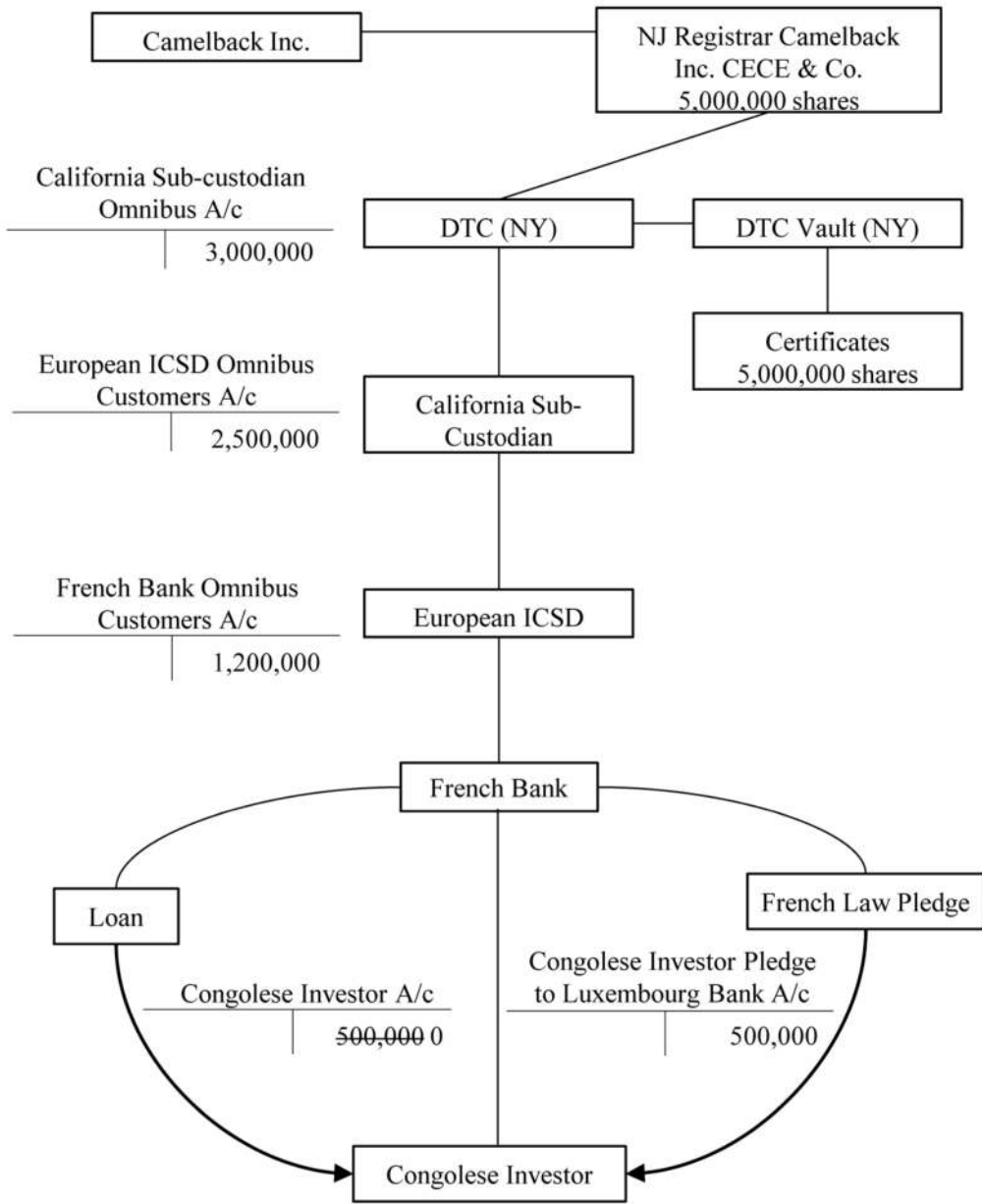


Figure 22: Fourth Variation⁷⁰

After the pledge in favour of French Bank has been executed, Congolese Investor enters into another pledge agreement with Italian Bank in respect of the same 500,000 Camelback, Inc. shares. Under Italian substantive law, which Congolese Investor and Italian Bank select in their pledge agreement, the second pledge is valid. Congolese Investor then enters insolvency in the Democratic Republic of the Congo. The liquidator asks the Congolese court

⁷⁰ Source: Christophe Bernasconi (*supra* n 44) 39.

to determine whether the pledges in favour of French Bank and Italian Bank are to be regarded as valid and, if both pledges are valid, how they should be treated as ranking against each other.

In this fourth variation on the initial fact pattern, French law (as the law of the place of French Bank, the intermediary on whose books the interest of French Bank is recorded) would govern proprietary issues, including whether French Bank obtained a perfected pledge of Congolese Investor's interest in shares of Camelback, Inc. French law would also apply to whether French Bank has priority over the interest of Italian Bank. It is important to note that since French Bank acts as both intermediary and collateral taker, the record of the pledge in favour of French Bank is made on its own books.

B. Evaluation of the EU PRIMA Rule

I. Account "Located", "Maintained", "Held", or "Situated"?

Under the PRIMA rule, the law applicable to certain questions in respect of book-entry securities is determined by the place of the most relevant intermediary (or rather, by the place of the securities account). Reference in the Settlement Finality Directive and in the Winding-up Directive is to the law of the place where the account is *located*. In contrast, the Financial Collateral Directive refers to the law of the place where the account is *maintained*.⁷¹ But no provision under EU law determines whether "located" and "maintained" have the same meaning. Nevertheless, it is submitted that this difference in wording does not constitute a difference in substance. First, the Financial Collateral Directive recites that the objective of the conflict of laws provision is to extend the principle already set out in the Settlement Finality Directive (Recital 7 of the Financial Collateral Directive):

"The principle in Directive 98/26/EC, whereby the law applicable to book entry securities provided as collateral is the law of the jurisdiction where the relevant register, account or centralised deposit system is located, should be extended in order to create legal certainty regarding the use of such securities held in a cross-border context and used as financial collateral under the scope of this Directive."

Second, in its 2018 Communication on the law applicable to proprietary effects of transactions in securities, the European Commission reiterated that the difference in wording reflects an evolution in the EU securities markets which allowed for a more suitable expression (the place where the account is maintained) to describe the same formula.⁷² Indeed, a securities account can-

⁷¹ Alexander Franz, *Überregionale Effekientransaktionen und anwendbares Recht: eine kollisionsrechtliche Untersuchung unter besonderer Berücksichtigung der Vorschrift des § 17 a DepotG* (Peter Lang, Bern 2005) 36.

⁷² European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of

not be physically “located” and is more accurately described as being “maintained”.⁷³ Third, only the English versions of the Directive differ from one another in terminology; the English versions of the Winding-up Directive and the Settlement Finality Directive use the term “located” whereas the English version of the Financial Collateral Directive use the term “maintained”. But versions of the Settlement Finality Directive and Financial Collateral Directive use the same term in other language versions; for example, the French, Italian, and Romanian versions of these directives refer to where the relevant account is “located” (*situé – situate – se află*). But the discrepancy in the term can also be found in the Dutch and the Portuguese versions of the directives: the Portuguese versions refer to “located” and “situated”; the Dutch versions make a distinction between “located” and “held”.

In conclusion, the directives have failed to harmonise the conflict of laws provisions on proprietary aspects of transactions in securities. Indeed, the wording of the provisions in the Settlement Finality Directive, the Financial Collateral Directive, and the Winding-up Directive is not always sufficiently clear or precise. Consequently, their rules and interpretations have been transposed into national law differently across Member States. Although the directives afford nations some leeway, in the end the different transpositions may result in different governing laws being applied in practice in each EU Member State.

II. Unclear Location of Securities Accounts under PRIMA

The three aforementioned directives have been transposed into national law by all EU Member States.⁷⁴ Although the difference in the directives’ respective choice of words is not substantive (designating as the applicable law the place of the location or maintenance of the relevant securities account), the national implementations of the directives reveal different ways of determining where the register or the securities account is “located” or “maintained”. These discrepancies among Member States can be explained by the absence of any direction on how to make such a determination. It is not self-explanatory: in modern financial markets, the data may be stored in one country while the client relationship is managed from another country, with electronic records accessible

the Regions on the Applicable Law to the Proprietary Effects of Transactions in Securities COM(2018) 89 final, 4.

⁷³ Commission of the European Communities, *Legal Assessment of Certain Aspects of the Hague Securities Convention*, SEC(2006) 910, 8. Nevertheless, the essence of the rule is the same as the *lex conto sitae* (Changmin Chun, *Cross-Border Transactions of Intermediated Securities: A Comparative Analysis in Substantive Law and Private International Law* (Springer, Heidelberg 2012) 374; Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.10).

⁷⁴ In 2013, Croatia, as a new Member State, adopted the directives.

through different locations. The Financial Collateral Directive clearly underscores the common basis for conflict of laws across the EU:

“The *lex rei sitae* rule, according to which the applicable law for determining whether a financial collateral arrangement is properly perfected and therefore good against third parties is the law of the country where the financial collateral is located, is currently recognised by all Member States. Without affecting the application of this Directive to directly-held securities, the location of book entry securities provided as financial collateral and held through one or more intermediaries should be determined. If the collateral taker has a valid and effective collateral arrangement according to the governing law of the country in which the relevant account is maintained, then the validity against any competing title or interest and the enforceability of the collateral should be governed solely by the law of that country, thus preventing legal uncertainty as a result of other unforeseen legislation.”⁷⁵

However, so far there is no case law of the Court of Justice of the European Union on how to interpret the concepts of maintenance and location. Other EU acts do not clarify how these concepts should be interpreted, either; and consequently the EU Member States, while transposing the provisions of the Settlement Finality Directive and the Winding-up Directive into national law, enacted different ways of determining where a securities account is “maintained” or “located”.⁷⁶ In its 2018 Communication on the law applicable to proprietary effects of transactions in securities, the Commission noted that many Member States included no additional criteria in their national legislation to prescribe how to determine what jurisdiction the account is “located” in. At least sixteen Member States included no further clarifications in their national provisions implementing the Settlement Finality Directive and the Winding-up Directive.⁷⁷ In transposing the Financial Collateral Directive into national law, at least thirteen Member States omitted any clarification of how to determine where the account is “maintained”.⁷⁸ While some Member States did provide additional guidance in transposing the directives into national law,⁷⁹ the results of their various approaches differ. In Member States that provided no clarification, case law or academic literature can of course offer guidance on how the concepts of location or maintenance are supposed to operate. Yet different interpretations between even these non-codified sources lead to divergent results.⁸⁰

As to the application of the EU PRIMA rule in the different EU Member States, there are considerable inconsistencies in terms of the national approaches used to determine the relevant account and its location or mainte-

⁷⁵ Recital 8 of the Financial Collateral Directive.

⁷⁶ European Commission (*supra* n 72) 5.

⁷⁷ See Evaluation in Annex 5 to the Impact Assessment SWD(2018)52, 116–117.

⁷⁸ European Commission (*supra* n 72) 5; Evaluation in Annex 5 to the Impact Assessment SWD(2018)52, 117–118.

⁷⁹ European Commission (*supra* n 72) 5.

⁸⁰ Evaluation in Annex 5 to the Impact Assessment SWD(2018)52, 117–118.

nance. Some Member States interpret and apply the rule by looking at the place where the custody services are provided; others look to the account agreement to determine where the account is maintained, an advantageous interpretation if it avoids different laws applying internationally in transactions involving States which apply a choice-of-law solution. In still other Member States, the term “maintained” operates in a way which allows a choice of that Member State’s law to be valid under the Hague Securities Convention.⁸¹ Under this approach, “maintained” is defined as *effecting or monitoring entries to securities accounts, administering payments or corporate actions, or performing any other regular activity necessary for the administration of securities accounts*. The European Commission indicated in its 2018 Communication that all these solutions are in line with the relevant EU provisions, subject to any future decision of the Court of Justice of the European Union. Here are some specific examples of the different criteria that are used to determine the PRIMA location in a few EU Member States:⁸²

- Under Portuguese conflict of laws rules, the relevant location is not the physical location of the securities but rather the location of the “legal situation of a security”, meaning the location of the management of the CSD and the location of the custodian where the securities are registered or deposited;
- The criteria used in Denmark to determine the location of the relevant account are as per the Hague Securities Convention rules (for instance, “relevant intermediary”);
- There are no criteria under Dutch law for determining the PRIMA location, though Dutch conflict of laws rules do offer some guidance on how to identify the place of maintenance of the relevant account;
- In France, there are no objective criteria for determining the PRIMA location, which in practice means that the securities account is located in the country where the custody services are provided;
- In Luxembourg, there is no definition of any objective criteria which allow the PRIMA location to be determined;
- The Italian conflict of laws rules refer to the account in which the book entries or annotations are directly performed in favour of the account holder.

Due to the different transpositions of the Settlement Finality Directive, the Financial Collateral Directive, and the Winding-up Directive into domestic laws, there is no homogeneity to the rules each Member State follows. This gives rise to legal uncertainty and consequently constitutes an obstacle to

⁸¹ This is the case in Denmark. Outside of the European Union, this approach has been also adopted in Switzerland.

⁸² Source: Evaluation in Annex 5 to the Impact Assessment SWD(2018)52, 106.

cross-border trade in securities transactions.⁸³ This explains why most of those who responded⁸⁴ to the European Commission's 2018 impact assessment (41.03%) confirmed that they were aware of the fact that under the current EU law, PRIMA is not clear.⁸⁵

III. Uncertainty as to the Relevant Account under PRIMA

If intermediated securities are simultaneously recorded in several accounts at different levels of the holding chain and located in different countries, neither Article 9(2) of the Settlement Finality Directive nor Article 24 of the Winding-up Directive specifies what the relevant "record" is by which to determine the applicable law.⁸⁶ Although the Financial Collateral Directive defines the "relevant account"⁸⁷, most Member States in transposing the directives into national law left it an open question, among them France, Greece, Austria, the United Kingdom, and the Netherlands. Among the Member States which did specify at what level of the holding chain the provision of intermediated securities has to be recorded, there are nevertheless significant discrepancies. In Belgium, for instance, it could be at any level; in Germany, it is required to be at the level of the direct intermediary; in Slovakia, it is up to the CSD level to make a record.⁸⁸ The connecting factor under the aforementioned directives is therefore unclear; it is subject to different interpretations across the Member States. Depending on the jurisdiction, the question of what account is relevant for determining the applicable law can lead to dissimilar answers:

⁸³ See Conflicts of Laws Issues in T2S Markets – A Fact Finding Exercise by T2S Harmonisation Steering Group <https://www.ecb.europa.eu/paym/t2s/progress/pdf/ag/mtg29/item_4_20151116.pdf?7d32b%208e9f88a6823ffd9dd%2061650d3de3> (accessed 4 January 2021) 3.

⁸⁴ The description of the respondents to and the methodology of this evaluation is available at Evaluation in Annex 5 to the Impact Assessment SWD(2018)52, 102–103.

⁸⁵ See responses to Question 3 of the Consultation Document on the Conflict of Laws Rules for Third Party Effects of Transactions in Securities and Claims, available at <<https://ec.europa.eu/eusurvey/publication/securities-and-claims-2017?surveylanguage=en>> (accessed 23 January 2019).

⁸⁶ European Post Trade Report, 15 May 2017, 95–96. The EPTF Report and its Annexes are available at <https://ec.europa.eu/info/publications/170515-eptf-report_en> (accessed 4 January 2021). Further, this issue is also subject to the national securities law and the holding model of each Member State.

⁸⁷ Article 2(1)(h) of the Financial Collateral Directive: "'relevant account' means in relation to book entry securities collateral which is subject to a financial collateral arrangement, the register or account – which may be maintained by the collateral taker – in which the entries are made by which that book entry securities collateral is provided to the collateral taker."

⁸⁸ Evaluation in Annex 5 to the Impact Assessment SWD(2018)52, 108–109.

- (i) The accounts of the collateral taker on the intermediary's books;
- (ii) The account where the intermediary's entitlement to the securities is recorded, perhaps the next intermediary up the custody chain or the CSD; or
- (iii) The account of the collateral provider.⁸⁹

IV. Uncertainty as to How Many Laws Apply in the Holding Chain under PRIMA

The previous section explored whether there is only one “relevant account” or whether more than one account may be relevant for determining the applicable law under the EU's PRIMA rule. This very issue translates into a question of whether there is a single legal system applicable or whether several governing laws may apply to a given case. For this question as well, there is no homogeneity among EU Member States.⁹⁰ For instance, for securities issued in a CSD in Portugal, the governing law is that of the Member State where the management of the CSD is located. With respect to other securities registered and deposited but issued elsewhere than in a CSD, the governing law is that of the place of their initial issuance. In Italy, the conflict of laws rules allow several conflict of laws rules to apply across the holding chain; in the Netherlands, Dutch law applies to the whole security chain as long as the accounts are held in country; and similarly in France, a single law will cover the entire holding chain.⁹¹

V. Renvoi

Article 9(1) of the Financial Collateral Directive provides: “The reference to the law of a country is a reference to its domestic law, disregarding any rule under which, in deciding the relevant question, reference should be made to the law of another country.” This provision eliminates the application of *renvoi*. Conversely, Article 9(2) of the Settlement Finality Directive and Article 24 of the Winding-up Directive are both silent on the matter of *renvoi*.⁹² It is thus worth exploring whether the Member States have excluded *renvoi* in their implementing legislation, and if not, whether *renvoi* is applied in prac-

⁸⁹ European Post Trade Report, 15th May 2017, p. 76, available at <https://ec.europa.eu/info/publications/170515-eptf-report_en> (accessed 4 January 2021).

⁹⁰ See responses to Question 5 and 6 of the Consultation Document on the conflict of laws rules for third party effects of transactions in securities and claims, available at <<https://ec.europa.eu/eusurvey/publication/securities-and-claims-2017?surveylanguage=en>> (accessed 4 January 2021).

⁹¹ Evaluation in Annex 5 to the Impact Assessment SWD(2018)52, 111.

⁹² Nevertheless, it has been a common view that *renvoi* is excluded in the application of Article 9(1) of the Settlement Finality Directive. See Fabian Reuschle (*supra* n 42) 719.

tice.⁹³ In countries such as Portugal, Denmark, the Netherlands, and Italy, the conflict of laws rules expressly exclude *renvoi*; in other countries, such as Germany, *renvoi* is ruled out by way of interpretation. Conversely, in France and Belgium, the national conflict of laws rules are deemed to allow *renvoi* by way of interpretation. In the United Kingdom and in Luxembourg, the national conflict of laws rule allow *renvoi* if an agreement between the parties to a securities transaction is governed by a law other than the law of the forum, and this law allows *renvoi*.⁹⁴ All these variations add to legal uncertainty for anyone seeking to determine whether a foreign legislation could apply in connection with intermediated securities transactions.⁹⁵

VI. The Location of the Securities Account and European Discussions regarding the Hague Securities Convention

The PRIMA rule offers the advantage of submitting all an account holder's interests in a securities portfolio to the law of a single jurisdiction⁹⁶ even in situations in which issuers, registers, certificates evidencing the underlying securities, or any higher-tier intermediaries are located in different jurisdictions.⁹⁷ However, it also gives rise to a fundamental difficulty: There is no criterion – at least none that is generally acceptable for all types of securities or categories of intermediaries globally – by which to determine beyond doubt the intermediary's office which maintains a specific account or the location of a securities account.⁹⁸ Indeed, an account is intangible, and an intangible has no real location. In this regard, *Rogers* aptly points out:

“One can retain the basic concept that the governing law is determined by the location of the property – the traditional *lex situs* rule – and *merely shift the identification of the rele-*

⁹³ On this issue, see Conflicts of Laws Issues in T2S Markets – A Fact Finding Exercise by T2S Harmonisation Steering Group <https://www.ecb.europa.eu/paym/t2s/progress/pdf/ag/mtg29/item_4_20151116.pdf?7d32b%208e9f88a6823ffd9dd%2061650d3de3> (accessed 4 January 2021) 3.

⁹⁴ Evaluation in Annex 5 to the Impact Assessment SWD(2018)52, 113.

⁹⁵ Conflicts of Laws Issues in T2S Markets – A Fact Finding Exercise by T2S Harmonisation Steering Group <https://www.ecb.europa.eu/paym/t2s/progress/pdf/ag/mtg29/item_4_20151116.pdf?7d32b%208e9f88a6823ffd9dd%2061650d3de> (accessed 4 January 2021) 3; European Post Trade Report, 15 May 2017, available at <https://ec.europa.eu/info/publications/170515-eptr-report_en> (accessed 4 January 2021) 76, footnote 100.

⁹⁶ Stephan Saager (*supra* n 26) 130.

⁹⁷ Roy Goode, Hideki Kanda & Karl Kreuzer, *Explanatory Report on the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (Hague Securities Convention)* (2nd edition, Permanent Bureau, The Hague 2017) s. Int-42.

⁹⁸ Jean-Pierre Deguée & Diego Devos, ‘La loi applicable aux titres intermédies: l’apport de la Convention de La Haye de décembre 2002’ (2006) 1 *Revue de droit commercial belge* 5, 14 (particularly s 11) and 23 (particularly s 36).

vant property from the underlying securities to the securities account [my emphasis]. However, there is a problem. An account does not have a location. Period. There is no way around that fact. An account is an abstract legal relationship between two entities. *Abstract relationships do not have locations* [my emphasis].”⁹⁹

To further illustrate the difficulty of determining the intermediary’s office which maintains a specific account or the location of a securities account under the PRIMA rule, consider another conflict of laws problem: the law governing the validity of a marriage. There are several ways to determine the law applicable to an international marriage,¹⁰⁰ but none of them is accomplished by determining *where the marriage is located*. People, events, or ceremonies have locations; marriages (as relationships) do not. And accounts, similarly, do not have locations.¹⁰¹

To determine the location of an office at which a securities account is maintained, one might submit the question to tax, regulatory requirements, or account requirements.¹⁰² In some states, intermediaries are in fact required to assign a code to each securities account which effectively allocates it to a specific office for regulatory reporting, tax, or accounting purposes. For instance, under Cameroonian law, Article 3(1) of Act n°2014/007 provides that the issuer or the intermediary must issue a confirmation (*attestation de titre*) to the owner which must contain, notably, the securities owner’s code, identification, and address as well as a value code (an international securities identification number, or ISIN¹⁰³). But with the exception of Cameroon, no OHADA Member State requires that securities accounts appear on an intermediary’s balance sheet. In addition, the OHADA Uniform Act on Accounting Law and Financial Reporting contains no accounting rules for assets and liabilities on an intermediary’s balance sheet; the considerations on which accounting, regulatory, and tax rules are based are entirely unrelated to those that underlie the global business of security custody, clearing, and settle-

⁹⁹ James Steven Rogers, ‘Conflict of Laws for Transactions in Securities Held Through Intermediaries’ (2006) 39 Cornell International Law Journal 285, 304.

¹⁰⁰ For instance, see Article 12 of the Decree of 4 May 1895 under Congolese law. See also Dagmar Coester-Waltjen, ‘Marriage’ in Jürgen Basedow et al (eds), *Encyclopedia of Private International Law, Volume 2: Entries I-Z* (Edward Elgar, Cheltenham 2017) 1227–1234.

¹⁰¹ James Steven Rogers (*supra* n 99) 304.

¹⁰² See Christophe Bernasconi, ‘The Hague Convention of 5 July 2006 on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary’ (2006) IMF Seminar Paper 1, 7.

¹⁰³ As indicated above, the ISIN code is an international identification number assigned by the Central Depository to securities (shares, bonds, etc.) at the time of issue. The ISIN code is a twelve-character international alphanumeric code assigned to each security whose first two letters identify the country in which the value was issued (for example: CM0000035113). This is the code used by the Central Depository to identify the securities.

ment.¹⁰⁴ Consequently, it would be arbitrary to use the allocation of a securities account to a particular office for accounting and tax purposes to determine the law that will govern interests in intermediated securities.

Furthermore, in modern global trading, any attempt to specify the office that maintains a specific account is difficult since some or even all functions pertaining to maintaining and servicing a securities account are regularly performed from more than one location or, increasingly, are even outsourced to third parties in several locations. For instance, assume an intermediary incorporated under German law has agreed with its client that their account agreement will be maintained in New York; that is where the account was initially opened and where the securities were first credited to the account. Assume further that all the account statements the intermediary sends the client come from an office located in Singapore; the dividends the client receives come from an office in Hong Kong; advice pertaining to the ongoing status of the account is conveyed from an office in Dublin; two separate computer systems, run from the intermediary's offices in London and Chicago, back up and monitor all the intermediary's operations in respect of the client's securities account; and finally, the client regularly monitors the relevant securities account from a laptop while traveling around the world.¹⁰⁵ In this case, the PRIMA rule (which seeks to identify the location of the securities account or of the office where the securities account is maintained) would not work.

In this respect, *Rogers* aptly indicates that “[t]he annoying reality is that abstract relations simply do not have a location. Thus, at present, the law in the European Union is stuck in the situation of having adopted a conflict of laws rule that those who have examined the matter carefully have determined simply will not work.”¹⁰⁶ In essence, this also appears to be the Commission's conclusion from an evaluation of Article 9 of the Financial Collateral Directive which indicated:

“Therefore, also in the event that the Council would decide not to go forward with the [Hague Securities] Convention, Article 9 [of the Financial Collateral Directive] (as well as Article 9 [of the Settlement Finality Directive] and Article 24 Winding-up Directive) would still have to be amended to improve the situation within the Community by specifying the exact criteria for determining the relevant location of an account. The example of the two Member States (France and Portugal), that have developed such criteria, shows that different interpretations are indeed possible.”¹⁰⁷

¹⁰⁴ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s Int-43; Christophe Bernasconi (*supra* n 102) 7.

¹⁰⁵ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s Int-44.

¹⁰⁶ James Steven Rogers (*supra* n 99) 305.

¹⁰⁷ Commission of the European Communities, *Report from the Commission to the Council and the European Parliament: Evaluation Report on the Financial Collateral Arrangements Directive (2002/47/EC)*, Brussels, 20 December 2006, COM(2006) 833 final, 11.

This conclusion reflects the Commission's 2003 proposal in support of the Hague Securities Convention.¹⁰⁸ The Commission similarly criticised the PRIMA rule too, expressing the following view in favour of the Hague Securities Convention:

“The implementation of the Hague Convention in the EU will enable participants to determine in advance of any action, with certainty and with only reasonable effort what national substantive law governs their rights to indirectly-held securities. In the context of its responsibilities, the Commission will make the necessary arrangements for the signature and subsequent accession to the Convention by the European Union and its ratification by the Member States. The Commission will also take the necessary steps to bring the Settlement Finality and the Financial Collateral Directive in line with the conflicts of law provisions of the Hague Convention.”¹⁰⁹

In 2004, Mrs. Terry, the chairperson of the Civil Law Committee, kindly asked the ECB to provide its informal views regarding the Hague Securities Convention. In response, the ECB subsequently provided two letters, dated respectively 24 January and 7 September 2004, and then on 17 March 2005 released an opinion concerning the signing of the Hague Convention. The ECB indicated that it:

“[...] would, in view of the Convention's possible implications and current Community legislation, [...] welcome a comprehensive prior assessment of the Convention's impact in the Community. [...] In order not to pre-empt an open-ended outcome, this assessment should be undertaken prior to a discussion of the possible signature of the Convention, considering that the existing Community regime is sufficiently satisfactory and does not require an urgent or compelling signature of the Convention [my emphasis].”¹¹⁰

The ECB reiterated its opinion on 25 May 2005.¹¹¹ On 16 March 2005, the Ministry of Finance of Luxembourg requested from the ECB its opinion on a draft law on financial collateral arrangements that had been submitted to the Chamber of Representatives of Luxembourg on 25 November 2003.¹¹² From a conflict of laws perspective, the draft law contained provisions relating to

¹⁰⁸ Commission of the European Communities, *Proposal for a Council Decision Concerning the Signing of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary*, COM(2003) 783, dated 15 December 2003.

¹⁰⁹ Commission of the European Communities, *Communication from the Commission to the Council and the European Parliament Clearing and Settlement in the European Union – The Way Forward*, COM(2004) 312, 24.

¹¹⁰ European Central Bank, *Opinion of the European Central Bank of 17 March 2005 at the Request of the Council of the European Union on a proposal for a Council Decision Concerning the Signing of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary* COM(2003) 783 final, 10.

¹¹¹ ECB, *Opinion of the European Central Bank of 25 May 2005 at the Request of the Ministry of Finance of Luxembourg on a Draft Law on Financial Collateral Arrangements* (CON/2005/12).

incorporating certain provisions of the Hague Securities Convention into Luxembourg's legal framework. Interestingly, the ECB indicated:

“The conflict of law rule proposed by the draft law refers to the law of the country in which the relevant account is located. This location-based conflict-of-law rule is inconsistent with the Hague Convention's conflict-of-law rule, which is primarily based on the freedom of contract of the relevant intermediary and the account holder, subject only to a relevant office requirement in order to avoid entirely arbitrary choices. If the Hague Convention were to be ratified by the Community, it would not therefore be possible to apply the conflict-of-law rule established by the draft law in the light of the Convention.”¹¹³

However, as to the adoption of the Hague Securities Convention, the ECB restated the view that it was important to make a comprehensive prior assessment of the Convention's impact in the Community. The Commission shared that view and indicated in a green paper¹¹⁴ that it would prepare such a legal assessment by the end of 2005. The EU's legal assessment of the Hague Securities Convention, released the same day Switzerland and the US signed the convention (5 July 2006),¹¹⁵ concluded that joining the Hague Securities Convention was the best way to address the problems with the EU's current conflict of laws regimes for the intermediary system.¹¹⁶ More particularly, the Commission concluded that the “adoption of the Convention would be in the best interest of the Community” and recommended that the Convention “be signed after or with at least two of its trading partners, the USA included.” Moreover, on the same day, Charlie McCreevy, the internal market and services commissioner, commented in a press release that:

“In today's global financial markets we can no longer afford uncertainty about which law is applicable to indirectly held securities. The “location of the account formula” has worked fine in Europe's transition to a fully integrated single securities market, but now that European citizens are able to reap the benefits of participation in global financial markets, we need legal rules that are sustainable world-wide. Therefore, we need to change. The USA and Switzerland are about to sign the Convention and the EU should not lag behind.”¹¹⁷

¹¹² It is important to note that the ECB had competence to deliver an opinion pursuant to the third, fifth, and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the Consultation of the European Central Bank by National Authorities Regarding Draft Legislative Provisions (OJ L 189, 3 July 1998, 42). In that case, the draft law related to (i) the *Banque Centrale du Luxembourg* (BCL) and the other central banks in the European System of Central Banks (ESCB); (ii) securities settlement systems; and (iii) the stability of financial institutions and markets.

¹¹³ ECB (*supra* n 111) 8.

¹¹⁴ Commission of the European Communities, *Green Paper on Financial Services Policy (2005–2010)*, COM(2005) 177, 3 May 2005, 10.

¹¹⁵ See the notice ‘Switzerland and the United States sign Hague Securities Convention’, available at <<https://www.hcch.net/en/news-archive/details/?varevent=117>> (accessed 4 January 2021).

¹¹⁶ Commission of the European Communities (*supra* n 73) 23.

In light of the above, the European Parliament's resolution of 14 December 2006 on the implications of signing the Hague Securities Convention¹¹⁸ was surprising: the Parliament "[r]eiterates its commitment to the PRIMA principle, to defining a common framework for clearing and settlement activities, to effectively combating money laundering and to respect for shareholders' voting intentions" (point E.3 of the Resolution).¹¹⁹ Such a commitment to the PRIMA rule is most surprising given the opinions of the Commission in support of the Hague Securities Convention and the aforementioned difficulties resulting from the application of the PRIMA rule. Indeed, the Commission's 2006 report on the Financial Collateral Directive noted that there was not a sufficient level of legal certainty at either the international or the Community level.¹²⁰ Hence, in case the Council decided not to go forward with the Hague Securities Convention, the Commission proposed modifying Article 9 of the Financial Collateral Directive as well as Article 9 of the Settlement Finality Directive and Article 24 of the Winding-Up Directive to improve legal certainty within the Community. The Commission highlighted that to improve legal certainty, it was important to determine exact criteria for determining the relevant location of the account, a conclusion that underscores how the PRIMA rule, as currently embodied in the three directives, does not offer legal certainty and predictability. The European Parliament's resolution stressing a "commitment" to the PRIMA rule is quite inconsistent with the Commission's position.

In addition, the European Parliament's 2006 resolution indicates that the body "[c]onsiders that ensuring the security of intra-European transactions must take precedence over the facilitation of transactions between the European Union and the rest of the world" (point E7 of the Resolution). But this is not in line with the reality of today's global financial markets; in the modern indirect holding system, there is no clear-cut distinction between holding patterns that would be purely "intra-European" on one hand and others that involve "the rest of the world". Additionally, the European Parliament reiterated the need for democratic checks on the negotiations carried on in the

¹¹⁷ See the press release 'Securities markets: Commission calls upon Member States to sign Hague Securities Convention' of 5 July 2006, available at <http://europa.eu/rapid/press-release_IP-06-930_en.htm?locale=en> (accessed 4 January 2021).

¹¹⁸ The text of the resolution can be found at <<http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//NONSGML+MOTION+B6-2006-0632+0+DOC+PDF+V0//EN>> (accessed 4 January 2021).

¹¹⁹ See point E.3 of the Resolution.

¹²⁰ Commission of the European Communities, *Report from the Commission to the Council and the European Parliament: Evaluation Report on the Financial Collateral Arrangements Directive (2002/47/EC)*, Brussels, 20 December 2006, COM(2006) 833 final, 10, 11.

context of the Hague Conference on Private International Law.¹²¹ It is not a convincing position, because the European Commission was represented during the process of negotiating the Hague Securities Convention.¹²²

Moreover, the European Parliament

“[r]egret[ed] the highly inadequate nature of the reality test (Article 4(1) of the Convention) and the exemptions with regard to public policy legislation (Article 11(3) of the Convention), which risk encouraging the choice of the least restrictive legislation and creating distortions in the internal market in financial services.”¹²³

The resolution also pointed out that the Convention is incompatible with the directives on collateral, settlement finality, and the winding-up of credit institutions.¹²⁴ Under point E.9 of the resolution, the European Parliament invited the Commission to submit a comprehensive impact study on the implications of accession to the Hague Securities Convention for the law and economy of the European Union; in particular, it asked the Commission to specify the fiscal consequences of acceding to the convention and the implications of the transfer risks between entities (central depositories, depositors, and banks) deriving from abandonment of the PRIMA principle.¹²⁵

In addition, the European Parliament indicated that the College of Commissioners had to adopt the impact study before making any commitment to sign on behalf of the EU.¹²⁶ A 2008 impact assessment report on the Settlement Finality Directive and the Financial Collateral Directive¹²⁷ noted three distinct policy options to be considered:

- (i) Option 1: Keeping the current PRIMA rule (the “do nothing option”);
- (ii) Option 2: Adopting the Hague Securities Convention;
- (iii) Option 3: Developing an “enhanced” PRIMA rule.

¹²¹ See point E.1 of the Resolution.

¹²² For instance, during the meeting of the Working Group of Experts (15 to 19 January 2001), the European Commission was represented by Mr Marc Vereecken (Administrator, European Commission, Brussels), Mr Peter Restelli-Nielsen (National Expert Danmarks Nationalbank, Brussels) and Mr Michael Wilderspin (European Commission, Brussels). See Prel. Doc. No 13 of June 2001, Annex A.

¹²³ Point E.8 of the Resolution.

¹²⁴ See point A of the Resolution.

¹²⁵ In addition, the Commission had to specify the implications for the exercise of voting rights attached to securities and the impact on the remuneration of the ultimate owner of securities, the effectiveness of the clearing and settlement system, the identification of risks of insolvency of credit institutions, on combating money-laundering, market abuses, and the funding of terrorism (point E.9 of the Resolution).

¹²⁶ Point E.10 of the Resolution.

¹²⁷ See Commission of the European Communities, *Commission Staff Working Document Accompanying the Proposal for a Directive of the European Parliament and of the Council Amending the Settlement Finality Directive and the Financial Collateral Directive: Impact Assessment*, COM(2008) 213 final, SEC(2008).

In respect of the second option, the Commission indicated:

“The [Hague Securities Convention] provides a comprehensive and global conflict-of-laws rule that, to a large extent, allows parties to choose the law governing third party rights, but which is contrary to the objective location-of-account rule. The adoption of the Convention, as proposed by the Commission in 2003, would be one way to overcome the perceived weaknesses of the location-of-account rule and to improve the legal certainty concerning the applicable law in case of indirectly held securities at a global level. Unfortunately, the Convention has become subject of growing opposition among Member States, the European Parliament and the European Central Bank. The objections raised go to the very heart of the Convention. Therefore, it is difficult to consider the Convention in its present shape still as a realistic option for the Community.”¹²⁸

Based on that assessment, the Commission rejected the second option and recommended that a more refined version of PRIMA be developed to ensure that it is interpreted the same way in all Member States. More particularly, the Commission suggested the use of tax, regulatory, or accounting requirements to determine the location of a securities account.¹²⁹ Indeed, some states require intermediaries to assign a code to each securities account that effectively allocates it to a particular office for those purposes.¹³⁰ However, as indicated above, the considerations upon which the tax, regulatory, or accounting rules are based are wholly unrelated to the private international law issues involving the clearing and settlement of intermediated securities. Therefore, it would be quite uninformed to use a designation of a securities account to a specific office for those purposes in order to determine what law applies to an unrelated business purpose. This is particularly so in light of the global business of securities custody, clearing, and settlement, in which some or all of the functions related to maintaining and servicing a securities account are increasingly being undertaken from more than one office or are outsourced to third parties in several locations. Moreover, these tax, regulatory reporting, or accounting requirements in EU Member States have not been made uniform so far. Since the discussion within the EU had failed to reconcile the diverging opinions held by the different players, the Commission contended that “the situation was not yet mature for proposing any changes to the current PRIMA rule”¹³¹ Consequently, the Commission considered the “do nothing” option to be the one it preferred at the time.

¹²⁸ Commission of the European Communities (*supra* n 127) 30.

¹²⁹ In addition, the Commission suggested making it mandatory for all securities accounts to refer to a country code. Such code would help determine the country where the securities account is located and thus the governing law.

¹³⁰ This is as opposed, for instance, to a sort code identifying a particular branch or office of the intermediary. It is important to note that during the elaboration process of the Hague Securities Convention, it was also envisaged that tax, regulatory, and accounting requirements should be used to determine the location of a securities account (Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s Int-40).

The second public consultation questionnaire of an envisaged directive on securities law suggests a harmonisation of scope similar to that of the Hague Securities Convention. It also suggests sticking to the current *lex rei sitae* as the connecting factor, though with some complementing explication for more legal certainty.¹³² The proposed choice of law principle is as follows:

“The national law should provide that any question with respect to any of the matters specified below arising in relation to account-held securities should be governed by the national law of the country where the relevant securities account is maintained by the account provider. Where an account provider has branches located in jurisdictions different from the head offices’ jurisdiction, the account is maintained by the branch which handles the relationship with the account holder in relation to the securities account, otherwise by the head office. In addition, an account provider is responsible for communicating in writing to the account holder whether the head office or a branch and, if applicable, which branch, handles the relationship with the account holder.”

In conclusion, the EU’s PRIMA rule gives rise to a severe difficulty since there is no generally acceptable criterion for all types of securities or all categories of intermediaries on a global basis by which to determine, beyond doubt, what office of an intermediary maintains a specific account or what the location is of a securities account. Even within the EU Member States, there are significant discrepancies in how the conflict of laws rules in Article 9(2) of the Settlement Finality Directive, Article 9(1) of the Financial Collateral Directive, and Article 24 of the Winding-up Directive have been enacted into national law and interpreted. Several reports and studies by the European Commission have underscored the legal uncertainty of the existing conflict of laws rules in the EU in the field of proprietary effects of securities transactions and have suggested that the EU accede to the Hague Securities Convention. Against this backdrop, this thesis submits that the EU’s PRIMA rule should not serve as an analogue for a conflict of laws rule to determine what law applies to *in rem* rights in security interests in intermediated securities in the OHADA region.

C. Summary and Evaluation

1. The dematerialisation of securities has meant that the great majority of those transferred and pledged daily in cross-border transactions are held with intermediaries, in electronic book-entry form in securities accounts. These intermediaries may be located in different jurisdictions, and so several jurisdictions may be involved; how many depends on the length of the intermediation chain. Consequently, there is a need for a clear, uniform conflict of

¹³¹ Commission of the European Communities (*supra* n 127) 30, 44.

¹³² European Commission, *Legislation on Legal Certainty of Securities Holding and Dispositions (Consultation Document)*, DG Market G2 MET/OTacg D(2010) 768690 (hereinafter referred to as European Commission, *Legal Certainty*) 23–25.

laws rule to determine, with certainty and predictability, the law (and thus the relevant jurisdiction) that governs market participants' securities.

2. To address this issue of legal uncertainty, the EU introduced the PRIMA rule through the Settlement Finality Directive (Article 9(2)) in 1998 and included it in the later Winding-up Directive (Article 24) and Financial Collateral Directive (Article 9(1)) too. Under PRIMA, which stands for the "place of the relevant intermediary approach", questions of the creation, perfection or completion, priority, and realisation of interests in intermediated securities are governed by the law of the place of the intermediary on whose books the relevant interest is recorded. There is thus a single jurisdiction in which an investor's entire interest in a portfolio of securities is situated even if the certificates that evidence such underlying securities or their issuers are located in different countries.
3. PRIMA applies regardless of whether a transfer takes the form of a collateral transaction or a sale; if it is a collateral transaction, PRIMA applies irrespective of whether the transaction takes the form of a pledge or a transfer of title. PRIMA also applies regardless of the particular legal status of the collateral provider or collateral taker.
4. If the collateral taker is the collateral provider's intermediary, the law of the relevant intermediary will be the law of the place of the relevant intermediary.
5. An analyst can use different methods to determine the location of the relevant intermediary:
 - (i) An address indicated in the account agreement that governs the relationship between the relevant intermediary and its client;
 - (ii) An address indicated on an account statement sent by the relevant intermediary to its clients; or
 - (iii) In any other case, the *statutory seat* of the intermediary or the law under which it has been *incorporated* or *formed*.
6. However, an evaluation of the EU's PRIMA rule indicates it does not achieve enough certainty as to what law governs the proprietary effects of securities transactions. The way the assorted provisions are worded is often unclear and imprecise. Consequently, there are discrepancies among the various national transpositions of the directives' rules and among interpretations thereof. Moreover, there may be some difficulty in determining the location of the relevant intermediary, in particular if an entitlement is recorded through a computer network that connects the intermediary to an international network of branches and other offices. There is no readily identifiable place of record in such a case. The rule or rules in the EU therefore do not provide sufficient legal certainty or predictability; the location of the relevant account is not an easily ascertainable connecting factor on which parties might reasonably rely to ascertain the applicable law.

Chapter 3: Conflict of Laws Rules for Intermediated Securities under the Uniform Commercial Code

A. Conflict of Laws Issues under UCC Article 8

I. Introduction

UCC § 8-110 deals with the choice of law issues related to intermediated securities.¹³³ The difference between the direct and the indirect holding systems plays an important role in determining the governing law: within the direct holding system, an investor has possession of a security certificate or is registered on the books of the issuer, so the location of the certificate or the jurisdiction of incorporation of the issuer determines the governing law. But as discussed *supra*,¹³⁴ an investor in the indirect holding system does not have a direct interest in the underlying security but rather a security entitlement, which is a bundle of rights against the securities intermediary regarding a security.¹³⁵ Accordingly, in the indirect holding system, the issuer's jurisdiction of incorporation or the location of any certificates an intermediary or a higher-tier intermediary may hold does not determine the governing law.

It is worth noting that the official comment in no way indicates that the conflict of laws rules are intended for other nations' laws. However, the choice of law rules specified in UCC Articles 8 and 9 can apply by analogy to cases where a foreign law has been chosen, a solution justified by the use of the term "jurisdiction" instead of "state"¹³⁶ in UCC § 8-110. Moreover, UCC Article 8 Part 5 is based on recognition of the relevant intermediary's decision to undertake certain duties.

II. Issues governed by the Applicable Law

1. Issues governed by the Local Law of the Issuer's Jurisdiction

Under Subsection (a) of UCC § 8-110, the law of an issuer's jurisdiction applies to certain issues on which the substantive rules of UCC Article 8 determine the issuer's rights and duties. First, paragraph (1) of subsection (a) of UCC § 8-110 provides that the local law of the issuer's jurisdiction¹³⁷ ap-

¹³³ In contrast, the choice of law provisions on security interests in securities and security entitlements are determined in UCC § 9-305 (*see* section B of this chapter).

¹³⁴ *See* chapter 4 of part II of this thesis.

¹³⁵ Olivier Favre, *Die Berechtigung von Depotkunden an auslandsverwahrten Effekten: Verwahrungskonzepte und ihre Bedeutung im internationalen Privatrecht aus schweizerischer Sicht* (Schulthess, Zürich 2003) 98.

¹³⁶ The term "state" refers to one of the US states.

¹³⁷ The phrase "local law" refers to the law of a jurisdiction other than its conflict of laws rules. *See* Restatement (Second) of Conflict of Laws UCC § 4. It is important to

plies to the validity of the security. This provision allows a single body of law to apply to issues addressed in Part 2 of UCC Article 8 (on the circumstances in which an issuer can and cannot assert invalidity as a defence against purchasers).¹³⁸ Second, paragraph (2) provides that the local law of the issuer's jurisdiction also governs the issuer's rights and duties with respect to registration of a transfer. Third, paragraph (3) provides that the law of the issuer's jurisdiction also governs the effectiveness of registration of a transfer by the issuer. Under paragraph (4), whether the issuer owes any duties to an adverse claimant to a security is also governed by the local law of the issuer's jurisdiction. These provisions ensure that the issuer will be able to look to a single body of law to answer questions dealt with in Part 4 of UCC Article 8 (on the issuer's duties and liability in respect of registering a transfer).¹³⁹ Last, paragraph (5) of subsection (a) of UCC § 8-110 designates the local law of the issuer's jurisdiction as applicable to the issue of whether an adverse claim can be asserted against a purchaser to whom a transfer has been registered or who has obtained control over an uncertificated security. This issue is related to the rights of persons other than the issuer, and yet the local law of the issuer's jurisdiction applies since the "purchasers" the rule contemplates are those whose protection against adverse claims is contingent on the fact that their interests have been recorded on the books of the issuer.

The hallmark of the provisions in subsection (a) of UCC § 8-110 is that an issuer or others should not have to look to the law of all the different jurisdictions in which the security holders may reside. They should instead be able to look to a single body of law on the matters specified in subsection (a). The provisions of subsection (a) of UCC § 8-110 do not require that the body of law governing all of the matters mentioned there must be that of the jurisdiction in which the issuer is incorporated, however; the phrase "issuer's jurisdiction" under subsection (d) of UCC § 8-110 therefore means the jurisdiction in which the issuer is organised, or, if permitted by that law, the law of another jurisdiction selected by the issuer. Further, pursuant to subsection (d) of UCC § 8-110, issuers organised under the law of a state which adopts the Article may make such a selection, except as to the validity issues specified in paragraph (1) of UCC § 8-110(a). Whether an issuer can assert the defence of invalidity may implicate significant policies of the issuer's jurisdiction of incorporation.¹⁴⁰

note that in respect of *renvoi*, the term "local law" refers to substantive law and does not encompass conflict of laws rules.¹³⁷ Hence, no *renvoi* is applicable to the conflict of laws provisions in UCC Article 8.

¹³⁸ Uniform Commercial Code, Official Text and Comments (2007) 774.

¹³⁹ Uniform Commercial Code, Official Text and Comments (2007) 774.

¹⁴⁰ See, for instance, UCC § 8-202.

Under subsection (a) of UCC § 8-110, the issuer's rights and duties in respect of registering a transfer are governed by the law of the issuer's jurisdiction. However, other matters concerning registration of transfer, including the appointment of a guardian for a registered owner or the existence of agency relationships, might be governed by the law of another jurisdiction.¹⁴¹ Neither UCC § 8-110 nor UCC Article 1-105 addresses what law applies to the appointment of an administrator or executor. Those issues are left to be determined under generally applicable choice of law rules.

2. *Issues governed by the Local Law of the Securities Intermediary's Jurisdiction*

As per subsection (b) of UCC § 8-110, the law of the securities intermediary's jurisdiction applies to the issues concerning the indirect holding system which are addressed in UCC Article 8. Under paragraphs (1) and (2) of subsection (b), the law of the securities intermediary's jurisdiction governs, respectively, the acquisition of a security entitlement from the securities intermediary and the rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement. These two provisions cover the issues addressed in UCC Article 8's rules which define the concept of a security entitlement and which specify the duties of securities intermediaries.¹⁴² Paragraph (3) of subsection (b) provides that the law of the securities intermediary's jurisdiction determines whether the intermediary owes any duties to an adverse claimant; paragraph (4) provides that the law of the securities intermediary's jurisdiction governs whether adverse claims can be asserted against entitlement holders and others.

III. Determination of the "Securities Intermediary's Jurisdiction"

1. Introduction

The "securities intermediary's jurisdiction" is defined in subsection (e) of UCC § 8-110. The policy behind subsection (b) of UCC Article 8 was to ensure that a securities intermediary and all its entitlement holders can look to a single, readily identifiable body of law to determine their rights and duties; subsection (e) therefore contains a sequential series of tests by which to identify that body of law.

¹⁴¹ Uniform Commercial Code (*supra* n 138) 775.

¹⁴² Uniform Commercial Code (*supra* n 138) 775.

2. *Specification of the Securities Intermediary's Jurisdiction by Agreement*

Under paragraph (1) of subsection (e) of UCC § 8-110, the securities intermediary's jurisdiction can be determined by agreement.¹⁴³ Since the basic legal nature of a security entitlement is of rights *in personam* vis-à-vis the relevant intermediary, the subjective connecting factor provided in UCC § 8-110(e) derives naturally from the analysis of the "security entitlement" concept in the substantive law. If there is no specification of what law governs the intermediary, the law chosen by the parties to govern the securities account determines the securities intermediary's jurisdiction (paragraph (2) of subsection (b) of UCC § 8-110).¹⁴⁴ Since the purpose of UCC § 8-110 is to enable parties to determine, in advance and with certainty, what law will govern transactions under UCC Article 8, the parties' selection of the applicable law by way of agreement is valid independent of any determination that the jurisdiction whose law is chosen bears a "reasonable relation" to the transaction.¹⁴⁵ The same goes for similar provisions in subsection (d) of UCC § 8-110¹⁴⁶ and UCC § 9-305¹⁴⁷.

3. *Additional Default Rules for Determining the Securities Intermediary's Jurisdiction*

The first additional rule is enshrined in paragraph (3) of subsection (e) of UCC § 8-110:

"If neither paragraph (1) nor paragraph (2) of the same subsection applies and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction."

The second additional rule is found in paragraph (4) of subsection (e) of UCC § 8-110, which provides that if paragraphs (1), (2), and (3) of the same subsection all do not apply, "the securities intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the entitlement holder's account is located."¹⁴⁸ Paragraph (5) of sub-

¹⁴³ Steven L. Schwarcz & Joanna Benjamin (*supra* n 45) 323.

¹⁴⁴ Stephan Saager (*supra* n 26) 164.

¹⁴⁵ Uniform Commercial Code (*supra* n 138) 775. See UCC Article 4A-507 and UCC Article 1-105(1).

¹⁴⁶ Under subsection (d) of UCC § 8-110, "issuer's jurisdiction" means "the jurisdiction under which the issuer of the security is organised or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified by the issuer. An issuer organised under the law of this State may specify the law of another jurisdiction as the law governing the matters specified in subsection (a)(2) through (5)."

¹⁴⁷ This provision is analysed *infra* (section B of this chapter).

¹⁴⁸ Stephan Saager (*supra* n 26) 164.

section (e) of UCC § 8-110 contains the third additional rule, which provides that if none of the preceding paragraphs of the same subsection applies, “the securities intermediary’s jurisdiction is the jurisdiction in which the chief executive office of the securities intermediary is located.”

4. *Exclusion of Certain Connecting Factors*

Subsection (f) of UCC § 8-110 underscores an implicit point in UCC Article 8’s description of a security entitlement, not as a direct interest in the underlying security or other financial asset, but rather as a bundle of rights against the intermediary regarding a security or financial asset. Under subsection (f), the physical location of certificates representing financial assets, the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement, or the location of facilities for data processing or other record keeping concerning the account cannot be taken into account to determine a securities intermediary’s jurisdiction.

IV. *Choice of Law Rules for Adverse Claim Issues*

Subsection (c) of UCC § 8-110 contains a choice of law rule in respect of adverse claim issues which may arise in relation to the delivery of security certificates in the direct holding system. It applies to the law of the place of the delivery¹⁴⁹ and provides that “the local law of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim can be asserted against a person to whom the security certificate is delivered.” Assume, for instance, that a certificated security issued by an Idaho corporation is sold, and the sale is settled by physical delivery of the certificate from Seller to Buyer in New York. In such a case, pursuant to subsection (c) of UCC § 8-110, the law of New York determines whether Buyer takes free of adverse claims. The domicile of Seller, Buyer, and any adverse claimant is immaterial.

V. *Example illustrating the Provisions in UCC § 8-110*

The following examples illustrate how the governing law may be determined pursuant to UCC § 8-110. First, assume that JM is a resident of Kansas and maintains a securities account with IM & Co. IM is incorporated in Delaware. Its chief executive offices are located in Illinois. The office where JM transacts business with IM is located in Missouri. The agreement between JM and IM provides that Illinois is the securities intermediary’s (IM) jurisdiction. Through the account, JM holds securities of a Colorado corporation, and IM holds the securities through Clearing Corporation. Under the rules of Clearing

¹⁴⁹ Uniform Commercial Code (*supra* n 138) 775.

Corporation, the rights and duties of Clearing Corporation and its participants are governed by New York law. In such a case, subsection (a) of UCC § 8-110 provides that any controversy in respect of rights and duties as between the issuer and Clearing Corporation is governed by Colorado law. Moreover, as per subsection (b) and (e) of UCC § 8-110, any claim with respect to rights and duties as between Clearing Corporation and IM is governed by New York law; any controversy regarding rights and duties as between IM and JM is governed by Illinois law.

Secondly, assume under the same fact pattern that, through the account, JM holds securities of a Congolese corporation, and IM also holds those through Clearing Corporation. Clearing Corporation's operations are located in Belgium. The rules of Clearing Corporation and its agreements with its participants specify that they are governed by Belgian law. Clearing Corporation holds the securities through a custodial account at the Paris branch office of International Bank, which is organized under German law. The agreement between International Bank and Clearing Corporation specifies that it is governed by French law. Under subsection (e) of UCC § 8-110, any controversy in respect of rights and duties as between the issuer and International Bank is governed by Congolese law. Additionally, pursuant to subsections (b) and (e) of UCC § 8-110, any controversy in respect of rights and duties as between International Bank and Clearing Corporation is governed by French law; a controversy related to rights and duties as between Clearing Corporation and IM is governed by Belgian law; and any controversy concerning rights and duties as between IM and JM is governed by Illinois law.¹⁵⁰

VI. Application of General Choice of Law Rules

It is worth highlighting that general choice of law rules apply to the extent UCC § 8-110 does not specify the governing law. Assume for instance that in either of the fact patterns mentioned above, JM enters into an agreement with DOE, which is also a resident of Kansas. Under that agreement, JM agrees to transfer all its interests in the securities it holds through IM to DOE. UCC Article 8 does not address whether such an agreement is enforceable or whether it gives DOE an interest in JM's security entitlement.¹⁵¹ UCC § 8-110 instead indicates the jurisdiction whose law applies to the issues addressed in UCC Article 8. UCC Article 8 specifies, however, that securities intermediaries have only limited duties in respect of adverse claims.¹⁵² In the example mentioned above, under subsection (b)(3) of UCC § 8-110, Illinois law governs

¹⁵⁰ Please note that these examples are inspired by those provided in the Uniform Commercial Code (*supra* n 138) 776.

¹⁵¹ Uniform Commercial Code (*supra* n 138) 776.

¹⁵² See UCC § 8-115.

whether IM owes any duties to an adverse claimant, so UCC § 8-115 as enacted in Illinois will determine whether DOE has any rights against IM.

B. Choice of Law Provisions concerning Security Interests in Security Entitlements

I. General Rules

UCC § 9-305, which is former UCC § 9-103(6), determines the choice of law rules for the perfection and priority of security interests in investment property.¹⁵³ The scope of subsection (a)(1) of UCC § 9-305 is limited to security interests in certificated securities.¹⁵⁴ Subsection (a)(2) of UCC § 9-305 covers security interests in uncertificated securities; subsection (a)(3) covers security interests in security entitlements and securities accounts; subsection (a)(4) of UCC § 9-305 deals with security interests in commodity contracts and commodity accounts.

These paragraphs all share the same approach: using the same principles which UCC Article 8 uses to determine other questions in respect of investment securities, they identify the jurisdiction whose law applies to issues of perfection and priority.¹⁵⁵ For certificated securities, the applicable law is therefore that of the jurisdiction where the certificate is located.¹⁵⁶ In contrast, the law of the issuer's jurisdiction applies to uncertificated securities.¹⁵⁷ As to security entitlements and securities accounts, the law of the securities intermediary's jurisdiction governs.¹⁵⁸ For commodity contracts and commodity accounts, the law of the commodity intermediary's jurisdiction governs. Since UCC Article 8 does not apply to commodities, subsection (b) of UCC § 9-305 encompasses provisions that specify the commodity intermediary's jurisdiction. These rules are analogous to those enshrined in subsection (e) of UCC § 8-110, which specify a security intermediary's jurisdiction.

II. Exceptions

Subsection (c) of UCC § 9-305 contains an exception to the general rules set out in subsection (a). It provides that the local law of the jurisdiction in which

¹⁵³ It should be recalled that an investment property is a security, whether certificated or uncertificated, a security entitlement, a securities account, a commodity contract, or a commodity account (subsection (a)(49) of UCC § 9-102).

¹⁵⁴ Stephan Saager (*supra* n 26) 165. See also Hans Kuhn, 'Neufassung des Kollisionsrechts für Mobiliarsicherungsgeschäfte in den Vereinigten Staaten von Amerika' (2000) IPRax 332.

¹⁵⁵ Stephan Saager (*supra* n 26) 165, 166.

¹⁵⁶ See subsection (c) of UCC § 8-110.

¹⁵⁷ See subsection (a) of UCC § 8-110.

¹⁵⁸ See subsection (b) of UCC § 8-110; Bradley Crawford (*supra* n 39) 161.

the debtor is located (as determined under UCC § 9-307) governs: (1) perfection of a security interest in investment property by filing; (2) automatic perfection of a security interest in investment property created by a broker or securities intermediary¹⁵⁹; and (3) automatic perfection of a security interest in a commodity contract or commodity account created by a commodity intermediary¹⁶⁰. This rule can be illustrated as follows: First, assume a customer who resides in New Jersey maintains a securities account with IM & Co. The agreement between the customer and IM provides that it is governed by Pennsylvania law; but it also expressly specifies that the law of California is IM's jurisdiction for purposes of the UCC. The customer holds securities of a Massachusetts corporation which IM holds through a clearing corporation located in New York. IM grants a margin loan to the customer. Under subsection (a)(3) of UCC § 9-305, the law of the securities intermediary's jurisdiction (in this case, California law) applies to perfection and priority of the security interest even if California has no other relationship to the parties or the transaction.

In addition, assume that a customer residing in New Jersey maintains a securities account with IM & Co. The agreement between IM and the customer indicates that it is governed by Pennsylvania law. Through the account, the customer holds securities of a Massachusetts corporation which IM holds through a clearing corporation located in New York. A lender located in Illinois grants a loan to the customer, takes a security interest in the New Jersey customer's position, and perfects it by obtaining an agreement among the debtor, itself, and IM, according to the requirements of UCC § 8-106(d)(2), to give the lender control. Pursuant to subsection (a)(3) of the UCC § 9-305, the law of the securities intermediary's jurisdiction (in this case, Pennsylvania law) governs perfection and priority of the security interest even if Pennsylvania has no other relationship to the parties or the transaction.

For a third illustration, assume that a customer residing in New Jersey maintains a securities account with IM & Co. Under the agreement between the customer and IM, it is governed by Pennsylvania law. Through the account, the customer holds securities of a Massachusetts corporation which IM holds through a clearing corporation located in New York. Assume further that the customer borrows from LC-1. LC-1 files a financing statement in New Jersey. Later, the customer borrows from LC-2. LC-2 takes a security interest in the same securities and perfects it by obtaining an agreement among the debtor, itself, and IM, in line with the requirements of UCC § 8-106(d)(2), to give control to LC-2. As per subsection (c) of UCC § 9-305, perfection of LC-1's security interest (by filing) is governed by the law of the location of the debtor, and hence it was appropriate to file in New Jersey.

¹⁵⁹ See UCC § 9-309(10).

¹⁶⁰ See UCC § 9-309(11).

However, subsection (a)(3) of UCC § 9-305 provides that the law of the securities intermediary's jurisdiction (in this case, Pennsylvania law) applies to other questions of perfection and priority. Consequently, Pennsylvania law governs perfection of LC-2's security interest as well as the priority of the respective security interests of LC-1 and LC-2.

III. Change in Law Governing Perfection

If the jurisdiction of the issuer, the securities intermediary, or the commodity intermediary changes, the jurisdiction whose law applies to perfection pursuant to subsection (a) UCC § 9-305 also changes.¹⁶¹ Similarly, the law applicable to perfection of a possessory security interest in a certificated security changes if the collateral moves to another jurisdiction (subsection (a)(1) of UCC § 9-305), and the law governing perfection by filing changes if the debtor changes its location (subsection (c) of UCC § 9-305). However, these changes do not lead to an immediate loss of perfection (*see* UCC § 9-316).

C. Entry into Force of the Hague Securities Convention in the United States

I. Background and Applicability of the Hague Securities Convention

1. Signature and Ratification

The United States signed the Hague Securities Convention on 5 July 2006. It is worth mentioning that Switzerland also signed the Hague Securities Convention on 5 July 2006; Mauritius signed the Convention later, on 28 April 2008. In the United States, the Hague Securities Convention was supported by all relevant regulatory agencies including the Department of the Treasury, the Securities and Exchange Commission, the Commodity Futures Trading Commission, and the New York Federal Reserve Bank. It was also supported by the National Conference of Commissioners on Uniform State Laws, also known as the "Uniform Law Commission" (NCCUSL).¹⁶² The US Senate's Committee on Foreign Relations held a hearing to consider the Hague Securities Convention on 19 May 2016.¹⁶³ On 23 June 2016, the Committee considered the Hague Securities Convention and recommended that the Senate give advice and consent to its ratification. More particularly, the committee was of the view that the Hague Securities Convention would significantly benefit US

¹⁶¹ Uniform Commercial Code (*supra* n 138) 920.

¹⁶² Report of the Committee on Foreign Relations, Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (September 2016) 114th Congress, 2nd session, U.S. Senate, Exec. Rept. 114-15, 2.

¹⁶³ To view the published transcript of the 19 May 2016 hearing (Senate Hrg. 114-324), *see*: <www.govinfo.gov/browse/content/pkg/CHRG-114shrg20973/pdf/CHRG-114shrg20973.pdf> (accessed 4 January 2021). The hearing was chaired by Senator Isakson.

investors and financial institutions by increasing legal certainty in cross-border transactions and reducing legal and systemic risk without a need to adapt to a new legal framework. The committee also believed that the Hague Securities Convention would provide predictability, reduce costs, and facilitate capital flows; and more importantly, it underscored that the Convention would not contradict any federal or state laws or common practices in the United States: “Because the Convention reflects much of the Uniform Commercial Code, the Convention would in many respects extend current US law and practice to the global financial markets.”¹⁶⁴

On 15 December 2016, the United States ratified the Hague Securities Convention, thereby triggering its entry into force.¹⁶⁵ Indeed, Article 19(1) of the Hague Securities Convention provides: “This Convention shall enter into force on the first day of the month following the expiration of three months after the deposit of the third instrument of ratification, acceptance, approval or accession referred to in Article 17.” Consequently, the Hague Securities Convention came into effect in the United States (as well as in Mauritius and Switzerland) on 1 April 2017.

2. Implementing Legislation

The Hague Securities Convention is “self-executing” or “directly applicable” in domestic law, meaning that its provisions are applied by courts or executive agencies as provisions of domestic law without a need for further legislative or administrative measures.¹⁶⁶ In other words, no new legislation was necessary or sought in conjunction with the Hague Securities Convention. In light of the US Supreme Court decision *Medellin v Texas*¹⁶⁷ the Committee believed it war-

¹⁶⁴ Report of the Committee on Foreign Relations, Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (September 2016) 114th Congress, 2nd session, U.S. Senate, Exec. Rept. 114-15, 6.

¹⁶⁵ Please note that Mauritius and Switzerland ratified the Convention respectively on 15 October 2009 and on 14 September 2009. See the status of the Convention at <<https://www.hcch.net/en/instruments/conventions/status-table/?cid=72>> (accessed 4 January 2021).

¹⁶⁶ Karen Kaiser, ‘Treaties, Direct Applicability’ in Rüdiger Wolfrum (ed), *The Max Planck Encyclopedia of Public International Law* (Oxford University Press, Oxford 2013) 1108–1109.

¹⁶⁷ *Medellin v Texas* [2008] 552 U.S. 491, 128 S. Ct. 1346. *Medellin v Texas* is a United States Supreme Court decision which held that an international treaty is not binding domestic law unless Congress has enacted statutes that implement it or unless the treaty itself is “self-executing”. It also held that decisions of the International Court of Justice are not binding domestic law and that, without authority from the United States Congress or the Constitution, the President of the United States lacks the power to enforce international treaties or decisions of the International Court of Justice. For more details, see Ben Geslison, ‘Treaties, Execution, and Originalism in *Medellin v Texas*, 128 S. Ct. 1346 (2008)’ 32 *Harvard Law Journal of Law & Public Policy* 767; Margaret E. McGuinness,

ranted to include a clear statement in the resolution of advice and consent to ratification.¹⁶⁸ The resolution therefore declared the treaty self-executing:

“SECTION 1. SENATE ADVICE AND CONSENT SUBJECT TO AN UNDERSTANDING AND A DECLARATION.

The Senate advises and consents to the ratification of the Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, adopted at The Hague on July 5, 2006, and signed by the United States on that same day (the “Convention”) (Treaty Doc. 112–6), *subject to the declaration of section 2* [my emphasis].

SEC. 2. DECLARATION.

The advice and consent of the Senate under section 1 is subject to the following declaration: *The Treaty is self-executing* [my emphasis].”¹⁶⁹

As an international treaty, the Hague Securities Convention prevails over inconsistent UCC provisions; but as long as the Qualifying Office requirement is met, the parties to a secured transaction, by agreeing that all issues regarding at least the issues mentioned in Article 2(1) of the Hague Securities Convention will be governed by the chosen US state law, may nevertheless specify the law of a particular US state to apply to perfection of a security interest in intermediated securities. And in any case the UCC’s and the Hague Securities Convention’s rules lead to the same result in most cases, as examined in the next sub-section.

II. Scope of Application of the Hague Securities Convention

In the United States, the Hague Securities Convention applies to any transaction falling within its scope, including any such transaction involving a non-US entity (and not just ones from the other countries party to the Convention). As examined in the next chapter, transactions that fall within the scope of the Convention are “all cases involving a choice of law between the laws of different States” (Article 3 of the Hague Securities Convention) with respect to certain rights regarding securities credited to a securities account through a securities intermediary. More particularly, as per Article 2(1) of the Hague Securities Convention, the Convention determines the law applicable to the following issues in respect of intermediated securities: a) the legal

‘Three Narratives of *Medellín v. Texas*’ (2008) 31 (2) *Suffolk Transnational Law Review* 227; Steve Charnovitz, ‘Revitalizing the U.S. Compliance Power’ (2008) 102 (3) *American Journal of International Law* 551; James A. Turner, ‘The Post-Medellin Case for Legislative Standing’ (2010) 59 (3) *American University Law Review* 732.

¹⁶⁸ A further discussion of the Committee’s views on this matter can be found in Section VIII of Executive Report 110–12 (available at <www.gpo.gov/fdsys/pkg/CRPT-110erpt12/pdf/CRPT-110erpt12.pdf> (accessed 4 January 2021)).

¹⁶⁹ Report of the Committee on Foreign Relations, Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (September 2016) 114th Congress, 2nd session, U.S. Senate, Exec. Rept. 114-15, 7.

nature, and the effects against the intermediary and third parties, of the rights resulting from a credit of securities to a securities account; b) the legal nature, and effects against the intermediary and third parties, of a disposition of securities held with an intermediary; c) the requirements, if any, for perfecting a disposition of securities held with an intermediary; d) whether a person's interest in securities held with an intermediary extinguishes or has priority over another's interest; e) an intermediary's duties, if any, to a person, other than the account holder, who asserts an interest in securities held with that intermediary in competition with the account holder or another person; f) the requirements, if any, for realising an interest in securities held with an intermediary; g) whether a disposition of securities held with an intermediary extends to entitlements to dividends, income, or other distributions, or to redemption, sale, or other proceeds.¹⁷⁰ However, the Convention does not determine the law applicable to: a) the rights and duties arising from the credit of securities to a securities account to the extent that such rights or duties are purely contractual or otherwise purely personal; b) the contractual or other personal rights and duties of parties to a disposition of securities held with an intermediary; or c) a securities issuer's rights and duties, or those of an issuer's registrar or transfer agent, whether in relation to the holder of the securities or any other person (Article 2(3) of the Convention).

In comparison, UCC §§ 8-110(b) and (e) as well as 9-305(a)(3) specify the material scope and the connecting factor. Under UCC §§ 8-110(b) and 9-305(a)(3), the local law of the intermediary's jurisdiction governs the following issues:

- (1) The acquisition of a security entitlement from the intermediary;
- (2) The perfection, the effect of perfection or non-perfection, and the priority of a security interest in a security entitlement or securities account;
- (3) The rights and duties of an intermediary and an entitlement holder arising from a security entitlement;
- (4) Whether the intermediary is subject to any duties vis-à-vis an adverse claimant to a security entitlement; and
- (5) Whether an adverse claim can be asserted against an acquirer of a security entitlement from the intermediary or against a purchaser of a security entitlement or interest therein from an entitlement holder.¹⁷¹

¹⁷⁰ Under Article 2(2) of the Hague Securities Convention, the Convention determines the law applicable to the issues specified in Article 2(1) of the same in relation to a disposition of or an interest in securities held with an intermediary even if the rights resulting from the credit of those securities to a securities account are determined in accordance with Article 2(1)(a) to be contractual in nature.

¹⁷¹ See the Financial Collateral Directive, which addresses four issues: 1) the legal nature and proprietary aspects of collateral securities; 2) perfection requirements; 3) priori-

§ 9-305(c) also contemplates two particular, exceptional situations in which the connecting factor is different from the general intermediary's jurisdiction as referred to in § 9-305(a)(3): the law of the jurisdiction of the debtor's location applies to (i) perfection of a security interest in investment property by filing and (ii) automatic perfection of a securities interest in investment property established by an intermediary. (§ 9-307 determines the location of the debtor.)

III. Comparison of Hague Securities Convention and UCC Choice of Law Rules

UCC Articles 8 and 9 contain special choice of law rules for certain proprietary issues of intermediated securities dispositions. The content and approach of these rules are similar to those in the Hague Securities Convention; both UCC Articles 8 and 9 and the Hague Securities Convention allow for choice of law in determining the law applicable to a disposition of intermediated securities.¹⁷² Nevertheless, there are still differences in material scope. Another difference is the Hague Securities Convention's Qualifying Office requirement.

As discussed in far greater detail in the next chapter, the Hague Securities Convention sets forth, in Article 4(1), the primary rule for determining the choice of law: "The law applicable to all the issues specified in Article 2(1) is the law in force in the State expressly agreed in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law." This rule resembles the choice of law rules for perfection under the UCC (analysed *supra*),¹⁷³ which allow the parties to specify the applicable perfection law by agreeing on the "jurisdiction" of the securities intermediary for purposes of the securities account. The Hague Securities Convention, however, contains an important constraint on the parties' ability to choose the applicable law: it adds what is known as the "Qualifying Office" test. This constraint requires the securities intermediary to have an office in the designated country at the time the parties designated its law in the account agreement. Indeed, Article 4(1) second sentence of the Hague Securities Convention provides:

ties; and 4) realisation. Interestingly, UCC Article 8 does not address the issue of the steps needed to realise collateral in securities.

¹⁷² It is noteworthy that choice of law in UCC Articles 8 and 9 as well as in the Hague Securities Convention is not identical with party autonomy as usually referred to in contract choice of law rules. Indeed, the Hague Securities Convention and UCC focus on the choice of law made by the account holder and its intermediary rather than on the choice made by parties to a securities transaction.

¹⁷³ See sections A and B of this chapter.

“The law designated in accordance with this provision applies only if the relevant intermediary has, at the time of the agreement, an office in that State, which -

- a) alone or together with other offices of the relevant intermediary or with other persons acting for the relevant intermediary in that or another State -
 - i) effects or monitors entries to securities accounts;
 - ii) administers payments or corporate actions relating to securities held with the intermediary; or
 - iii) is otherwise engaged in a business or other regular activity of maintaining securities accounts; or
- b) is identified by an account number, bank code, or other specific means of identification as maintaining securities accounts in that State.”

As underlined in the next chapter, the office which satisfies the Qualifying Office requirement for the intermediary does not have to be the same office that handles the securities account in question; but on the other hand, activities that are generally administrative in nature would not suffice to meet the Qualifying Office requirement.

Further, it is interesting to note that the Hague Securities Convention uses the concept of a “multi-unit State”. Under Article 1(1)(m) of the Hague Securities Convention, a “multi-unit State” is “a State within which two or more territorial units of that State, or both the State and one or more of its territorial units, have their own rules of law in respect of any of the issues specified in Article 2(1)”. Under that definition, the United States, with its territorial units of states, the District of Columbia, Puerto Rico, and other subordinate units, is a multi-unit State.

The multi-unit state concept is crucial to applying the Qualifying Office requirement. Indeed, if the parties choose the law of a subordinate unit of a multi-unit state to apply to their securities account, the rules of the Hague Securities Convention will respect the conflict of laws rules of that subordinate unit if those choice of law rules identify the substantive law of another subordinate unit in the same multi-unit state to govern perfection by filing. If, for instance, the parties chose the law of Illinois to govern their securities account, and the debtor/account holder of the securities account is a New York corporation, Illinois’ UCC perfection choice of law rules (and therefore also the Hague Securities Convention) would look to New York law for perfection by filing of a security interest in the securities account. Hence, in most cases, the conflict of laws rules of the UCC and those of the Hague Securities Convention lead to the same results.

Moreover, if the account agreement fails to designate a governing law or the Qualifying Office requirement is not met, Article 5 of the Hague Securities Convention also provides “fall-back rules” to help determine the governing law. These refer to the location of the office of the intermediary, the law of its jurisdiction of organisation, the law of its place of business or, if it has more than one place of business, the law of its principal place of business.

In addition, Article 6 of the Hague Securities Convention indicates certain factors to be disregarded in determining the applicable law, including the jurisdiction of the issuer of the securities, the place where certificates evidencing the securities are located, and the place where a register is maintained. Similarly, § 8-110(f) contains a list of items that are immaterial to determining the intermediary's jurisdiction: (i) the physical location of certificates representing financial assets; (ii) the jurisdiction in which the issuer of the financial asset is organized to which an entitlement holder holds a security entitlement; and (iii) the location of facilities for data processing or other record keeping concerning the account.

D. Summary and Evaluation

1. UCC § 8-110 addresses choice of law issues in respect of intermediated securities. It is based on the difference between the direct and the indirect holding systems. It disregards the jurisdiction of incorporation of the issuer of the underlying securities and the location of any certificates which might be held by the intermediary or by a higher-tier intermediary.
2. Under UCC § 8-110(a), the law of an issuer's jurisdiction governs the validity of a security, the rights and duties of the issuer with respect to registration of transfer, the effectiveness of registration of transfer by the issuer, whether the issuer owes any duties to an adverse claimant to a security, and whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security.
3. The choice of law rules in subsection (a) of UCC § 8-110 are based on the policy that an issuer or others should not have to look to the law of all the different jurisdictions in which security holders may reside but rather should be able to look to a single body of law on the matters specified in subsection (a) of UCC § 8-110.
4. Under subsection (b) of UCC § 8-110, the law of the intermediary's jurisdiction applies to the issues concerning the intermediary system which are addressed in UCC Article 8. Paragraphs (1) and (2) address issues dealt with in Article 8's provisions which define the concept of a security entitlement and which specify the duties of securities intermediaries. Under Paragraph (3), the law of the intermediary's jurisdiction determines whether the intermediary owes any duties to an adverse claimant. Paragraph (4) provides that the law of the intermediary's jurisdiction governs whether adverse claims can be asserted against entitlement holders and others.
5. The intermediary's jurisdiction is defined in subsection (e) of UCC § 8-110, which sets out a sequential series of tests to facilitate the determination of a single, readily-identifiable applicable law. Paragraph (1) of sub-

section (e) allows specification of the intermediary's jurisdiction by agreement. If there is no such specification, the law chosen by the parties to apply to the securities account determines the jurisdiction of the intermediary. It is important to highlight that the parties' choice of the governing law by agreement is valid independent of any determination that the jurisdiction whose law is chosen bears a "reasonable relation" to the transaction. This provision is aimed at enabling parties to determine the applicable law in advance and with certainty. Similarly, Article 4(1) first sentence of the Hague Securities Convention provides that the law applicable to all the issues specified in Article 2(1) of the Convention is the law in force in the state expressly agreed in the account agreement as the one whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law. However, unlike UCC § 8-110(e)(1), Article 4(1) second sentence of the Hague Securities Convention provides that the designated law applies only if the jurisdiction has a "reasonable relation" to the transaction (the Qualifying Office requirement).

6. The remaining paragraphs of UCC § 8-110(e) provide additional default rules for determining the intermediary's jurisdiction. Subsection (f) provides further that the applicable law for relationships in the intermediary system is not determined by the jurisdiction of incorporation of the issuer of the intermediated securities or by the location of any physical certificates held by the intermediary or by a higher-tier intermediary. This provision reflects the definition of a security entitlement not as a direct interest in the underlying security or other financial asset but rather as a bundle of rights against the intermediary in respect of a security or other financial asset.
7. UCC Articles 9-301 to 9-316 contain rules regarding the law to govern perfection and priority of security interests. Under UCC § 9-305(a)(3), the local law of the intermediary's jurisdiction governs perfection, the effects of perfection or non-perfection, and the priority of a security interest in a security entitlement or securities account. However, the law of the securities intermediary is to be specified pursuant to UCC § 8-110(e).
8. Following its ratification by the United States in December 2017, the Hague Securities Convention has become effective as a matter of US federal law on 1 April 2017. The Hague Securities Convention is a self-executing treaty, so as to matters falling within its scope, it preempts the conflict of laws rules found in UCC Articles 8 and 9 as well as federal book-entry regulations (*see* chapter 4 of part III of this thesis). Nevertheless, subject to certain exceptions, the rules of the Hague Securities Convention typically lead to the same results as would flow from the application of existing US law.

Chapter 4: The Hague Securities Convention

A. History of the Negotiations leading to the Hague Securities Convention

The Hague Securities Convention is a conflict of laws instrument.¹⁷⁴ Its history goes back to a proposal made during a meeting of the Hague Conference on Private International Law's special commission on general affairs and policy (hereinafter referred to as the Special Commission) held from 8–12 May 2000 in The Hague. In light of intense discussion within the international legal and financial communities on the need for uniform conflict of laws rules on a world-wide level,¹⁷⁵ Australia, the United Kingdom, and the United States suggested that the Hague Conference develop a convention on the law applicable to interests in and dispositions of securities held with an intermediary.¹⁷⁶

The Special Commission then unanimously recommended that this topic should be included as a priority on the Hague Conference's agenda for future work and that, without waiting for the next Diplomatic Conference, an expert meeting should be convened to assess, in collaboration with international organisations and members of the private sector specialised in the field, whether it was feasible to develop an international instrument on the law applicable to intermediated securities:

¹⁷⁴ Christophe Bernasconi & Thomas Keijser (*supra* n 174) 549; Andrea Bonomi, 'The Hague Securities Convention: Introductory Remarks' in Andrea Bonomi, Eleanor Cashin Retaine & Bart Volders (eds), *La loi applicable aux titres intermédiaires: La Convention de La Haye du 5 juillet 2006 – Une opportunité pour la place financière suisse?* (Schulthess, Zürich 2006) 17; Changmin Chun (*supra* n 73) 387; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss Int-49 et seq.

¹⁷⁵ See Stéphane Mouy & Hubert de Vauplane, 'La réforme du nantissement des titres dématérialisés' (1996) *Banque et Droit* 1091, 3–7; Euroclear, *Cross-Border Clearance, Settlement and Custody: Beyond the G30 Recommendations* (Brussels 1993) 62; Marc van der Haegen, 'Transfer and Collateralization of Book-Entry Securities in Belgium' (1994) IBA 25th Biennial Conference 13 et seq; see also the Preamble of the Hague Securities Convention.

¹⁷⁶ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s Int-1. See also Reinhard Ege, *Das Kollisionsrecht der Indirekt Gehaltene Wertpapiere* (De Gruyter Recht, Berlin 2006) 131; Michael D. Diathesopoulos, 'Interests in Securities: Private International Law Issues According to European Regulation and Hague Securities Convention' (2010) available at SSRN: <<https://ssrn.com/abstract=1626755>> or <<http://dx.doi.org/10.2139/ssrn.1626755>> (accessed 4 January 2021); Florence Guillaume, 'Preliminary Remarks on Conflicts of Laws' in Hans Kuhn, Barbara Graham-Siegenthaler & Luc Thévenoz (eds), *The Federal Intermediated Securities (FISA) and the Hague Securities Convention (HSC)* (Stämpfli, Bern 2010) 4; Bradley Crawford (*supra* n 39) 172.

“[T]he question of the law applicable to the *taking of securities as collateral*¹⁷⁷, it being understood that, without waiting for the Diplomatic Conference, a working group open to all Member States, to experts and associations specialised in the field, should convene to examine, in collaboration with other international organisations, notably UNCITRAL and UNIDROIT, and the private sector, the feasibility of drawing up a new instrument on this topic.”¹⁷⁸

Given not only the high volume of financial transactions involving intermediated securities at the time¹⁷⁹ but also the immediate and practical need to provide financial markets with legal certainty, it was decided to adopt a “fast track procedure”¹⁸⁰ or accelerated basis for preparing the convention. Indeed, the Special Commission was of the opinion that there was a real possibility of working expeditiously in this area since preliminary studies had already been conducted and experts in this field were prepared to collaborate with the Hague Conference on the project.¹⁸¹ To prepare for the expert meeting, the

¹⁷⁷ The mention of the “law applicable to the taking of securities as collateral” was not only too broad but also too narrow. On the one hand it was too broad since it suggested that the Hague Securities Convention would have extended to *direct* holdings even though the project as conceived was limited to *indirectly* held securities. On the other hand it was too narrow since it incorrectly suggested that the scope of Hague Securities Convention would have included only pledges and title transfer arrangements and not outright *sales* of securities (see Report on the meeting of the Working Group of Experts of January 2001 and Related Informal Work Conducted by the Permanent Bureau on the Law Applicable to Dispositions of Securities Held with an Intermediary, prepared by the Permanent Bureau, Prel. Doc. n° 2 of June 2001 for the attention of the Nineteenth Session (hereinafter referred to as Prel. Doc. n° 2) 1, 5, and 6).

¹⁷⁸ See the Conclusions of the Special Commission of May 2000 on General Affairs and Policy of the Conference, prepared by the Permanent Bureau, Preliminary Document n° 10 of June 2000 for the attention of the Nineteenth Session, 25–27; Annex VI to the Conclusions, reproducing the joint proposal made by the experts from Australia, the United Kingdom, and the United States for the Hague Conference to develop a “short multilateral Convention clarifying applicable law rules for securities held through intermediaries” (page 1 of Annex VI); Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s. Int-6.

¹⁷⁹ The Explanatory Report on the Hague Securities Convention indicates that in countries belonging to the Organisation for Economic Co-operation and Development (OECD), the volume of trades and collateral transactions in corporate securities by 2005 had grown to nearly 2 trillion USD (\$ 2,000,000,000,000) or more per day (see Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss Int-49 s. Int-2; Christophe Bernasconi (*supra* n 102) 2).

¹⁸⁰ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s Int-6. See also Karl Kreuzer, ‘Innovative Features of the Hague Securities Convention’ in The Permanent Bureau of the Hague Conference, *A Commitment to Private International Law. Essays in Honour of Hans van Loon / Un engagement au service du droit international privé. Mélanges en l’honneur de Hans van Loon* (Intersentia, Cambridge 2013) 271 et seq; Christophe Bernasconi (*supra* n 179) 3.

¹⁸¹ Christophe Bernasconi (*supra* n 44) 1; Conclusions of the Special Commission of May 2000 on General Affairs and Policy of the Conference (*supra* n 178) 26.

Permanent Bureau drafted a comprehensive report¹⁸² which identified the most important issues in the law to apply to intermediated securities and examined possible solutions thereto; this was to serve as a basic working document at the expert meeting in January 2001. Chaired by Ms Kathryn Sabo (Canada),¹⁸³ the meeting recommended that the Hague Conference draw up a new instrument on an accelerated basis providing financial markets with legal certainty and predictability, in particular as to the law governing perfection requirements for dispositions of intermediated securities.¹⁸⁴ A first draft of the future convention's key provisions had already been produced by the drafting committee.

At the January 2001 meeting of experts, with the assistance the project's legal advisor Richard Potok, an innovative informal network was organised that was characterised by four important factors: (i) transparency, (ii) an active drafting committee that met frequently between formal meetings to assist the Permanent Bureau in submitting a series of preliminary drafts of the convention, (iii) widespread consultations with member states, and (iv) continual private sector and industry participation.¹⁸⁵ The drafting committee was placed under an express mandate to carry on work after the January 2001 expert meeting to further refine its first draft and to suggest additional drafting proposals. Pursuant to this mandate, the drafting committee was empowered not only to implement decisions made during the plenary meeting but also to propose novel approaches and solutions that would help build consensus.¹⁸⁶

After an initial, informal meeting in Paris in May 2001¹⁸⁷ and following the official endorsement of the securities convention project in June 2001,¹⁸⁸ the drafting committee held several informal meetings: in Oxford (in October

¹⁸² Christophe Bernasconi (*supra* n 44).

¹⁸³ The Expert Group met from 15 to 19 January 2001 at the Peace Palace in The Hague. The meeting was attended by 119 experts from twenty-nine different Member States and seventeen international organisations. For a full list of participants, see Report on the Meeting of the Working Group of Experts of January 2001 and Related Informal Work Conducted by the Permanent Bureau on the Law Applicable to Dispositions of Securities Held with an Intermediary (*supra* n 177), Appendix A, 35. Note that this document was also presented as Prel. Doc. n° 13 of June 2001 for the attention of the Nineteenth Session of the Hague Conference.

¹⁸⁴ Report on the Meeting of the Working Group of Experts of January 2001 and Related Informal Work Conducted by the Permanent Bureau on the Law Applicable to Dispositions of Securities Held with an Intermediary (*supra* n 177) 37.

¹⁸⁵ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s. Int-8.

¹⁸⁶ Report on the Meeting of the Working Group of Experts of January 2001 and Related Informal Work Conducted by the Permanent Bureau on the Law Applicable to Dispositions of Securities Held with an Intermediary (*supra* n 177) 2.

¹⁸⁷ This first informal meeting of the Drafting Committee was convened at the invitation of De Pardieu Brocas & Maffei.

¹⁸⁸ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s. Int-9.

2001, at the invitation of the chair of the drafting committee),¹⁸⁹ in Brussels (in December 2001, at the invitation of the Euroclear Group),¹⁹⁰ in Frankfurt (in March 2002, at the invitation of the Deutsche Bundesbank),¹⁹¹ and in London (in May 2002, at the invitation of Davis Polk & Wardwell).¹⁹² During these meetings, the drafting committee reviewed all the comments made on previous drafts and prepared new interim drafts of key provisions of the future convention. These were widely circulated by the Permanent Bureau to allow Member States,¹⁹³ industry representatives, and any interested party to contribute comments and recommendations.¹⁹⁴ The securities convention project, including

¹⁸⁹ After this meeting, a new draft was sent for comments to all Member States, observers, and any interested party: HCCH, Prel. Doc. n° 6 of November 2001 for the attention of the Special Commission of January 2002, *Tentative Text on Key Provisions for a Future Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, Suggestions for Further Amendment of the Text Contained in Preliminary Document n. 3 of July 2001 (Annotated July 2001 Draft)*. See also *Memorandum on Federal Clauses with New Drafting Proposals for a Future Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary*, Prel. Doc. n° 4 of November 2001, submitted by the Permanent Bureau.

¹⁹⁰ This meeting produced a new intermediate draft of key provisions for the future Convention: *Tentative Text on Key Provisions for a Future Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, Suggestions for Further Amendment of the Text Contained in Preliminary Document No 6 of November 2001 (November 2001 Draft)*, submitted by the Permanent Bureau, Prel. Doc. n° 7 of December 2001 for the attention of the Special Commission of January 2002.

¹⁹¹ *Preliminary Draft Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, Suggestions for Amendment of the Provisional Version Adopted by the Special Commission on 17 January 2002*, Prel. Doc. n° 10 of April 2002, submitted by the Permanent Bureau; *Chart summarising the comments received on the "April 2002 Preliminary Draft Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary"* (Prel. Doc. n° 10), Prel. Doc. n° 14 of May 2002, submitted by the Permanent Bureau.

¹⁹² Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s. Int-9.

¹⁹³ The Permanent Bureau kept a liaison with the Member States throughout the informal working process. It organised a total of seventeen regional discussion workshops (RDWs) in two series around the globe (Copenhagen, Frankfurt (2x), Hong Kong, London, Milan, New York (2x), Paris (2x), Rio de Janeiro, Rome, Stockholm, Sydney, Tokyo, and Toronto (2x)) to discuss and assess the most recent available draft of the Convention with State officials, legal experts, and market participants.

¹⁹⁴ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s. Int-9. See *Tentative Text on Key Provisions for a Future Convention on the Law Applicable to Proprietary Rights in Indirectly Held Securities*, submitted by the Permanent Bureau, Prel. Doc. n° 3 of July 2001 for the attention of the Special Commission of January 2002; *Chart Summarizing Comments Received on the Annotated July 2001 Draft*, prepared by the Permanent Bureau, Prel. Doc. n° 5 of November 2001 for the attention of the Special Commission of January 2002; *Tentative Text on Key Provisions for a Future Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary: Suggestions for Further*

the fast track procedure, was officially endorsed during the first part of the Nineteenth Diplomatic Session of the Hague Conference in June 2001.

In January 2002, under the chairmanship of Ms. Stefania Bariatti (Italy), a special commission met in The Hague to finalise a new comprehensive draft convention.¹⁹⁵ In May 2002, the Permanent Bureau, following the informal working process described above, proposed a redraft of the core provisions of the future convention (the primary rule and the fall-back rules): in lieu of attempting to “locate” a securities account or the office maintaining a securities account to determine the law applicable under the convention, the Permanent Bureau suggested focusing on the choice of law provision of a securities account contract and subjecting this agreement to specific conditions.¹⁹⁶ This proposal formed the basis for the primary rule in Article 4 and the fall-back rules in Article 5 of the Hague Securities Convention.¹⁹⁷

The project reached its final phase in December 2002 with the adoption of a draft of the securities convention during the second part of the Nineteenth Diplomatic Session of the Hague Conference, which was held in The Hague.¹⁹⁸ A commission, again chaired by Ms. Stefania Bariatti (Italy), was

Amendment, submitted by the Permanent Bureau for the attention of the Special Commission of January 2002, Preliminary Document n° 7 of December 2001 for the attention of the Special Commission of January 2002.

¹⁹⁵ *Preliminary Draft Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary*, as adopted by the Special Commission on 17 January 2002 (provisional version), Prel. Doc. n° 8 of February 2002, submitted by the Permanent Bureau; *Chart Summarizing the Comments Received on the Provisional Version of the “Preliminary Draft Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary” as adopted by the Special Commission on 17 January 2002* (Prel. Doc. n° 8), Prel. Doc. n° 9 of March 2002, submitted by the Permanent Bureau.

¹⁹⁶ *Proposal for a redraft of Articles 4 and 4 bis*, Prel. Doc. n° 13 of May 2002, submitted by the Permanent Bureau. See also *Chart Summarizing the Comments Received on the April 2002 Preliminary Draft Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary*, Prel. Doc. n° 14 of May 2002, prepared by the Permanent Bureau for the attention of the Special Commission on indirectly held securities.

¹⁹⁷ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s. Int-15; Hans Van Loon, ‘News from The Hague, The Hague Conference on Private International Law, Work in Progress (2002–2003)’ in Peter Šarčević (eds), *Yearbook of Private International Law* (Kluwer Law International, The Hague 2003) 169, 170.

¹⁹⁸ Christophe Bernasconi, ‘Some Observations from the Hague Conference on Private International Law’ (2007) 101 *American Society of International Law Proceedings* 350, 352; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s. Int-15. In keeping with the tradition observed by the Hague Conference at that time, the Nineteenth Diplomatic Session of the Hague Conference in fact adopted a *draft* convention; it was not until Switzerland and the United States of America signed the convention, *i.e.*, 5 July 2006, that the *draft* became a convention. See Christophe Bernasconi (*supra* n 44) 2; Michael D. Diathesopoulos (*supra* n 176) 19. The tradition whereby a Hague Convention bears the date of its first signing was abandoned with the Convention on the Choice of Court Agreements

established to finalise the work on the securities convention project. The final text of the draft convention was released in February 2003 after a subsequent round of revisions coordinated by the Permanent Bureau.¹⁹⁹

B. Scope of Application of the Hague Securities Convention

I. Focus Solely on Choice of Law Questions

As mentioned above, the Hague Securities Convention is strictly a choice of law convention limited to determining the applicable law.²⁰⁰ Therefore, it does not affect any national substantive law.²⁰¹ Similarly, no national or international regulatory regimes related to intermediated securities are affected by its provisions.²⁰² In fact, in spite of the choice of law rules it provides, national law makers and regulators are free to determine what constitutes an acceptable choice of law.²⁰³ The Convention would thus not affect the provisions contained in OHADA's Uniform Acts. Indeed, the rules provided in the Uniform Acts are not conflict of laws rules in general²⁰⁴ but rather are incorporated into the substantive law of each OHADA Member State when a Uniform Act enters into force.²⁰⁵ As they relate to the Hague Securities Convention, the OHADA

– which bears the date of its adoption, 30 June 2005. The text of the Hague Securities Convention is available at <<https://www.hcch.net/en/instruments/conventions/full-text/?cid=98>> (accessed 4 January 2021).

¹⁹⁹ For a complete chronology of the negotiations leading up to the Hague Securities Convention, see Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Appendix 2.

²⁰⁰ Florence Guillaume (*supra* n 176) 42; Christophe Bernasconi (*supra* n 198) 352.

²⁰¹ Bradley Crawford (*supra* n 39) 175–176; Christophe Bernasconi (*supra* n 44) 14; Yoshiaki Nomura, 'Japanese Law as the Applicable Law Under the Hague Securities Convention: What Rule of Substantive Law Should Be Applied?' (2010) 57 *Osaka University Law Review* 1, 2; Fabian Reuschle, 'Haager Übereinkommen für die auf bestimmte Rechte in Bezug auf intermediär-verwahrte Wertpapiere anzuwendende Rechtsordnung' (2003) *IPRax* 495, 498. Moreover, it is worth noting that the Hague Securities Convention applies whether or not the designated law is that of a Contracting State (Article 9 of the Hague Securities Convention).

²⁰² See Article 2(1) of the Hague Securities Convention, which provides that "[t]his Convention determines the law applicable to...". See also Stephen Kozey, 'The Hague Securities Convention: An Opportunity to Take the UCC Global' (2015) 46 *Georgetown Journal of International Law* 1223; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s. Int-49; Christophe Bernasconi & Thomas Keijser (*supra* n 174) 549; Andrea Bonomi (*supra* n 174) 17.

²⁰³ Christophe Bernasconi & Thomas Keijser (*supra* n 174) 549, 554.

²⁰⁴ See part I, chapter 1, section A of this thesis.

²⁰⁵ Articles 5 and 10 of the OHADA Treaty; Abarchi Djibril, 'La Supranationalité de l'OHADA' (2000) *Revue EDJA* 44, 7 et seq; Ba Demba Boubakar, 'Le Problème de la Compatibilité entre l'UEMOA et l'OHADA' in Pierre Meyer (ed), *La libéralisation de l'économie dans le cadre de l'intégration régionale: le cas de l'UEMOA, Actes du Colloque de Ouagadougou* (CEEI, Ouagadougou 2001) 157.

Uniform Acts would thus apply only if the applicable law under the Hague Securities Convention is that of one of the OHADA Member States.

Similarly, the Hague Securities Convention does not govern questions of direct and indirect jurisdiction, and nor does it apply to issues regarding the recognition and enforcement of foreign judgments.²⁰⁶ These questions are governed by the rules of private international law of each state.²⁰⁷

II. Issues to Which the Hague Securities Convention Applies

1. Article 2(1) of the Hague Securities Convention

Article 2(1) of the Hague Securities Convention is among its most important provisions, because it defines the Convention's substantive scope of application. It contains a comprehensive catalogue of specific, practical proprietary issues that are typical of transactions involving intermediated securities and to which the Convention applies.²⁰⁸ Any issue not included in the list in Article 2(1) is not governed by the law designated by the Convention.²⁰⁹ Article 2(3) by contrast contains a list of issues to which the Convention does not apply (so-called "black list"²¹⁰).

a) The Nature of the List

The Hague Securities Convention determines the law applicable to the following issues in respect of intermediated securities:²¹¹

²⁰⁶ Florence Guillaume (*supra* n 176) 42.

²⁰⁷ Under OHADA law, Article 27 of the Uniform Act on the Carriage of Goods by Road is the only provision which contains rules regarding international jurisdiction and the recognition and enforcement of foreign judgments (Justin Monsenepwo, *Harmonisation du droit congolais avec le droit OHADA des transports* (Editions Universitaires Européennes, Saarbrücken 2012) 77; Emmanuel Bokalli & Dorothé C. Sossa, *OHADA: Droit des contrats de transport de marchandises par route* (Bruylant, Bruxelles 2006) 119).

²⁰⁸ Reinhard Ege (*supra* n 176) 135; note that "the Convention law" means the substantive law determined by the Hague Securities Convention (*see* Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 1-44, 2-9).

²⁰⁹ Florence Guillaume (*supra* n 176) 42. In respect of the material scope of the Hague Securities Convention, *see* Emmanuel Gaillard, 'After Morrison: The Case for a New Hague Convention on the Law Applicable to Securities Frauds' (2011) 5 *Dispute Resolution International* 35, 43. Following the decision of 24 June 2010 of the US Supreme Court in the *Morrison v National Australia Bank Ltd* (130 S Ct 2869 (2010)), the authors submitted that the issue of the law applicable to the civil aspects of securities fraud should also be included in the agenda of the Hague Conference or in the scope of a "new Hague Securities Convention".

²¹⁰ Stephan Saager (*supra* n 26) 175.

²¹¹ "Intermediated securities", "securities held with an intermediary", or "indirectly held securities" are securities, meaning "any shares, bonds, or other financial instruments or assets (other than cash), or any right to such securities" (Article 1(1)(a) of the Hague

- The legal nature and effects against the intermediary and third parties of the rights resulting from a credit of securities to a securities account;
- The legal nature and effects against the intermediary and third parties of a disposition of securities held with an intermediary;
- The requirements, if any, for perfection of a disposition of securities held with an intermediary;
- Whether a person’s interest in securities held with an intermediary extinguishes or has priority over another person’s interest;
- An intermediary’s duties, if any, to a person other than the account holder who asserts, in competition with the account holder or another person, an interest in securities held with that intermediary;
- The requirements, if any, for the realisation of an interest in securities held with an intermediary;
- Whether a disposition²¹² of securities held with an intermediary extends to entitlements to dividends, income, or other distributions, or to redemption, sale, or other proceeds.²¹³

All issues mentioned in Article 2(1) of the Convention are governed by the same law.²¹⁴ This may be inferred from Articles 4, 5, and 7, which contain the phrase “all the issues specified in Article 2(1)”.²¹⁵ Consequently, a detailed consideration of the wording of the list or of the particular category of the list into which an issue falls will seldom be needed; for a given securities account, it is not possible for one law to govern some of the issues and a different law to govern other issues listed in Article 2(1). Article 2(1) ensures not only universal recognition of the coverage of the law determined by the Con-

Securities Convention) held with an intermediary, that is, “a person that in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity” (Article 1(1)(c) of the Hague Securities Convention). For a security to be held with an intermediary, it must be entered in an indirect holding system by being credited to a securities account held with an intermediary. It is important to note that the Hague Securities Convention applies solely to intermediated securities (Article 2(1) of the Convention). Its material scope does not include securities held directly, or to cash.

²¹² The term “disposition” in the Hague Securities Convention refers both to transfers of title and to grants of security interests (Article 1(1)(h) of the Hague Securities Convention).

²¹³ Article 2(1) of the Hague Securities Convention.

²¹⁴ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss. Int-60, 2-10, and 4-10.

²¹⁵ Changmin Chun (*supra* n 73) 394; Alexander Kern, ‘Uniform Choice of Law Rule for the Taking of Collateral Interests in Securities: Using Private International Law Approaches to Reduce Credit and Legal Risk in Financial Systems’ ESRC Centre for Business Research, University of Cambridge, Working Paper No.211/2001, 15 <https://www.cbr.cam.ac.uk/fileadmin/user_upload/centre-for-business-research/downloads/working-papers/wp211.pdf> (accessed 4 January 2021).

vention but also the extension of a single law to all issues.²¹⁶ Similarly, it is readily apparent from the wording of the list in Article 2(1) that more than one sub-paragraph can apply to the same fact pattern.²¹⁷ Thus, there is no need to determine which specific sub-paragraph applies; it is sufficient that an issue falls within the list.

For instance, the granting of a security interest in intermediated securities is a disposition as per Article 2(1)(b). Consequently, the Convention determines the law governing the security interest's "effects against the intermediary and third parties" (Article 2(1)(a) of the Hague Securities Convention). Yet for a security interest to be effective against third parties, the relevant perfection requirements must be met (Article 2(1)(c)). According to Article 2(1)(d), the Convention also determines whether the collateral taker's security interest extinguishes or has priority over an interest of another person such as the account holder, the relevant intermediary,²¹⁸ or any third party.²¹⁹ It appears from this example that the list in Article 2(1) should be read as a whole,²²⁰ and therefore it is only when an issue does not fit into any of the sub-paragraphs that the Convention does not apply.

The choice of law process generally starts with characterisation,²²¹ the primary purpose of which is to classify and categorise the issue before the forum court, in order to determine a connecting factor that directs it to a substantive law. Characterisation is in principle performed according to the *lex fori*.²²² However, to determine whether a given issue falls within the scope of Article 2(1) of the Hague Securities Convention, the language of Article 2(1) is to be consulted alone and independently of the Convention law itself. For the Convention to apply, it is immaterial to classify the rights of an account holder in respect of securities, or resulting from a credit of securities to a securities account, as personal or proprietary or otherwise. As mentioned above, if securities are credited to a securities account, the Convention ap-

²¹⁶ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Examples 2-2, 2-3.

²¹⁷ Stephan Saager (*supra* n 26) 175.

²¹⁸ Under Article 1(1)(g) of the Hague Securities Convention, a relevant intermediary is the intermediary who maintains the securities account for the account holder.

²¹⁹ See Preliminary Document n° 4 of November 2001: Memorandum on Federal Clauses with New Drafting Proposals for a Future Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, 4.

²²⁰ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 2-9.

²²¹ Note that early in the process of elaborating the Hague Securities Convention, it was suggested that the word "characterisation" be used in Articles 2(1)(a) and (b) to express the idea that the governing law would determine the legal nature of the rights. However, the use of the word "characterisation" in an international convention was strongly criticised by the Permanent Bureau because private international law doctrine uses this expression in many different ways. Therefore, the word "characterisation" was replaced by the phrase "legal nature of the rights".

²²² Changmin Chun (*supra* n 73) 394.

plies to the rights related to such securities, whether or not the account holder has rights directly against the issuer, and regardless of the legal nature or the classification of those rights.²²³

b) Analysis of the Content of the List in Article 2(1) of the Hague Securities Convention

(1) Legal Nature and Effects of Rights resulting from a Credit of Securities to a Securities Account

The characterisation of the account holder's rights resulting from a credit to a securities account differs from one legal system to another. Some systems characterise or denominate account holders' rights as regular deposits, special deposits, or as some other form of property rights traceable to individual securities; other systems characterise account holders' rights as irregular deposits, general deposits, or as some other form of purely personal (contractual) rights against the intermediary.²²⁴ Regardless of the characterisation of an investor's rights against the relevant intermediary in relation to intermediated securities, all legal systems need a clear conflict of laws rule to determine the law that governs the legal nature and effects of an account holder's rights. This need is addressed in Article 2(1) of the Hague Securities Convention, which provides that the Convention determines the law governing the legal nature and effects of the account holder's rights resulting from a credit of securities to a securities account.²²⁵

Article 2(1)(a) of the Hague Securities Convention also covers situations where there is no subsequent disposition of securities after an initial credit to a securities account.²²⁶ Moreover, it is important to recall that questions arising in relation to directly held securities do not fall within Article 2(1)(a) of the Convention. If, pursuant to Convention law, the forum court determines that the securities in question have not yet been credited to a securities ac-

²²³ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 2-5.

²²⁴ Some legal systems even characterise such rights as the interest of a trust beneficiary, a fiduciary interest, a *Gutschrift in Wertpapierrechnung*, co-property rights in a fungible, notional, or book-entry pool of securities, security entitlements, or some other bundle of property, contractual, or other rights. See also Charles W. Mooney, Jr. & Hideki Kanda, 'Core Issues Under the UNIDROIT (Geneva) Convention on Intermediated Securities: Views from the United States and Japan' in Louise Gullifer & Jennifer Payne (eds), *Intermediated Securities: Legal Problems and Practical Issues* (Hart Publishing, Oxford 2010) 79.

²²⁵ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 2-12.

²²⁶ This may occur for instance when an investor buys securities and wants to know what rights it has against the intermediary following the credit of the securities to the investor's securities account. See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 2-13.

count and therefore have not yet entered the intermediary system, the Convention does not apply; any issues related to the securities will then be governed by other conflict of laws rules of the forum.²²⁷

Assume for instance that Investor MN is the holder of certain registered securities. MN possesses certificates representing other securities too; these are bearer securities. Assume further that MN sells all these to JM, who obtains registration in place of MN as the holder of the registered securities and to whom the certificates representing the bearer securities are delivered. Since the securities in this situation were never credited to a securities account, the Hague Securities Convention will not determine the law governing any of the issues arising out of the interests of MN or JM in the securities or their disposition; the law applicable to all the issues arising out of an interest in these securities or their disposition will be determined by conflict of laws rules of the forum other than those contained in the Convention.

But the result will be different if JM instructs MN to deliver the certificates to JM's intermediary to be credited to JM's securities account. Subsequently, JM instructs its intermediary to transfer the securities to TC's intermediary, to be credited to TC's account. But due to computer error, there is a delay in crediting the securities to TC's account. Now, Convention law kicks in as soon as JM's intermediary credits the securities to JM's securities account. Under the Convention law, if the securities are deemed not to have been credited to a securities account, the securities are not in the intermediary system yet and the Hague Securities Convention does not apply. But if the securities are deemed to have been credited to JM's securities account, they have entered the intermediary system, and the Convention will determine what law governs the legal nature and effects of the rights resulting from the credit of securities to JM's and TC's respective securities accounts.²²⁸ Similarly, the rights and duties of an issuer of securities, whether held directly or with an intermediary, are excluded from the scope of Article 2(1)(a) of the Convention.²²⁹

Article 2(1) of the Hague Securities Convention ensures that the Convention's conflict of laws rules apply uniformly regardless of the treatment of rights in intermediated securities under national law (as rights *in rem*, claims, etc.).²³⁰ Article 2(2) specifies that the Convention is applicable even where

²²⁷ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 2-16.

²²⁸ However, in no event will the law applicable to the rights and duties of the issuer be determined by the Hague Securities Convention (*see* Article 2(1) of the Hague Securities Convention). Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following Example 2-2.

²²⁹ *See* Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 2-14.

²³⁰ Jean-Pierre Degué, 'La Convention de La Haye du 5 juillet 2006 sur la loi applicable à certains droits sur des titres détenus auprès d'un intermédiaire – Champ d'appli-

rights in intermediated securities are determined to be contractual in nature; however, it does not apply to purely contractual aspects which may arise from the relationship between the account holder and its intermediary (Article 2(3)(a) and (b) of the Hague Securities Convention).

(2) *Legal Nature and Effects of a Disposition*

The Hague Securities Convention determines the legal nature and effects against the intermediary and third parties of a disposition of securities (Article 2(1)(a) of the Hague Securities Convention). This provision ensures that a disposition by the parties will not be challenged pursuant to any law other than that designated by the Convention.²³¹ Under Article 1(1)(h), the term disposition means “any transfer of title whether outright or by way of security and any grant of a security interest, whether possessory or non-possessory”. Unlike the Financial Collateral Directive and the Settlement Finality Directive,²³² the Convention applies to outright transfers such as a sale, repurchase, purchase and resale, transfer for the purpose of collateral, transfer under a sell/buy-back or buy/sell-back arrangement, or a stock loan.²³³ This all-inclusive approach embodied in the Hague Securities Convention is conceptually and practically more satisfactory than the fragmented approach seen in the Settlement Finality Directive and the Financial Collateral Directive.²³⁴ As to security transactions, the Convention extends to both possessory²³⁵ and non-possessory security.²³⁶

The meaning of the term “disposition” is further elaborated in Article 1(2) of the Convention, which sets out three provisions aimed at avoiding error

tion et domaine de la loi applicable’ in Andrea Bonomi, Eleanor Cashin Ritaine & Bart Volders (eds), *La loi applicable aux titres intermédies: La Convention de La Haye du 5 juillet 2006 – Une opportunité pour la place financière suisse?* (Schulthess, Zürich 2006) 43–45.

²³¹ Florence Guillaume (*supra* n 176) 43.

²³² For an analysis of the conflict of laws provisions of these directives, *see supra* (part II, chapter 3 of this thesis).

²³³ Changmin Chun (*supra* n 73) 392.

²³⁴ Joanna Benjamin, Madeleine Yates & Gerald Montagu (*supra* n 44) 78, 90.

²³⁵ Note that the reference to possessory security interests in Article 1(1)(h) of the Hague Securities Convention pertains to legal systems (especially civil law systems) that know the concept of delivery of possession of intangibles, allowing the creation of a possessory security interest in securities by book-entry (*see* Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 1-20).

²³⁶ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 1-19. Needless to recall, dispositions of securities held directly by the grantor of the security interest (*see* Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s Int-24) are not covered by the Hague Securities Convention. The Convention would therefore not apply to a pledge of bearer securities effected by physical delivery of the relevant certificates by the pledger.

with respect to the term's scope. As per Article 1(2)(a), "disposition" extends both to a disposition of an entire securities account as well as to a disposition of one, some, or all of the securities credited to a securities account.²³⁷ To see how this would operate, it follows from Articles 146 and 148 of the OHADA Uniform Act on Security Interests that, in order to accomplish the grant of a security interest, OHADA law has opted for a technique in which all securities credited to the account then or thereafter are automatically covered.²³⁸ If an OHADA Member State or the entire OHADA region were to apply the Hague Securities Convention, then this technique, too, would come within the meaning of the term "disposition" under Article 2(1)(a).

Furthermore, the term "disposition" includes dispositions in favour of the account holder's intermediary (Article 1(2)(b) of the Hague Securities Convention). To secure extensions of credit to the account holder, intermediaries often require a pledge, or a title transfer in their favour, of securities they hold for an account holder. Moreover, a lien by operation by law²³⁹ in favour of the account holder's intermediary is treated as a "disposition" for the purpose of applying the Hague Securities Convention – but only if the lien is linked to any claim resulting from the maintenance and operation of a securities account (as opposed to a bank deposit account). Any non-consensual lien (such as a tax lien) that does not pertain to the maintenance and operation of a securities account and that thus falls outside Article 1(2)(c) of the Convention cannot be treated as a disposition of the purpose of the Convention. But the Convention might affect it, if for instance it determined the outcome of a priority dispute between the grantee of a consensual security interest and the holder of a non-consensual lien (Article 2(1)(d) of the Hague Securities Convention).

²³⁷ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 1-30; Christophe Bernasconi & Thomas Keijser (*supra* n 174) 553.

²³⁸ See Joseph Issa-Sayegh, Paul-Gérard Pougoué & Filiga Michel Sawadogo (eds), *OHADA: Traité et Actes Uniformes Commentés et annotés* (Juriscope, Poitiers 2014) 928. As discussed above, the advantage of this technique is that it allows effective provision of collateral while leaving the collateral giver the flexibility to manage its investments. It is important to note that this technique differs from an outright transfer of securities: in an outright transfer of a securities account, the account would no longer be maintained by the transferor, who would no longer be able to deal in the intermediated securities in the account. The implementation of an outright transfer of securities account consists of transfer of all the securities then credited to that account to an account maintained for the transferee (see Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 1-30). However, there is no need in order for the Hague Securities Convention to apply to assess *a priori* whether a disposition is a transfer of title by way of security or an outright sale; it is for the applicable law to determine the nature of the disposition (and the effects thereof against third parties).

²³⁹ "Operation by law" includes all liens not merely based on agreement. This includes statutory liens and judicially created or recognised liens such as clearing liens and banker's liens; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 1-31.

This broad definition of the term “disposition” is in line with the functional approach of the Hague Securities Convention, which consists in including all transfers²⁴⁰ and not restricting the meaning of the concept of “disposition” on the sole basis of the economic function of the disposition or the legal category into which it might be placed.²⁴¹

(3) Perfection Requirements

Article 1(1)(i) of the Hague Securities Convention defines the term “perfection” as the “completion of necessary steps to render a disposition effective against persons who are not parties to that disposition”, including an insolvency administrator and general creditors in the insolvency proceedings. In many systems, a validly created security interest or other disposition may be effective as between the parties by virtue of the agreement.²⁴² However, for such security interests or other dispositions to be effective against a third party who might have acquired an interest in the subject-matter, some additional steps must be taken, such as public filing, recording, registration, or the taking of “control”²⁴³.

Perfection requirements can serve to publicise the transaction. They also serve as anti-fraud devices; indeed, they provide objective evidence of a transaction and a “date certain”. Nevertheless, fulfilling any perfection requirements that might exist under the applicable law does not guarantee that the perfected dispositions are invulnerable to claims by third parties. Further, whether a perfected disposition has priority over competing interests (other perfected interests, certain types of unperfected interests, purchasers who acquire a competing interest in good faith without notice of an adverse claim) or whether a security interest perfected by one method (for instance, taking control over a pledged securities account) has priority over one perfected by another method (such as filing a public notice) is a question of priority rather than of perfection.²⁴⁴

²⁴⁰ See Article 1(1)(h) of the Hague Securities Convention.

²⁴¹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-18.

²⁴² See for instance in United States law § 9-201 of the Uniform Commercial Code (*see supra* part III, chapter 3 of this thesis). Under OHADA law, the Uniform Act on Security Interests requires a declaration of pledge the mandatory content of which is specified in Article 147 of that Uniform Act.

²⁴³ In some States, taking control may be achieved without debiting the collateral provider’s account. Instead, the intermediary agrees to accept instructions from the collateral taker concerning the collateral, without further consent from the collateral provider (the account holder), even if the collateral provider has retained the right and power to dispose of the collateral (*see* Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-18.).

²⁴⁴ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 1-21.

(4) Priority Issues

The applicable law – not the Hague Securities Convention – determines priority between two or more competing claims to an interest in securities, be it two limited interests (such as security interests), two absolute interests, or one limited and one absolute interest. Note that the issues specified in Article 2(1)(d) of the Hague Securities Convention include not only the simple question of priority but also the effects thereof: whether the competing interests co-exist, with one being preferred over the other, or whether one takes free of the other altogether.²⁴⁵

(5) Duties of an Intermediary Against a Person Asserting a Competing Interest

Under Article 2(1)(e) of the Hague Securities Convention, the law that applies under the Convention governs (for instance) whether an intermediary has fulfilled its duty by honouring a transfer instruction from a party whose interest has priority under the Convention law. It also determines whether the intermediary is protected if it honours an instruction from one claimant even if it is later found that another claimant's interest has priority.²⁴⁶ The applicable law, as determined by the Convention, governs the obligations of an intermediary if there are competing interests, including between: (i) the account holder and a person asserting a competing interest in the intermediated securities; (ii) the parties to successive dispositions made by the account holder, each claiming priority for its interest in such securities.

Moreover, the applicable law as determined by the Convention governs whether upper-tier attachments are permitted; indeed, several intermediaries might stand between an account holder and the issuer of securities credited to the account holder's securities account.²⁴⁷ Under Article 2(1)(e), the applicable law determines whether an opposing claimant may assert its interest not

²⁴⁵ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-23. Taking free of a competitor's interest equals extinguishing the other interest as between these two competitors; but it does not necessarily mean the competitor's interest is extinguished as far as third parties are concerned.

²⁴⁶ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-24.

²⁴⁷ Christophe Bernasconi & Thomas Keijser (*supra* n 174) 553. Note that the Hague Securities Convention applies independently to each account holder and its own intermediary. In case of transfer of securities, the rights of the transferee and all other issues mentioned in Article 2(1) of the Hague Securities Convention remain governed by the law determined by the Convention in respect of the transferor's securities account as long as the securities are still credited to that account. However, as soon as the securities are credited to the transferee's securities account, the transferee's rights and all other Article 2(1) issues are governed by the law the Convention determines in respect of the transferee's account. See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 2-24, 4-11, 4-43 et seq.

only against the account holder's intermediary but also against any other upper-tier intermediary between it and the issuer of the underlying securities.

Article 2(1)(e) primarily pertains to situations in which the intermediary faces a claim by an attachment creditor of the account holder or another competing claim. However, this provision also determines the liability of an intermediary who is supposed to have breached a duty to a claimant other than the account holder. In such cases, the applicable law, as determined by the Convention, controls *inter alia* whether the intermediary did in fact owe a duty towards that claimant, whether the intermediary violated that duty and, if so, what that claimant's remedies are.²⁴⁸

(6) Realisation

The applicable law, as determined by the Hague Securities Convention, also governs the requirements for the realisation of an interest in intermediated securities. Under the applicable law, these requirements might for instance include court approval of a sale or a sale by public auction rather than private agreement. For example, the collateral provider is in default, Convention law will determine whether and under what conditions the collateral taker can sell the collateral given to it by the collateral provider.

(7) Entitlements to Dividends, Income, or Other Distributions, or to Redemption, Sale, or Other Proceeds

While purpose of Article 2(1)(g) of the Hague Securities Convention is not to broaden the meaning of the term "securities held with an intermediary" so that it extends to cash held through an intermediary, the applicable law, as determined by the Convention, governs whether a disposition of intermediated securities includes an entitlement to dividends, income, or other distributions, or an entitlement to redemption, sale, or other proceeds.²⁴⁹ The elements included in Article 2(1)(g) may take various forms: interests, dividends, rights issues, bonus issues, proceeds of redeemed debt securities, proceeds of sales by the account holder, and conversion of securities into other securities.

III. Limitations of the Scope of the Convention Solely to Intermediated Securities

1. Introduction

The Hague Securities Convention applies only to intermediated securities or securities held with an intermediary.²⁵⁰ Rights held directly from the issuer by

²⁴⁸ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 2-27.

²⁴⁹ Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.15-10.16; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 2-29.

a person who is in physical possession of certificates representing the securities do not fall within its scope.²⁵¹ However, if the securities are credited to a securities account and thereby enter the intermediary system, the applicable law as determined by the Convention will govern all the Article 2(1) issues with respect to (i) any rights resulting from such a credit or (ii) a disposition of any such rights. This is so even if a disposition does not result in securities being credited to the transferee's securities account; if such rights derive directly or indirectly from a securities account, whether held by the transferor, the transferee, or by any other party, the Convention applies.

2. *Proprietary Rights in Respect of Intermediary Securities*

The focus at the beginning of the process of elaborating the Hague Securities Convention was on proprietary rights in respect of intermediated securities.²⁵² But in the course of the proceedings (and in the final text), the limitation of the Convention to such rights was significantly modified as a result of an extensive discussion at the Diplomatic Conference on the need to cover all the Article 2(1) issues, however a particular legal system might classify them. This led to the abandonment of proprietary or contractual terminology as the basis for defining the scope of the Convention and the relationship between Article 2(1) and what are now Articles 2(2) and 2(3).²⁵³ The Convention draws a clear distinction between (i) rights resulting exclusively from the contractual relationship between the account holder and its intermediary or the parties to a disposition *inter se*, whether contractual, proprietary, mixed, or otherwise, and (ii) rights that can result exclusively from the contractual relationship between the account holder and its intermediary or the parties to a disposition *inter se*, to the extent they do not fall under Article 2(1) of the

²⁵⁰ Under Article 1(1)(f) of the Hague Securities Convention, the term “securities held with an intermediary” means “the rights of an account holder resulting from a credit of securities to a securities account”, whether those rights are contractual, proprietary, mixed, or otherwise under the applicable law determined under Article 2(1)(a). This was the first time the term “securities held with an intermediary” was defined in a legal text. See Reinhard Ege (*supra* n 176) 136; Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.12. See also Karl Kreuzer, ‘Das Haager Übereinkommen über die auf bestimmte Rechte in Bezug auf intermediär-verwahrte Wertpapiere anzuwendende Rechtsordnung’ in *Le droit international privé: esprit et méthodes, Mélanges Paul Lagarde* (Daloz, Paris 2005) 530. It is noteworthy that Article 1(b) of the Geneva Securities Convention defines the term “intermediated securities” as “securities credited to a securities account or rights or interests in securities resulting from the credit of securities to a securities account.”

²⁵¹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following ss 1-16; Reinhard Ege (*supra* n 176) 136.

²⁵² See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following ss 1-16, 2-4.

²⁵³ Changmin Chun (*supra* n 73) 396.

Hague Securities Convention.²⁵⁴ The former do fall under Article 2(1) and are therefore governed by the law determined by the Convention; the latter types of rights are not governed by the conflict of laws rules of the Convention but rather by those of the forum.²⁵⁵

The list of all the issues falling within the scope of the Hague Securities Convention in Article 2(1) is intentionally very broadly worded.²⁵⁶ Article 2(2) highlights the breadth of Article 2(1) by providing that the Convention determines the law applicable to the issues specified in Article 2(1) in relation to a disposition of or an interest in intermediated securities even if the rights resulting from the credit of those securities to a securities account are determined in accordance with paragraph (1)(a) to be contractual in nature.²⁵⁷ The issues listed in Article 2(1)(a)–(g) of the Hague Securities Convention are governed by the applicable law under Article 4 or 5 of the Hague Securities Convention.²⁵⁸

3. Contractual Claims

a) Introduction

At the beginning of the process of elaborating the Hague Securities Convention, there was a focus on proprietary rights in respect of intermediated securities. Indeed, the January 2001 preliminary draft read, “[the] Convention determines the law governing proprietary rights in respect of securities held with an intermediary.”²⁵⁹ However, the original approach focusing on proprietary rights in respect of intermediaries significantly changed in the course of the

²⁵⁴ A transaction in intermediated securities has two components: the contractual aspects relate to the parties’ obligations under the transaction; the proprietary aspects deal with transfer of rights in the property. The proprietary issues can be found in the following phrases of the Hague Securities Convention: “the legal nature and effects against ... third parties” (Article 2(1)(a) & (b)), perfection (Article 2(1)(c)), priorities (Article 2(1)(d)), realisation (Article 2(1)(f)), and character of subrogation on entitlements (Article 2(1)(g)). All these Article 2(1) issues (including the issue of an intermediary’s duties in Article 2(1)(e)) are encompassed in the words “certain rights” in the official title of the Convention. This distinction is reflected by the elaboration of Article 2(1) by Article 2(2) and by the subordination of Article 2(3)(a) and (b) to Article 2(2).

²⁵⁵ Christophe Bernasconi & Thomas Keijser (*supra* n 174) 553; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 2-4.

²⁵⁶ Christophe Bernasconi & Thomas Keijser (*supra* n 174) 552; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-2.

²⁵⁷ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-30.

²⁵⁸ Christophe Bernasconi & Thomas Keijser (*supra* n 174) 553.

²⁵⁹ Article 1(1) of the January 2001 Preliminary Draft Convention. See Hague Conference on Private International Law, Permanent Bureau, Prel. Doc. n° 3 of July 2001 – *Tentative Text on Key Provisions for a Future Convention on the Law Applicable to Proprietary Rights in Indirectly Held Securities*.

elaboration process as the final text reflects.²⁶⁰ An extensive discussion at the Diplomatic Conference took place over the need to cover all the issues mentioned in Article 2(1) regardless of how they might be classified in a particular legal system.²⁶¹ This discussion resulted in the abandonment of the proprietary or contractual terminology as the basis for determining the Convention's scope.²⁶² One may infer from the clarification of Article 2(1) by Article 2(2) and from the subordination of Article 2(3)(a) and (b) to Article 2(2) of the Convention that the purpose was to establish a distinction between:

- Rights (regardless of whether they are contractual, proprietary, mixed, or other) relating to either the securities themselves and resulting from the credit of securities to a securities account or to the disposition of intermediated securities; and
- Rights not included among the issues listed in Article 2(1) and resulting solely from the contractual relationship between the intermediary and the account holder or the parties to a disposition *inter se*.

The former rights fall within the scope of Article 2(1) of the Hague Securities Convention and thus are governed by the law determined by the Convention; the latter are governed by the forum's conflict of laws rules, which are not contained in the Hague Securities Convention. Article 4(1) of the Convention mirrors this, providing that parties to an account agreement may choose a law different from the law governing the account agreement to govern the Article 2(1) issues. In such a case, the law governing the account agreement is determined by conflict of laws rules of the forum other than those contained in the Convention. Under Article 2(3), the Convention does not apply to certain issues; these include rights and duties arising from the credit of securities to a securities account to the extent that such rights or duties are purely contractual or otherwise purely personal (Article 2(3)(a)), the contractual or other personal rights and duties of parties to a disposition of securities held with an intermediary (Article 2(3)(b)), and the rights and duties of an issuer of securi-

²⁶⁰ The method listing specific issues considered to be proprietary (as in the current version of Article 2 of the Hague Securities Convention) had been adopted from the November 2001 draft of the Hague Securities Convention. See Hague Conference on Private International Law, Permanent Bureau, Prel. Doc. n° 6 of November 2001 – *Tentative Text on Key Provisions for a Future Convention on the Law Applicable to Certain Rights in Respect of Securities Held With an Intermediary*; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-4; Harry C. Singman, 'The Convention from the Viewpoint of the Collateral-Taker' (Paper presented in the Tokyo Symposium, October 2004) [unpublished] 3.

²⁶¹ This extensive discussion also focused on the relationship between Article 2(1) and current Articles 2(2) and 2(3) of the Hague Securities Convention. See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-4; Christophe Bernasconi & Thomas Keijser (*supra* n 174) 553.

²⁶² Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-4.

ties or of an issuer's registrar or transfer agent, whether in relation to the holder of the securities or to any other person (Article 2(3)(c)).

b) Disposition of an Interest in Securities in case of Contractual Claims against the Intermediary

Notwithstanding Articles 2(3)(a) and (b) of the Hague Securities Convention, the Convention determines the law applicable to the issues mentioned in Article 2(1) with respect to a disposition of an interest in intermediated securities even if the rights subsequent to those securities being credited to a securities account are contractual by nature under the applicable law as determined by the Convention.²⁶³ There is a discrepancy in this regard between the French and the English versions of Article 2(2) of the Hague Securities Convention: Indeed, the English text correctly mentions both a "disposition of" or "an interest in" securities, whereas the French text refers to a "disposition of either securities or an interest in securities" (*concernant un transfert de titres ou d'un droit sur ces titres détenus auprès d'un intermédiaire*). The Explanatory Report on the Hague Securities Convention indicates that the English version prevails and that, consequently, the French text must be read accordingly.²⁶⁴

c) Exclusion of Purely Contractual or Otherwise Personal Rights between an Account Holder and its Intermediary Inter Se

In respect of the issues listed in Article 2(1) of the Hague Securities Convention, the Convention determines the law applicable to the legal nature and effects against the intermediary and third parties of the rights resulting from a credit of securities to a securities account and of a disposition of intermediated securities.²⁶⁵ Subject to Article 2(2), the Convention does not determine the law governing purely contractual or otherwise purely personal rights and duties of the parties to an account agreement or a disposition *inter se*. Matters such as the intermediary's standard of care in maintaining a securities account and any securities credited to it, the content and regularity of account statements, the deadline for an account holder to issue instructions to ensure they are carried out on the same day, or the risk of loss (for example, in case of computer failure) of securities held for the account holder, as between the account holder and the intermediary, are not within the Convention's scope (Article 2(3)(a) of the Hague Securities Convention).²⁶⁶ Likewise excluded are issues related to a

²⁶³ Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.19–10.20.

²⁶⁴ Christophe Bernasconi & Thomas Keijser (*supra* n 174) 553; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-31.

²⁶⁵ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-32.

²⁶⁶ It is submitted that these matters in practice are often but not necessarily dealt with in the account agreement.

disposition, such as price, the number and type of affected securities, the date on which the securities must be transferred against payment, or the consequences of a failure by either party to transfer securities or make payment when contractually obligated to do so (Article 2(3)(b)). The law applicable to those contractual rights are determined by the conflict of laws rules of the forum (excluding those the Convention provides). Parties to an account agreement are generally allowed to choose a law to apply to their contractual rights and duties under that agreement.²⁶⁷ But such a choice will still not affect the applicability of the Convention to the issues listed in Article 2(1).²⁶⁸

4. *Rights and Duties of an Issuer of Securities or of an Issuer's Registrar or Transfer Agent*

Under Article 2(3)(c) of the Hague Securities Convention, rights and duties of an issuer of securities or of an issuer's registrar or transfer agent are excluded from the scope of the Convention. Within this exclusion are an issuer's duties regarding all corporate actions, such as dividend and registration rights, voting rights, or an issuer's rights to define steps for achieving good discharge of a note, bond, or other debt security. The exclusion of corporate law issues is an approach also taken by the Geneva Securities Convention.²⁶⁹ It is also important to note that the Hague Securities Convention does not affect regulatory rules with respect to issuing or trading in securities.²⁷⁰

5. *Relationship between Article 2(1), (2), and (3) of the Hague Securities Convention*

Article 2(3)(a) of the Hague Securities Convention should not be read as a qualification of Article 2(1) but rather as dealing with purely contractual or purely

²⁶⁷ For instance, see Article 234 of the Uniform Act on General Commercial Law; in the Democratic Republic of the Congo, Article 11 of the Decree of 4 May 1895 (Bulletin Officiel, 1895, 138); in the Central African Republic, Article 42.1 of Law n° 65-71 of 3 June 1965 regarding the obligatory force of laws and the conflict of laws in time and space, effective on 1 July 1965; in Chad, Article 70.6 of Ordinance n° 6 of 21 March 1967 for the Reform of Judicial Organisation; in the Republic of the Congo Article 826 of Law n° 073/1984 of 17 October 1984; in Gabon, Article 55 of the of the Civil Code; in Guinea-Bissau, Article 41 of the Civil Code of Guinea-Bissau (initially enacted by the Portuguese Ordinance n° 22-869 of 4 September 1967 and renewed by Guinea-Bissau Law n° 1-73 of 27 September 1973, published in Boletim Oficial n° 1, of 4 January 1975); in Burkina Faso, Articles 1047–1048 of the Code of Persons and Family (Law VII 0013 of 19 November 1989, effective 4 August 1990; in Senegal, Article 848 of the Family Code of Senegal (Law n° 76-61 of June 1972, Official Journal of Republic of Senegal n° 4243 of 12 August 1972, 1295); and in Togo, Articles 722 and 724 of the Code of Persons and Family (Law 80-16 of 31 January 1980 as revised by Law of 29 June 2012).

²⁶⁸ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-33, Example 2-11.

²⁶⁹ Changmin Chun (*supra* n 73) 398.

personal rights that fall outside Article 2(1) altogether. Article 2(3)(a) is therefore subordinate to Article 2(2), which provides that the Convention applies to the rights relating to all securities held with an intermediary even if the rights resulting from a credit of securities to a securities account are determined to be contractual in character. What Article 2(3)(a) intends to highlight, however, is that Article 2(1) of the Hague Securities Convention does not cover matters such as deadlines for issuing instructions, the intermediary's standard of care in maintaining securities accounts, or the content and frequency of account statements, etc.²⁷¹ Article 2(3)(b) is subordinate to Article 2(2) in the same way: it underscores that Article 2(1) does not apply to certain matters related to a disposition of securities, such as price or the number and type of securities to be disposed.²⁷² Accordingly, Article 2(1) should be interpreted very broadly, as encompassing all rights resulting from the credit of securities to an account regardless of how the legal nature of those rights is classified.

IV. Internationality

Those participating in the first preparatory sessions in January 2001 unanimously decided that the Hague Securities Convention should apply if the owner of the securities, the collateral taker, the transferee, and the relevant intermediary are in the same country, but the issuer of the securities is located in another.²⁷³ Article 3 of the Convention does not establish specific factors to determine the internationality of a situation, nor does the Convention provide a definition of the term "internationality" that parties or courts could use to assess it. On the contrary, Article 3 refers to an autonomous notion of internationality by providing, simply, that the Convention applies in all cases involving "a choice between the laws of different States". This means that it applies to a situation involving intermediated securities relating in any way to more than one state.²⁷⁴ Some foreign elements that can trigger the applicability of the Convention

²⁷⁰ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-34.

²⁷¹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 2-7.

²⁷² Michael D. Diathesopoulos (*supra* n 176) 19; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 2-1 following s 2-7.

²⁷³ Tentative text on key provisions for a future Convention on the law applicable to proprietary rights in indirectly held securities – Suggestions for further amendment of the text contained in Working Document n° 16 of the January 2001 experts meeting, by the Permanent Bureau, Prel. Doc. n° 3 of July 2001, Article 3, 19; Bradley Crawford (*supra* n 39) 177.

²⁷⁴ Christophe Bernasconi (*supra* n 44) 19; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 3-1; Stephen Kozey (*supra* n 202) 1225. This wide applicability of the Hague Securities Convention is reinforced by the general applicability principle in Article 9 of the Convention, which provides that the Convention applies even if the applicable law is that of a non-Contracting State (Michel Germain & Catherine Kessedjian, 'La loi applicable à certains droits sur des titres détenus auprès d'un intermédiaire: le projet de convention de la Hayes de Décembre 2002' (2004) *Revue critique de Droit International Privé* 57, 57–58.

under Article 3 are for instance the “location” of a person involved in or affected by a transaction, the “location” of a security or its issuer, or a choice of law factor or element.²⁷⁵ For example, the situation is international under Article 3 if an intermediary has its registered office or domicile in one state while the securities account is maintained in another state, the securities are held with a central depository located in another state, and the registered office of the issuing company is located in another state or the issuing company is subject to foreign law. The crucial element in determining the internationality of a situation is whether the foreign element creates some doubt as to which law should govern a right in securities held with an intermediary.²⁷⁶ Consequently, the Convention does not apply unless some factor necessitates a decision as to which of two or more legal systems is applicable.²⁷⁷

It is important to note that Article 3 does not require a conflict of laws under the private international law rules of the forum or any other state.²⁷⁸ Consequently, for a question of applicability of the Convention it is not relevant whether the forum considers the foreign element to be material to the particular issue before it: Assume there is a priority dispute between J and M with respect to securities issued by T, which is incorporated under the laws of Germany. The securities are held by I in an account administered by A and successively given in security to J and M. J, M, I, and A are all in England. Although the issuer has nothing to do with the priority dispute, there is a foreign element that triggers the applicability of the Hague Securities Convention.

The chapeau worn by Article 3 of the Hague Securities Convention (“Internationality”) was vigorously debated during the process of elaborating the Convention.²⁷⁹ Some argued that the word “internationality” might exclude many situations to which the Convention ought to apply; as illustrated below, it might apply to several situations which may seem wholly “internal”. The chapeau of Article 3 of the Hague Securities Convention is thus not intended as a presupposition that the Convention applies; it merely alerts readers to the general content of the provision.²⁸⁰

²⁷⁵ Stephen Kozey (*supra* n 202) 1225.

²⁷⁶ Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.03.

²⁷⁷ Changmin Chun (*supra* n 73) 399; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 3-3. Note that the elements to be disregarded in determining the applicable law pursuant to Article 6 of the Hague Securities Convention are still relevant to whether the situation under consideration involves a foreign element for the purpose of Article 3 of the Hague Securities Convention.

²⁷⁸ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 3-4; Christophe Bernasconi (*supra* n 44) 19.

²⁷⁹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 3-4.

²⁸⁰ Christophe Bernasconi (*supra* n 44) 19; Stephen Kozey (*supra* n 202) 1225; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 3-4.

Article 3 refers to a “choice between the laws of different States”. On one hand, this reference does not mean that the Convention applies solely to cases in which the parties to an agreement have “chosen” or agreed upon a law to apply to their account agreement or to any agreement in respect of a disposition or otherwise. It also does not mean that a traditional conflict of laws analysis under the forum’s private international law must be engaged in or brought to a satisfactory conclusion. Rather, the term “choice” in Article 3 of the Convention refers to the determination of the applicable law made in relation to an issue listed in Article 2(1), because a case involving intermediated securities may encompass several elements connected in one way or another to different states, leading to a question of which law should apply. The Convention applies in all situations related in any way to more than one state, that is, in all situations encompassing a foreign element.²⁸¹ One of the parties, be it the account holder, the issuer, the relevant intermediary, or any of the parties to a disposition of the securities or the securities account, can supply such a foreign element; if any of these has its place of business or incorporation, habitual residence, or domicile in a different state, for instance, or is active in a different state in a situation involving intermediated securities, the Hague Securities Convention applies.²⁸² The use of the term “case” in Article 3 does not mean that the Convention applies only to a judicial proceeding; in fact, the word “case” there means “situation”.²⁸³

V. Temporal Scope of Application of the Hague Securities Convention

1. Entry into Force

a) Entry into Force on the International Plane (Article 19(1))

On 5 July 2006, the United States and Switzerland jointly signed the Hague Securities Convention.²⁸⁴ The Republic of Mauritius also signed the Hague

²⁸¹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 3-5, 3-6.

²⁸² See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 3-7, Example 3-1 and 3-2; Stephen Kozey (*supra* n 202) 1225, 1226. The applicability of the Hague Securities Convention is not temporally limited to the moment of litigation or of the occurrence of a particular disposition or crediting to a securities account. As indicated in the Explanatory Report on the Hague Securities Convention, the occurrence of circumstances at a point in time after a particular transaction (e.g., the subsequent acquisition of rights by an adverse claimant) would also make the Convention applicable (*see* Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 3-11).

²⁸³ See the French text of Article 3 of the Hague Securities Convention (Stephen Kozey (*supra* n 202) 1225, 1226; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 3-12).

²⁸⁴ The date of the Hague Securities Convention flows from the occasion this joint signing even though the adoption of the final text of the Hague Securities Convention occurred at the end of the Nineteenth Diplomatic Session of the Hague Conference on Private International Law in December 2002. For more details on the joint signing, *see*

Securities Convention, on 28 April 2008.²⁸⁵ On 14 September 2009, Switzerland became the first state to ratify the Convention, and it was incorporated into the Swiss Private International Law Act (SPILA) through a new article, 108c, which refers directly to it in order to determine the law applicable to rights in intermediated securities.²⁸⁶ Article 108c of SPILA allowed direct application of the Convention as national law in Switzerland even before the Convention entered into force at the international level.²⁸⁷ Parties have been able to invoke the Convention in Switzerland for the determination of the law applicable to all issues falling within its scope since 1 January 2010.²⁸⁸ The Republic of Mauritius deposited its instrument of ratification on 15 October 2009.

The European Union, it is worth noting, has postponed its ratification of the Hague Securities Convention, due mainly to the difference between it and EU law regarding the system of connections relating to rights in intermediated securities. Under EU law, these rights are subject to the law of the place where the securities are located.²⁸⁹ Under this PRIMA rule, the parties are not given any freedom of choice.²⁹⁰ As mentioned above, the Convention departed from this rule due to the difficulty – or even the impossibility – of determining, in practice, the location of a securities account.²⁹¹ In July 2006, the

<<https://www.hcch.net/en/news-archive/details/?varevent=117>> (accessed on 4 January 2021). For the status of ratification, acceptance, approval, or accession to the Hague Securities Convention, see <<https://www.hcch.net/en/instruments/conventions/status-table/?cid=72>> (accessed on 16 February 2017).

²⁸⁵ See <<https://www.hcch.net/en/news-archive/details/?varevent=144>> (accessed on 4 January 2021).

²⁸⁶ To better clarify the concept of intermediated securities within Swiss private international law, and add to the Hague Securities Convention rules regarding the conflict of jurisdictions and the recognition and enforcement of foreign judgments, two other provisions were introduced into the SPILA (respectively Articles 108a, 108b, and 108d SPILA) to form a Chapter 7a (Daniel Girsberger, ‘Hague Securities Convention – The Swiss Prospects’ in Andrea Bonomi, Eleanor Cashin Ritaine & Bart Volders (eds), *La Loi Applicable aux Titres Intermédiés: La Convention de La Haye du 5 Juillet 2006 – Une Opportunité pour la Place Boursière Suisse?* (Schulthess, Zürich 2006) 104–106).

²⁸⁷ See <<https://www.hcch.net/en/news-archive/details/?varevent=171>>; <<https://www.hcch.net/en/instruments/conventions/status-table/?cid=72>> (accessed on 4 January 2021). For more on the Hague Securities Convention and Swiss law, see also Hans Kuhn, Barbara Graham-Siegenthaler & Luc Thévenoz (eds), *The Federal Intermediated Securities Act (FISA) and the Hague Securities Convention (HSC)* (Stämpfli, Bern 2010); Florence Guillaume (*supra* n 176) 11–111. See also Maisie Ooi, ‘Intermediated Securities: The Choice of a Choice of Law Rule’ in Louise Gullifer and Jennifer Payne (eds), *Intermediated Securities: Legal Problems and Practical Issues* (Hart Publishing, Oxford 2010) 223, 223.

²⁸⁸ Florence Guillaume (*supra* n 176) 7.

²⁸⁹ Article 9(2) of the Settlement Finality Directive; Article 24 of the Winding-up Directive; Article 9(1) of the Financial Collateral Directive. See chapter 2 of part III of this thesis.

²⁹⁰ Florence Guillaume (*supra* n 176) 5.

European Commission issued a report²⁹² concluding that the adoption of the Convention would not require any amendment to the European rules governing insolvency proceedings²⁹³ and thus recommended that it be signed as soon as at least two of the European Union's principal trading partners (including the United States of America) would be bound by it.²⁹⁴ On 15 December 2016, the US deposited its instrument of ratification of the Hague Securities Convention, triggering the entry into force of the Convention,²⁹⁵ and so pursuant to Article 19, it entered into force on 1 April 2017, binding the US, Switzerland, and the Republic of Mauritius.²⁹⁶ The date the Convention entered into force is important for the operation of Article 16: it drew a dividing line between pre- and post-Convention account agreements and securities accounts.²⁹⁷ It also marked the start-date of the so called "Gap-Period", which is of particular importance in the case of declaration as per Article 16(2) of the Hague Securities Convention.

²⁹¹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s Int-41 – Int-46; Florence Guillaume (*supra* n 176) 5.

²⁹² See Commission of the European Communities (*supra* n 73).

²⁹³ These Community rules applicable to insolvency proceedings include the Insolvency Proceedings Regulation and the Winding-up Directive.

²⁹⁴ Bariatti Stefania, 'The Hague Securities Convention: Introductory Remarks' in Andrea Bonomi, Eleanor Cashin Ritaine & Bart Volders (eds), *La loi applicable aux titres intermédies: la Convention de La Haye du 5 Juillet 2006 – une opportunité pour la place boursière suisse?* (Schulthess, Zürich 2006) 19–23; Jean-Pierre Degué (*supra* n 230) 25–51; Diego Devos, 'The Hague Convention on the Law Applicable to Book-Entry Securities – The Relevance for the European System of Central Banks' in *Legal Aspects of the European System of Central Banks, Liber Amicorum Paolo Zamboni Garavelli* (European Central Bank, Frankfurt am Main 2005) 377–395; Ionna Thoma, 'Applicable Law to Indirectly Held Securities: A Non-"Trivial Pursuit"' (2008) *Butterworths Journal of International Banking and Financial Law* 190, 191.

²⁹⁵ This was subsequent to the US Senate's advice and consent to the ratification by the United States of the Hague Securities Convention. Note that the Hague Securities Convention is self-executing in the United States. See Report of the Committee on Foreign Relations, Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (September 2016) 114th Congress, 2nd session, U.S. Senate, Exec. Rept. 114-15, September 2016. See part III, chapter 3 of this thesis.

²⁹⁶ See <<https://www.hcch.net/en/news-archive/details/?varevent=531>> (accessed on 4 January 2021). Other countries are considering ratifying the Hague Securities Convention. In Japan for instance a report recommending ratification of the Convention was submitted to the Legislative Council of the Ministry of Justice. However, such a ratification was subject to the outcome of the reviews of the Convention by the European Union. Indeed, the Recommendation of 13 February 2008 entitled "Report on Results of Deliberation Concerning Consultation No. 57" indicated: "Japan should ratify the Convention at a proper time upon careful observation of the outcome of reviews of the Convention by the EU." See Yoshiaki Nomura (*supra* n 201) 1 fn 4.

²⁹⁷ Christophe Bernasconi (*supra* n 44) 20, 21.

b) *Entry into Force for a State and for a REIO*

(1) *For the States Bringing the Hague Securities Convention into Force (Article 19(1))*

For the three states that have deposited their instruments of ratification and thereby triggered the entry into force of the Hague Securities Convention on the international plane, it entered into force the same day, 1 April 2017. Article 19 of the Hague Securities Convention does not explicitly state this result, but it is self-evident: treaty practice commands that a convention that enters into force on the international plane be in force for the states that brought it into force.²⁹⁸ With respect to a territorial unit of a multi-unit state²⁹⁹ that was among the first three convening states (such as the US), the Convention entered into force on the same date as it entered into force for the multi-unit state. In general, this outcome can be reached in two ways: if a multi-unit state makes no declaration under Article 20(3) of the Convention, the Convention by its terms enters into force for all the territorial units of that state. However, if the state makes a declaration under Article 20(1),³⁰⁰ that declaration takes effect simultaneously with the entry into force of the Convention for the state concerned (Article 22(d)).

(2) *For Subsequent States and REIOs (Regional Economic Integration Organizations) under Article 19(2)*

Under Article 19(2) of the Hague Securities Convention, the Convention enters into force for the fourth and all subsequent states, as well as for REIOs, on the first day of the month following the expiration of three months after each deposits its respective instrument (Article 19(2)(a)). As used in Article 19(2)(a), the term “subsequent” refers not to the Convention’s entry into force on the international plane but rather to the deposit of the third instrument of ratification, acceptance, approval, or accession.³⁰¹

²⁹⁸ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 19-6.

²⁹⁹ Under Article 1(1)(m) of the Hague Securities Convention, a multi-unit state is a “state within which two or more territorial units of that state, or both the state and one or more of its territorial units, have their own rules of law in respect of any of the issues specified in Article 2(1)”. See Changmin Chun (*supra* n 73) 402; Christophe Bernasconi & Thomas Keijser (*supra* n 174) 554.

³⁰⁰ Note that a declaration must be made only at the time of signature, ratification, acceptance, approval, or accession. Declarations made at a subsequent time as well as new declarations take effect on the first day of the month following the expiration of three months after the date on which the Depository made the notification in accordance with Article 24 of the Hague Securities Convention.

³⁰¹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 19-8. Note that if the deposit of the fourth instrument had occurred on the same day as the deposit of the third, the Convention would have entered into force for the first three states and for the fourth depos-

2. *Temporal Scope of Application and Pre-convention Account Agreements and Securities Accounts*

a) *Article 16(1)*

The Hague Securities Convention applies to account agreements entered into, and to securities account agreements opened, before its entry into force on the international plane in accordance with Article 19. Indeed, Article 16(1) explicitly affirms that references in the Convention to “account agreement” and “securities account” extend to account agreements entered into prior to the Convention’s entry into force on the international plane. They also cover securities accounts opened prior to the Convention’s entry into force on the international plane (Article 19(1)). Consequently, any general notion about retroactivity may not affect the proper application of the Hague Securities Convention in respect of this particular point.³⁰²

b) *Article 16(2)*

(1) *Guidelines as to the Application of Articles 16(3) and (4)*

Articles 16(2) of the Hague Securities Convention contains rules as to when to apply Article 16(3) and (4), which set out rules for the interpretation of certain pre-Convention account agreements in applying Article 4(1). The interpretative rules in Article 16(3) and (4) of the Convention do not contain independent conflict of laws rules. They apply to pre-Convention account agreements, except when (i) the account agreement contains an express reference to the Convention³⁰³ or (ii) the account agreement is entered into during the period between when the Convention enters into force in accordance with Article 19(1) but before it enters into force for that State in accordance with Article 19(2). Article 16(3) and (4) do not apply if the state in which court proceedings are pending has made a declaration under Article 16(2) of the Convention that its courts will not apply these provisions to account agreements entered into during this “Gap Period”. If one of these two elements is fulfilled, the law applicable to the issues in Article 2(1) of the Convention will be determined by a direct application of Article 4(1) without regard to the interpretative rules of Article 16(3) and (4).

itor on the same day. However, this was not the case: no other state deposited its instrument of ratification on the same day as the United States (on 16 December 2016).

³⁰² Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 16-1, 16-10.

³⁰³ Pre-Convention account agreements which contain an express reference to the Hague Securities Convention are excluded from the scope of Article 16 of the Convention since the parties to such agreements must by definition have tailored their agreements to the terms of the Convention in the same way as the parties to post-Convention agreements will have. In such a case, it is unnecessary and inappropriate to distinguish between pre- and post-Convention agreements. See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 16-12.

(2) *Declaration Mechanism*

Under Article 16(2) of the Hague Securities Convention, a Contracting State may declare, at the time of signature, ratification, acceptance, approval, or accession, that its courts will not apply Article 16(3) and (4) to account agreements entered into after the Convention enters into force in accordance with Article 19(1) but before it does so for that State in accordance with Article 19(2).³⁰⁴ If such a declaration is made, Articles 4, 5, and 6 of the Convention will apply directly to the agreements entered into during the Gap Period without resort to the interpretative rules of Articles 16(3) or (4).

c) *Article 16(3)*

(1) *Interpretative Rule*

The interpretative rule of Article 16(3) of the Hague Securities Convention treats provisions of pre-Convention account agreements as having the effect of determining the law governing all issues listed in Article 2(1) of the Hague Securities Convention.³⁰⁵ If the rules of the state or territorial unit of a multi-unit state whose law governs the account agreement uphold an express choice of law in an account agreement that would have the effect of determining the applicable law for any issues listed in Article 2(1) of the Hague Securities Convention, under the Convention the chosen law will govern all Article 2(1) issues, subject to the Qualifying Office requirement³⁰⁶ specified in the second sentence of Article 4(1). (Where it applies, Article 16(3) of the Convention may expand the scope of the governing law determination from some to all issues specified in Article 2(1).) In some cases, Article 16(3) might also have the effect of producing a result under Article 4 of the Convention even if that provision might not otherwise have produced a result, thereby avoiding recourse to the fall-back rules of Article 5.

(2) *Declaration Mechanism*

At the time of the signature, ratification, acceptance, approval, or accession, a state may make a declaration under Article 16(3) and may further declare that its courts will not apply the interpretive rule of Article 16(3) if the parties to the account agreement have expressly agreed that the securities account is

³⁰⁴ Under Article 16(2) of the Hague Securities Convention, a multi-state unit may make such a declaration regarding any of its territorial units (*see also* Article 20 of the Hague Securities Convention; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 20 et seq).

³⁰⁵ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 16-14.

³⁰⁶ *See* Christophe Bernasconi (*supra* n 44) 21; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss Int-47, 4-21.

maintained in a *different* state than the one whose law would otherwise be applicable by reason of the interpretive rule of Article 16(3).³⁰⁷

d) Article 16(4)

The interpretative rule of Article 16(4) of the Hague Securities Convention treats some provisions of pre-Convention account agreements as having the effect of determining, in connection with Article 4 of the Convention, the law governing all the issues listed in Article 2(1). Article 16(4) applies only when Article 16(3) does not apply or does not determine the applicable law.³⁰⁸ Consequently, the Convention will treat the law of the state or territorial unit expressly specified by a pre-Convention account agreement to which Article 16(3) does not apply as the law governing the issues mentioned in Article 2(1). However, Article 16(4) requires that the relevant intermediary have a Qualifying Office in that State at the time the account agreement was entered into.

Unlike Article 16(3), Article 16(4) of the Convention provides that the agreement in respect of the state or territorial unit where the securities account is maintained may be express or implicit; it can be implied from the terms of the pre-Convention agreement as a whole or from the surrounding circumstances at the time it was entered into. Article 16(3) applies only if the relevant terms are expressly stated; Article 4(1) requires an express agreement; Article 5(1) of the Hague Securities Convention requires that the specified term be “expressly and unambiguously stated in a written account agreement”.³⁰⁹

e) When the Applicable Law Is Not Determined using Article 16(3) or Article 16(4)

As mentioned above, Article 16(3) and (4) of the Hague Securities Convention are solely interpretative rules, are not conflict of laws rules. Therefore, if the applicable law is not determined with the help of those provisions, Articles 4, 5, and 6 of the Convention apply directly and determine the applicable law independently. This preserves the overall structure of the Convention in certain circumstances, such as if: (i) its entry into force on the international plane occurred after the account agreement was entered into; (ii) the account agreement contains an express reference to the Hague Securities Convention; (iii) the pre-Convention agreement does not encompass any of the terms mentioned in Articles 16(3) and (4); (iv) the pre-Convention account agreement was entered into during the Gap Period and the forum is a Contracting State

³⁰⁷ Note that such a declaration may be made by a multi-unit state with respect to any of its territorial units (Articles 16(3) and 20 of the Hague Securities Convention).

³⁰⁸ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 16-16, 16-17.

³⁰⁹ Alexander Kern (*supra* n 215) 17.

that has declared that its courts will not apply Articles 16(3) and (4) to such account agreements; (v) at the moment the pre-Convention agreement was entered into, the intermediary had no Qualifying Office in the relevant state or territorial unit; or (vi) the account agreement contains no express or implied agreement as to where the securities account is maintained and Article 16(3) of the Hague Securities Convention does not apply.³¹⁰

C. *Applicable Law under the Hague Securities Convention*

I. *Introduction: Determining the Applicable Law*

The Hague Securities Convention encompasses on one hand a primary rule in Article 4 and on the other hand a set of fall-back rules in Article 5. Under Article 4, the law governing rights in intermediated securities is chosen by the account holder and its intermediary in their account agreement. The choice may be expressed in two ways: If the parties expressly choose a law that will generally apply to their account agreement (general governing clause), that law will also apply to all the issues mentioned in Article 2(1) of the Convention. However, if the account holder and its relevant intermediary expressly choose a law that will apply to all the specific issues mentioned in Article 2(1), that law will govern all Article 2(1) issues regardless of a different choice in a general governing clause in the same agreement. The Convention regards this choice of law as valid under two conditions: (i) it must be expressly made; and (ii) the relevant intermediary must have a Qualifying Office in the state whose law it designates.³¹¹

Article 5 of the Convention provides three cascading fall-back rules applicable only if the choice of law is not valid or none was made. Under the first cascading rule in Article 5(1), the governing law is that of the state where the office of the relevant intermediary (the party to the agreement) is located. However, two conditions must be met: (i) it must be possible to determine with certainty the office through which the account agreement was entered into, and (ii) this office must be a Qualifying Office. This first fall-back rule does not apply if it is not possible to determine with certainty the office through which the account agreement was entered into, nor does it apply if that office is not a Qualifying Office. In such a case the second fall-back rule, in Article 5(2), designates the law of the state under whose law the relevant intermediary is incorporated or otherwise organised. Article 5(2) does not apply if the relevant intermediary is not validly incorporated or organised; in such a case, the third fall-back rule, in Article 5(3), designates the law of the principal place of business of the relevant intermediary.

³¹⁰ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 16-22.

³¹¹ Stephan Saager (*supra* n 26) 185–186.

The following figure schematically summarises the aforementioned rules for determining the applicable law under the Hague Securities Convention.

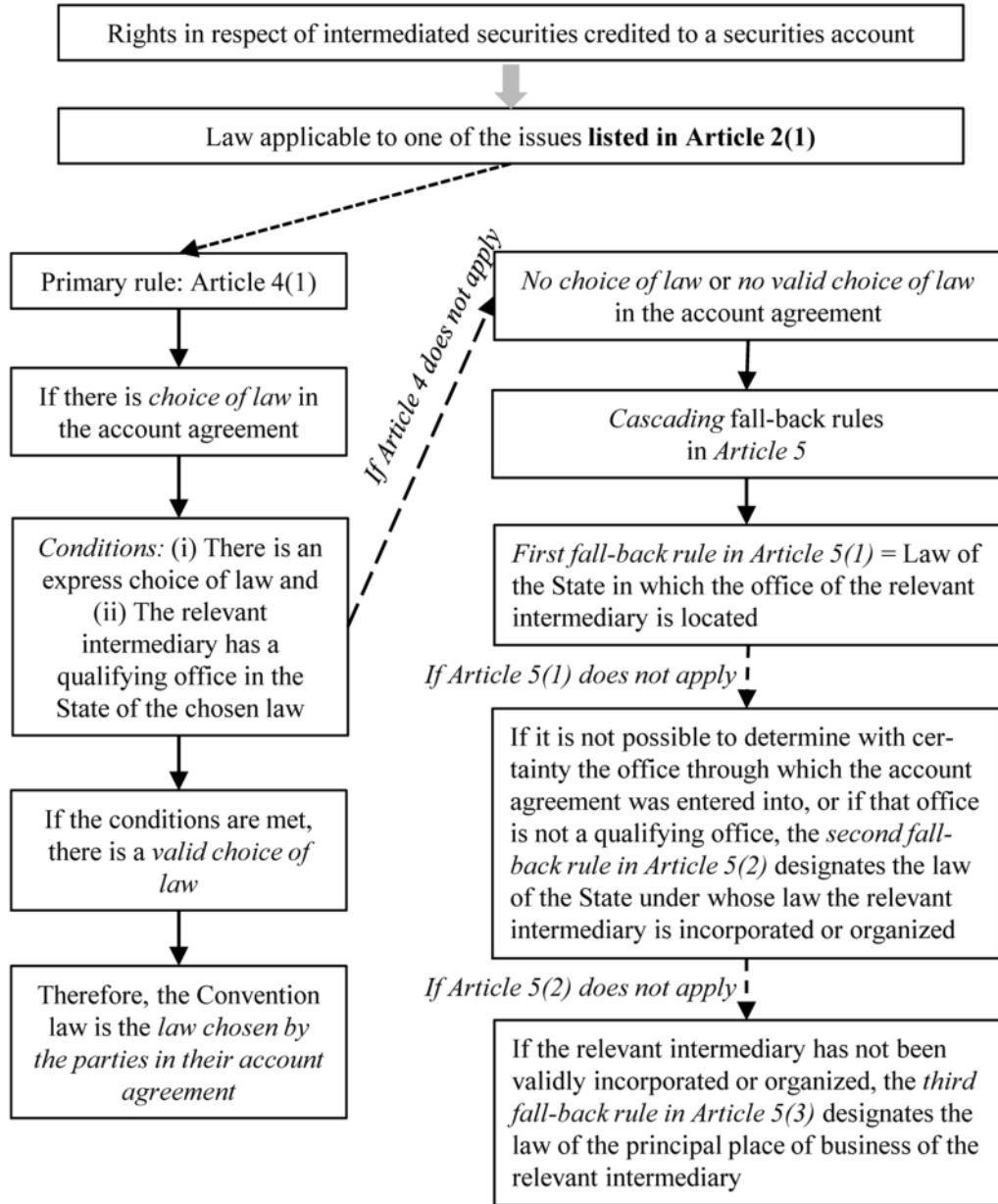


Figure 23: Determination of the Applicable Law under the Hague Securities Convention

II. The Primary Rule in Article 4(1)

1. Operation

Article 4 of the Hague Securities Convention supplies the primary conflict of laws rules that determine the law applicable to the issues listed in Article 2(1). It is the Convention's key provision.³¹² Subject to the Qualifying Office requirement in the second sentence of Article 4(1),³¹³ the primary rule (also called *contractual PRIMA*³¹⁴) determines the law applicable to the issues mentioned in Article 2(1) as follows:

- (i) The law in force in a particular state chosen by an account holder and its relevant intermediary to apply to their account agreement will govern the issues mentioned in Article 2(1). However, if the parties have selected a different law to govern the issues listed in Article 2, that law would apply;
- (ii) If there is no express agreement on the law which should govern the account agreement but there is an agreement on the law applicable to *all* the issues mentioned in Article 2(1), then that law will govern those issues.³¹⁵

The rule in Article 4 departs from the *lex rei sitae* rule as it rejects any attempt to physically locate the securities, the issuer, or other parties to a transaction.³¹⁶ Instead, it focuses on the relationship between the intermediary and

³¹² Christophe Bernasconi & Thomas Keijser (*supra* n 174) 551.

³¹³ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 4-21 et seq.

³¹⁴ Philipp Paech 'Market Needs a Paradigm – Breaking Up the Thinking on EU Securities Law' in Pierre-Henry Conac, Ulrich Segna & Luc Thévenoz, *Intermediated Securities – The Impact of the Geneva Securities Convention and the Future European Legislation* (Cambridge University Press, Cambridge 2013) 15. For a comparison with what might be termed *factual PRIMA*, see Christophe Bernasconi and Harry C. Sigman, 'Déterminer la Loi Applicable – Les Facteurs de Rattachement Retenus par la Convention de la Haye' in Andrea Bonomi, Eleanor Ritaine & Bart Volders (eds.), *La loi applicable aux titres inter-médiés: la Convention de La Haye du 5 Juillet 2006 – une opportunité pour la place financière suisse?* (Schulthess, Zürich 2006) 53–65; Dorothee Einsele, 'Das Haager Übereinkommen über das auf bestimmte Rechte im Zusammenhang mit zwischenverwahrten Wertpapieren anzuwendende Recht' (2003) WM 2349; Richard Potok, Guy Morton & Antoine Maffei (*supra* n 26) 229; Maisie Ooi, 'The Ramifications of Fragmentation in the Choice of Law for Shares' (2016) 12 2 Journal of Private International Law 416.

³¹⁵ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-14; Changmin Chun (*supra* n 73) 402. The sequence and provision in Article 4(1) of the Hague Securities Convention is similar to the rule specified in § 8-110(e) of UCC Article 8.

³¹⁶ In contrast, *Deschamps* suggests that the connecting factor to determine the law applicable to the effectiveness of transfer against the issuer, and for perfection and priority, should be the place where the issuer has been formed or constituted (and not the law chosen in the account agreement pursuant to Article 4(1) of the Hague Securities Convention). (Michel Deschamps (*supra* n 37) s 1.104).

the account holder.³¹⁷ More particularly, it gives effect to the parties' express covenant in an account agreement on the law applicable to all the issues mentioned in Article 2(1).³¹⁸

This primary rule of the Convention has been regarded as embodying the principle of "party autonomy" since the parties to the account agreement determine the law governing certain issues related to intermediated securities.³¹⁹ However, it is submitted that the use of the term "party autonomy" is not appropriate, since it implies that the parties to the collateral transaction may determine, by agreement, the law governing the proprietary aspects of the transaction. Even in the UCC, for instance, "party autonomy" refers only to the relation between the investor and the intermediary, not the relation between the investor and the secured party.³²⁰ If there is party autonomy, it is only at the level of the account agreement, as the account holder and the intermediary can choose the law applicable either to the Article 2(1) issues or to the whole account agreement. However, such a choice is not what the primary rule in Article 4 suggests: Article 4 merely offers to the investor and its intermediary the possibility of *localising their account*. It is evident that such a localisation may still have an *effet réflexe* on an actual transaction concluded between the collateral taker or transferee and the investor; after all, this is the law that would apply to the proprietary aspects of the transaction. But it would be misleading to refer to this as "party autonomy". Here it is worth noting that during the process of elaborating the Convention, some delegations invoked a parallel to the situation in which an investor might choose to do business with an intermediary

³¹⁷ Harry C. Sigman & Christophe Bernasconi, 'Myths About the Hague Convention Debunked' (2005) 24 *International Financial Law Review* 31, 33.

³¹⁸ Interestingly, during the process of elaborating the Hague Securities Convention, it was first suggested that all significant issues resulting from dispositions of interests in intermediated securities should be referred to the law of the "place of the relevant intermediary" (Christophe Bernasconi (*supra* n 44) 9, 30). However, the final text of the Hague Securities Convention shifts from the location of the intermediary to the choice of the applicable law. See Bradley Crawford (*supra* n 39) 173.

³¹⁹ Stephen Kozey (*supra* n 202) 1226. On the prevalent tendency throughout jurisdictions worldwide towards allowing the applicable law to be determined based on the choice of the parties, see Ole Böger, 'Close-out Netting Provisions in Private International Law and International Insolvency Law (Part I)' (2013) 18 *Uniform Law Review* 240; Permanent Bureau of the Hague Conference on Private International Law, 'Choice of Law in International Commercial Contracts: Hague Principles?' (2010) *Uniform Law Review* 883; Mo Zhang, 'Party Autonomy and Beyond: An International Perspective of Contractual Choice of Law' (2006) 20 *Emory International Law Review* 511; Gisela Rühl, 'Party Autonomy in the Private International Law of Contracts: Transatlantic Convergence and Economic Efficiency' in Eckart Gottschalk et al (eds), *Conflict of Laws in a Globalized World* (Cambridge University Press, Cambridge 2007) s 2-054.

³²⁰ See *supra* part III, chapter 3 of this thesis.

located in State X rather than one in State Y.³²¹ Although such a “choice” would lead to the application of a different law, it would not be appropriate to refer to it as an example of “party autonomy”. In other words, there is no “choice of law” or “party autonomy” at the level of the collateral transaction that will trigger the application of Article 4(1) of the Convention.³²² Consequently, this thesis prefers referring to the primary rule in Article 4 of the Hague Securities Convention as a *consensual approach*; this focuses on the agreement between the investor and its intermediary.

If the account holder and its intermediary expressly choose a law to govern the account agreement in general (general governing clause), that law will govern all the issues mentioned in Article 2(1); however, if the parties have expressly chosen a law to govern particular issues mentioned in Article 2(1), that law will apply to all the issues mentioned in Article 2(1) regardless of a separate choice of law to generally apply to the account agreement.³²³ But if the Qualifying Office requirement is not satisfied, however, the applicable law will be determined by the relevant fall-back rule in Article 5 of the Hague Securities Convention.³²⁴ The Hague Securities Convention requires that all issues in Article 2(1) be governed by the same law.³²⁵ Provided that the Qualifying Office requirement is satisfied, parties may choose different laws for different intermediated securities by opening different accounts or sub-accounts, each governed by its own law.³²⁶

2. The “Law in Force” and the “Law of” a State

The phrase “law in force” in Articles 4(1), 5(1), 5(2), 5(3), 10, 12(2), 16(3), and 16(4) of the Hague Securities Convention is preferred over the “law of” because of situations in which the relevant law encompasses both the law of a territorial unit and, to the extent applicable under its law or the law of a multi-unit state, the law of the multi-unit state. The meaning of the phrase “law in force” is clarified in Article 12(2)(a): “the law in force in a territorial unit of a Multi-unit State includes both the law of that unit and, to the extent applicable in that unit, the law of the Multi-unit State itself”. Article 12(2)(a) thus

³²¹ Prel. Doc. n° 2 (*supra* n 177) 21, fn 41.

³²² Please note that the option under which the collateral taker and the collateral provider choose the law applicable to their *in rem* rights is analysed in chapter 5 of part III of this study.

³²³ Christophe Bernasconi & Thomas Keijser (*supra* n 174) 552; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 4-2, 4-16; Reinhard Ege (*supra* n 176) 152.

³²⁴ Philipp Paech (*supra* n 314) 27; Christophe Bernasconi & Thomas Keijser (*supra* n 174) 552.

³²⁵ Christophe Bernasconi & Thomas Keijser (*supra* n 174) 551.

³²⁶ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-20; Changmin Chun (*supra* n 73) 402.

automatically implements the federalism rules that exist in some multi-unit states; for instance, it preserves the effect of the federal rules applicable to US government and agency securities. So if under the relevant Convention rule the applicable law is, say, New York law, then not only will New York state law apply but so will any US federal law in force in New York which is relevant to the issue in question. Note that pursuant to Article 10, the phrase “law in force in a territorial unit of a Multi-unit State” means the law other than conflict of laws rules; consequently, the territorial unit of a multi-unit state cannot call for *renvoi* or further reference to the law of a different state or territorial unit. Similarly, internal *renvoi* or further reference to the law of a different territorial unit of that multi-unit state is ruled out by the plain language of Article 12(2)(a) of the Convention.³²⁷

3. Requirement of an Express Choice

Article 4(1) of the Hague Securities Convention requires the law applicable to the issues listed in Article 2(1) of the Convention to be *expressly*³²⁸ agreed upon in the account agreement; the choice of a law to govern the issues in Article 2(1) may *not* be implied from the terms of the account agreement considered as a whole or from the surrounding circumstances.³²⁹ This solution contrasts with Article 16(4) of the Convention, under which (in limited circumstances) the parties’ agreement as to where the securities account is maintained is effective even when that agreement is implied from the terms of the account agreement or from the surrounding circumstances at the time the account agreement was entered into.³³⁰ This provision in Article 16, which is aimed at providing ways to interpret pre-Convention account agreements that do not expressly refer to the Convention, does not affect post-Convention agreements or pre-Convention agreements which do expressly refer to the Convention (*see* Article 16(2)).

Without the requirement that a choice of law under Article 4(1) of the Convention be expressly made, a court could imply a choice, reducing the certainty of the conflict of laws regime created by Articles 4 and 5. Matters

³²⁷ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 4-15, 12-12, 12-13. Note that the only types of *renvoi* permitted under the Hague Securities Convention and excepting from the rule in Article 10 are: (i) the limited form of internal *renvoi* which might result from Article 12(2)(b) of the Hague Securities Convention; and (ii) the limited form of internal *renvoi* which might result from Article 5 of the Hague Securities Convention if a multi-unit state makes a declaration under Article 12(3).

³²⁸ The words “express” or “expressly” should not be understood as a form requirement that the account agreement must be in writing. *See* Article 5(1) of the Hague Securities Convention which clearly requires a writing (Christophe Bernasconi (*supra* n 44) 9).

³²⁹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-17, Example 4-7.

³³⁰ Christophe Bernasconi (*supra* n 44) 9; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 16-20, 16-21.

which are outside the scope of Article 2(1) and thus outside the scope of the Convention may still be governed by such an implied choice of law under the same account agreement, and issues listed in Article 2(1) will still be governed by the law determined by the relevant fall-back rule under Article 5; under no circumstance will they be governed by any other law impliedly chosen by the parties.³³¹ In order to be effective under Article 4(1), the choice of law must be expressed as part of the account agreement, which may consist of one or more documents; and the parties may elect to express their choice of law in the general terms and conditions of the account agreement.

4. *Form and Validity of the Choice of Law Clause*

Article 4(1) of the Hague Securities Convention does not require that the account agreement be in writing. (Article 5 (1) is the only provision of the Convention which requires a writing.³³²) Under Article 4(1), an oral expression of a choice of law is thus effective even if a writing or other formality requirement would render it ineffective under any jurisdiction's private international law or substantive writing requirement. Moreover, the Convention is silent if the issue is whether there was no agreement on the governing law due to a lack of consent.³³³ This is a question that would be governed by the conflict of laws rules of the forum other than those contained in the Convention. So if the applicable substantive law would hold that there was no consent, then there can be no agreement for the purpose of Article 4(1) of the Convention, and the law applicable to the issues listed in Article 2(1) would consequently be determined by the relevant fall-back rule in Article 5.

5. *Validity of the Account Agreement*

If the account agreement itself is void, due for example to a lack of capacity of one of the parties, the connecting factor may be indeterminate because the primary rule of the Hague Securities Convention is based on the contents of the account agreement. In such a case, the conflict of laws rules of the forum (other than those contained in the Convention) will govern the validity of the account agreement.³³⁴ If the agreement is void under the applicable substantive law, the fall-back rules of Article 5 will apply.³³⁵ The Explanatory Report on the Hague Securities Convention does not specifically indicate which fall-back rule might be relevant. If the account agreement is a nullity, however,

³³¹ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-17.

³³² Changmin Chun (*supra* n 73) 404.

³³³ This might be the case, for instance, by reason of a generally applicable contract law doctrine such as lack of capacity.

³³⁴ Christophe Bernasconi (*supra* n 44) 13.

³³⁵ Changmin Chun (*supra* n 73) 404.

Article 5(1) does not apply, because it refers to a “written account agreement”. The fall-back rules in Article 5(2) and (3) of the Convention³³⁶ would apply accordingly.

6. *The Qualifying Office Requirement*

a) *The Debate between the Common Law and the Civil Law Approaches*

As already noted, Article 4 of the Hague Securities Convention provides the primary rule of the Convention under which the law applicable to all the issues specified in Article 2(1) is the law in force in the state the account agreement expressly identifies as the one whose law will govern the entire account agreement; or, if the account agreement expressly provides that a different jurisdiction’s law will apply to the Article 2(1) issues, then that other law. This rule does not attempt to localise the place of the relevant intermediary; rather, it allows the account holder and the relevant intermediary to choose the applicable law subject to the limits imposed by the Convention.³³⁷ However, common law and civil law jurisdictions approach the parties’ freedom to choose the applicable law by contract very differently. The governing principle in common law jurisdictions is indeed fairly generous in granting party autonomy; for instance, the leading case under Canadian law in Ontario is *Vita Food Products Inc. v Unus Shipping Co.*,³³⁸ under which an express choice of law clause in a contract must be enforced so long as it is *bona fide* and not against public policy. Many civil law jurisdictions regard party autonomy by contrast as being somewhat more restricted, in particular where property rights and potential third-party interests are at issue.³³⁹ The law selected by the parties in their contract is then subject to a juridical “reality check”: choice of law clauses are enforced only if they lead to application of the law of a place where the property may conceivably be considered to be located.³⁴⁰ Although some civil law jurisdictions allow party autonomy to apply to the proprietary aspects of a transaction, none of them seems to allow for this choice of law to be invoked against third parties.³⁴¹ Many representa-

³³⁶ The provisions in Article 5(2) and (3) of the Hague Securities Convention provide that if there is no account agreement, the time factor for the operation of the fall-back rules is the moment the securities account was opened.

³³⁷ Bradley Crawford (*supra* n 39) 185.

³³⁸ *Vita Food Products Inc v Unus Shipping Company Limited in liquidation* [1939] UKPC 7, [1939] A.C. 277 (P.C.).

³³⁹ Kalongo Mbikayi, *Droit civil, Tome 1: Les obligations* (Editions Universitaires Africaines, Kinshasa 2012) 177.

³⁴⁰ Bradley Crawford (*supra* n 39) 185.

³⁴¹ For instance, the Russian Civil Code also allows parties to choose the law applicable to proprietary aspects. Indeed, Article 1210(1) of the Russian Civil Code provides: “When they enter into a contract or later on the parties thereto may select by agreement

tives of civil law jurisdictions therefore underscored the issue of identifying the *place where the affected securities account is actually located* during the process of elaborating the Convention.³⁴² In contrast, many representatives of the common law countries considered the search for the location of dematerialised (and therefore intangible) property as a highly unrealistic pursuit; one delegation indicated that the ability to designate the applicable law should not be subject to any requirement of a connection between the place designated in the agreement and other facets of the transaction.³⁴³

Therefore, although there was consensus among the experts on the need for *ex ante* certainty, initially they did not fully agree on how to achieve this goal. Article 4 of the Convention bears the scars of the conflict between these competing approaches. Indeed, Article 4 is the result of the compromise reached at the January 2001 meeting: the parties to the custody agreement are allowed to designate an agreed place as the location of the account, but the designation will be conclusive only if it satisfies one of the specified tests designed to indicate that the designated place is where the account is actually maintained.³⁴⁴

b) *The Conditions for a Qualifying Office*

The parties' freedom to select the applicable law is not unlimited.³⁴⁵ Indeed, the effectiveness of the parties' choice of law to govern their agreement under Article 4(1) first sentence of the Hague Securities Convention requires that the relevant intermediary, at the time the account agreement is first entered into, has an office which meets the requirements set out in the Article 4(1) second sentence.³⁴⁶

As to the Qualifying Office requirement, different possibilities may be envisaged:

- *Case 1:* The account holder and the intermediary choose one law to apply to the account agreement and another law to apply to the issues mentioned in Article 2(1) of the Convention; if these two choice of law claus-

between them the law that will govern their rights and duties under the contract. The law so selected by the parties shall govern the emergence and termination of a right of ownership and other rights *in rem* relating to movable property *with no prejudice for the rights of third persons* [my emphasis]." Similarly, the Dutch Private International Law Act provides with another example of extension of choice of law to the area of international property law (see Article 10:128(2) *Burgerlijk Wetboek*). This question is further analysed under part III, chapter 5, section C of this thesis.

³⁴² Prel. Doc. n° 2 (*supra* n 177) 20.

³⁴³ Prel. Doc. n° 2 (*supra* n 177) 20.

³⁴⁴ Prel. Doc. n° 2 (*supra* n 177) 21.

³⁴⁵ This constitutes a major difference from the conflict of laws rules in UCC Articles 8 and 9.

³⁴⁶ Christophe Bernasconi (*supra* n 44) 9.

- es satisfy the Qualifying Office requirement, the choice of law for the issues mentioned in Article 2(1) will have priority;³⁴⁷
- *Case 2*: The account holder and the intermediary select one law to apply to the account agreement and another to apply to the issues mentioned in Article 2(1); but if the two choice of law clauses do not meet the Qualifying Office requirement, the fall-back rule in Article 5 will apply;³⁴⁸
 - *Case 3*: The parties select one law to govern the issues mentioned in Article 2(1) and a different law to govern the account agreement. If the former (but not the latter) fails to satisfy the Qualifying Office requirement, the law selected by the parties to govern the account agreement will apply to the issues in Article 2(1) (*case 3a*). This is because Article 4(1) first sentence is based on the assumption that the selection of a law to apply to the issues mentioned in Article 2(1) is effective.³⁴⁹ Conversely, where the law selected to govern the account agreement fails the Qualifying Office requirement (but the law selected to govern the issues mentioned in Article 2(1) satisfies it), the applicable law will be the law selected by the parties to govern the issues mentioned in Article 2(1) (*case 3b*). This is because even if the law the parties chose to govern the account agreement did satisfy the Qualifying Office requirement, it is the law the parties chose to govern the issues in Article 2(1) that would have been given effect to;
 - *Case 4*: If the account holder and the intermediary make a split designation, agreeing that one law governs some and another law governs other issues in Article 2(1), their choice cannot be effective under the Convention; it would lead to application of the law the parties expressly chose to govern the account agreement (*case 4a*) or, absent an effective choice of that law, to application of the relevant fall-back rule in Article 5 (*case 4b*).³⁵⁰

The following table summarises the discussion and the cases mentioned above:

Table 5: Qualifying Office Requirement

Choice of Law Clauses	Qualifying Office Test		Convention Law***
	Art. 2(1) IC*	AAC**	
Case 1	√	√	Law designated by Article 2(1) IC
Case 2	x	x	Law designated by Fall-Back Rules

³⁴⁷ Reinhard Ege (*supra* n 176) 155.

³⁴⁸ Changmin Chun (*supra* n 73) 403.

³⁴⁹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-21.

³⁵⁰ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-10; Changmin Chun (*supra* n 73) 403.

Choice of Law Clauses	Qualifying Office Test		Convention Law***
	Art. 2(1) IC*	AAC**	
Case 3 (a)	x	√	Law designated by the ACC
Case 3 (b)	√	x	Law designated by Article 2(1) IC
Case 4 (a)	x	√	Law designated by the ACC
Case 4 (b)	x	x	Law designated by Fall-Back Rules

* Article 2(1) IC = Clause designating the law applicable to the issues mentioned in Article 2(1) of the Hague Securities Convention.

** AAC = Clause designating the law applicable to the account agreement.

*** Convention Law= Law that is applicable under the Hague Securities Convention.

To satisfy the Qualifying Office requirement of Article 4(1) of the Convention, there are two conditions which must be fulfilled when the parties agree on what law should apply:

- (i) Within the state whose law the parties expressly agree upon, the relevant intermediary must have an office that satisfies the definition provided in Article 1(1)(j) of the Convention;³⁵¹
- (ii) The office must either stand alone, with other offices of the relevant intermediary, or with other persons who are:
 - Engaged in the maintenance of securities accounts, whether by fulfilling one of the functions specified in Article 4(1)(a)(i) or (ii) or otherwise; or
 - Identified by a specific means of identification as maintaining securities accounts in the state in question.³⁵²

In today's financial markets, customer service operations and the activities involved in maintaining even a single securities account may be undertaken from a variety of offices or outsourced to third parties in numerous places. For instance, assume that an intermediary incorporated under the laws of Germany agreed with its client that the client's securities account will be maintained in New York; that was the where the account was first opened and securities first credited to it. But the intermediary sends all account statements from an office in Hong Kong and advises the client about the account on an ongoing basis from an office near the client's main office in South Africa. In addition, the back-up and the monitoring of all the intermediary's securities account operations is performed by two separate computer systems run from offices located in Tokyo and San Francisco; account entries are also made through these systems. Finally, the client accesses information about the relevant securities account from a laptop as she travels the world.

³⁵¹ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 1-22 et seq.

³⁵² Stephen Kozey (*supra* n 202) 1226; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-22.

The scenario above permits no certainty as to where the securities account, or the office where the securities account is maintained, is located. The Qualifying Office requirement and related rules thus do not refer to a specific account maintained by the relevant intermediary or to a specific account holder.³⁵³ As long as an office engages in the business or in other regular activities of maintaining securities accounts in the selected state, it is a Qualifying Office under the Hague Securities Convention. The fact that the office might be in another state than the one identified as the place of a particular account holder's securities account when an issue arises with that account is not relevant. This is depicted in the following figure.³⁵⁴ Assume that a French investor, F, opens his account with the Brussels branch of intermediary IM and agrees that California law will govern the account agreement. The parties do not make a separate choice of a law to govern the Article 2(1) issues. Assume further that IM's Delaware branch is engaged in maintaining *some* securities accounts, though not F's.

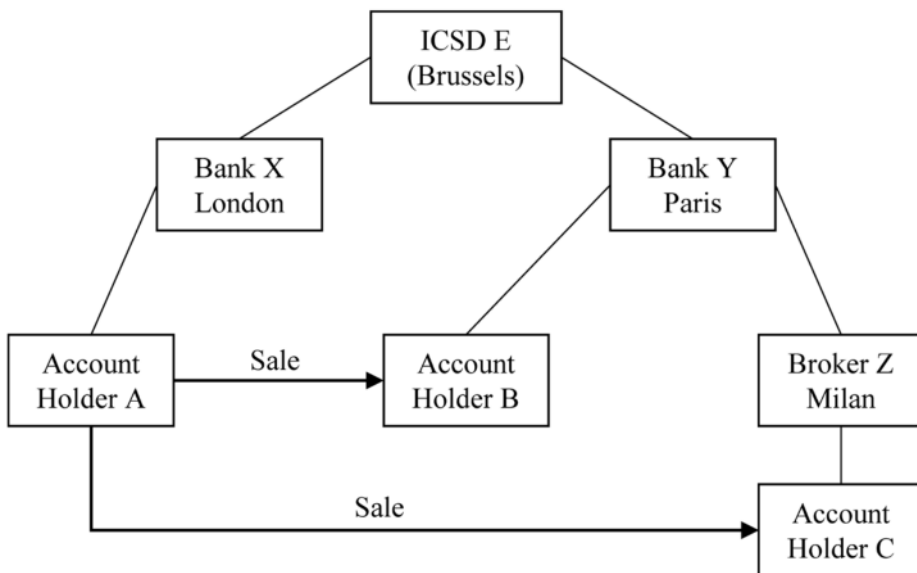


Figure 24: Qualifying Office Requirement

In the fact pattern described above, the Qualifying Office requirement is met pursuant to Articles 4(1) and 12 of the Convention even if IM's Delaware branch does not service the particular securities account F opened in Brussels. It suffices under the Convention that an office is engaged in the business or other regular activities of maintaining securities accounts in the selected state (though not necessarily the specific account in question).

³⁵³ Christophe Bernasconi (*supra* n 44) 10.

³⁵⁴ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Examples 4-3, 4-4, and 4-5.

c) *Definition of the Term “Office”*

Under Article 1(1)(j) of the Hague Securities Convention, the term “office” means, with respect to an intermediary, “a place of business at which any of the activities of the intermediary are carried on, excluding a place of business which is intended to be merely temporary and a place of business of any person other than the intermediary”. Under this definition, the existence of an office is not conditioned by any specific facilities or features. Therefore, the interpretation of the “place of business” in Article 1(1)(j) must be in accordance with its ordinary meaning. It might include, for instance, a ship on which a mobile branch of the intermediary conducts its business on a regular basis; and it covers technological developments, such as the use of the Internet to conduct activities relating to securities and to maintaining securities accounts. Indeed, there are “virtual banks” whose communication with their clients occurs solely by electronic means such that account agreements are not concluded at any physical location of the bank’s. This leads to no difficulty under the Convention since the Convention does not require reference to the location where the account agreement was concluded (although the parties may designate that place expressly under the first fall-back rule in Article 5(1)).³⁵⁵ Note that the fact that an office is a Qualifying Office under the Convention does not imply it is an authorised office for regulatory purposes.

d) *The Time Factor*

For there to be a Qualifying Office, the time to be taken into account for the application of the conditions set out in the second sentence of Article 4(1) of the Hague Securities Convention is the time when the express agreement on the governing law was made.³⁵⁶ If no office is a Qualifying Office at that time, the choice of law is ineffective under Article 4(1) even if some office subsequently becomes a Qualifying Office.³⁵⁷ Conversely, if the applicable law is agreed on when there is an office that counts as a Qualifying Office, the agreement on the applicable law is effective under Article 4(1) even if that office is subsequently closed down. Nevertheless, the Qualifying Office test must be reapplied each time the intermediary and its client amend the account agreement, either by changing the governing law, otherwise modifying the agreement, or even by singling out and expressly reconfirming the pre-existing governing law provision. Generally, the agreement on the governing law is part of the account agreement *ab initio*. However, the parties may incorporate a governing law clause into the account agreement subse-

³⁵⁵ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 1-23; Changmin Chun (*supra* n 73) 406.

³⁵⁶ Reinhard Ege (*supra* n 176) 148.

³⁵⁷ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-27.

quently to the initial account agreement or amend a governing law clause they had agreed upon before. In these cases, the Qualifying Office test must be applied again in light of the amendment. If the choice of law then satisfies the Qualifying Office test, it is effective.

e) The Qualifying Activity

Article 4(1) of the Hague Securities Convention provides that the Qualifying Office has to be one: (i) which effects or monitors entries to securities accounts; (ii) through which payments or corporate actions in respect of intermediated securities are administered; or (iii) which is engaged in a business or other regular activity of maintaining securities accounts. Article 4(2) provides that for purposes of Article 4(1)(a), an office is not engaged in a business or other regular activity of maintaining securities accounts merely because the technology supporting the bookkeeping or data processing for securities accounts is located there (Article 4(2)(a)). Similarly, the fact that an office which merely is a place where call centres for communication with account holders are located or operated cannot be regarded as an office engaged in a business or other regular activity of maintaining securities accounts for the purpose of Article 4(1)(a)(iii) (Article 4(2)(b)). The same rule applies to an office that merely keeps files or archives, administers mailings related to securities accounts, or engages solely in representational or administrative functions not related to opening or maintaining securities accounts and lacks the authority to form binding account agreements.³⁵⁸

If an office does not meet the conditions in Article 4(1)(a)(i) or (ii) of the Convention, it will not be regarded as a Qualifying Office under Article 4(1)(a)(iii) solely because it carries on an activity mentioned in Article 4(2); but it may constitute a Qualifying Office if it falls under Article 4(1)(b) as an office “identified by an account number, bank code, or other specific means of identification as maintaining securities accounts in that State.”

7. Rejection of the Idea of a “Super-PRIMA”

The wording of Articles 4 and 5 of the Hague Securities Convention (“securities held with an intermediary” and “relevant intermediary”) indicates that these provisions apply separately to each individual relationship between an

³⁵⁸ None of the activities listed in Article 4(2) of the Hague Securities Convention is a disqualification. The list in Article 4(2) of the Hague Securities Convention sets a bottom line and determines that any of the enumerated activities *alone* would not constitute the office as being engaged in maintaining securities accounts for the purpose of Article 4(1)(a)(iii) of the Hague Securities Convention. Article 4(2) does not apply in respect of Article 4(1)(a)(i) and (ii).

account holder and a relevant intermediary.³⁵⁹ Similarly, Article 6(d) of the Convention provides that in determining the applicable law under the Convention, no intermediary's location will be taken into account other than the relevant intermediary's. Consequently, if there is a chain of intermediaries between the issuer and the account holder, no single law would apply to all Article 2(1) issues across all the accounts maintained by intermediaries between the issuer and the account holder. If a disposition of securities is made by transfer through a chain of intermediaries, Articles 4 and 5 apply separately to each securities account.³⁶⁰ And with respect to each securities account, this may (and often will) result in a different law governing the Article 2(1) issues. The Convention rules out the concept of a "Super-PRIMA" rule, which would consist in applying the same law to every securities account held with each intermediary standing between an account holder and the issuer or to every securities account involved in a disposition of securities made by transfer through a chain of intermediaries.³⁶¹

8. *Explanatory Rules for Transfers by an Account Holder in favour of its Intermediary*

Article 4(3) of the Hague Securities Convention addresses issues of which account agreement and which intermediary are the relevant ones if an account holder executes a transfer in favour of its intermediary.³⁶² Under Articles 4(3)(a) and (b) of the Convention, the relevant intermediary is the account holder's intermediary. These provisions also confirm that the relevant account agreement is the account agreement between the account holder and its intermediary for purposes of Articles 4(1) and 5(1). As per Article 4(3)(c), the relevant securities account for purposes of Article 5(2) and (3) is the one to which securities were credited immediately before the disposition. In applying the interpretative rules provided in Article 4(3), it is immaterial whether the intermediary maintains a securities account in its own name to which any securities debited from the account holder's securities account are then credited.³⁶³

³⁵⁹ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-41.

³⁶⁰ Christophe Bernasconi (*supra* n 44) 14.

³⁶¹ Reinhard Ege (*supra* n 176) 183. This issue is further discussed in section II.5. of this chapter.

³⁶² This also includes situations where the intermediary has a corresponding position in the same quantity and type of securities with an upper-tier intermediary or transmits securities from one account to another with an upper-tier intermediary based on customer regulatory or contractual segregation requirements.

³⁶³ Christophe Bernasconi (*supra* n 44) 10.

III. Fall-Back Rules under Article 5 of the Hague Securities Convention

1. Introduction

If the law governing the Article 2(1) issues is not determined under the Convention's primary rule in Article 4(1), the fall-back rules in Article 5 of the Hague Securities Convention apply in a hierarchical structure. This might occur where the account agreement contains no express choice of law to apply to the account agreement or to all the Article 2(1) issues. Similarly, it might occur if the account holder and intermediary do select a law to apply to the account agreement or the Article 2(1) issues but the selection is not effective under the Convention because it does not satisfy the Qualifying Office requirement.³⁶⁴

The fall-back rules set out in Article 5 operate as a cascade and can be understood as the original PRIMA concept.³⁶⁵ This "cascade solution" was adopted very early in process of negotiating the Convention to provide a "safe harbour solution"³⁶⁶ should the facts of a particular situation not lead to a valid choice of law under Article 4. If the law governing the issues in Article 2(1) is not determined under Article 4, then Article 5(1) will apply, as the first back-rule, to determine the applicable law. Should the applicable law not be determined under Article 5(1), then Article 5(2) applies as the next fall-back rule; and if the governing law is not be determined under Article 5(2), then Article 5(3) applies.

2. The First Fall-Back Rule: Article 5(1)

If the written account agreement *expressly* and *unambiguously* states that the account agreement was entered into through a particular office, the law applicable to all the Article 2(1) issues will be the law in force³⁶⁷ in the state or territorial unit of a multi-unit state where that office was located at the moment the account agreement was entered into.³⁶⁸ (The office must satisfy the

³⁶⁴ Stephen Kozey (*supra* n 202) 1227.

³⁶⁵ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 5-2; Changmin Chun (*supra* n 73) 406; Alexander Kern (*supra* n 215) 15, 16. On the question whether under the Hague Securities Convention the relevant intermediary is the same for all dispositions of securities held with a particular intermediary, see Prel. Doc. n° 18 of November 2002 – *Chart Reflecting the Comments Received on the Preliminary Draft Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary and on Options A and B in Article 4(1)*; Prel. Doc. n° 17 of October 2002, *Does the Current Draft Convention Adequately Ensure that the Relevant Intermediary is the Same for All Dispositions of Securities Held with a Particular Intermediary, or Is There a Need for a Specific Provision to Achieve This?*, 3 et seq.

³⁶⁶ Bradley Crawford (*supra* n 39) 188.

³⁶⁷ On the meaning of the expression "law in force", see the comments in Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 4-15, 12-12 and 12-13.

³⁶⁸ Changmin Chun (*supra* n 73) 406, 407.

Qualifying Office requirement set out in the second sentence of Article 4(1).
The first fall-back rule of Article 5(1) requires:

1. That the agreement be written;
2. That it expressly and unambiguously state that it was entered into by the relevant intermediary through the office in question; and
3. That the designated office be a Qualifying Office.

The Qualifying Office requirement has already been discussed.³⁶⁹ This leaves for consideration the definition of the term “written” and the requirement that the account agreement contain an express and unambiguous statement that it was entered into through a particular office.

a) “Written” Agreement

Article 1(1)(n) of the Hague Securities Convention defines the term “written” as “a record of information (including information communicated by teletransmission) which is in tangible or other form and is capable of being reproduced in tangible form on a subsequent occasion”. This broad definition is aimed at keeping pace with technological developments.³⁷⁰ It is based on the definition provided in Article 1(nn) of the 2001 Convention on International Interests in Mobile Equipment (Cape Town Convention).³⁷¹ However, unlike Article 1(nn) of the Cape Town Convention, Article 1(1)(n) of the Hague Securities Convention omits the phrase “and which indicates by reasonable means a person’s approval of the record”. Consequently, the Hague Securities Convention does not require an authentication by a physical or electronic signature or otherwise.³⁷²

b) Express and Unambiguous Statement in the Account Agreement as to a Particular Office

The wording of the account agreement forms the basis for the first fall-back rule. The requirement that the account agreement contain an express and unambiguous statement that it was entered into through a particular office is aimed at promoting certainty and avoiding disputes, since a vague implication or an ambiguous statement would not be sufficient. In determining whether the account agreement contains an express and unambiguous statement that

³⁶⁹ See subsection C.II.6 of this chapter.

³⁷⁰ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 1-29.

³⁷¹ Under Article 1(nn) of the Cape Town Convention, the term “written” means a record of information (including information communicated by teletransmission) which is in tangible or other form and is capable of being reproduced in tangible form on a subsequent occasion and which indicates by reasonable means a person’s approval of the record.”

³⁷² Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 1-29.

the relevant intermediary entered into the account agreement through a particular office under Article 5(1) of the Hague Securities Convention, none of the following is considered:

1. A provision that notices or other documents shall or may be served on the relevant intermediary at that office;
2. A provision that legal proceedings shall or may be instituted against the relevant intermediary in a particular state or in a particular territorial unit of a multi-unit state;
3. A provision that any statement or other document shall or may be provided by the relevant intermediary from that office;
4. A provision that any service shall or may be provided by the relevant intermediary from that office;
5. A provision that any operation or function shall or may be carried on or performed by the relevant intermediary at that office.

Accordingly, the inclusion of any of these provisions in the account agreement does not meet the express and unambiguous statement requirement.³⁷³

3. *The Second Fall-Back Rule: Article 5(2)*

The second fall-back rule of Article 5(2) of the Hague Securities Convention takes into consideration the state or territorial unit of a multi-unit state under “whose law the relevant intermediary is incorporated or otherwise organised at the time the written account agreement is entered into or, if there is no such agreement, at the time the securities account was opened.” The second fall-back rule establishes a difference between an intermediary incorporated under a given law (to become an entity with a legal personality distinct from that of its members) and an intermediary “otherwise organised” under a given law. “Otherwise organised” would encompass an unincorporated association which, “though it may not have a distinct legal personality, nevertheless has a status in law derived from the fact that it is formed in accordance with specified legal rules and thus is more than simply a group of natural persons coming together in business”. In short, all forms of association recognised by law, whether incorporated or unincorporated, whether having a legal personality or not, are covered by the second fall-back rule.

The second fall-back rule of Article 5(2) applies to situations where the applicable law cannot be determined under Articles 4(1) and 5(1). It also applies where the relevant intermediary is incorporated or otherwise organised under the law of a multi-unit state as distinct from the law of one of its

³⁷³ As to circumstances in which an amendment of the account agreement may lead to a change of the applicable law, see Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 7-1 and 4-27 et seq.

territorial units. In such a case, Article 5(2) provides that the applicable law is the law in force in the territorial unit in which the relevant intermediary has its place of business, or, if the relevant intermediary has more than one place of business, its principal place of business,³⁷⁴ at the time the written account agreement is entered into or, if there is no such agreement, at the time the securities account was opened.³⁷⁵

4. *The Third Fall-Back Rule: Article 5(3)*

If the first and second fall-back rules do not apply, Article 5(3) of the Hague Securities Convention provides that the applicable law is that

“[...] in force in the State, or the territorial unit of a Multi-unit State, in which the relevant intermediary has its place of business, or if more than one such place, its principal place of business, at the time the written account agreement was entered into or, if there was no such agreement, at the time the securities account was opened.”

5. *The “Page 37 Problem”*

a) *Introduction*

A securities transaction in the multi-tiered intermediary system may involve several intermediaries and several securities account agreements. During the process of elaborating the Hague Securities Convention, two sets of issues were raised about how the PRIMA principle would apply within the framework of the Convention to transfers involving several intermediaries: First, should it be accepted to regard one and the same transfer as involving two or more “relevant intermediaries”, resulting in the application of more than one PRIMA law? Or should the Convention attempt to avoid this possibility by providing the application of one Super-PRIMA law? Secondly, what would the consequences be of potential discrepancies between the relevant laws as to whether a defect in the contractual validity of a transfer impairs its effectiveness as a transfer of property?³⁷⁶ The question raised by the task of choosing one of these multiple connecting factors to be the relevant one is the so-called “Page 37” problem.³⁷⁷

³⁷⁴ Under the Hague Securities Convention, the principal place of business in both Article 5(2) and (3) is the place from which the intermediary’s business is managed, including its head office or chief executive office (often also referred to as its place of central administration).

³⁷⁵ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 5-10.

³⁷⁶ See Prel. Doc. n° 12 of May 2002 – *Transfers involving several intermediaries: An Explanatory Note on the functioning of PRIMA within the framework of the preliminary draft Convention on securities*, 3.

³⁷⁷ The origin of the Page 37 Problem is the illustration of transfers involving two or more intermediaries on page 37 of the Bernasconi Report (Christophe Bernasconi (*supra* n 44) 37).

b) *Transfers involving Two or More Intermediaries*

The following example illustrates the first set of issues.³⁷⁸ Suppose that an account holder, A, holds a portfolio of securities with its intermediary, Bank X in London, which in turn holds its interests in the relevant kinds of securities with its intermediary, ICSD E. Assume further that A sells some of its securities to another account holder, B, and the rest to a third account holder, C. B holds its securities with Bank Y in Paris; C holds its interests in an account with Broker Z in Milan, which in turn holds its interests in a securities account with Bank Y in Paris. Lastly, note that Bank Y holds its interests in a securities account with the same ICSD E as Bank X. The following figure schematically depicts this fact pattern.

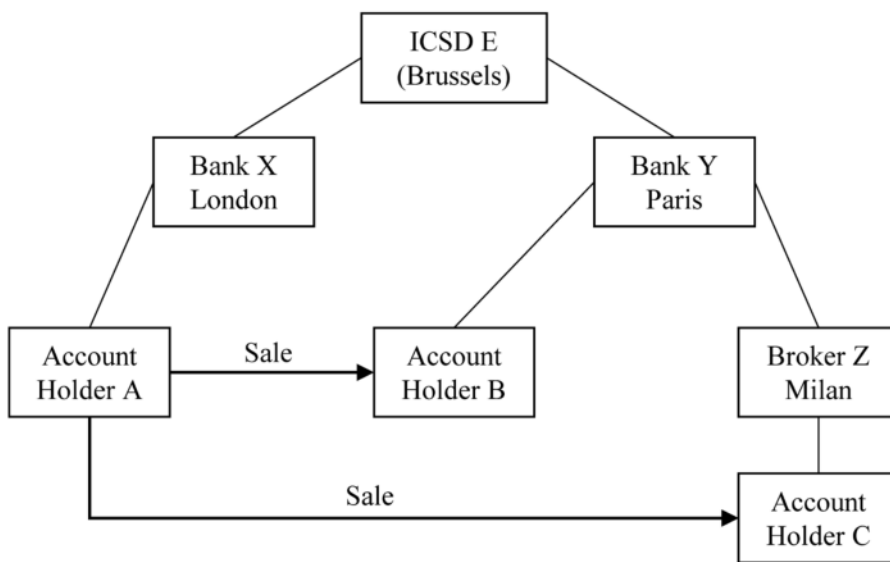


Figure 25: Transfers involving Two or More Relevant Intermediaries³⁷⁹

Note that the Page 37 Problem arises not only when transfers involve two or more intermediaries but also when transfers involve only one intermediary. Assume for instance that both Investor A and Investor B have the same relevant intermediary, X. In considering the applicable law regarding the transfer of securities from A to B, the applicable law for A is determined by the agreement between A and X; for B, it is by the agreement between B and X. These two applicable laws may differ. Thus, the Page 37 problem exists when only one intermediary is involved. See Working Document submitted by the delegation of Japan Page 37 problem and its Proper Application, Commission III Indirectly held Titles, Nineteenth Session of the Hague Securities Convention, Hague Conference on Private International Law, 5 December 2002; Ulrich Segna, *Bucheffekten: ein rechtsvergleichender Beitrag zur Reform des deutschen Depotrechts* (Mohr Siebeck, Tübingen 2018) 530.

³⁷⁸ See Prel. Doc. n° 12 of May 2002 – *Transfers involving several intermediaries: An Explanatory Note on the functioning of PRIMA within the framework of the preliminary draft Convention on securities*, 3.

The first issue this fact pattern raises is identifying the relevant intermediary. For example, who is the relevant intermediary of A's transfer of securities to B? Is it A's intermediary (Bank X) or B's intermediary (Bank Y)? As we have seen, the Hague Securities Convention focuses primarily on the account agreement between an account holder and its relevant intermediary; it also focuses on the place where the relevant intermediary is located.³⁸⁰ The definitions of "securities held with an intermediary" and "relevant intermediary" in Article 1(f) and (g) of the Convention are indications of the "stage-by-stage approach (or analysis)" under the Convention³⁸¹ whereby the Convention law is determined according to each relevant account agreement.³⁸² Furthermore, Article 6(d) provides that the applicable law under the Convention is to be determined without reference to the location of any intermediary other than the relevant intermediary. This means that the Convention rejects the solution of determining a single unitary law, also known as a super-PRIMA, to apply to all the other PRIMAs at each tier.³⁸³ In the example of A's transfer to B, the analysis under the Convention would be:

1. Whether B's interest in Bank Y's pool of customer securities held with ICSD E is valid is a matter of French law, that is, the law of the intermediary on whose books A's interests are recorded;
2. Whether A's interest in Bank X's pool of customer securities is validly extinguished is a matter of English law, that is, the law of the intermediary on whose books A's interest in that pool is recorded;
3. Whether the transfer of the appropriate proportion of Bank X's interest in ICSD's pool of its participants' securities to Bank Y is valid is a matter of Belgian Law, that is, of the law of the intermediary on whose books both Bank X's and Bank Y's interests are recorded;
4. Whether any defects under English or Belgian law in the earlier elements of the transfer would flow through so as to impair or invalidate B's interest will be matter of French law.³⁸⁴

³⁷⁹ See Prel. Doc. n° 12 of May 2002 – *Transfers involving several intermediaries: An Explanatory Note on the functioning of PRIMA within the framework of the preliminary draft Convention on securities*, 4, from which this fact pattern is taken.

³⁸⁰ Changmin Chun (*supra* n 73) 412.

³⁸¹ Reinhard Ege (*supra* n 176) 178, 188, 217; Changmin Chun (*supra* n 73) 413.

³⁸² Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-43.

³⁸³ See Ulrich Segna (*supra* n 377) 531; Preliminary Document n° 14A of May 2002, *Comments on Transfers Involving Two or More Intermediaries: A Response to Preliminary Document n° 12*, submitted by the Japanese delegation.

³⁸⁴ See Christophe Bernasconi (*supra* n 44) 37; Prel. Doc. n° 12 of May 2002 – *Transfers Involving Several Intermediaries: An Explanatory Note on the Functioning of PRIMA Within the Framework of the Preliminary Draft Convention on Securities*, 4; Prel. Doc.

In other words, the Hague Securities Convention's answer to the question "who is the relevant intermediary" differs depending on the portion of the overall transfer (that is, on the "individual level"³⁸⁵ of the multi-tiered holding system) under consideration.³⁸⁶ Consequently, if there is a chain of intermediaries between the issuer and the account holder, under the Convention no single law applies to all the Article 2(1) issues across all the accounts maintained by the intermediaries standing between the issuer and the account holder. If a disposition of securities is effected by a transfer through a chain of intermediaries, Articles 4 and 5 apply to each securities account separately. This means that the ultimate transferee or purchaser (in the illustration above, B) will assess his position by analysing one single law (in the illustration above, French substantive law). And a further assessment depends on what that law provides: If the applicable law prescribes that the transferee or purchaser can acquire a valid interest his intermediary's pool of customer securities regardless of the transfer's earlier elements, the transferee or purchaser will need no further assessment to consider his position. If any defect in one of the earlier elements of the transfer impairs the transferee or purchaser's interest according to the applicable law, however, then the transferee or purchaser will need to further assess his position by retracing the steps of any previously effected transfer.

c) The Unitary Solution

During the process of elaborating the Hague Securities Convention, in lieu of the stage-by-stage analysis described above some experts suggested that a *single* law should govern proprietary issues at *all* stages of a transfer between parties who use different intermediaries. They suggested in particular that this law be that of the state of the recipient's intermediary.³⁸⁷ According to this solution, also referred to as the "Super-PRIMA" approach, *one single* law would override *all the individual PRIMAs* at each level of a transfer between

n° 3 of July 2001 – *Tentative Text on Key Provisions for a Future Convention on the Law Applicable to Proprietary Rights in Indirectly Held Securities*, 5–6.

³⁸⁵ Prel. Doc. n° 12 of May 2002 – *Transfers Involving Several Intermediaries: An Explanatory Note on the Functioning of PRIMA Within the Framework of the Preliminary Draft Convention on Securities*, 4.

³⁸⁶ Prel. Doc. n° 12 of May 2002 – *Transfers Involving Several Intermediaries: An Explanatory Note on the Functioning of PRIMA Within the Framework of the Preliminary Draft Convention on Securities*, 4; Changmin Chun (*supra* n 73) 412–413; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-43; Christophe Bernasconi (*supra* n 44) 14.

³⁸⁷ Prel. Doc. n° 3 of July 2001 – *Transfers Involving Several Intermediaries: An Explanatory Note on the Functioning of PRIMA Within the Framework of the Preliminary Draft Convention on Securities*, 5–6.

parties who use different intermediaries.³⁸⁸ The unitary solution seems simple, since it calls for one law to govern all the proprietary issues at *all* stages of a transfer involving two or more relevant intermediaries.³⁸⁹ But nevertheless it also seemed to give rise to more uncertainty than the stage-by-stage solution: the parties involved in the early or middle stages of the transfer may not know, or may not be in a position to determine, the ultimate transferee or the law of its intermediary.³⁹⁰ This is because (mainly due to privacy or confidentiality concerns) information about the transfer is generally relayed by one intermediary to another without any particular information about the ultimate transferor or transferee. Furthermore, intermediaries will adopt different practices for sending settlement orders: some will input settlement orders transaction by transaction while others will aggregate them vis-à-vis their upper tier intermediary.³⁹¹ Consequently, it is very unlikely that upper-tier intermediaries will know or be in a position to know about other transactions; they stand in a direct relationship only with their immediate counterparts down the chain and for each disposition are only liable to those lower-tier intermediaries.

Take for instance the position of the ICSD E in the above illustration: The stage-by-stage analysis of the Hague Securities Convention ensures that courts of other states will apply the law of the ICSD E's own jurisdiction to proprietary aspects of transfers ICSD E is instructed to make from Bank X's account to Bank Y's account.³⁹² Under the unitary solution, however, ICSD E will hardly be in a position to know whether the transfer running across its account is part of a larger transfer between parties at another level who use different intermediaries. Nor will it know who the ultimate transferee or recipient is. Consequently, ICSD E would not know which *single law* applies to all the stages of the transfer, not even the stage it is involved in. The unitary solution or super-PRIMA approach thus does not provide more certainty; instead, it shifts the burden of uncertainty from the immediate parties to the disposition to the intermediaries, in particular to those who sit at the early and intermediate stages of transfers.

Additionally, the parties to a transaction are in the best position to assess any risk and protect themselves against it since they can investigate the chain of

³⁸⁸ Ulrich Segna (*supra* n 377) 531, 532; Prel. Doc. n° 12 of May 2002 – *Transfers Involving Several Intermediaries: An Explanatory Note on the Functioning of PRIMA Within the Framework of the Preliminary Draft Convention on Securities*, 4.

³⁸⁹ See Uli Rentsch, *Das Haager Wertpapierübereinkommen* (Verlag Dr. Kovac, Hamburg 2008) 150 et seq.

³⁹⁰ Changmin Chun (*supra* n 73) 415.

³⁹¹ Settlement fees are usually computed per settlement instruction. Therefore, many intermediaries prefer to input settlement instructions on a net basis unless a regulation or any other reason requires settlement per disposition. See Changmin Chun (*supra* n 73) 418.

³⁹² The reason being that ICSD E would be the relevant intermediary for Intermediary Bank X and Intermediary Bank Y.

transfer and negotiate appropriate contractual provisions with each other and the intermediaries they employ. By contrast, it is very unlikely that intermediaries who are involved in the early or middle stage of transactions with multiple intermediaries will be able to investigate the holding patterns at other levels.³⁹³ Consequently, they should not face exposure to the effects of the substantive law of a jurisdiction of which they are unaware. Moreover, assuming that such an investigation would be possible in theory, the significant volume of transfers between the customer securities accounts of major banks and other types of intermediaries would give rise to serious complications in practice.

Another difficulty related to the unitary or super-PRIMA solution is that the law applicable to the early stages of a transfer is fixed only *retrospectively*: each stage is governed first by a different law that is then supplanted by another law after it becomes clear that an ultimate transferee ends up holding through an intermediary in another jurisdiction. The unitary solution also leads to greater uncertainty in composite transfers of securities to a number of different ultimate transferees who hold through different intermediaries in different jurisdictions; in these situations, it is difficult to determine which securities are attributable to which ultimate transferee.

d) The Problem of “Double-Interests”

One of the consequences of the stage-by-stage analysis adopted by the drafters of the Hague Securities Convention is that there can be two “owners” of the “same securities”. Returning to the illustration of transfers involving two intermediaries set out above in subsection b, assume that the intermediary Bank X’s debiting of account holder A’s interest was invalid under English law but Bank Y’s credit of securities to account holder B was valid under French law. In such a case, both A and B would regard themselves as owning the securities. However, there can never be enough securities to satisfy both entitlements. The figure on the following page schematically depicts this fact pattern:

Under the unitary solution, the account agreement between B and Bank Y would be the relevant connecting factor since the intermediated securities are credited to B’s account with Bank Y. Thus French law would govern all the Article 2(1) issues at all the stages of the transfer under the Convention. Consequently, if B’s interests in the intermediated securities are valid under French law, then A’s are extinguished; there would be no problem of double interests.

³⁹³ Prel. Doc. n° 12 of May 2002 – *Transfers involving several intermediaries: An Explanatory Note on the functioning of PRIMA within the framework of the preliminary draft Convention on securities*, 7.

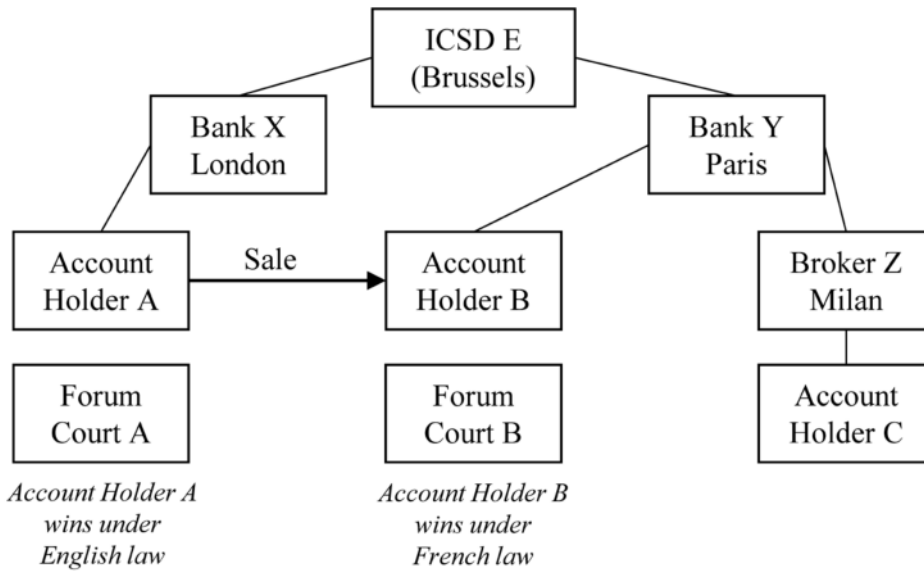


Figure 26: The Problem of “Double Interests”

However, the issue of double interest – real though it is – is not created by the stage-by-stage analysis of the Convention *per se*. *Au contraire*, it has always existed as a potential issue in cross-border transfers of securities through a chain of intermediaries.³⁹⁴ Due to conflict of laws rules, different laws may apply to issues that are similar to the Convention’s Article 2(1) issues in relation to securities disposed of through securities accounts maintained by a chain of intermediaries in a variety of states. Sophisticated intermediaries taking part in transnational transfers of securities therefore generally spread the risk over a pool of account holders, reallocate it in their account agreements with specific account holders, or decide to assume and manage the risk themselves. Although the Convention’s state-by-stage approach does not eliminate the double-interest risk, it allows the intermediaries to better identify, reallocate, or manage it by clearly determining which state’s law applies to the Article 2(1) issues with respect to each securities account.

D. The Black List of Immaterial Factors

Article 6 of the Hague Securities Convention provides that the following factors are not to be taken into consideration when determining the applicable law in accordance with the Convention: (i) the place where the issuer of the securities is incorporated or organised (Article 6(a)); (ii) the place where the issuer of the securities has its statutory seat or registered office, central administration, or place of principal business (Article 6(a)); (iii) the location of

³⁹⁴ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-49; Changmin Chun (*supra* n 73) 416–417.

the certificates representing or evidencing securities (Article 6(b)); (iv) the location of a register of holders of securities maintained by or on behalf of the issuer of the securities (Article 6(c)); (v) the location of any intermediary other than the intermediary (Article 6(d)).³⁹⁵ This provision aims at preventing conflict of laws rules that are designed for directly held securities from applying to intermediated securities.³⁹⁶ It may be inferred from the combination of Articles 4, 5, and 6 that any conflict of laws approach that would involve looking through an account holder's intermediary to a higher-tier intermediary or to the issuer itself would be irrelevant in determining the Convention law.

However, the factors listed in Article 6 are still to be taken into consideration in determining whether a situation involves an international element for the purpose of Article 3 of the Convention. Furthermore, Article 6 is immaterial with respect to the applicability of Article 16 in situations where the parties have agreed that the securities account will be maintained in a particular state or territorial unit.

E. Protection of Rights on Change of the Applicable Law

I. Scope of the Provision

The intermediary and the account holder may amend the account agreement. Article 7 of the Hague Securities Convention applies when, due to an amendment of the account agreement, the Convention law is no longer the law of a state or territorial unit of a multi-unit state pursuant to Article 4(1) or Article 5 of the Convention but that of a different State instead, as determined under Article 4 of the Convention.³⁹⁷ Article 7 presupposes that there was an account agreement before any amendment was made.³⁹⁸ Further, in order to apply, Article 7 presupposes that the parties have not entered into a new securities account agreement concerning different securities but rather have amended an already-existing securities account agreement. Lastly, for purposes of Article 7 the amendment must trigger a change of law by reason of an application of Article 4(1).

³⁹⁵ Bradley Crawford (*supra* n 39) 161.

³⁹⁶ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 6-1.

³⁹⁷ This solution is based in the assumption that, at the time of the first amendment, the Qualifying Office requirement of Article 4(1) of the Hague Securities Convention is satisfied. See Christophe Bernasconi & Thomas Keijser (*supra* n 174) 553.

³⁹⁸ Note that since the references in the Hague Securities Convention to an account agreement encompass pre-Convention agreements (Article 16 of the Hague Securities Convention), Article 7 of the Hague Securities Convention also applies to account agreements entered into prior to the entry into force of the Convention. See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 7-9.

Situations in which the content of the applicable law under the Convention changes are not covered by Article 7 but rather by the transition rules of the state whose law applies. Likewise, Article 7 does not apply to situations in which the applicable law changes because securities are transferred from one securities account to another, each governed by a separate account agreement.³⁹⁹ And similarly, Article 7 is not applicable when the originally applicable law was determined under Article 5(2) or (3) of the Convention and the place of incorporation, organisation, place of business or principal place of business of the relevant intermediary has changed. Since the applicable law under Article 5(2) or (3) is not affected by a subsequent change of one of these factors, there is not even a change of law in such a case.

II. “Old” and “New” Law

Under Article 7(2)(a) of the Hague Securities Convention, the term “new law” means the law applicable under the Convention after the change. The term “old law” means the law applicable under this Convention before the change (Article 7(2)(b)).⁴⁰⁰ In case of successive, different triggering amendments, each will result in an “old” and a “new” law; but even a “later” new law would nevertheless be subject to the protective rules provided in Article 7(4) and (5) of the Convention.⁴⁰¹ This means that if there are two successive triggering amendments leading to successive application of the laws X, Y, and Z, Article 7(4) will protect a security interest perfected under law X against not only the shift to Y but also the later shift to Z.

III. Applicability of the “New” Law under Article 7(3)

Subject to the exception in Article 7(4) of the Hague Securities Convention, the general rule is that all Article 2(1) issues are governed by the “new” law (Article 7(3)). Assume, for instance, that an intermediary is organised under the laws of Germany. It enters into an account agreement with a customer providing that the Article 2(1) issues are to be governed by the laws of Belgium, and the Qualifying Office of the intermediary (at the time) was located in Belgium. Assume further that the account holder grants an interest in the securities account to a bank organised under French law. The collateral taker perfects the security interest pursuant to Belgian law. Later, the account holder and the intermediary amend the account agreement so that now all the Article 2(1) issues are governed by English law. At the moment the amendment was made, the intermediary’s Qualifying Office was located in England.

³⁹⁹ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 7-12, 7-1, 4-11, 4-43 et seq; Example 7-3.

⁴⁰⁰ Changmin Chun (*supra* n 73) 407.

⁴⁰¹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 7-14.

Later, the account holder grants a security interest in the securities account to a lender organised under the laws of Luxembourg. The collateral-taking lender perfects the security interest under English law. (Note that under both Belgian and English law, security interests are perfected through a method that does not result in a credit of the securities to the lender's account.) Lastly, assume that in a state where the Convention is in force, a question arises as to the priority of the bank's versus the lender's security interests.

In such a case, Article 7 of the Convention will apply since the intermediary and the account holder amended the provision of the account agreement on the governing law. Consequently, pursuant to Article 4(1) the law governing the Article 2(1) issues changed from Belgian law to English law. Under the general rule of Article 7(3), the new law (English law) will apply to the issue of the priority of the security interests. None of the exceptions in Article 7(4) applies, particularly since lender's security interest arose *after* the governing law provision was amended (see Article 7(4)). It is important to note that it cannot be inferred from the application of the new law (English law) that the lender's security interest will have priority over the bank's; only the new substantive law, English law, can determine the outcome of that question.⁴⁰²

IV. Exceptional Application of the "Old" Law under Article 7(4)

1. Scope

Under Article 7(4) of the Hague Securities Convention, the old law applies to the following issues except in respect of a person who has consented to a change of law:

"a) [T]he existence of an interest in securities held with an intermediary arising before the change of law and the perfection of a disposition of those securities made before the change of law;

b) with respect to an interest in securities held with an intermediary arising before the change of law – (i) the legal nature and effects of such an interest against the relevant intermediary and any party to a disposition of those securities made before the change of law; (ii) the legal nature and effects of such an interest against a person who after the change of law attaches the securities; (iii) the determination of all the issues specified in Article 2(1) with respect to an insolvency administrator in an insolvency proceeding opened after the change of law;

c) priority as between parties whose interests arose before the change of law."

Article 7(4) of the Convention only applies to dispositions made before a change of law.⁴⁰³ Dispositions made after a change of law are not within the scope of this provision. Consequently, the old law does not determine the

⁴⁰² See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) Example 7-4.

⁴⁰³ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 7-17; Changmin Chun (*supra* n 73) 406.

priority of a security interest acquired before a change of law over one acquired through a disposition made afterward. Whether the person receiving the disposition consented to the change of law is immaterial; this issue is governed by the new law under Article 7(3).

Under Article 7(4), the old law governs all issues in respect of a security interest acquired before a change of law by a person who did not consent to the change. Besides the intermediary and the account holder, third parties (such as secured parties) may consent to a change of law in an account agreement, and the general rule of Article 7(3) then applies: the new law will govern all Article 2(1) issues. The only exception to this is when the party holding the competing interest is a protected person (meaning a person who did not consent to the change of law). If Article 7(4) applies with respect to the competing interest, the old law governs all the issues specified in the relevant category of Article 7(4) even when it competes with an interest of a person who consented to the change of law (subject, however, to Article 7(5)).⁴⁰⁴

2. Issues governed by the “Old” Law under Article 7(4)

Under Article 7(4)(a) of the Hague Securities Convention, the old law governs the issue of the existence of an interest in intermediated securities that arose before the change of law was made. Similarly, the perfection of a disposition made prior to the change is unaffected by the change of law. Article 7(4)(b)(ii) and (iii) deal respectively with attachment of securities and the opening of insolvency proceedings. The old law continues to govern the legal nature and effects of an interest in intermediated securities against a person who attaches the securities after the change of law. Likewise, all the Article 2(1) issues that refer to an insolvency administrator in an insolvency proceeding opened after the change of law are still governed by the old law. Consequently, despite the change of law, the old law will govern the relations between a “protected” person holding an interest perfected before the change of law and creditors who attach after the change or in an insolvency proceeding commenced after the change.

Article 7(4)(c) addresses the applicability of the old law to priority issues as between parties whose interests “arose”⁴⁰⁵ before the change of law. Subject to Article 7(5),⁴⁰⁶ the old law determines the priority issues as between the

⁴⁰⁴ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 7-18.

⁴⁰⁵ The term “arose” in Article 7(4)(c) of the Hague Securities Convention is to be construed as “perfected” since a priority issue presupposes the effectiveness of the security interest against third parties. See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 7-22.

⁴⁰⁶ Under Article 7(5) of the Hague Securities Convention, Article 7(4)(c) of the Convention does not preclude application of the new law to the priority of an interest that arose under the old law but is perfected under the new law.

interests of protected persons such as these. The priority status *inter se* of “protected persons” is not affected by the new law. If several security interests arose before the change of law and some secured parties consented to the change while others did not, the priority rules of the old law will apply to disputes between parties who consented on one hand and ones who did not consent on the other.⁴⁰⁷ If some dispositions of those securities were made before the change of law and others after, Article 7(3) provides that the new law will determine the relative priority of *all* the interests, subject to Articles 7(4)(c) and (5).⁴⁰⁸

V. Priority Issues: Article 7(5)

As per Article 7(5) of the Hague Securities Convention, Article 7(4)(c) does not preclude the new law applying to the priority of an interest that arose under the old law but is perfected under the new law. This provision is an “exception to the exception” in Article 7(4) of the Convention; what then applies is the general rule in Article 7(3). Article 7(5) only applies in situations where interests in the intermediated securities were created under the old law but are subsequently perfected under the new law; if the interests in the intermediated securities are perfected under both the old law and the new law (either before or after the change of law), Article 7(5) does not apply. The way Article 7(5) is worded (“an interest that *arose* under the old law *but is perfected* under the new law” [my emphasis]), the old law will determine the ranking of the security interests, since all of them were perfected before the change of law. Article 7(5) moreover protects the legal certainty provided by Article 7(4)(c) against any collateral taker who might wish, by a repetitious perfection, to trigger the applicability of the new law in its favour.

F. Insolvency

I. Scope of Article 8 of the Hague Securities Convention

1. Introduction

Article 8 of the Hague Securities Convention deals with the consequences of the opening of an insolvency proceeding for “any event” in respect of intermediated securities that arose prior to the opening of that insolvency proceeding.⁴⁰⁹ It is aimed at ensuring that pre-insolvency rights whose creation and

⁴⁰⁷ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 7-21, Example 7-5.

⁴⁰⁸ This is based on the assumption that none of the dispositions involves a transfer of securities from one securities account to another. See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 7-24, 7-1, Examples 7-6, 7-7, and 7-8.

⁴⁰⁹ Christophe Bernasconi & Thomas Keijser (*supra* n 174) 554; Simon Schwarz (*supra* n 51) 700; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 8-1. The same princi-

perfection occurred under the Convention law are respected as such in an insolvency proceeding (Article 8(1) of the Convention). However, Article 8(2) ensures that such rights are not exempted from general insolvency rules such as the avoidance of unfair preferences, enforcement rights, transactions to defraud creditors, or the ranking of claims. Therefore, in the context of an insolvency proceeding, on one hand the Convention guarantees *ex ante* certainty about the Convention law that will apply to all the Article 2(1) issues (*lex causae*), particularly the creation and the perfection of security interests; on the other hand, it also preserves the *lex concursus*.⁴¹⁰

2. Insolvency Proceedings

The Hague Securities Convention does not clearly indicate against whom the insolvency proceedings have to be brought for Article 8(1) to apply. Consequently, Article 8(1) of the Convention applies to any insolvent party, be it the issuer itself, an intermediary, or an account holder or its pledgee or transferee.⁴¹¹ Under Article 8(1), the perfected status of a pledge or transfer under the Convention law, and its priority pursuant that law, must be respected during the insolvency proceedings. For purposes of Article 8(1), no account is taken of any rule regarding the perfection and ranking of pledges or transfers *under the general law* (meaning non-insolvency law) of the jurisdiction in which those insolvency proceedings are opened.⁴¹² However, Article 8(1) does not affect the application of rules under the relevant insolvency law which would invalidate (for instance) a pledge, transfer, or other transaction made to unfairly preference or defraud creditors.⁴¹³

As per Article 8(1) of the Convention, the Convention law under Articles 4 and 5 will still govern the effectiveness of an account holder's rights against its

ple is specified in Article 2 of the Rome I Regulation and in Article 3 of the Regulation (EC) n° 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations (OJ L 199, 31.7.2007, 40–49, the Rome II Regulation).

⁴¹⁰ During the process of elaborating the Hague Securities Convention, this approach (on the one hand, recognition of interests acquired under the Convention law even in an insolvency proceeding and non-interference with insolvency laws on the other) had not been questioned. Only after focused discussions during the Diplomatic Conference was the final version of the provision adopted (*see* Working Documents n° 1, 5, and 9). The purpose of these discussions was to address the need to clearly determine not only the scope and content of each paragraph but also the relationship between them, specifically the limits between the Convention law and the *lex concursus* (*see* Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 8-2; Christophe Bernasconi (*supra* n 44) 19).

⁴¹¹ Changmin Chun (*supra* n 73) 400.

⁴¹² Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 8-4, Examples 8-1 and 8-2; Simon Schwarz (*supra* n 51) 700, 701.

⁴¹³ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 8-5, Example 8-3.

insolvent intermediary. The same law will also govern the perfection of a disposition in favour of a transferee of the intermediary. But if the intermediary is in insolvency proceedings, Article 8(1) nevertheless will not determine whether, when, or how an account holder or a transferee with a perfected interest in the account may realise that interest. Nor will it indicate how the positions of account-holders and transferees with a perfected interest are ranked or how priority is to be distributed among account holders.⁴¹⁴ The applicability of insolvency rules in respect of such issues is preserved by Article 8(2).

II. Recognition of Interests Acquired prior to an Insolvency Proceeding

It will be of concern during an insolvency proceeding that an insolvency administrator, rather than applying the Convention law, might apply domestic substantive law, either the forum state's or a law designated by the forum's conflict of laws rules, to pre-insolvency interests. Article 8(1) addresses that concern, providing that an interest acquired pursuant to the Hague Securities Convention but *before* an insolvency proceeding is opened⁴¹⁵ must be recognised in the insolvency proceeding. It is a rule mainly of recognition: it prohibits an insolvency court from requiring any perfection rule that is not imposed by the law designated by the Convention. In other words, an insolvency court does not have the power to refuse to recognise a right on the sole basis that its creation or perfection was not in accordance with *forum's* substantive law and conflict of laws rules, and to this extent the Convention supersedes the *lex concursus*.⁴¹⁶ The second half of Article 8(1) uses the past tense ("occurred"), the effect of which is that the provision applies only if the "event"⁴¹⁷ occurred before the insolvency proceeding opens. Consequently, Article 8(1) does not apply to events that occur *after* it opens. It is important to note that the scope of Article 8(1) covers all the Article 2(1) issues; in other words, Article 8(1) preserves the applicability of the Convention law to all the Article 2(1) issues after an insolvency proceeding is opened.

As mentioned above, Article 8(1) of the Convention is a rule of recognition which operates within the sphere of insolvency law. In insolvency proceedings, the *lex concursus* governs the effects of rights acquired previously and recognised pursuant to Article 8(1).⁴¹⁸ Pursuant to Article 8(2), these

⁴¹⁴ Reinhard Ege (*supra* n 176) 200, 201.

⁴¹⁵ The *lex concursus* determines the moment of the opening of an insolvency proceeding. It can be the moment when the proceeding is registered on a public record when a judgement opening proceedings becomes effective.

⁴¹⁶ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 8-7.

⁴¹⁷ In practice these events may be, most importantly, the crediting of securities to a securities account or the perfection of a disposition. See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 8-7.

⁴¹⁸ Christophe Bernasconi (*supra* n 44) 19.

rights are thus not immune from the application of the rules of the *lex concursus* which are generally applicable to such rights in insolvency proceedings.

III. Effects in an Insolvency Proceeding of Previously Acquired Interests

While Article 8(1) of the Hague Securities Convention preserves the applicability of the Convention law with respect to the existence of rights acquired before the opening of insolvency proceedings, Article 8(2) of the Convention ensures that any determination of the effects of those rights (meaning the extent to which the secured party can actually secure them in the insolvency) is left to the *lex concursus*.⁴¹⁹ The applicability of the *lex concursus* is expressed in two different ways in Article 8(2): The provision's chapeau indicates on one hand that "[n]othing in this Convention affects⁴²⁰ the application of any substantive or procedural insolvency rules". This general wording does not impair Article 8(1); on the contrary, Article 8(1) and (2) have to be construed together. The latter could have begun, "Without prejudice to paragraph 1, nothing ...". On the other hand, Article 8(2) encompasses a number of examples of insolvency rules that the Convention does not affect ("including any rules relating to [...]").

Consequently, Article 8(2)(a) of the Convention ensures the applicability of the rules of the *lex concursus* whereby fraudulent transfers and preferences are void. It also preserves rules of the *lex concursus* which determine the priority of certain types of claims (such as for wages or taxes) over any other interest. Further, Article 8(2)(b) preserves the rules of the *lex concursus* in respect of the enforcement of rights after the opening of an insolvency proceeding. This rule is aimed at preventing the collapse of reorganisation or bankruptcy proceedings, for instance if a secured party were to seize crucial assets.⁴²¹ Despite the opening of an insolvency proceeding, the applicable law under Articles 4 and 5 of the Convention still governs the nature and the perfected status of a pledgee's or transferee's interest. It is for the appropriate insolvency law, however, to determine whether the enforcement of that pledge is subject to a bankruptcy stay or the pledge is avoidable as unduly preferential.⁴²²

⁴¹⁹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 8-9.

⁴²⁰ By stating that "[n]othing in this Convention affects the application of any substantive or procedural insolvency rules", Article 8(2) provides that the Hague Securities Convention "does not deal with the substantive and the procedural law applicable to those issues" (*see* Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 8-11).

⁴²¹ For instance, under the *lex concursus*, certain securities such as those listed on a stock exchange may be exempted from the scope of a general stay provision.

⁴²² Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 8-10, Example 8-3.

G. Exclusion of Choice of Laws Rules (*Renvoi*)

Under Article 10 of the Hague Securities Convention, “[t]he term “law” means the law in force⁴²³ in a State other than its choice of law rules”. By specifying that its conflict of laws rules refer solely to domestic (substantive) rules and not to conflict of laws rules, the Convention excludes any *renvoi*. Therefore, there may be no further reference under the law determined by the Convention (be it the law of a state or that of a territorial unit) to the law of another state or territorial unit.

Article 10 is particularly important in the light of Article 9, which provides that the Convention applies whether or not the applicable law is that of a Contracting State. If *renvoi* were permissible under the Convention, it would affect the unifying project of the Convention in situations where the applicable law designated by the Convention’s conflict of laws rules is that of a state where the Convention is not in force and whose conflict of laws rules are not in line with the Convention’s. The exclusion of *renvoi* in Article 10 thus guarantees the very purpose of the Convention (*ratio conventionis*), which is the unification of diverging national conflict of laws rules in the interest of certainty, predictability, and simplicity.⁴²⁴ Accordingly, the rule on the exclusion of *renvoi* adopted by the Diplomatic Conference was and has remained uncontroversial from the very beginning.⁴²⁵ Further, a form of internal *renvoi* within a multi-state is contemplated in two locations in the Convention (Article 12(2)(b) and (3)).⁴²⁶

Instead of selecting a substantive governing law directly, parties to an account agreement may specify that their account agreement or all the Article 2(1) issues are to be governed by the law determined by the conflict of laws rules of a particular jurisdiction. In such a case, pursuant to Article 10 of the Convention, such a clause cannot be considered as an agreement on the governing law under Article 4, and as a consequence the relevant fall-back rules in Article 5 would apply.

⁴²³ The phrase “law in force” is preferred to “law of” to apply to situations where, in a territorial unit, the relevant law includes both the law of that territorial unit and, to the extent applicable in that unit, the law of the multi-unit state (Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 4-15, 12-12, and 12-13).

⁴²⁴ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 10-1.

⁴²⁵ Christophe Bernasconi (*supra* n 44) 41 and Article 8 of the January 2001 Draft. Note also that the provision on the exclusion of *renvoi* is in line with modern conventions of the Hague Conference on Private International Law, which in general exclude *renvoi*.

⁴²⁶ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 12-1 et seq.

H. Public Policy and Mandatory Rules

I. Public Policy Exception under Article 11(1) of the Hague Securities Convention

As with all modern instruments of the Hague Conference,⁴²⁷ the Hague Securities Convention contains, in Article 11, a public policy (*ordre public*) exception whereby “[t]he application of the law determined under this Convention may be refused only if the effects of its application would be manifestly contrary to the public policy of the forum.” The *ordre public* exception must be applied on a case-by-case basis since there is no definite formula which can describe the exact content or degree of stringency of a state’s public policy that would compel a court to decline to apply the law otherwise applicable under the Convention. Nevertheless, a particular judge does not have total discretion in respect of the matter; instead, the *ordre public* exception is admittedly limited to extremely rare situations where the relevant foreign rule, as applied to the fact of the case, would lead to a solution that departs so radically from the forum’s concepts of fundamental justice that its application would be intolerably offensive to the forum’s basic values.⁴²⁸ Consequently, it is clear that it does not amount to a fundamental departure from forum’s basic values if for instance the Convention law considers rights resulting from a credit of securities to a securities account to be proprietary in nature whereas the law of the forum considers them to be contractual or vice versa. Further, as expressed in Article 11(3) of the Convention, there is no violation of the forum’s public policy merely because the foreign perfection requirements or priority rules are different from the forum’s.⁴²⁹

⁴²⁷ See for instance Article 13 of the Protocol of 23 November 2007 on the Law Applicable to Maintenance Obligations; Article 21 of the Convention of 13 January 2000 on the International Protection of Adults; Article 22 of the Convention of 19 October 1996 on Jurisdiction, Applicable Law, Recognition, Enforcement, and Co-operation in Respect of Parental Responsibility and Measures for the Protection of Children; Article 24 of the Convention of 29 May 1993 on Protection of Children and Co-operation in Respect of Intercountry Adoption; Article 18 of the Convention of 1 August 1989 on the Law Applicable to Succession to the Estates of Deceased Persons; Article 18 of the Convention of 22 December 1986 on the Law Applicable to Contracts for the International Sale of Goods; Article 18 of the Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition. Nevertheless, it is important to note that Article 11(1) of the Hague Securities Convention must be read in conjunction with Article 11(3) of the Hague Securities Convention, to which Article 11(1) is subject (see Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 11-12).

⁴²⁸ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 11-6. See also Roel de Lange, ‘The European Public Order, Constitutional Principles and Fundamental Rights’ (2007) 1 *Erasmus Law Review* 3, 8.

⁴²⁹ Christophe Bernasconi (*supra* n 44) 20; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 11-7.

II. Mandatory Rules of the Forum

Under Article 11(2) of the Hague Securities Convention, the Convention does not prevent those provisions of the forum's law from applying which must be applied irrespective of conflict of laws rules, even to international situations. That is, the Convention does not prevent rules of the forum from applying that are "mandatory" from a private international law perspective. Regulatory rules with respect to supervisory regimes to which intermediaries are subject, or to enforcement actions taken by regulators, are not affected by the provisions of the Convention.⁴³⁰ Thus, under the Convention supervisory authorities may, in the exercise of their authority, prohibit intermediaries from choosing any governing law ("no choice at all") or from choosing a particular governing law ("cannot be X, Y, or Z"). Further, intermediaries may be prohibited from choosing a law that is different from that specified by the supervisory authority.⁴³¹

The provisions referred to in Article 11(2) of the Hague Securities Convention are not private international law rules⁴³² but rather are *substantive* rules which must apply to transnational or even to wholly foreign transactions. They must be mandatory in the sense that the forum court is bound to apply them even in non-domestic transactions governed by foreign law.⁴³³ As clearly expressed in Article 11(2), this exception is limited to contexts in which the forum's rules are mandatory even if applied "to international situations." Such rules of other states are not to be applied.⁴³⁴ If this exception were expanded in favour of mandatory rules of third states, it could potentially increase uncertainty since practitioners would have to determine (for instance) which third state's rules should be applied, which of those are mandatory, and whether reference to those rules was compulsory or mandatory.

⁴³⁰ Changmin Chun (*supra* n 73) 396; Christophe Bernasconi & Harry C. Sigman, 'The Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (Hague Securities Convention)' (2005) 10 Uniform Law Review 117, 138; Hague Conference on Private International Law, 'The Hague Convention: A Modern and Global Conflict of Laws Regime for Transactions Involving Securities Held with an Intermediary' (December 2006) s 6, available <<https://assets.hcch.net/docs/061ed8ea-552d-4d9e-bb1a-4311fb78041a.pdf>> (accessed 4 January 2021).

⁴³¹ Changmin Chun (*supra* n 73) 396.

⁴³² The provision in Article 11(2) of the Hague Securities Convention must be read in conjunction with Article 11(3) of the Convention, to which it is subject (*see* Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 11-12).

⁴³³ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 11-9.

⁴³⁴ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 11-11. During the process of elaborating the Hague Securities Convention, there was from the beginning a clear and swift consensus among the experts on that matter; *see* Christophe Bernasconi (*supra* n 44) 48; Prel. Doc. n° 2, 31. *See also*. Article 9(3) of the Rome I Regulation for application of mandatory rules of a third country.

Consequently, such an expansion of this exception would frustrate the purpose of the Convention, which is to allow *ex ante* certainty).⁴³⁵

III. An Important Limitation under Article 11(3) of the Hague Securities Convention

Article 11(3) of the Hague Securities Convention imposes an important limitation on the public policy (*ordre public*) exception in Article 11(1) of the Convention⁴³⁶ and the mandatory forum rule exception in Article 11(2): these exceptions may not be used in order to have provisions of the law of the forum apply that would impose requirements on perfection or relating to priorities between competing interests unless the law of the forum is the applicable law under the Convention. This provision ensures that the Convention law is not displaced by such forum laws on the pretext of a public policy exception or a mandatory rule. Thus, in exercising their authority, supervisory authorities may prohibit intermediaries from choosing any governing law (“no choice at all”), from choosing a particular law (“cannot be A, B, C, or D”), or from selecting a governing law other than one specified by the authority (“must be A”).⁴³⁷ Article 11(3) reinforces the rule in Article 8(1) which provides that an insolvency court cannot impose any perfection requirements other than ones imposed under the Convention law on any disposition that occurred before the opening of a particular insolvency proceeding.⁴³⁸

However, the rule in Article 11(3) of the Convention does not mean that the public policy or mandatory rules exceptions (Article 11(1) and (2) respectively) do not apply to a priority contest involving a sovereign claim of the forum state (for instance a tax lien) or to cases where application of the law determined by the Convention would conflict with the regulatory laws of the forum (for instance rules on money laundering or tax evasion).⁴³⁹

I. Evaluation of the Hague Securities Convention

I. Protection of Third-Party Rights

As mentioned above, the primary rule of the Hague Securities Convention refers to the choice of law made by the account holder and its intermediary. It has been argued that such a rule would disadvantage third parties because

⁴³⁵ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 11-11, Example 11-1.

⁴³⁶ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 11-6 to 11-18.

⁴³⁷ Christophe Bernasconi & Thomas Keijser (*supra* n 174) 554, 555.

⁴³⁸ See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 8-7 and 11-4; Christophe Bernasconi (*supra* n 44) 20.

⁴³⁹ These forums’ regulatory laws do not create competing interests but instead regulate behavior. See Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 11-12, Example 11-2.

they would not know about the choice made (problem of transparency (1)), or because they would consider the choice detrimental to their interests (problem of abuse (2)).

1. Transparency

It has been argued that if the agreement between the account holder and its intermediary contains a choice of the applicable law, it would be difficult for third parties to ascertain or discover what that law is. Indeed, this critique of the Hague Securities Convention underscores the fact that the account agreement is not a public document.⁴⁴⁰ In contrast, under the EU rules the law can often be ascertained from objective facts that do not require excessive enquiry. However, this critique of the primary rule of the Hague Securities Convention is not convincing. Third parties (such as collateral takers) seeking to gain an interest in intermediated securities must already acquire information about the existence and location of the securities account. Under the Convention, while these third parties will indeed need to know what law the account holder and its intermediary chose in the account agreement, this need does not represent a significant change: the cooperation of the account holder and its intermediary is always necessary. In practice, whether under Europe's current PRIMA rule or under the Hague Securities Convention, third parties willing to acquire a proprietary right in intermediated securities will always request information about which law applies to such securities.⁴⁴¹

Other third parties, such as ordinary public and private creditors seeking to attach securities to enforce a debt, may have had no prior dealings with the account holder *per se*. A competent authority or a creditor seeking to attach securities will generally need to establish the existence of the securities holding and the jurisdiction to which it is subject. Under the rule the current EU directives espouse, such a creditor needs to know the location of the debtor's securities account. The Hague Securities Convention does not significantly alter this situation; the crux of the issue is that determining the location of a securities account normally requires the cooperation of the account holder, any intermediaries, or both.⁴⁴² A competent authority charged with enforcing the attachment will usually approach the intermediary to obtain certain in-

⁴⁴⁰ See Commission of the European Communities (*supra* n 73) 11; Maisie Ooi, 'The Hague Securities Convention: A Critical Reading of the Road Map' (2005) 4 Lloyd's Maritime & Commercial Law Quarterly 467, 471; Herbert Rögner, 'Inconsistencies Between the Hague Securities Convention and German Law' (2006) 2 Zeitschrift für Bankrecht und Bankwirtschaft 98, 104.

⁴⁴¹ Commission of the European Communities (*supra* n 73) 12; Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.81; Harry C. Sigman & Christophe Bernasconi (*supra* n 317) 34.

⁴⁴² Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.82.

formation and place a block on the securities account. Consequently, an attaching creditor's current position is not materially compromised by the need to acquire a single piece of additional information, namely the law chosen by the intermediary and the account holder in the account agreement.⁴⁴³

2. Abuse

The primary rule of the Hague Securities Convention has also been criticised for allowing intermediaries to select a law that is more favourable to them than to account holders or to both parties vis-à-vis secured creditors.⁴⁴⁴ It may be admitted that the Hague Securities Convention may allow for some law-shopping strategies; indeed, including a choice of law clause in the account agreement appears easier than registering or maintaining an account in a particular place.⁴⁴⁵ However, that situation under the Hague Securities Convention is no different from what occurs under the EU's current PRIMA rule: Under the rules of the EU's directives, a domestic account holder can open a securities account in a foreign jurisdiction with a local intermediary. Nothing under the current PRIMA rule prevents them from locating accounts abroad. At least from a private international law perspective, parties may choose where their securities are to be maintained or held. In the same vein, nothing under the EU's current PRIMA rule prevents an intermediary from locating the securities accounts of its clients in a particular office.⁴⁴⁶

Moreover, critics have alleged that the Convention may disadvantage secured creditors if subsequent changes to the choice of applicable law are made without their consent. This argument is not convincing either: Article 7 preserves the pre-acquired rights of secured creditors. As per that provision, rights created under the then-applicable law may not be restricted or swept aside when the parties agree to modify the choice of law. In other words, under the Convention an agreement between an account holder and an intermediary to change the Convention law without a third party's consent may not be imposed on a third party who relied on the first account agreement.

⁴⁴³ Harry C. Sigman & Christophe Bernasconi (*supra* n 317) 34; Commission of the European Communities (*supra* n 73) 12.

⁴⁴⁴ European Parliament Resolution, OJ 2006 C317/904, 8.

⁴⁴⁵ Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.35.

⁴⁴⁶ Richard Potok, 'The Hague Securities Convention – Closer and Closer to Reality' (2004) 15 *Journal of Banking and Finance Law and Practice* 204, 219; Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.84; Harry C. Sigman & Christophe Bernasconi (*supra* n 317) 34.

II. Interaction with Substantive Law

1. Introduction

As mentioned above, the Hague Securities Convention contains only conflict of laws provisions. It does not affect any substantive law governing intermediated securities.⁴⁴⁷ However, it has been argued that its rules correspond better to those of certain legal systems and as a consequence may indirectly affect the substantive law applicable to intermediated securities in jurisdictions in which the substantive law does not correspond as well to the Convention's rules, particularly in the areas of company law and securities law.

2. Interaction of the Hague Securities Convention with Company Law

Although the scope of this study is limited to security interests in intermediated securities, it is worth examining whether existing rules that apply to commercial companies would be jeopardised by the rules enshrined in the Hague Securities Convention. Difficulties may arise if the law that applies to corporate actions such as the exercise of voting rights or payment of income is different from the law chosen by the account holder and its intermediary. For instance, some have complained that an issuer will not be able to know who the ultimate investor is; others have suggested that a situation could arise in which an issuer who needs to determine who is entitled to exercise the rights arising from the intermediated securities would have to require each claimant to provide proof of entitlement, such as for example the relevant account agreement, giving rise to additional expense and complications.⁴⁴⁸

However, under Article 2(3)(c) of the Convention, the Convention does not determine the law governing rights and duties of an issuer of intermediated securities and does not apply to the duties of the issuer in respect of corporate actions such as voting rights and income distribution. The Convention does not affect these questions; they are still subject to the applicable corporate law.⁴⁴⁹ From the perspective of OHADA, it follows that if the Hague Securities Convention were to be enforced in the OHADA region, it would not affect the provisions of the Uniform Act on Commercial Companies. Furthermore, the above-mentioned difficulties in determining who is entitled to exercise corporate rights derive from the very nature of the intermediary system, as stated in Recital 11 of the EU's Shareholders' Rights Directive⁴⁵⁰:

⁴⁴⁷ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-1.

⁴⁴⁸ Commission of the European Communities (*supra* n 73) 13.

⁴⁴⁹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-34.

⁴⁵⁰ Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies (OJ L 184, 14.7.2007, 17–24, hereinafter referred to as Shareholders' Rights Directive).

“Where financial intermediaries are involved, the effectiveness of voting upon instructions relies, to a great extent, on the efficiency of the chain of intermediaries, given that investors are frequently unable to exercise the voting rights attached to their shares without the cooperation of every intermediary in the chain, who may not have an economic stake in the shares.”

In conclusion, the chain of intermediaries within an intermediary system is inherently complex. Consequently, that complexity remains regardless of whether the private international law regime applicable to intermediated securities follows the Hague Securities Convention or the EU’s PRIMA rule.

3. *Interaction of the Hague Securities Convention with Securities Law*

In respect of securities law, the Hague Securities Convention seems to fit well with substantive law regimes that are based on a trust mechanism or on the creation of a new entitlement for each account holder vis-à-vis its intermediary.⁴⁵¹ In contrast, the Convention’s rules do not seem to fit as well with regimes that are based on the financial investor having a direct proprietary right⁴⁵² in securities registered or deposited at the level of an issuer CSD.⁴⁵³ By the same token, it has been alleged that the Hague Securities Convention does not fit well with transparent systems in which the names of the ultimate account holders are registered in individual, segregated accounts not only at the level of their custodian but also at the issuer CSD level. This critique of the Convention can be summarised as follows: The Hague Securities Convention has adopted a tier-by-tier approach, and for each tier the governing law is determined separately by reference to the choice of law that the corresponding account holder and intermediary have made in the relevant account agreement.⁴⁵⁴ That law governs the nature and effects of the account holder’s rights against both its intermediary as well as third parties. The nature of these rights may vary from one tier to another. There is no one, overarching law which would apply to the entire chain of intermediaries but instead only different layers of laws along the intermediary chain. This fragmentation under the Convention at the private international law level gives rise to severe difficulties in legal systems in which the substantive law recognises the ultimate investor has having direct, individual, or collective ownership in the original securities. Suppose, for example, that the jurisdiction in which the issuer CSD is located recognises an investor’s right to direct, pro rata ownership of the securities. However, the investor’s securities are held through a custodian located in a jurisdiction whose law attributes to the account holder a bundle of rights⁴⁵⁵ against its intermediary. It is hard to reconcile these two

⁴⁵¹ Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.35.

⁴⁵² Such direct property rights can be either individual rights or pro rata collective rights.

⁴⁵³ For more details, see chapter 2 of part I of this study.

⁴⁵⁴ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 2-34.

⁴⁵⁵ Such rights may crystallise into a “security entitlement” in an insolvency.

systems. How can the investor have both (i) a direct ownership right in securities registered at the issuer CSD and (ii) a “security entitlement” enforceable only against its intermediary at the same time?

A similar problem exists in dynamic situations: The Hague Securities Convention is adapted to legal systems in which a transfer of intermediated securities implies a discharge of the transferor’s rights and the creation of new rights in the transferee.⁴⁵⁶ In contrast, it does not fit well with systems of substantive law that call for a direct transfer of rights *in rem* over the securities; in other words, what the transferee acquires in those systems derives directly from the transferor. The rights *in rem* that the transferee acquires are the same as those disposed of by the transferor.⁴⁵⁷ However, if different laws govern each part of the transaction (as may be the case under the Hague Securities Convention), the question as to whether the transferor has lost its rights cannot (and should not) be material to an analysis of the acquisition by the transferee. Different laws apply to the acquisition side and the disposition side. At least conceptually, this may give rise to conflicting results, for instance in a so-called “double interest” situation.⁴⁵⁸

This problem, however, is not inherent in the Hague Securities Convention, but rather it arises from the PRIMA rule.⁴⁵⁹ Both kinds of rule create different layers of laws in situations where the chain of intermediaries crosses several jurisdictions; different laws will apply to each level or intermediary. The above-mentioned issues of cross-border compatibility may arise one way or the other. For that reason, the rules of the Hague Securities Convention call for an international instrument on substantive law that would ensure the compatibility between the material law and conflict of laws aspects.⁴⁶⁰

⁴⁵⁶ Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.91.

⁴⁵⁷ Dorothee Einsele, ‘Modernising German Law: Can the UNIDROIT Project on Intermediated Securities Provide Guidance?’ (2005) 10 Uniform Law Review 251, 255.

⁴⁵⁸ Commission of the European Communities (*supra* n 73) 10; Francisco Garcimartín, ‘Disposition and Acquisition of Intermediated Securities: The Geneva Convention and Traditional Property Law’ (2010) 15 Uniform Law Review 743, 749–750; Dorothee Einsele (*supra* n 457) 255; Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.91. For a conflict of laws analysis of this issue, see also Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) ss 4-43 to 4-51.

⁴⁵⁹ Guy Morton, ‘Security Interests in Financial Instruments: Commentary’ in Horst Eidenmüller & Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (De Gruyter Recht, München 2008) 370–371; Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 4-49; Changmin Chun (*supra* n 73) 416–417; Matthias Haentjens, *Harmonisation of Securities Law: Custody and Transfer in European Private Law* (Kluwer Law International, Alphen aan den Rijn 2007) 233, 290.

⁴⁶⁰ See, *inter alia*, Luc Thévenoz ‘Intermediated Securities, Legal Risk, and the International Harmonization of Commercial Law’ (2008) 13 Stanford Journal of Law, Business & Finance 384 426, 430; Dorothee Einsele (*supra* n 457) 256.

With respect to transparent systems, the Hague Securities Convention offers an appropriate solution. Article 1(3)(b) of the Convention does not consider mere operators as intermediaries; a financial institution which opens a securities account with a third party in its customer's name will not be considered an intermediary under the Convention even if it keeps a parallel record of the customer's holding.⁴⁶¹ If the investor has an individually segregated securities account in its name at the level of the issuer CSD, that will be the relevant account from a conflict of laws perspective. This can avoid issues of substantive incompatibility because the investor's rights in the securities are not governed by different layers of laws but rather by a single law.⁴⁶² Hence if the aim is to provide ultimate investors with the option of opening individually segregated accounts at the level of the issuer CSD, then Article 1(3)(b) constitutes an appropriate solution.

III. Relationship with Public Law

The Hague Securities Convention has been criticised for interfering with the enforcement of public laws. More particularly, there have been concerns about a risk of it conflicting not only with the reporting duties EU law imposes on intermediaries to prevent money laundering and market abuse but also with laws to preserve the confidentiality of clients' affairs arising under a chosen non-EU law.⁴⁶³ It has also been claimed that the parties' autonomy may be used to disempower supervisory authorities and interfere directly or indirectly with the application of public laws based on the location of the account. The Hague Securities Convention, however, only addresses private international law issues.⁴⁶⁴ Its scope of application does not include regulatory measures, and therefore it affects neither the application of public laws nor the powers of national authorities.⁴⁶⁵ These laws are generally based on territorial or personal rules that do not rely on private agreements but rather depend on objective connecting factors for the determination of their scope. Therefore, choosing the law of a non-EU (or in the context of OHADA, a non-OHADA) state does not affect the transaction reporting or tax obligations imposed on an intermediary, an account holder, or any other person concerned with securities that are held in a relevant securities account.⁴⁶⁶ For the same reason, neither the substantive scope nor the geographical reach of a supervisory authority's powers is affected by the Hague Securities Conven-

⁴⁶¹ Roy Goode, Hideki Kanda & Karl Kreuzer (*supra* n 97) s 1-35.

⁴⁶² Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.93.

⁴⁶³ Commission of the European Communities (*supra* n 73) 15.

⁴⁶⁴ See Article 2 of the Hague Securities Convention.

⁴⁶⁵ See Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.22.

⁴⁶⁶ Harry C. Sigman & Christophe Bernasconi (*supra* n 317) 31; Commission of the European Communities (*supra* n 73) 15.

tion.⁴⁶⁷ In addition, Article 11 of the Convention contains an exception for mandatory rules of public policy which makes it clear that in no event are obligations based on public laws (such as transaction reporting obligations) to be affected.

IV. Diversity of Laws in the Securities Settlement System

It has been claimed that the Hague Securities Convention may jeopardise the stability of securities settlement systems (SSSs). Indeed, since the Convention's primary rule refers to the choice of law made in the relevant securities account, an SSS and its members could use numerous different laws, and different participants may be subject to a variety of laws which do not coincide with the law that applies to the system. This could destroy the commonality needed for settlement operations within a system.⁴⁶⁸ However, even if this argument is convincing in theory, it is not realistic. Indeed, the system operator and all participants share an interest in a smoothly operating system, and therefore it is very unlikely that any system operator would agree to different laws among its members.⁴⁶⁹ If necessary, regulatory and supervisory authorities may moreover impose on system operators a duty to ensure that no unacceptable legal or systemic risk can arise from an application of different laws.⁴⁷⁰ For instance, regulatory and supervisory authorities may require that all participants in a national system must choose the same law.⁴⁷¹

J. Summary

1. The Hague Securities Convention is an international convention adopted under the aegis of the Hague Conference on Private International Law. It sets forth conflict of laws rules for a number of issues related to securities held through intermediaries. It has no effect on the substantive law that will be applied once the conflict of laws determination has been made. The Hague Securities Convention entered into force on Saturday, 1 April 2017. As of January 2021, the Hague Securities Convention counts three States Parties: the US, Switzerland, and Mauritius.
2. The Hague Securities Convention is designed to apply to a broad range of commercial law issues in any transaction or dispute involving a choice between the laws of different states. Its rules apply to the legal nature, and to the effects against both the intermediary and third parties, of rights

⁴⁶⁷ Harry C. Sigman & Christophe Bernasconi (*supra* n 317) 31.

⁴⁶⁸ Commission of the European Communities (*supra* n 73) 17; Maisie Ooi (*supra* n 287) 233.

⁴⁶⁹ Commission of the European Communities (*supra* n 73) 18.

⁴⁷⁰ Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.97.

⁴⁷¹ Harry C. Sigman & Christophe Bernasconi (*supra* n 317) 32; Commission of the European Communities (*supra* n 73) 18.

resulting from a credit of securities to a securities account and of dispositions of securities held with an intermediary. Its rules also apply to the requirements, if any, for perfection of a disposition of securities held with an intermediary. Further, the Convention determines the law governing whether a person's interest in securities held with an intermediary extinguishes or has priority over another person's interest; it determines the duties (if any) owed by an intermediary to a person other than the account holder who asserts an interest in securities held with that intermediary in competition with the account holder or another person; it determines the requirements (if any) for realising an interest in securities held with an intermediary; and it determines whether a disposition of securities held with an intermediary extends to entitlements to dividends, income, or other distributions or to redemption, sale, or other proceeds.

3. The Hague Securities Convention divides its conflict of laws rules into two components: the "primary rule" (Article 4) and the "fall-back rules" (Article 5). This cascade of rules follows quite closely the sets of rules laid out in UCC § 8-110(e).
4. Under Article 4 of the Hague Securities Convention, the law the account holder and its intermediary choose in their account agreement is the law that will govern rights in intermediated securities. The choice may be expressed in either of two ways: If the parties expressly choose a law that will generally apply to their account agreement (a general governing clause), that law will also apply to all the Article 2(1) issues. However, if the account holder and relevant intermediary expressly choose a law that will specifically apply to all the Article 2(1) issues, that law will govern all those issues. This primary rule of the Convention is not based on an attempt to "locate" a securities account or the office at which a securities account is maintained. Nor does it attempt to locate the intermediary, the issuer, or the underlying securities. It is based instead on the relationship between an account holder and its intermediary.
5. For this choice of law to be valid, the Hague Securities Convention requires that it be expressly made and that the relevant intermediary have a qualifying office in the state whose law has been chosen.
6. The three cascading fall-back rules provided in Article 5 of the Hague Securities Convention apply only if the choice of law is not valid or there is none in the account agreement. Under the first cascading rule in Article 5(1), the governing law is that of the state where the office of the relevant intermediary (the one that concluded the agreement) is located if two conditions are met: (i) it must be possible to determine with certainty the office through which the account agreement was entered into, and (ii) that office must be a Qualifying Office. If one of those conditions fails, this first fall-back rule does not apply. The second fall-back rule in Article 5(2) of the Convention then designates the law of the state under whose law the

- relevant intermediary is incorporated or otherwise organised. The second fall-back rule does not apply if the relevant intermediary is not validly incorporated or organised. Then the third fall-back rule in Article 5(3) designates the law of the principal place of business of the relevant intermediary.
7. The consensual and subjective approach embodied in Article 4 of the Hague Securities Convention appears concerning because of severe implications for some long-standing private international law traditions of the OHADA Member States which somewhat limit party autonomy, particularly in situations where there are issues of property rights and third-party interests. But this concern is addressed by the Qualifying Office requirement: the Convention does not validate just any choice of law the parties may make in a securities account agreement; it requires some minimal connection between the intermediary and the chosen governing law. Pursuant to Article 4, the law the parties to the account agreement choose applies only if the relevant intermediary has an office in the state whose law is selected at the time the agreement on the governing law is made.
 8. Since the account agreement is not a public document, the primary rule of the Hague Securities Convention would seem to lack transparency as it would be difficult for third parties to ascertain or discover the law chosen by the account holder and its intermediary. Under the EU's current PRIMA rule, by contrast, it seems that the law can often be ascertained from objective facts that do not require excessive enquiry. However, it is submitted that third parties (such as collateral takers) who are willing to acquire a security interests in intermediated securities will in practice always request information about which law applies to such securities.

Chapter 5: Alternative Conflict of Laws Rules and Connecting Factors

A. The "Substantive Law Solution" to the Choice of Law Problem

I. Regional Unification of Substantive Law in Respect of the Collateralisation of Intermediated Securities under OHADA Law

The first chapter of the second part of this study examines the uniform provisions in respect of pledges of securities accounts under OHADA law (Articles 146 et seq of the Uniform Act on Security Interests). This chapter explores whether the existence and application of those uniform substantive provisions removes the need for any conflict of laws rules at all in the OHADA region. Indeed, under Article 10 of the OHADA Treaty, all OHADA Member State legislation on pledges of intermediated securities are uniformly integrated. But comparing the solutions explored here, *Garcimartín* and *Guil-*

laume contend that “[...] the Geneva Securities Convention is in competition with the [Hague Securities Convention], for there is less need for conflict of laws rules when national substantive laws are harmonised.”⁴⁷² Following that rationale, courts will never have to grapple with difficult questions of what jurisdiction’s law applies to a dispute over intermediated securities: the laws of Mali, Niger, Togo, Senegal, or any other OHADA Member State would all yield the same result.⁴⁷³ In the context of OHADA, the substantive law solution looks even more appealing because the CCJA ensures that there is a common, binding authority for the interpretation of the unified OHADA law.

Assume, for instance, that Congolese Investor holds an interest in respect of 500,000 shares of Camelback, Inc. (a company incorporated in Guinea) through its intermediary, Senegalese Bank. In turn, Senegalese Bank holds through the Senegalese CSD. Congolese Investor pledges its account containing its interest in the Camelback, Inc. shares to Ivorian Bank under a pledge mechanism pursuant to Article 146 of the Uniform Act on Security Interests. In the first variation of this fact pattern, collateral taker Ivorian Bank and collateral provider Congolese Investor hold through the same intermediary, Senegalese Bank. The following diagram depicts this fact pattern:

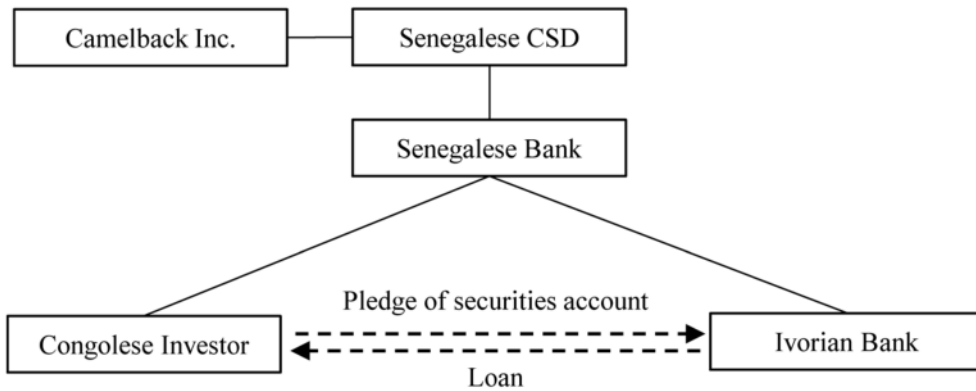


Figure 27: First Variation (Substantive Law Solution)

Since all the elements of this fact pattern can be found in the OHADA region, the courts of the Member States will not have to cope with difficult questions of which jurisdiction’s law is to govern the perfection or realisation of the pledge of Congolese Investor’s securities account. A choice of Congolese, Ivorian, Senegalese, or Guinean law would yield the same result under Articles 146 et seq of the Uniform Act on Security Interests.

⁴⁷² Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.11. *Contra*: Christophe Bernasconi & Thomas Keijser (*supra* n 138) 550.

⁴⁷³ See Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.11.

II. Rejection of the Substantive Law Solution

1. Inefficiency of the Substantive Law Solution from a Purely Legal Perspective

As the first chapter of the second part of this study demonstrates, the rules on collateralisation of intermediated securities are not completely unified from a legal perspective under OHADA law; topics such as title transfer collateral agreements and top-up or substitution of collateral are not regulated. Nor indeed are the rules on intermediated securities perfectly unified in general under OHADA law. OHADA law has no rules on a number of issues: the definition of intermediary and intermediated security; the relationship between intermediaries and the issuer; the rights of the account holder; the acquisition and disposition of intermediated securities by debit, credit, or other methods; the effectiveness of third parties' rights if an intermediary enters insolvency; acquisition of intermediated securities by an innocent person, to name a few. In addition, it is important to underscore that there is no single, defined "law on intermediated securities". Instead there are bodies of law such as property, trust, and insolvency which apply to intermediated securities.⁴⁷⁴ Although there are unified insolvency rules under OHADA law, any effort to comprehensively codify property law or related issues under OHADA law is unlikely to be feasible (or even desirable).⁴⁷⁵ For an idea of the difficulty, note that not even the Geneva Securities Convention or the EU's legislation is so comprehensive as to make the world's or the EU Member States' substantive regimes totally and perfectly identical. The unified substantive law does not eliminate the need to consult choice of law rules in respect of intermediated securities; to enhance legal certainty and predictability, unified substantive law provisions and unified conflict of laws rules must instead complement each other. The Hague Securities Convention and the Geneva Securities Convention are tangible evidence thereof.⁴⁷⁶

2. Practical Difficulties resulting from the Substantive Law Solution

Even if the substantive regime for holding securities in every OHADA Member State was nothing short of identical in every respect, from a practical

⁴⁷⁴ Maisie Ooi (*supra* n 287) 229; Charles W. Mooney, Jr., 'Global Standards for Securities Holding Infrastructures: A Soft Law/Fintech Model for Reform' (2019) 40 *Michigan Journal of International Law* 531, 532.

⁴⁷⁵ One indication of this is the fact that Article 2 of the OHADA Treaty does not mention any property law issues as being among the areas which OHADA can unify. Yet property law is the backbone of the intermediated system.

⁴⁷⁶ See Christophe Bernasconi & Thomas Keijser (*supra* n 472) 550. For a somewhat different opinion on this subject, see Francisco Garcimartín & Florence Guillaume (*supra* n 28) s 10.11.

perspective there would still be a need for rules to determine the applicable law in situations involving third countries, *i.e.*, non-OHADA countries. Indeed, in today’s globalised financial markets, securities holding chains are no longer confined within domestic or regional boundaries.⁴⁷⁷ Investors in securities often buy securities from issuers based in other jurisdictions or maintain their securities accounts with intermediaries located in different countries or regions. Moreover, in some international holding chains, the location of the CSD is in a state different from that of the issuer. In conclusion, to use *Bartın*’s expression,⁴⁷⁸ it is impossible to definitely eliminate any conflict of laws (*impossibilité d’arriver à la suppression définitive des conflits des lois*) in this area. This is illustrated in the diagram below, which depicts a situation where a company in State A chooses to register and deposit its securities with a CSD in a State B, which is the first intermediary in the holding chain. In turn, the CSD credits those securities to the account that it maintains on behalf of Intermediary 2, who is in State C. Intermediary 3, in State D, has an account with Intermediary 2, to whom the securities are also credited. In turn, Intermediary 3 also credits those securities to an account it maintains on behalf of Investor, also located in State D.

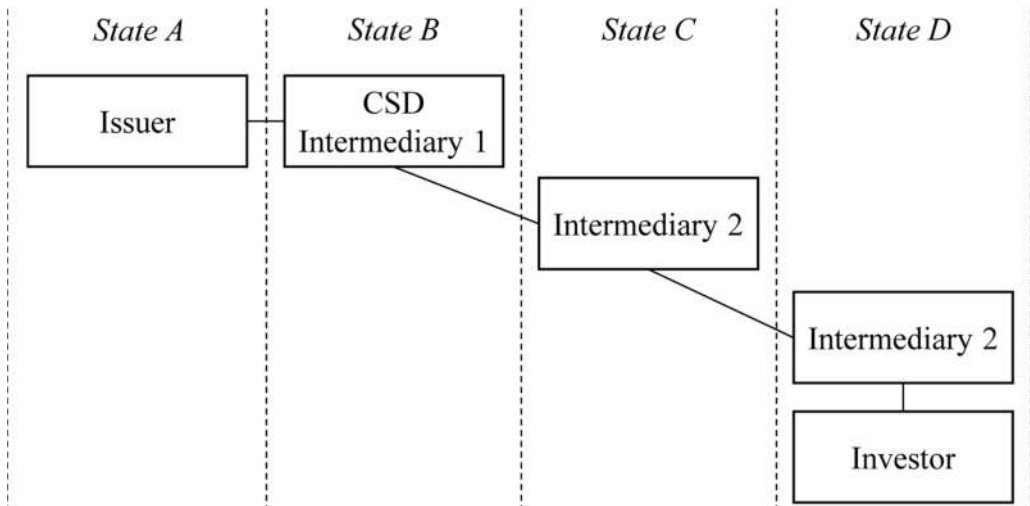


Figure 28: Cross-border Intermediated Securities Holding Chain spanning Four States

Capital markets today are global; many markets coexist in multi-layered fashion and interact with one another. Financial institutions act, and financial

⁴⁷⁷ On the global quality of the modern indirect holding system, see Bradley Crawford (*supra* n 39) 159–160; Simon Schwarz (*supra* n 51) 61, 89 et seq.

⁴⁷⁸ Etienne Bartin, ‘De l’impossibilité d’arriver à la suppression définitive des conflits de lois’ (1897) *Journal de droit international privé*, republished in *Etudes de droit international privé* 1.

transactions occur, across national borders in these multi-layered markets. An increase in cross-border transactions has made intermediated securities a phenomenon at the juncture of several national boundaries.⁴⁷⁹ Moreover, an investor in the OHADA region will very likely look for investment opportunities not just in the OHADA region but globally as a means of diversification and to offset currency fluctuation.⁴⁸⁰ Therefore, there is a very high probability of situations in which at least one element is connected to or located in a non-OHADA country. Even at the European level, the rules found in Article 9(2) of the Settlement Finality Directive and in Article 9 of the Financial Collateral Directive are of European application only; there has thus been concern, even for securities held through European systems (which in practice can be securities from any jurisdiction), of disputes arising and being litigated before the courts of a state which has not adopted these rules.⁴⁸¹

To better grasp the limits of the substantive law solution, assume Congolese Investor holds an interest in 500,000 shares of Camelback, Inc. through an intermediary, Senegalese Bank. In turn, Senegalese Bank holds through European ICSD, which holds through California Subcustodian. California Subcustodian in turn holds through DTC. DTC's nominee, Cede & Co., is recorded as the registered owner of the securities in the register maintained by NJ Registrar, in New Jersey. DTC keeps the physical share certificates representing the Camelback, Inc. shares in a vault in New York. Congolese Investor pledges its interest in the Camelback, Inc. shares to Luxembourg Bank under a pledge mechanism. Collateral taker Luxembourg Bank and collateral provider Congolese Investor hold through the same intermediary, namely Senegalese Bank. The contractual aspects of the pledge are governed by Luxembourgian law. As schematically depicted bellow, the pledge is represented on the books of Senegalese Bank by a debit of 500,000 Camelback, Inc. to the "Congolese Investor Account" shares and a corresponding credit to a "Congolese Investor Pledge to Luxembourg Bank Account".

This fact pattern involves several jurisdictions which do not belong to OHADA. Therefore, courts will potentially have to grapple with difficult

⁴⁷⁹ Thomas Keijser, 'Preface' in Thamos Keijser (ed), *Transnational Securities Law* (Oxford University Press, Oxford 2014) vii.

⁴⁸⁰ In comparison, see Edward F. Greene, 'Beyond Borders: Time to Tear Down the Barriers to Global Investing' (2007) 48 *Harvard International Law Journal* 85, 85–86, who regarding the US capital markets in the context of the emergence of global capital markets indicated: "Investing in non-[US] markets is no longer the exclusive province of mega institutions or the ultrawealthy; it is an essential component of prudent portfolio diversification for all [US] investors." For more details on the emergence of global capital markets, see Eric C. Chaffee, 'Contemplating the Endgame: An Evolutionary Model for the Harmonization and Centralization of International Securities Regulation' (2011) 79 *2 University of Cincinnati Law Review* 587, 592.

⁴⁸¹ Maisie Ooi (*supra* n 287) 221.

conflict of laws questions. Since private international law rules on pledges of intermediated securities are not unified under OHADA law, courts will refer to (the vagary of) their national laws pursuant to Article 10 of the OHADA Treaty. Articles 146 et seq of the Uniform Act on Security Interests will apply only if the conflict of laws analysis leads to the application of the substantive law of an OHADA Member State. This illustrates the practical limits of the substantive law solution to the choice of law problem that derives from the collateralisation of intermediated securities.

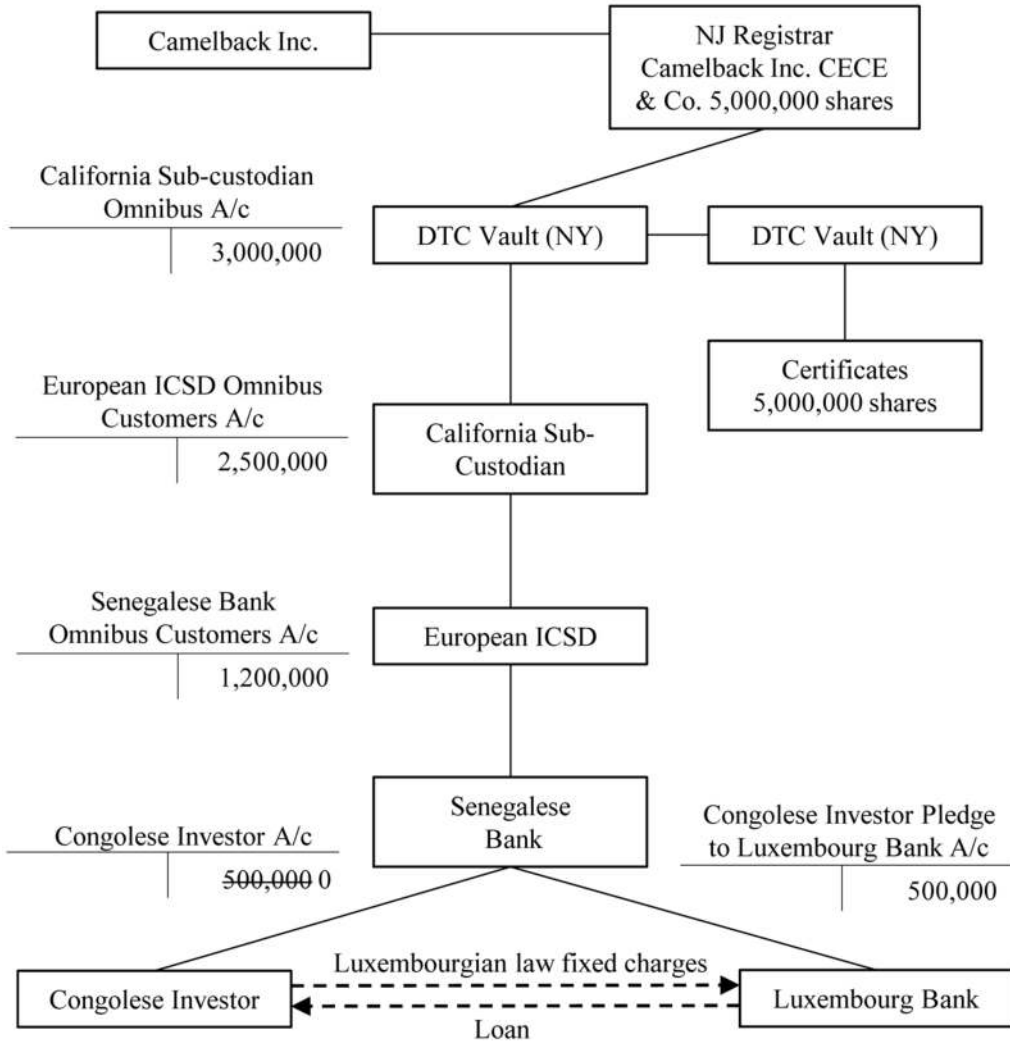


Figure 29: Second Variation (Substantive Law Solution)

B. The Law of the System

I. Introduction to the Rule of the Law of the System

The “law of the system” is a choice of law rule in EU law under Article 8 of the Settlement Finality Directive and Article 9 of Council Regulation (EC) n° 1346/2000 of 29 May 2000 on Insolvency Proceedings (the Insolvency Regulation).⁴⁸² The concept of a “system” is at the centre of the Settlement Finality Directive.⁴⁸³ Under Article 2 of the Settlement Finality Directive, the term “system” means a formal arrangement:

- between three or more participants, excluding the system operator of that system, a possible settlement agent, a possible central counterparty, a possible clearing house or a possible indirect participant, with common rules and standardised arrangements for the clearing, whether or not through a central counterparty, or execution of transfer orders between the participants
- governed by the law of a Member State chosen by the participants; the participants may, however, only choose the law of a Member State in which at least one of them has its head office, and
- designated, without prejudice to other more stringent conditions of general application laid down by national law, as a system and notified to the European Securities and Markets Authority by the Member State whose law is applicable, after that Member State is satisfied as to the adequacy of the rules of the system.”

The law of the system provides the conflict of laws rule to determine a party’s rights and obligations if an insolvency occurs in the context of a payment or settlement system.⁴⁸⁴ Pursuant to Article 9(1) of the Insolvency Regulation, the law to apply is the *law of the system*, not the *lex concursus*.⁴⁸⁵ Replacing the *lex concursus* with the law of the system allows parties to a payment or settlement system to base their expectations purely upon a single set of rules without having to consider the different national laws which might apply to counterparties and which may otherwise govern an insolvency of any of them pursuant to Article 4 of the Insolvency Regulation. The consultative document on Article 9 of the draft EC Convention on Insolvency Proceedings⁴⁸⁶ indicates that this provision aims:

“[...] to avoid any distortion of the mechanisms to regulate and settle transactions, provided for in any payment or settlement systems (netting) or in the organised financial markets,

⁴⁸² OJ (2000) L160/1. The Insolvency Regulation came into force on 31 May 2002.

⁴⁸³ Stephan Saager (*supra* n 26) 131.

⁴⁸⁴ Commission of the European Communities, *Report from the Commission: Evaluation Report on the Settlement Finality Directive 98/26/EC* (EU 25) COM(2005) 657 final/2, Brussels 2006, 9.

⁴⁸⁵ The *lex concursus* is the otherwise applicable law as per Article 4 of the Insolvency Regulation.

⁴⁸⁶ Article 9 of the EC Convention on Insolvency Proceedings is the precursor of Article 9 of the Insolvency Regulation and is *in pari materia* with it.

by applying the foreign insolvency law. These payment systems and these markets involve large-scale transactions and as a consequence have been found to require special rules to guarantee their smooth operation and security. That is why the law of the particular system or market concerned remains applicable.⁴⁸⁷

This is reaffirmed in Recital 27 of the Insolvency Regulation. For instance, in respect of Euroclear, the governing law would be Belgian law instead of the *lex concursus*. If any doubt remains after applying Article 9(1) of the Insolvency Regulation, Article 9(2) of the same provides that the law of the system applies to determine issues of voidability or unenforceability. Similarly, pursuant to Article 8 of the Settlement Finality Directive, if insolvency proceedings are open against a participant in a system, the rights and obligations arising from or in connection with the participation of that participant must be determined by the law which governs that system.

II. Evaluation of the Law of the System Rule

It appears the law of the system has the closest and most real connection with transactions which occur within and through the system. Indeed, the conflict of laws rule underpinning the law of the system is the *proper law of the transaction*.⁴⁸⁸ By analogy, market expectations in a transaction through a stock exchange would be that the laws which regulate the exchange would determine who was entitled to the securities traded through it. From a substantive law perspective, the law of the system ensures coherence between the substantive law and choice of law rules: in an indirect holding system, the operator of the system substitutes its own covenant for that of the security's issuers to pass on (to the intermediaries with whom it has contracted) the entitlements that arise from them. Since it is not the securities themselves but the chose in action that is traded through the system, the individual laws which would have applied in respect of those securities⁴⁸⁹ are replaced by the single law of the chose in action against the operator.⁴⁹⁰

Moreover, an issuer of securities deposited in the system is likely to have undertaken measures to comply with the law of the system; for instance, it has likely amended its constituent documents. Thus, having the law of the system apply avoids difficulties that may arise if the law of the issuer or other applicable law treats the account holder's entitlement differently.⁴⁹¹ Having

⁴⁸⁷ Department of Trade and Industry, 'EC Convention on Insolvency Proceedings: A Consultative Document' (February 1996) 60.

⁴⁸⁸ Maisie Ooi (*supra* n 287) 232.

⁴⁸⁹ Depending on the view taken, this could be the *lex situs*, the *lex incorporationis*, or the law of the register.

⁴⁹⁰ Maisie Ooi (*supra* n 287) 232.

⁴⁹¹ This legal and practical reason to support the law of the system is highlighted by Potok, who acknowledged the difficulty of some systems (such as German and Japanese

the law of the system apply in the OHADA region would mean that the same law applies to issues of property rights in intermediated securities regardless of whether the challenge arises in an insolvency situation. The law of the system obviates the need to decide whether property law or insolvency principles should apply since either will coincide with the law of the system.⁴⁹²

However, the law of the system provides neither legal certainty nor predictability from an OHADA substantive law perspective. Although the law of the system ensures that one law will apply to all issues within a system, it is not suited to the OHADA region, where there are no “systems” as per the definition in Article 2 of the Settlement Finality Directive. A “system” under that definition is a formal arrangement between big financial institutions based on common rules for the processing, clearing, and settlement of payment or securities transactions. The indirect holding systems in the OHADA region are not integrated or well enough developed to have instituted a payment or settlement system as was done in the European Union. First, there is no payment system for the entire OHADA region, *i.e.*, a system for the settlement of payment instructions on the basis of which funds between institutions are transferred; second, OHADA does not have a clearing system operated by a “central counterparty” (a CCP) that interposes itself between the transaction counterparties in order to assume their rights and obligations. The term “system” as described above is not even mentioned in any Uniform Act or court decision under OHADA law. Harmonisation (let alone unification) of financial laws and financial supervision is very complex and difficult.⁴⁹³ Therefore, the law of the system as a conflict of laws rule to determine the law applicable to security interests in intermediated securities is not suitable for the OHADA region and would lead to more legal uncertainty.

C. Choice of the Law Applicable to the Collateral Agreement

I. Towards Recognition of Party Autonomy in the Law of Property?

1. “*In Dubio pro Libertate*”: Choice of Law in Current European Developments

The worldwide recognition of the principle of party autonomy as a prevalent approach in conflicts of laws is reflected not only in national and regional laws

law) which apply the PRIMA principle on the one hand but maintain the *lex rei sitae* tradition on the other. Richard Potok (*supra* n 446) 211.

⁴⁹² Maisie Ooi (*supra* n 287) 233.

⁴⁹³ See Christian Tietje & Matthias Lehmann, ‘The Role and Prospects of International Law in Financial Regulation and Supervision’ (2010) 13 3 *Journal of International Economic Law* 663, 671; Alexander Kern, Rahul Dhumale & John Eatwell, *Global Governance of Financial Systems: The International Regulation of Systemic Risk* (Oxford University Press, Oxford 2006).

(such as in the laws of Australia,⁴⁹⁴ the Democratic Republic of the Congo,⁴⁹⁵ the EU and its Member States,⁴⁹⁶ India,⁴⁹⁷ Japan,⁴⁹⁸ OHADA and its Member States,⁴⁹⁹ Russia,⁵⁰⁰ Singapore,⁵⁰¹ South Africa,⁵⁰² South Korea,⁵⁰³ or Switzerland⁵⁰⁴) but also in relevant international instruments. The 1994 Inter-American Convention on the Law Applicable to International Contracts (the Mexico City Convention)⁵⁰⁵ and more recently the Hague Principles on Choice of Law in International Commercial Contracts (the Hague Principles)⁵⁰⁶ are

⁴⁹⁴ See the decision of the Privy Council in *Vita Food Inc v Unus Shipping Co* [1939] AC 277. See further Martin Davies, Andrew Bell, & Paul Brereton, *Nygh's Conflict of Laws in Australia* (8th edition, LexisNexis, London 2008) 389; Michael Whinkop & Mary Keyes, 'Putting the "Private" Back into Private International Law: Default Rules and the Proper Law of the Contract' (1997) 21 Melbourne University Law Review 515, 517.

⁴⁹⁵ Article 11(2) of the Decree of 4 May 1895.

⁴⁹⁶ Article 3(1) of the Rome I Regulation.

⁴⁹⁷ See the decision of the Supreme Court of India in *National Thermal Power Corporation v Singer Company* [1993] AIR 1993 SC 998.

⁴⁹⁸ Article 7 of the Japanese Act on General Rules for Application of Laws; see also Yoshiaki Sakurada & Eva Schwittek, 'Die Reform des japanischen Internationalen Privatrechts' (2012) 76 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 86, 93.

⁴⁹⁹ Article 234 of the Uniform Act on General Commercial Law.

⁵⁰⁰ Article 1210(1) of the Civil Code of the Russian Federation.

⁵⁰¹ See the decision of the Singapore Court of Appeal in *Peh Teck Quee v Bayerische Landesbank Girozentrale* [2000] 1 SLR 148; see also Tiong Min Yeo, 'The Effective Reach of Choice of Law Agreements' (2008) 20 *Singapore Academy of Law Journal* 723, 726.

⁵⁰² See Christopher Forsyth, *Private International Law* (4th edition, Juta, Lansdowne 2003) 298, who argues that under Roman-Dutch law the courts, despite some earlier authorities to the contrary, have, at least *obiter* and for certain contracts, allowed the parties to choose the applicable law. However, he also points out that the question of whether the parties can avoid an otherwise applicable mandatory rule by their choice was as yet undecided.

⁵⁰³ Article 25(1) of the South Korea Private International Law Act.

⁵⁰⁴ Article 116(1) of the Swiss Private International Law Act (*Bundesgesetz über das Internationale Privatrecht*).

⁵⁰⁵ See Article 7 first sentence of the Mexico City Convention. The Mexico City Convention was adopted by the Organisation of American States (hereinafter referred to as OAS).

⁵⁰⁶ See Daniel Girsberger, 'Die Haager Prinzipien über die Rechtswahl in internationalen kommerziellen Verträgen' (2014) 24 *Schweizerische Zeitschrift für internationales und europäisches Recht/Revue suisse de droit international et européen* 545; Dieter Martiny, 'Die Haager Principles of Choice of Law in International Commercial Contracts – Eine weitere Verankerung der Parteiautonomie' (2015) 79 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 624; José Antonio Moreno Rodríguez & María Albornoz, 'Reflections on the Mexico Convention in the Context of the Preparation of the Future Hague Instrument on International Contracts' (2011) 7 *Journal of Private International Law* 491; Jan L. Neels, 'The Nature, Objective and Purposes of the Hague Principles on Choice of Law in International Contracts' (2013/2014) 15 *Yearbook of Private International Law* 45; Marta Pertegás & Brooke Adele Marshall, 'Party Autonomy and its Limits: Convergence Through the New Hague Principles on Choice of Law in International Commercial Contracts' (2014) 39 *Brooklyn Journal of International Law* 975; Symeon C.

two examples. Choice of law clauses are mainly the domain of contract law. For instance, the scope of the Hague Principles covers only contractual matters, not international property law.⁵⁰⁷ But in recent years, under the motto “*in dubio pro libertate*”⁵⁰⁸, the European legislator has extended the freedom to choose what law will govern a contract to other areas, including family law, succession law⁵⁰⁹, and tort law⁵¹⁰. Even in areas such as company law, in the case law of the European Court of Justice⁵¹¹ the incorporation theory of international company law can also be regarded as a *de facto* or indirect freedom to make a choice of law because of the ease of manipulating the connecting factor may be achieved.⁵¹² Doctrinal writings contain many pleas in favour of extending the freedom to make a choice of law to the area of international property law in general⁵¹³ or only to specific aspects of it (such as pertain to disposi-

Symeonides, ‘The Hague Principles on Choice of Law for International Contracts: Some Preliminary Comments’ (2013) 61 *The American Journal of Comparative Law* 873; Jürgen Basedow, ‘The Hague Principles on Choice of Law: Their Addresses and Impact’ (2017) 22 *2 Uniform Law Review* 304. The Hague Principles have already proved their usefulness by serving as a model for the Paraguayan Law No. 5393 on the Law Applicable to International Contracts. See <<https://www.hcch.net/en/news-archive/details/?varevent=392>> (accessed 4 January 2021). In July 2015, they were also endorsed by UNCITRAL (see <https://www.hcch.net/index_en.php?act=events.details&year=2015&varevent=414> (accessed 4 January 2021)). See also, more generally, José Antonio Moreno Rodríguez, ‘Los contratos y La Haya: ¿Ancla al pasado o puente al futuro?’ (2010) 15 *Revista Brasileira de Direito Constitucional* 125.

⁵⁰⁷ Hague Conference on Private International Law, *Principles on Choice of Law in International Commercial Contracts* (Hague Conference on Private International Law, The Hague 2015) s 1.1. On the theoretical foundations of party autonomy see Jürgen Basedow, *The Law of Open Societies – Private Ordering and Public Regulation of International Relations, General Course on Private International Law* (Rec. des Cours 360, 2013) 164 et seq.

⁵⁰⁸ Jürgen Basedow (*supra* n 507) 164.

⁵⁰⁹ See Kathrin Kroll-Ludwigs, *Die Rolle der Parteiautonomie im europäischen Kollisionsrecht* (Mohr Siebeck, Tübingen 2013) 99 et seq.

⁵¹⁰ See for instance Article 14 (1)(b) of Rome II. For further details on the discussions of the European Group of Private International Law (hereinafter referred to as GEDIP) on party autonomy in different legal areas, see Marc Fallon, Patrick Kinsch & Christian Kohler (eds), *Building European Private International Law: Twenty Years’ Work by GEDIP* (Intersentia, Cambridge 2011) 23 et seq, 109, 255, 322, 374, 524, 548, 563, 598, 611, and 630.

⁵¹¹ Dirk A. Verse, ‘Niederlassungsfreiheit und grenzüberschreitende Sitzverlegung’ (2013) *ZEuP* 458.

⁵¹² Michel Menjucq, *Droit international et européen des sociétés* (Montchretien, Paris 2011) ss 40, 41; Eva-Maria Kieninger, ‘Freedom of Choice of Law in the Law of Property?’ (2018) 7 *3 European Property Law Journal* 221.

⁵¹³ See, for instance, Peter von Wilmsowsky, *Europäisches Kreditsicherungsrecht: Sachenrecht und Insolvenzrecht unter dem EG-Vertrag (Beiträge zum ausländischen und internationalen Privatrecht Europäisches Kreditsicherungsrecht)* (Mohr Siebeck, Tübingen 1996) 94 et seq; Axel Flessner, ‘Rechtswahl im internationalen Sachenrecht – neue Anstöße

tion).⁵¹⁴ Other authors have called for an extension of choice of law to the area of international property law for problematic cases such as assignments of claims, transfers of stolen goods to an assurer, and the *res in transitu*⁵¹⁵; or they have called for granting the law of the location of the property the possibility of being treated as the dispositive *loi de police*.⁵¹⁶

Legal doctrine has brought forth many arguments in favour of extending party autonomy to international property law. The first argument for party autonomy in the law of movable property is that the location of property is irrelevant in determining the interests of the parties involved.⁵¹⁷ Under EU law, the second argument for party autonomy in the law of movable property is that the fundamental freedoms enshrined in the Treaty on the Functioning of the European Union (TFEU) fundamentally protect party autonomy such restricting it requires justification based on mandatory requirements in the public interest.⁵¹⁸ However, from a private international law perspective, such

aus Europa' in Peter Apathy et al (eds), *Festschrift für Helmut Koziol* (Jan Sramek Verlag, Wien 2010) 125–147. More generally on choice of law in international property law, see Karl Kreuzer, *La propriété en droit international privé*, Rec. des Cours 259 (1996) 118 et seq; Eva-Maria Kieninger, 'Die Zukunft des deutschen und europäischen Mobiliarkreditsicherungsrechts' (2008) 208 Archiv für die civilistische Praxis 182, 192.

⁵¹⁴ See Ann-Christin Ritterhoff, *Parteiautonomie im internationalen Sachenrecht* (Duncker und Humblot, Berlin 1999) 281 et seq, who pleads for freedom of choice of law only in relation to the law applicable to the disposition while still regarding the *lex rei sitae* as the basic rule of international property law.

⁵¹⁵ Jeroen André van der Weide, *Mobiliteit van goederen in het IPR. Tussen situsregel en partijautonomie (Mobiliteit van goederen in het IPR)* (Kluwer, Deventer 2006), whom Flessner cites and who argues that freedom of choice of law in property law applies only for an "ultimum remedium" which should be utilised only in cases where other connecting factors fail to reflect the place of location (Axel Flessner (*supra* n 513) 183, 246); Jan Neels, 'The Proprietary Effect of Reservation-of-title Clauses in Private International Law' (2006) South African Mercantile Law Journal 66. As discussed in the previous paragraph, this now corresponds to the statutory rules in the Netherlands.

⁵¹⁶ See Louis d'Avout, *Sur les solutions du conflit de lois en droit des biens* (Economica, Paris 2006) 612, 656 et seq.

⁵¹⁷ See Axel Flessner (*supra* n 513) 133 et seq.

⁵¹⁸ Axel Flessner, 'Between Arts. 14 and 27 of Rome I: How to interpret a European Regulation on Conflict of Laws?' in Roel Westrik & Jeroen van der Weide (eds), *Party Autonomy in International Property Law* (Verlag Dr. Otto Schmidt, Cologne 2011) 207 et seq; Axel Flessner, 'Die internationale Forderungsabtretung nach der Rom I-Verordnung' (2009) IPRax 35; Axel Flessner, 'Rechtswahlfreiheit auf Probe – zur Überprüfung von Art. 14 der Rom I-Verordnung' in Jürgen F. Baur et al, *Festschrift für Gunther Kühne zum 70. Geburtstag* (Recht und Wirtschaft, Frankfurt am Main 2009) 703 et seq. In addition, it is argued that freedom of choice of law has already been extended to proprietary rights in Article 14 (1) of the Rome I Regulation. On this question, see Eva-Maria Kieninger, 'Das auf die Forderungsabtretung anwendbare Recht im Licht der BIICL-Studie' (2012) IPRax 289. It is also worth noting that the European Commission is currently developing a proposal for a new private international law regulation regarding the proprietary aspects of

an argument is not in line with the more nuanced approach that the Court of Justice of the European Union (CJEU) has taken.⁵¹⁹ Indeed, the CJEU has strictly avoided general conclusions about whether certain national private international law rules are compatible with primary or secondary European law. In this regard, *Basedow* aptly notes: “The law of the European Union may help to scrap the *lex situs* rule in some of the situations described above. But the basic freedoms do not replace the existing conflict rules with new ones.”⁵²⁰ A violation of European law always derives from the *result* of the rapport between private international law and substantive law.⁵²¹ Moreover, that the CJEU does not derive from the fundamental freedoms a general freedom to make a choice of law is clearly indicated in the *Alsthom* ruling⁵²², in which the Court found that mandatory application of French contract law did not amount to a restriction on the free movement of goods. Protecting the fundamental freedoms as enshrined in the TFEU and interpreted by the CJEU thus does not compel EU Member States to grant the freedom to make a choice of law with respect to proprietary rights in tangible movables. Additionally, it is important to examine whether a specific transaction falls within the scope of various freedoms under the TFEU. For instance, the CJEU in *Keck*⁵²³ restricted the scope of the free movement of goods such that it is hard to make the case that non-recognition of a security interest in movable property constitutes a restriction pursuant to the meaning of Article 28 TFEU.⁵²⁴

However, despite all these pleas formulated in academic publications, international property law appears to have remained unaffected by this development

transfers of claims and financial instruments (*see* <https://ec.europa.eu/info/law/better-regulation/initiatives/com-2018-96_en> (accessed 4 January 2021). Whatever solution the Commission and the European legislator adopt, for all practical purposes the debate over whether Article 14 (1) of the Rome I Regulation already covers proprietary aspects will be concluded in the near future (and be answered in the negative) (Eva-Maria Kieninger (*supra* n 512) 223).

⁵¹⁹ See Roth Wulf-Hennig, ‘Secured Credit and the Internal Market: The Fundamental Freedoms and the EU’s Mandate for Legislation’ in Horst Eidenmüller & Eva-Maria Kieninger (eds), *The Future of Secured Credit in Europe* (De Gruyter, Boston 2008) 36, 45.

⁵²⁰ Jürgen Basedow (*supra* n 507) 10 et seq.

⁵²¹ If it is not possible to justify the restriction, the importing Member State may remove the restriction either by amending its substantive law or modifying its conflict of laws rules.

⁵²² ECJ 24.1.1991, case 339/89 (*Alsthom Atlantique SA v Compagnie de construction mécanique Sulzer SA*), [1991] ECR I-00107.

⁵²³ European Court of Justice (ECJ) 24 November 1993, cases 267/91 and 268/91 (*Keck and Mithouard*), EuZW 1993, 770.

⁵²⁴ For more details, *see* Eva-Maria Kieninger, *Mobiliarsicherheiten im Europäischen Binnenmarkt Zum Einfluß der Warenverkehrsfreiheit auf das nationale und internationale Sachenrecht der Mitgliedstaaten* (Nomos Verlagsgesellschaft, Baden-Baden 1996) 127 et seq.

– with a few exceptions discussed below.⁵²⁵ Due to the publicity principle, most legal systems do not permit choices of law in the context of proprietary issues. For instance, under German law, Article 43 EGBGB does not allow parties to make a choice of the law to apply to proprietary issues. According to the German legislator’s reasoning, the applicability of a chosen law cannot be founded on the exception clause in Article 46 EGBGB.⁵²⁶ Other European states also use the *lex situs* rather than party autonomy as the general rule in the context of proprietary issues. These include, notably, France (Article 3 Code Civil), Spain (Article 10 Código Civil), Bulgaria (Article 64 Bulgarian PIL Act 2005), Switzerland (Article 99(1) of the Swiss PIL Act), Belgium (Article 87 § 1 Belgian PIL Act 2004), Italy (Article 51 Italian PIL Act), Austria (§ 31 Austrian PIL Act), Lithuania (Article 1.48 Lithuanian Civil Code), the Czech Republic (Article 69 (1) Czech PIL Act), Poland (Article 41 Polish PIL Act 2011), Rumania (Article 2613 Rumanian Civil Code), Greece (Article 27 Greek Civil Code), and Estonia (Article 18 (1) Estonian PIL Act 2002).⁵²⁷

2. Looking for Models for a Reform of International Property Law

a) The Russian Civil Code

The Russian Civil Code allows parties to choose the law to apply to proprietary aspects of a transaction. Russian law fundamentally applies the *lex rei sitae*, as Article 1205(1) of the Russian Civil Code provides: “The content of a right of ownership and other rights in rem relating to immovable and movable property, the exercise and protection thereof shall be determined according to the law of the country where such property is located.” Article 1210(1) of the Russian Civil Code, however, contains an exception:

“When they enter into a contract or later on the parties thereto may select by agreement between them the law that will govern their rights and duties under the contract. *The law so selected by the parties shall govern the emergence and termination of a right of ownership and other rights in rem relating to movable property with no prejudice for the rights of third persons* [my emphasis].”

Hence, subject to the rights of third persons, the scope of the power to make a choice of law under Russian law includes the emergence and termination of a right of ownership and other rights *in rem* relating to movable property.⁵²⁸

⁵²⁵ Dieter Martiny, ‘Lex Rei Sitae as a Connecting Factor in EU Private International Law’ (2012) IPRax 119, 124.

⁵²⁶ Bundestagsdrucksache 14/343, 14.

⁵²⁷ See also Dicey, Morris & Collins, *The Conflict of Laws* (15th ed., Sweet & Maxwell, London 2012) rule 132; Jürgen Basedow, ‘The Lex Situs Rule in the Law of Movables: A Swiss Cheese’ (2016/2017) 18 Yearbook of Private International Law 1, 2 et seq.

b) *The Dutch Private International Law Act*

The Dutch Private International Law Act⁵²⁹ seems to exemplify an extension of the choice of law principle to the area of international property law. Dutch law fundamentally applies the *lex rei sitae* (Article 10:127(1) Burgerlijk Wetboek (hereinafter referred to as BW)). But it also contains various cautious openings in the direction of a freedom to make a choice of law.⁵³⁰ As to property law issues of retaining title in movables destined for export, Article 10:128(2) BW provides that the parties may alternatively choose to apply the law of the importation state under two conditions: first, that the retention of title must remain effective under the chosen law until full payment of the purchase price; second, that the movable must be slated for import into the state whose law is chosen by the parties. Similar provisions apply to leasing transactions if the leased movables are intended for use abroad (Article 10:128(3) BW). From a practical perspective, the law chosen to apply to the property in this freedom of choice set-up typically corresponds to the location where the movable will be upon execution of the transaction. Consequently, for international proprietary issues Dutch law does not replace the *lex rei situs* rule with a choice of law rule; it simply allows parties to reconcile the applicable law and the envisaged location instead. The same approach is embodied by the second condition to deviating from the *lex rei sitae*: as per Article 10:133(1) BW, movables exported under an international transport agreement are subject to the law of the state of destination. The applicable law must be determined not according to a connection to a random location reached during transport but rather to the place where the movables will be, at least for a certain period after transport.⁵³¹ But Dutch law nevertheless pro-

⁵²⁸ Vladimir Orlov, 'Updated International Private Law of Russia' (2017) 3 Athens Journal of Law 75, 91. In comparison, under Article 38 of the Law of the People's Republic of China on the Application of Laws to Foreign-Related Relations (the Chinese PIL Act 2010), the parties may designate the law governing the transfer of property rights in movables in transit (*res in transit*). Absent any choice by the parties, the applicable law is the law of the destination. Therefore, under the Chinese PIL Act 2010, party autonomy is the primary conflict of laws rule for goods in transit.

⁵²⁹ The Dutch Law on Conflicts of Property Law ("Wet conflictenrecht goederenrecht") of 1 May 2008 (Official Gazette 2008, n° 70; see hereto also Staatscommissie voor het internationaal privaatrecht, *Rapport aan de Minister van Justitie, Internationaal goederenrecht* (November 1998)). It has been incorporated into the tenth book of the Dutch Civil Code (*Burgerlijk Wetboek*, BW) with effect from 1 January 2012.

⁵³⁰ This is except for the usual exceptions for registered ships and airplanes which are subject to the law at the place of registration (Article 10:127(2) and (3) BW).

⁵³¹ See Article 101 Swiss IPRG for a similar rule. Under German law, a few authors have pleaded for the law of the country of destination pursuant to Article 46 EGBGB: Bernd von Hoffmann & Karsten Thorn, *Internationales Privatrecht* (9th edition, C.H. Beck,

vides that the law governing property rights in exports of movables under a purchase or other agreement shall be determined accessorially to the law governing the agreement. Indeed, Article 10:133(2) BW provides:

“If the transport meant in paragraph 1 takes place in the performance of a sale contract or another contract containing an obligation to transfer the transported thing, or in the performance of a contract containing an obligation to establish a real property right in that thing, then the designation of the law which is applicable to that contract, as inserted in that contract, shall, notwithstanding paragraph 1, be deemed to relate also to the property regime in respect of the object carried.”

However, the formulation and the wording of this provision do not clearly indicate what exact property rights fall within the scope of this rule. In November 1998, the State Commission for Private International Law (hereinafter referred to as State Commission) issued an advisory report on a preliminary bill prepared by the Ministry of Justice concerning a Conflict of Property Law Act. The wording in Article 10: 133(2) BW is similar to that in the State Commission’s proposal.⁵³² The explanation attached to the State Commission’s proposal indicates that the scope of this provision includes only transfers performed in execution of purchase or other sale agreements; the same explanation does not address other property rights such as statutory liens in favour of transport companies. Moreover, there is no mention of the legal relationship between the law chosen indirectly to apply to the transfer and the provisions on retention of title (Article 10:128 BW) or good-faith acquisition (Article 10:131 BW).⁵³³ Consequently, if a *bona fide* acquisition comes up, it is unclear whether the law designated by the parties applies in relation to the former owner of the property. It is also unclear whether the law of the destination country remains mandatory according to Article 10:131 BW. As regards retention of title, it is important to underscore that goods in transport are by their very nature goods intended to be exported.⁵³⁴ In that regard, it is uncertain whether an unlimited and indirect choice of law as per Article 133(2) BW is permitted, or whether only a limited choice of law is permitted under Article 10:128(2) BW. A lack of consistency with Article 10:128 BW also makes it unclear whether Article 10:133 BW applies to security rights. Considering these uncertainties, it can be concluded that Dutch law cannot be regarded as a model for a reform of international property law.

München 2007) § 12, 39; Jan Kropholler, *Internationales Privatrecht* (6th edition, Mohr Siebeck, Heidelberg 2006) 564 et seq.

⁵³² See Staatscommissie voor het internationaal privaatrecht, *Rapport aan de Minister van Justitie, Internationaal goederenrecht* (November 1998).

⁵³³ Eva-Maria Kieninger (*supra* n 512) 243.

⁵³⁴ This was already noted by Ulrich Drobnig, ‘Eigentumsvorbehalte bei Importlieferungen nach Deutschland’ (1968) 32 *Rabels Zeitschrift für ausländisches und internationales Privatrecht* 450, 461 fn 18. See also Stephan Saager (*supra* n 26) 125.

II. Choice of Law in Collateral Agreements regarding Intermediated Securities

1. Party Autonomy in Collateral Agreements regarding Intermediated Securities

This section discusses the possible introduction of party autonomy with respect to intermediated securities. More particularly, it examines whether the collateral taker and the collateral provider can make a free choice of the law to apply to the proprietary aspects of a collateral agreement in respect of intermediated securities.⁵³⁵ Assume Paping SA is incorporated in Porto-Novo (Benin) and has 5,000,000 shares outstanding, all held through STRATE, a CSD incorporated in South Africa (Johannesburg). STRATE keeps the physical certificates representing the Paping SA shares in its vault in South Africa. Paping SA maintains a share register with a registrar located in Dakar (Senegal). Congolese Investor has 100 shares of Paping SA reflected by a book entry credited to an account entitled “Congolese Investor Securities Account” kept with intermediary Ivorian Bank, which is located and has its principal place of business in Abidjan. Ivorian Bank’s position corresponding to Congolese Investor’s interest is represented on the books of one French Bank (together with interests of other customers of French Bank) as entries credited to an account entitled “Ivorian Bank Omnibus Customer Securities Account”. For all customers including Congolese Investor, Ivorian Bank holds a total of 45,000 Paping SA shares. Through book entries credited to an account entitled “French Bank Omnibus Customer Securities Account”, French Bank in turn holds interests on the books of STRATE in South Africa corresponding to Ivorian Bank’s interest in 45,000 Paping SA shares plus other clients’ interests. For all its customers including Ivorian Bank, French Bank holds a total of 950,000 Paping SA shares.

Now suppose Congolese Investor wants to borrow funds from Gabonese Bank in Libreville, whose own securities account is at the same Ivorian Bank in Abidjan, and that Congolese Investor and Gabonese Bank enter into a loan agreement under which Congolese investor provides the 100 shares of Paping SA to Gabonese Bank as collateral. The above fact pattern can be illustrated as the following figure.

If the parties were permitted to make a choice of law in this context, Congolese Investor and Gabonese Bank would choose the law to govern the proprietary issues under their collateral agreement; for instance, they could choose French law. French law would then govern the requirements, if any, for perfec-

⁵³⁵ For an analogous inquiry particularly in respect of intermediated securities, see Stephan Saager (*supra* n 26) 123 et seq; Dorothee Einsele, ‘Das neue US-amerikanische Wertpapierrecht als Modell für einen funktionsfähigen Effektengiroverkehr’ (1997) RIW 269, 274.

tion of a disposition of the intermediated securities as well as for realising the security interest in the intermediated securities. It would also govern whether Gabonese Bank’s security interest had priority over another person’s interest.

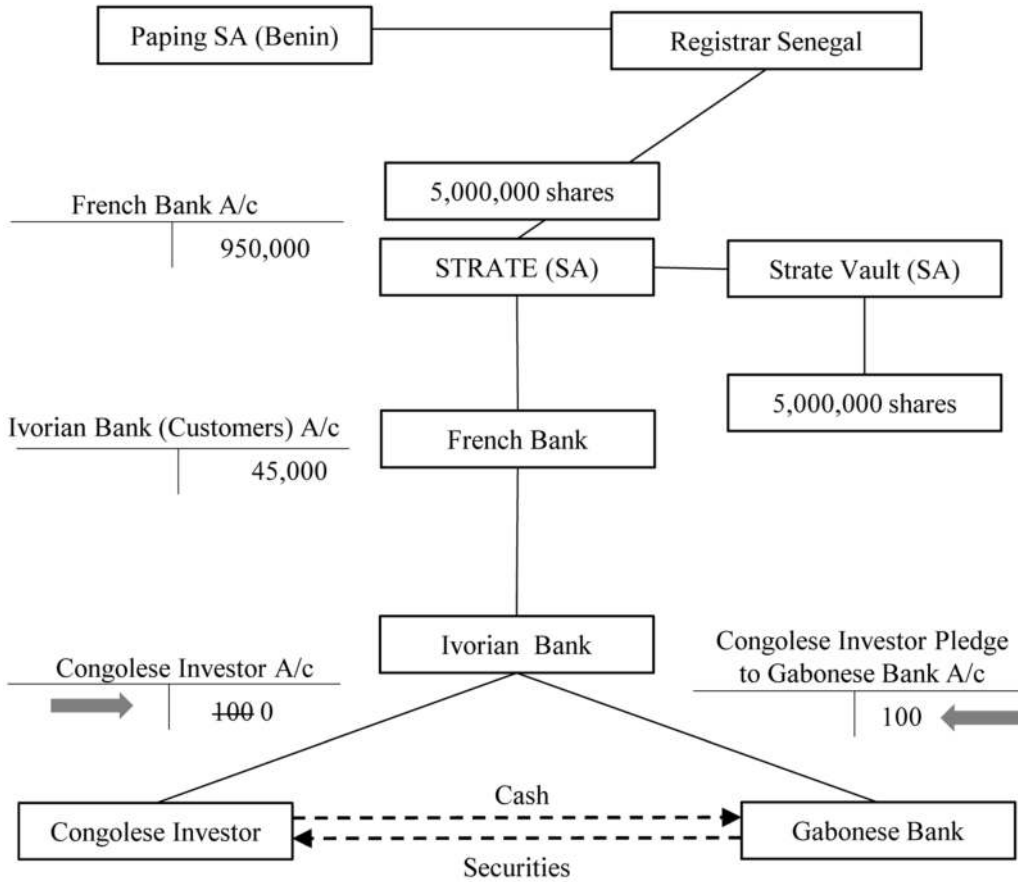


Figure 30: Look-Through Approach

2. Legal Risks and Practical Difficulties

Allowing the parties to choose the law to apply under their collateral agreement to *in rem* rights in intermediated securities contrasts with the common approach of the OHADA Member States. That approach somewhat limits party autonomy, in particular in situations where there are issues of property rights and possibly of third-party interests.⁵³⁶ Indeed, in such jurisdictions choice of law clauses are enforced only if they lead to the application of the law of a place where the property may conceivably be considered to be located. As of January 2021, no jurisdiction in the OHADA region empowers parties to choose the law applicable to *in rem* rights.

⁵³⁶ For instance, under the law of the Democratic Republic of the Congo, see Kalongo Mbikayi (*supra* n 339) 177. See also more generally Bradley Crawford (*supra* n 39) 185.

In addition, empowering the collateral provider and the collateral taker to choose the law to apply under their collateral agreement to *in rem* rights in intermediated securities leads to practical difficulties; in particular, the intermediary will not want to have another law interfere with finality issues. Indeed, intermediaries would never accept having proprietary aspects of transactions that go across their books be subject to just any law that the parties to a collateral agreement may choose and which would not be “under the control of the intermediaries”. The intermediaries would suddenly have to be willing to subject their activities and responsibilities to almost any law in the world, which of course would be totally impractical.

D. Summary and Evaluation

1. This chapter has attempted to find alternative further connecting factors as to the law to govern issues of crucial practical importance for cross-border holdings and transfers of intermediated securities. It has examined the “substantive law solution”, the law of the system, and a choice of law by the collateral provider and the collateral taker in their collateral agreement.
2. It has explored whether integration and regional unification of substantive laws on intermediated securities in the OHADA region removes the need for any conflict of laws rule at all. Courts would not have to grapple with difficult questions of which jurisdiction’s law will apply to a dispute over the intermediated securities, because the law of any Member State would yield the same result. However, the “law of intermediated securities” actually involves a collection of provisions of drawn from different areas such as property, trust, and insolvency law. Such a unification is unlikely to be feasible or even desirable in the OHADA region, because the scope of harmonisation is limited under Article 2 of the OHADA Treaty. Moreover, from a practical viewpoint it is worth noting that securities holding chains in today’s globalised financial markets are no longer confined within domestic boundaries, so even if the substantive regime for holding securities was literally identical in every respect in every OHADA Member State, there would still be a need for rules to determine the applicable law in situations involving third countries, *i.e.*, non-OHADA countries.
3. Under EU law, the law of the system is the choice of law rule in Article 8 of the Settlement Finality Directive and Article 9 of the Insolvency Regulation. Pursuant to Article 9(1) of the Insolvency Regulation, it is the *law of the system* and not the *lex concursus*⁵³⁷ which determines rights and ob-

⁵³⁷ The *lex concursus* is the otherwise applicable law as per Article 4 of the Insolvency Regulation.

- ligations if an insolvency occurs in the context of a payment or settlement system. Although the law of the system ensures that one law will apply to all issues within a system, it is not adapted to the OHADA region, where there are no “systems” as per the definition in Article 2 of the Settlement Finality Directive. Indeed, the financial markets and indirect holding systems in the OHADA region are not enough evolved or sufficiently integrated to implement a regional payment and settlement system.
4. Given that the principle of party autonomy in conflict of laws is recognised worldwide as the modern, prevalent approach, this chapter has examined whether the collateral taker and the collateral provider can freely choose the law applicable to the proprietary aspects of a collateral agreement in respect of intermediated securities. It is submitted that such a rule would give rise to severe difficulties; intermediaries would never accept that proprietary aspects of transactions that cross their books should be subject to just any law that the parties to a collateral agreement might choose and not be “under their control”. Intermediaries would otherwise find their activities and responsibilities being subject to almost any law in the world, which would be totally impractical.

Chapter 6: Comparison of the Operation of the Different Conflict of Laws Rules from an OHADA Perspective

A. *Fact Pattern*

As the pinnacle of this study, this last chapter aims to concretely lay out the advantages and disadvantages of these conflict of laws rules in order to identify the best (system of) connecting factor(s) for determining the law applicable to security interests in intermediated securities in the OHADA region. It is important to highlight that this chapter will take into consideration not only conflict of laws aspects (part III of this thesis) but also the substantive law rules in respect of the collateralisation of intermediated securities which are analysed in part II. In this regard, this chapter analyses differences that occur respectively in applying PRIMA, the primary rule of the Hague Securities Convention, and the choice of law made by the collateral taker and the collateral provider in the context of the following fact pattern.

Assume Congolese Investor holds 500,000 shares of Camelback, Inc. through its intermediary, French Bank. French Bank in turn holds through European ICSD, which holds through California Subcustodian. California Subcustodian in turn holds through DTC. DTC’s nominee, Cede & Co., is recorded as the registered owner of the securities in the register maintained by NJ Registrar in New Jersey. DTC keeps the physical share certificates representing the Camelback, Inc. shares in a vault in New York.

For the first three variations of this fact pattern, the following section examines a situation where Congolese Investor seeks a loan from Luxembourg Bank, an international investment bank incorporated in Luxembourg and based in Luxembourg City. For the last variation, Congolese Investor seeks the loan from its intermediate intermediary, French Bank.

B. Variations and Solutions under the Different Choice of Law Rules

I. First Variation: Collateral Provider and Collateral Taker Hold through the Same Intermediary and Collateral Is Provided by way of Pledge

1. Presentation of the Fact Pattern's Variation

In the first variation, the collateral taker (Luxembourg Bank) and the collateral provider (Congolese Investor) hold securities through the same intermediary (French Bank). Congolese Investor pledges its securities account, with its interest in the Camelback, Inc. shares, to Luxembourg Bank under a pledge mechanism pursuant to Article 146 et seq of the OHADA Uniform Act on Security Interests. If the pledge were of the intermediated securities *per se*, the pledge would have been represented on the books of French Bank by a debit to the “Congolese Investor Account” of 500,000 Camelback, Inc. shares and a corresponding credit to a “Congolese Investor Pledge to Luxembourg Bank Account”.⁵³⁸ However, under Article 149 of the OHADA Uniform Act on Security Interests the pledged securities account must take the form of a special account opened in the name of the account holder and maintained by the issuing legal entity or a financial intermediary. In this case, the special account will be maintained by Congolese Investor’s intermediary (French Bank).

After making the pledge in favour of Luxembourg Bank, Congolese Investor enters into a pledge agreement on the same 500,000 Camelback, Inc. shares with Italian Bank. Congolese Investor and Italian Bank choose Italian law to govern their account agreement. Under Italian law, the second pledge is valid. Assume further that Congolese Investor enters insolvency in the Democratic Republic of the Congo. The liquidator asks the Congolese court to determine if the pledges in favour of Luxembourg Bank and Italian Bank should be treated as valid. Further, the liquidator asks the Congolese court to indicate how both pledges should be regarded as ranking against each other. To answer these questions, the insolvency court will have to determine the law governing the proprietary aspects of the transactions.

⁵³⁸ In that case, the pledge would have not lead to any change on the books of the European ICSD, California Sub-custodian, or the DTC. This would be the case under Chapter V of the Geneva Securities Convention (*see* chapter 2 of part II of this thesis).

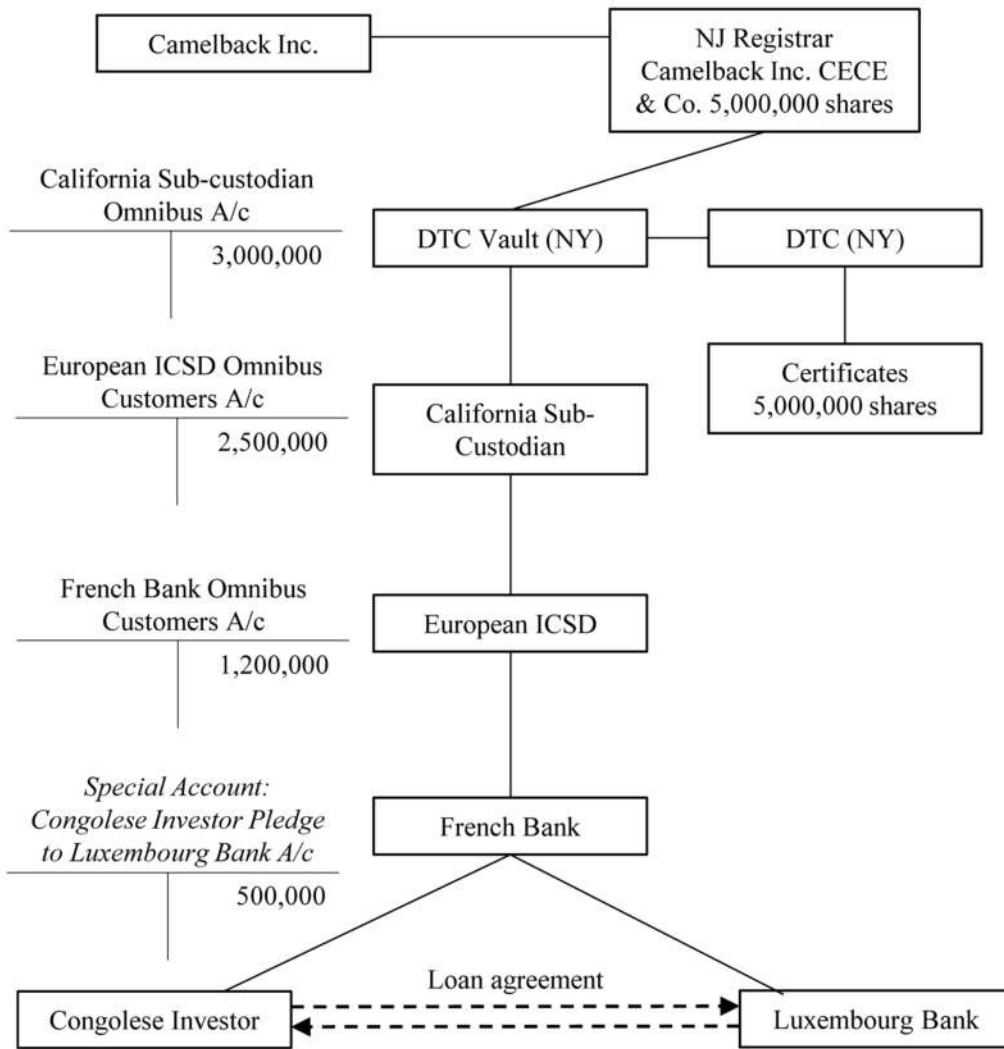


Figure 31: First Variation: Collateral Provider and Collateral Taker Hold through the Same Intermediary and Collateral Is Provided by way of Pledge

2. Solutions under Different Conflict of Laws Rules

a) Solution under PRIMA

If OHADA had adopted the PRIMA rule as applied under European Union law (Article 9 of the Settlement Finality Directive, Article 9 of the Financial Collateral Directive, and Article 24 of the Winding-Up Directive), in this fact pattern it would lead to the application of French law as the law of the place of French Bank, the intermediary on whose books the pledge in favour of Luxembourg Bank is recorded. French law will therefore determine if the pledges in favour of Luxembourg Bank and Italian Bank should be treated as valid and how both pledges should be regarded as ranking against each other. However, under PRIMA there may be some difficulty in ascertaining the location of the record of

the interests in the pledged securities, particularly if the recording is done through a computer network. In case the recording of an entitlement or transfer is done via a computer network which links the intermediary with an international network of different branches and several offices (which is often the case), there is no readily identifiable place of record. In the absence of a physical place or legislative guidance pointing to a notional one, it might not be possible to confirm with certainty the location of the account. It will be impossible for Luxembourg Bank, Italian Bank, or any other third party to determine with certainty the location of Congolese Investor's account with French Bank. Therefore, if the EU's PRIMA rule were adopted in the OHADA region, it would not provide legal certainty and predictability; the location of the account does not constitute an easily identifiable connecting factor to which third parties might reasonably look to determine the governing law.

b) Solution under the Primary Rule of the Hague Securities Convention

Assume the Hague Securities Convention is applicable in the OHADA region. Under Article 2(1) and 4(1) of the Hague Securities Convention and subject to the Qualifying Office requirement, whether the pledges in favour of Luxembourg Bank and Italian Bank should be treated as valid and how both pledges should be regarded as ranking against each other will be governed by the law in force in the State expressly agreed in the account agreement between Congolese Investor and French Bank as the State whose law governs the account agreement. Or, if the account agreement expressly provides that another law is applicable to all such issues, those two questions will be governed by that other law. It is important to underline that in this case, Luxembourg Bank, Italian Bank, or any other third party would be able to ascertain the applicable law by reference to the account agreement between Congolese Investor and French Bank. It is true that Article 147 of the Uniform Act on Security Interests does not impose on the collateral provider (in this case, Congolese Investor) a duty to divulge the choice of law made in the account agreement with its intermediary (in this case, French Bank). Nevertheless, there is no doubt that the collateral taker or any party treating with Congolese Investor can in practice request and obtain such an information. Hence, the Hague Securities Convention in this case provides greater legal certainty than the PRIMA rule in the context of the OHADA region.

c) Solution under the Law chosen in the Pledge Agreement

Under this solution, the applicable law will be the law the collateral provider and the collateral taker choose to govern the proprietary aspects of their transaction in the pledge agreement. However, this solution gives rise to severe practical difficulties. First, in this case there are two collateral agreements, each of which may contain a different choice of the applicable law.

Assume Congolese Investor and Luxembourg Bank have chosen Luxembourgian law whereas Congolese Investor and Italian Bank have chosen Italian law. Which law will be preferred in determining the validity of the pledges in favour of Luxembourg Bank and Italian Bank? How should both pledges be regarded as ranking against each other? Further, this solution would be difficult in practice because the intermediary (French Bank) would never accept proprietary aspects of a transaction that comes across its books being subject to just any law that Congolese Investor and its collateral taker might happen to choose in their collateral agreement. French Bank would suddenly have to be willing to have its activities and responsibilities subjected to almost any law in the world, which of course would be totally impractical.

II. Second Variation: Collateral Provider and Collateral Taker Hold through Different Intermediaries and Collateral Is Provided by way of Pledge

1. A Variation on the Fact Pattern

Say collateral taker (Luxembourg Bank) holds its interests in Camelback, Inc. securities not through French Bank but rather through Swiss Bank, which is incorporated in Switzerland and located in Zurich. On the books of European ICSD, Swiss Bank owns an account named “Swiss Bank Omnibus Customers Account” in which it maintains 100,000 Camelback, Inc. shares for its customers.

Assume that Congolese Investor asks for a loan from Luxembourg Bank. Under the Geneva Securities Convention, the Financial Collateral Directive, or the Uniform Commercial Code, Luxembourg Bank could require of Congolese Investor that it move its interests in respect of Camelback, Inc. shares to Swiss Bank, the pledge to be recorded on the books of Swiss Bank. For Luxembourg Bank, this transferring of shares to the books of an intermediary it trusts would help it avoid exposure to French Bank – more specifically, to the possible consequences of administrative error, wrongdoing, or insolvency of French Bank. Prior to executing the pledge, Congolese Investor’s interest with respect to the 500,000 Camelback, Inc. shares will therefore have been debited from “Congolese Investor Account” at French Bank and credited to “Congolese Investor Account” at Swiss Bank.⁵³⁹ However, under OHADA law, Congolese Investor will pledge its securities account containing the Camelback, Inc. shares to Luxembourg Bank under a pledge mechanism

⁵³⁹ In this case, there would be a transfer from French Bank to Swiss Bank of interests in respect of 500,000 Camelback, Inc. shares. On the books of European ICSD, this transfer furthermore would result in a debit to the “French Bank Omnibus Account” which will reduce the balance from 1,200,000 to 700,000. In addition, the transfer would result in a corresponding credit to the “Swiss Bank Omnibus Customers Account” which will increase the balance from 100,000 to 600,000.

pursuant to Article 146 et seq of the Uniform Act on Security Interests; and pursuant to Article 149 of the Uniform Act on Security Interests, the pledged securities account must take the form of a special account opened in the name of the account holder and maintained by the issuing legal entity or a financial intermediary (in this case, French Bank).

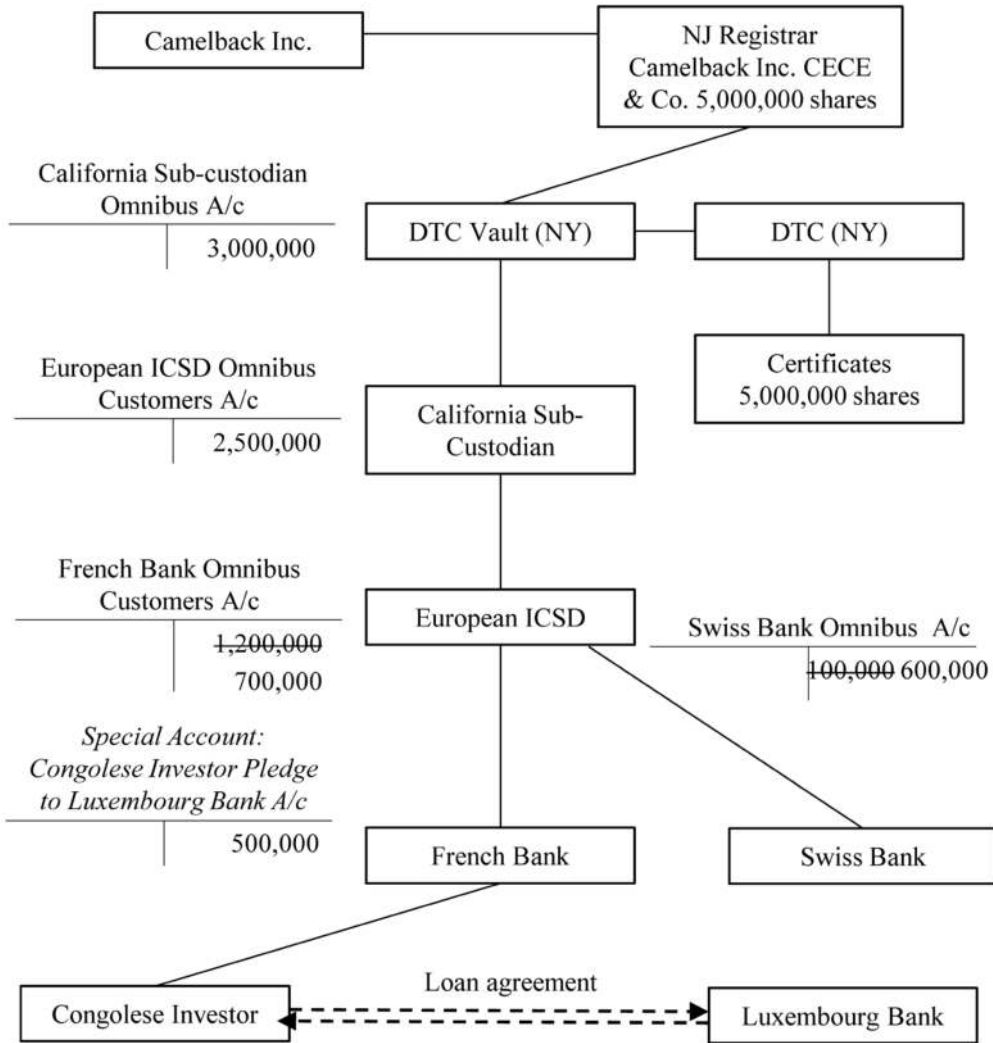


Figure 32: Second Variation: Collateral Provider and Collateral Taker Hold through Different Intermediaries and Collateral Is Provided by way of Pledge

After the pledge in favour of Luxembourg Bank, Congolese Investor pledges the same 500,000 Camelback, Inc. shares to Italian Bank. Congolese Investor then enters insolvency in the Democratic Republic of the Congo. The liquidator petitions the Congolese court to determine whether the pledges in favour of Luxembourg Bank and Italian Bank can be regarded as valid, and if both are both valid, to rule on how they should be regarded as ranking against each other.

2. *Solution under Different Conflict of Laws Rules*

a) *Solution under PRIMA*

For this second variation, Swiss law (as the law of the place of Swiss Bank, the intermediary on whose books the pledge in favour of Luxembourg Bank is recorded) would govern proprietary issues under PRIMA, including whether Luxembourg Bank received a perfect interest in respect of Camelback, Inc. shares. Swiss law would also determine whether Luxembourg Bank's interest has priority over Italian Bank's. However, PRIMA gives rise to severe difficulties in ascertaining the location of the record of the interest in the pledged securities under this second variation, particularly if the recording is done through a computer network. In such a case, there is no readily identifiable place of record; Luxembourg Bank, Italian Bank, or any other third party might not be able to determine with certainty the location of Congolese Investor's account with French Bank. Therefore, PRIMA does not provide legal certainty and predictability.

b) *Solution under the Primary Rule of the Hague Securities Convention*

As in the previous variation, whether the pledges in favour of Luxembourg Bank and Italian Bank should be treated as valid and how they should be regarded as ranking against each other will be governed by the law in force in the state Congolese Investor and French Bank expressly agree should govern the account agreement; or if the account agreement expressly provides that another law is applicable to all such issues, then that other law will govern (Article 2(1) and 4 of the Hague Securities Convention).⁵⁴⁰ In this case, too, it appears that the Hague Securities Convention provides greater certainty than PRIMA: Luxembourg Bank, Italian Bank, or any other third party will be able to ascertain the applicable law by reference to the account agreement between Congolese Investor and French Bank. Indeed, in practice, Luxembourg Bank, Italian Bank, or any party treating with Congolese Investor can easily request and obtain such an information.

c) *Solution under the Law chosen in the Pledge Agreement*

In this case, the governing law will be the law that the collateral provider and the collateral taker have chosen in their pledge agreement to govern the proprietary aspects of their transaction. However, assume that Congolese Investor and Luxembourg Bank choose Luxembourgian law to govern the contractual and the proprietary aspects of their pledge agreement whereas Congolese Investor and Italian Bank choose Italian law. If the two collateral agreements choose two different laws like this, it is impossible to determine which to

⁵⁴⁰ This solution is subject to the Qualifying Office requirement being met.

prefer over the other in determining whether the pledges in favour of Luxembourg Bank and Italian Bank should be treated as valid and how they should rank against each other. Further, as highlighted above, this solution would be impractical for French Bank, which would find its activities and responsibilities subjected to almost any law in the world that Congolese Investor and its collateral takers might choose. However, this solution could be acceptable if Congolese Investor and Luxembourg Bank were allowed to choose the law of the account agreement between Congolese Investor and French Bank as the law applicable to the proprietary aspects of their collateral agreement.

III. Third Variation: Collateral Taker and Collateral Provider Hold through Different Intermediaries and Collateral Is Provided by way of Title Transfer

1. Another Variation on the Fact Pattern

Assume the facts are the same as in the second variation, except that in return for a loan, Congolese Investor does not use a pledge mechanism under Articles 146 et seq of the OHADA Uniform Act on Security Interests but instead transfers to Luxembourg Bank title to its interest in the 500,000 Camelback, Inc. shares under a Luxembourgian law that controls transfer of title documentation. Pursuant to the title transfer agreement, Luxembourg Bank must return equivalent shares once the loan is repaid. Assume further that before the title transfer, Congolese Investor's interest in the Camelback, Inc. shares is recorded as a credit to the "Congolese Investor Account" on the books of its intermediary, French Bank. "Congolese Investor Account" on the books of French Bank is debited in the amount of 500,000 Camelback, Inc. shares, and "Luxembourg Bank Account" on the books of Luxembourg Bank's intermediary (Swiss Bank) is correspondingly credited. At the level of European ICSD, these transactions will also be reflected by (i) a debit to the "French Bank Omnibus Customers Account" that leads to a decrease of its interest in Camelback, Inc. from 1,200,000 to 700,000 shares and (ii) a corresponding credit to the "Swiss Bank Omnibus Customers Account", the balance of which increases from 100,000 to 600,000 shares of Camelback, Inc. None of these operations resulting from the pledge leads to any change on the books of California Sub-custodian or DTC.

In addition, assume that after signing the transfer-of-title documentation but before completing the transfer to Luxembourg Bank (which is accomplished though the appropriate book entries), Congolese Investor also pledges the same 500,000 Camelback, Inc. shares to Italian Bank. Congolese Investor and Italian Bank choose Italian substantive law to govern the pledge agreement, and the pledge under Italian law is valid. The title transfer in favour of Luxembourg Bank is completed after Congolese Investor enters into the second pledge agreement.

Finally, assume Congolese Investor then goes into insolvency in the Democratic Republic of the Congo. The liquidator asks the Congolese court to determine:

- (i) Whether the pledge in favour of Italian Bank should be treated as valid,
- (ii) Whether Luxembourg Bank should be treated as having acquired a valid and competent interest, and
- (iii) In case the answers to both (i) and (ii) are yes, whether the interest of Luxembourg Bank should be treated as subject to Italian Bank’s pledge.

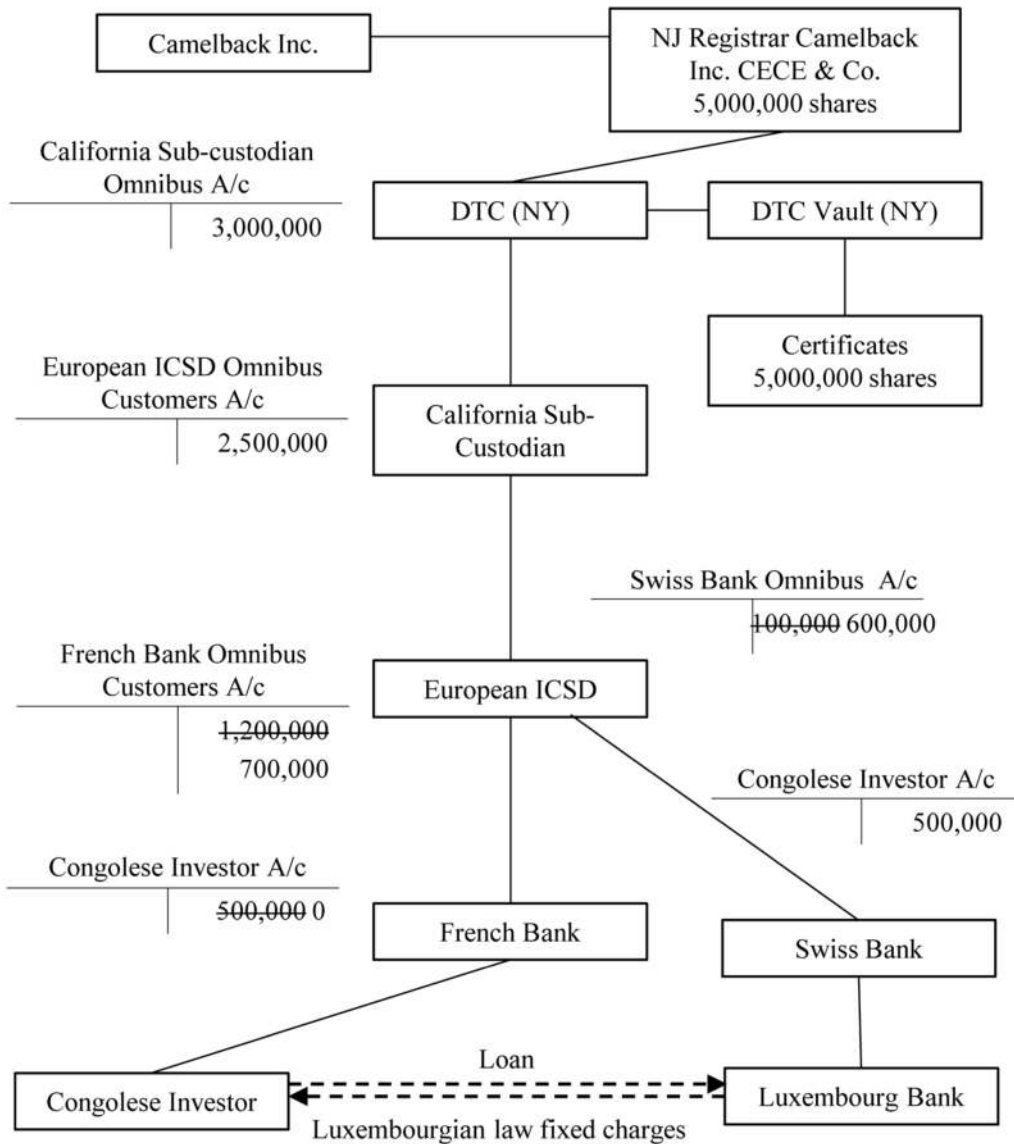


Figure 33: Third Variation: Collateral Taker and Collateral Provider Hold through Different Intermediaries and Collateral Is Provided by way of Title Transfer

It is important to note that under this variation of the fact pattern, Congolese Investor instructs its intermediary, French Bank, to transfer interests forming part of French Bank's pool of customer securities held through European ICSD to Swiss Bank's pool of customer securities, also held through European ICSD, Swiss Bank to credit Luxembourg Bank's account at Swiss Bank. Congolese Investor therefore ceases to have any interest in French Bank's pool of customer securities (the size of which is reduced); Luxembourg Bank receives an interest in Swiss Bank's pool of customer securities (the size of which is enlarged).

2. *Solutions under Different Conflict of Laws Rules*

a) *Solution under PRIMA*

Under PRIMA, the following laws will govern the proprietary aspects of the three stages of this transfer process:

- (i) Whether Luxembourg Bank acquires a valid interest in Swiss Bank's pool of customer securities is governed by Swiss law, which is the law of the place of Swiss Bank, the intermediary on whose books interests in that pool are recorded;
- (ii) Whether Congolese Investor's interest in French Bank's pool of customer securities is validly extinguished is governed by French law, which is the law of the place of French Bank, the intermediary on whose books Congolese Investor's interest is recorded;
- (iii) Whether the appropriate portion of French Bank's interest in European ICSD's pool of customer securities is validly transferred to Swiss Bank is governed by the law of the place of European ICSD, the intermediary on whose records French Bank and Swiss Bank's interests are recorded.

However, in such a complex situation it is even more difficult to ascertain the location of the record of the interest in the securities, particularly if the recording is done through a computer network.

b) *Solution under the Primary Rule of the Hague Securities Convention*

Under Articles 2(1) and 4 of the Hague Securities Convention, and subject to the Qualifying Office requirement, the following laws will apply:

- (i) The law chosen in the account agreement between Luxembourg Bank and Swiss Bank will govern whether Luxembourg Bank acquires a valid interest in Swiss Bank's pool of customer securities;
- (ii) The law chosen in the account agreement between Congolese Investor and French Bank will govern whether Congolese Investor's interest in French Bank's pool of customer securities is validly extinguished;

- (iii) The law chosen in the account agreement between French Bank and European ICSD will govern whether the appropriate portion of French Bank's interest in European ICSD's pool of customer securities is validly transferred to Swiss Bank.

IV. Fourth Variation: Collateral Provider Holds through Collateral Taker as Intermediary and Collateral Provided by way of Pledge

1. Another Variation on the Fact Pattern

In this last variation, Congolese Investor requests that its intermediary, French Bank, make the loan in return for a pledge of Congolese Investor's interest in Camelback, Inc. shares. Assume Congolese Investor indeed pledges its interest in 500,000 Camelback, Inc. shares to French Bank under a pledge pursuant to Article 146 et seq of the OHADA Uniform Act on Security Interests. As presented in the figure on the next page, on the books of French Bank the pledge results in a special account pursuant to Article 149 of the Act. The pledge leads to no changes on the books of European ICSD, California Sub-custodian, or DTC.

After making the pledge in favour of French Bank, Congolese Investor also enters into an agreement with Italian Bank on the same 500,000 Camelback, Inc. shares. Congolese Investor then enters insolvency in the Democratic Republic of the Congo. The liquidator asks the Congolese court to determine whether the pledges in favour of French Bank and Italian Bank are both to be regarded as valid and, if so, how they should be treated as ranking against each other.

2. Solution under Different Conflict of Laws Rules

a) Solution under PRIMA

In this fourth variation on the initial fact pattern, French law (as the law of the place of French Bank, the intermediary on whose books the interest of French Bank is recorded) would govern proprietary issues, including whether French Bank obtained a perfected pledge of Congolese Investor's interest in Camelback, Inc. French law would also apply to whether French Bank has priority over Italian Bank's interest. It is important to note that since French Bank acts as both intermediary and collateral taker, the record of the pledge in favour of French Bank is made on its own books. However, and as in the previous variations, if the recording is done through a computer network, it may be difficult even for French Bank to determine the specific location of the record of the interest in the securities. *A fortiori*, it will be even more difficult for Italian Bank or any other party to determine with enough predictability and certainty the location of the record of the interest in the securities.

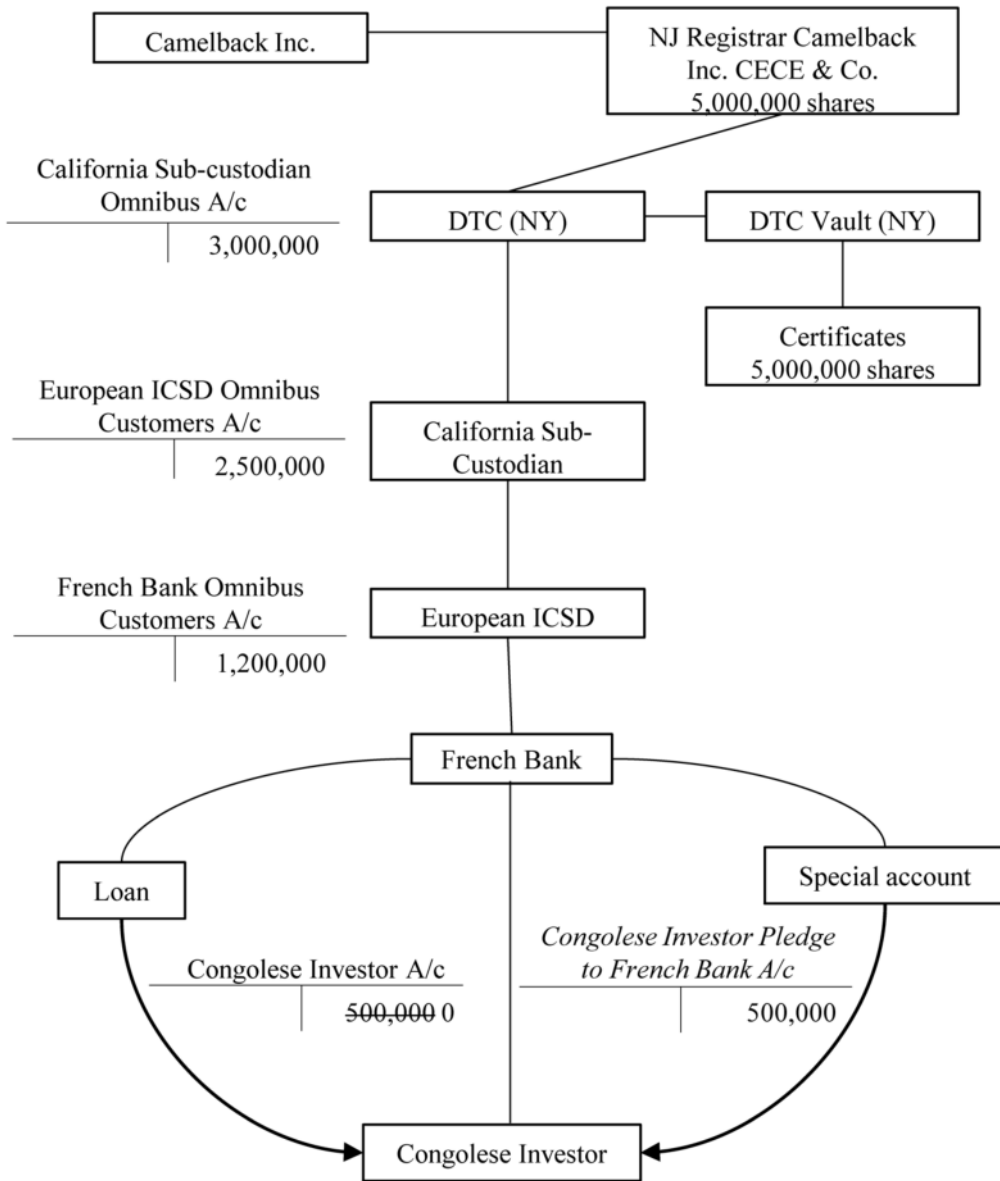


Figure 34: Fourth Variation: Collateral Provider Holds through Collateral Taker as Intermediary and Collateral Is Provided by way of Pledge

b) Solution under the Primary Rule of the Hague Securities Convention

Under Articles 2(1) and 4 of the Hague Securities Convention, and subject to the Qualifying Office requirement, whether the pledges in favour of French Bank and Italian Bank should be treated as valid and how they should be regarded as ranking against each other will be governed by the law in force in the state Congolese Investor and French Bank expressly agree on to govern the account agreement; or, if the account agreement expressly provides that another law is applicable to all such issues, then by that other law. The prima-

ry rule of the Hague Securities Convention allows Italian Bank and any other third party to ascertain the applicable law by reference to the account agreement between Congolese Investor and French Bank. Hence, in this variation also, the Hague Securities Convention provides greater legal certainty and predictability.

c) Solution under the Law chosen in the Pledge Agreement

Under this solution, the applicable law will be the law Congolese Investor and French Bank choose in their pledge agreement to govern the proprietary aspects of their transaction. However, this solution leads to more difficulties since the choice of law made by Congolese Investor and French Bank (French law, for example) may be different from that made by Congolese Investor and Italian Bank (Italian law, for instance). Which choice of law would be upheld over the other? Furthermore, while it is true that since French Bank is both intermediary and collateral taker, it may accept having its operations and responsibilities subjected to a law it chooses with Congolese Investor. However, it is important to recall that under the OHADA Uniform Act on Security Interests, no registration is required in order to constitute a pledge of a securities account; the only publicity measure contemplated in the Act is the declaration of pledge (Article 147). But the declaration of pledge is still not published and does not mention the law chosen by the collateral provider and the collateral taker. Therefore, in this variation, neither Italian Bank nor any other third party would be able to determine in advance the law French Bank and Congolese Investor choose to apply to the security interests in the securities. Consequently, this solution does not offer enough legal certainty and predictability.

C. Summary and Evaluation

1. Though different variations and fact patterns, this chapter has attempted to concretely lay out the advantages and disadvantages of these conflict of laws rules to identify the best (system of) connecting factor(s) to determine the law applicable to security interests in intermediated securities in the OHADA region.
2. Of all the conflict of laws rules examined, this thesis reaches the conclusion that the rules of the Hague Securities Convention provide the most legal certainty and predictability, particularly if the applicable law is determined by reference to the collateral provider's intermediary (which is in line with the OHADA substantive law provisions on pledges of intermediated securities).
3. In the various fact patterns, it appears that under PRIMA there may be some difficulty in ascertaining the location of the record of the interest in the pledged securities, particularly if the recording is accomplished

through a computer network, which is very often the case. A choice of law made by the collateral provider and the collateral taker gives rise to severe practical difficulties, the most important of which is that the intermediary would never accept proprietary aspects of a transaction coming across its books being subject to just any law the collateral provider and taker may happen to choose.

General Conclusion

“Das Wesen der Papiere auf den Inhaber wurde [...] darin gesetzt, daß das Recht des Glaubigers gebunden seyn solle nicht (wie bei anderen Obligationen) an eine bestimmte Person, sondern an ein gewisses Verhältnis irgend einer Person zu dem Papier, der Urkunde.”¹

In the middle of the nineteenth century, *Savigny* regarded the embodiment of a right in a certificate that may be owned or possessed as the foundation not only of the concept but also of the law of securities. Nearly two centuries later, however, commercial developments in the global financial markets and in the OHADA region in particular have led to a significant reduction in the traditional physical delivery of securities certificates. Indeed, with the dematerialisation (*Entmaterialisierung*) of securities certificates, title is no longer rooted either in a piece of paper or in the company’s register. Instead it is an electronic book entry on the books of a central operator. Securities transactions are settled through electronic book-entry transfers between securities accounts. Moreover, the immobilisation of securities means a global note representing the entire issue of securities is then held by a central depository which in turn holds for one or more intermediaries, who then hold either for other intermediaries or for investors. In such an *indirect holding system*, one or more intermediaries stand between the investor and the issuer.

Although the indirect holding system has helped increase the breadth and depth of participation in the global securities markets in the OHADA region, it has also multiplied legal uncertainty as it allows divergent applicable laws to come into play within the same system of securities holding. Under the law of all the jurisdictions within the OHADA region, the traditional conflict of laws rule for determining the enforceability of a pledge of securities effected through the indirect holding system is the *lex rei sitae* (or the *lex cartae sitae* or the *lex situs*) rule. However, the traditional *lex rei sitae* cannot apply in a satisfactory way to a system in which dematerialised securities are held

¹ “The character of the certificates in respect of the owner is based on the fact that the right of the creditor should not be bound (contrary to other obligations) to a particular person but to a certain relationship of a person to the certificate” (Friedrich Karl von Savigny, *Das Obligationenrecht als Teil des heutigen römischen Rechts*, Bd. 2 (1853, Neudruck 1973) § 66 at 130).

through multiple tiers of intermediaries located in different jurisdictions; they have no specific *situs*. Any attempt to apply the traditional *lex rei sitae* rule to indirect holding systems would require an approach that “looks through” the tiers of intermediaries up to the level of the issuer, the register, or the actual certificates. Such an approach gives rise to severe difficulties. Particularly if securities are held through fungible accounts (omnibus accounts), there is indeed no record of an investor’s interest in the securities at the level of the issuer’s register or at that of any intermediary other than the immediate intermediary, that is, the one with whom the investor has a direct relationship.

Consequently, under the current conflict of laws rules in the jurisdictions of the OHADA region, a collateral taker finds itself exposed to a legal risk in that the adjudicating forum might select an unexpected legal regime to determine the validity of the collateral interest in the intermediated securities. Yet efficient and safe markets require that in the event of a dispute, those taking collateral interests in intermediated securities be able to ascertain, speedily and with certainty, the law which governs their transactions. As long as the legal risks related to determining the law applicable to certain rights in intermediated securities are not addressed in the OHADA region, the intermediary system and the collateralisation of intermediated securities there will continue to operate in somewhat murky legal waters, resulting in more instability for the financial markets.

Hence, given the deficiencies of the *lex rei sitae* rule and the “look through approach” described above, this thesis has aimed to find an appropriate and uniform approach which reflects the reality of the indirect holding system in the OHADA region. This thesis has also explored an alternative approach: the “place of the relevant intermediary” (PRIMA) rule, under which the governing law is that of the jurisdiction of the intermediary on whose accounts the disputed interest is recorded (Article 9(2) of the Settlement Finality Directive, Article 9(1) of the Financial Collateral Directive and Article 24 of the Winding-up Directive). The PRIMA rule offers the advantage of submitting all an account holder’s interests in a securities portfolio to the law of a single jurisdiction. Moreover, from an OHADA perspective, the appeal of the PRIMA rule is that it seems to be in line with the traditional conflict of laws principles of the Member States, in particular the aforementioned *lex rei sitae* rule. Indeed, based on the concept that the applicable law is determined by the location of the property, the PRIMA rule merely shifts the identification of the relevant property from the underlying securities to the securities account.

However, the PRIMA rule gives rise to a severe difficulty: there is no criterion which could be generally acceptable for all types of securities and all categories of intermediaries globally that would enable participants to determine, beyond doubt, which office of an intermediary maintains a specific account or would count as the location of a securities account. Indeed, a securities account is a legal relationship between two entities, and legal relation-

ships simply do not have a location. Consequently, it is not possible to speak of the location of an “account” or even of where it is “maintained”. In addition, in modern global trading some or even all the functions pertaining to maintaining and servicing a securities account are undertaken from more than one office or even outsourced to third parties in different locations. Therefore, any attempt to “localise” the securities account or the place where it is maintained would give rise to more legal uncertainty. In light of these difficulties, this thesis submits that the PRIMA rule, as currently embodied in the EU’s Settlement Finality Directive, Winding-up Directive, and Financial Collateral Directive, is fundamentally flawed because it reflects a misconception of today’s financial markets’ reality.

Against this backdrop, this thesis has explored the conflict of laws rules enshrined in the Hague Securities Convention, which are divided into two components: a “primary rule” (found in Article 4) and a set of “fall-back rules” (found in Article 5). This cascade of rules adheres quite closely the sets of rules laid out in UCC § 8-110(e). Article 4 of the Hague Securities Convention provides that the law governing rights in intermediated securities is the law chosen by the account holder and its intermediary in the account agreement between them. The choice may be expressed in either of two ways: If the parties expressly choose a law that will generally apply to their account agreement (a general governing clause), that law will also apply to all the Article 2(1) issues. And in case the account holder and its relevant intermediary expressly choose a law to apply to all the specific issues mentioned in Article 2(1), then that law will govern all these issues. This, the primary rule of the Convention, is not based on an attempt to “locate” a securities account, the office at which it is maintained, the intermediary, the issuer, or the underlying securities. The primary rule of the Hague Securities Convention is based instead on the *relationship between an account holder and its intermediary*. It looks to the law in force in the jurisdiction expressly chosen in the agreement between the investor and the intermediary to govern either the issues falling within the scope of the Convention or the account where the securities are held.

It may seem that this consensual approach embodied in Article 4 of the Hague Securities Convention would have severe implications for long-standing private international law traditions of the OHADA Member States, which to some extent limit party autonomy, particularly in situations where there are issues of property rights and interests of third parties. In such jurisdictions, choice of law clauses are enforced only if they lead to the application of the law of a place where the property may conceivably be considered to be located. Nonetheless, the Convention imposes a Qualifying Office requirement, and it is submitted that the requirement addresses this concern. Indeed, the Convention does not validate literally any choice of law the parties to a securities account agreement might happen to make; it requires some

minimal connection between the intermediary and the governing law they choose. Their choice applies only if the relevant intermediary has an office (a “Qualifying Office”) in the state whose law is selected at the time the parties agree on a governing law. Satisfying the Qualifying Office requirement necessitates more than a mere agency presence; if the physical presence lacks a true function in maintaining securities accounts, the Qualifying Office test would not be met. That is, the office must serve certain functions related to maintaining securities accounts or must be identified by some specific means as maintaining securities accounts in the state. Either way, the particular account in question need not be among the accounts it maintains there.

In comparison with the EU’s current PRIMA rule, the Hague Securities Convention would also seem to lack transparency. This is because it would be difficult for third parties to ascertain or discover what law the account holder and its intermediary have chosen. Indeed, the primary rule of the Hague Securities Convention does not render account agreements public documents. And following this same rationale, it seems that the EU’s rules often allow the law to be ascertained, in contrast, from objective facts that do not require excessive enquiry. However, it is submitted that this critique of the primary rule of the Hague Securities Convention is not convincing, because third parties (such as collateral takers) seeking to gain an interest in intermediated securities already need to acquire certain information about the existence and location of the securities account. Under the Hague Securities Convention (or even the EU’s PRIMA rule), such third parties will also need to know what law the account holder and its intermediary chose in the account agreement. The need to obtain such additional information in order to work with the rule would not constitute a significant change in the OHADA region since the cooperation of the account holder and its intermediary is always necessary in financial transactions. In practice, whether under the EU’s current PRIMA rule or the Hague Securities Convention, third parties willing to acquire a security interest or proprietary rights in the intermediated securities will always request information about what law applies to them. Other third parties, such as ordinary public and private creditors seeking to attach securities to enforce a debt, may have had no prior dealings with the account holder. A competent authority or a creditor seeking to attach securities will generally need to establish the existence of the securities holding and the jurisdiction to which it is subject. Under the EU’s current PRIMA rule, such a creditor would also need to know the location of the debtor’s securities account. The Hague Securities Convention does not significantly alter this situation: the crux of the issue is that determining the location of a securities account normally requires the cooperation of the account holder, the intermediary, or both. A competent authority needing to enforce the attachment will usually approach the intermediary to obtain certain information and block the securities account. Consequently, an attaching creditor’s current situation will not

be materially compromised by the need to acquire a single piece of additional information, *i.e.*, what law the intermediary and the account holder chose in their account agreement.

In conclusion, this thesis submits that, compared to other conflict of laws rules, the Hague Securities Convention would offer greater legal certainty and predictability in determining what law governs proprietary rights in security interests in intermediated securities under OHADA law. This brings up four different options that may be envisaged regarding how the rules enshrined in the Hague Securities Convention could apply in the OHADA region. The first and by far the most satisfactory option is for OHADA to accede to the Hague Securities Convention. However, there is no provision in the OHADA Treaty which addresses the competence of OHADA to join an international treaty. Furthermore, as of January 2021 OHADA has not acceded to any international conventions. But Article 18(1) of the Hague Securities Convention nevertheless provides that a regional economic integration organisation (REIO) constituted by sovereign states and granted competence over certain matters governed by the Convention may similarly sign, accept, approve, or accede to the Convention. OHADA, being constituted by western and central African sovereign states, is indeed a REIO to which its Member States have transferred part of their legislative sovereignty. But Article 2 of the OHADA Treaty (which lists the areas falling within the harmonisation competence of OHADA) does not mention “conflict of laws rules” or “private international law”, and consequently it might seem that, for the purpose of Article 18(1) of the Hague Securities Convention, OHADA does not have competence over conflict of laws issues, neither in general nor in respect of intermediated securities. However, most of the Uniform Acts, such as the Uniform Act on General Commercial Law and the Uniform Act on Arbitration Law, encompass conflict of laws provisions. Thus, it is submitted that the rationale of the OHADA legislator is that the competence to unify a legal area also entails the competence to legislate on the conflict of laws issues that may arise in respect thereof. Based on that rationale, it is worth noting that Article 2 of the OHADA Treaty includes issues mentioned in Article 2(1) of the Hague Securities Convention: company law and securities law (Articles 2(1)(a), (b), (d), (e) and (g)) and the law of security interests (Articles 2(1)(c) and (f)). It follows that OHADA has competence to regulate any conflict of laws issues related thereto and, consequently, to accede to the Hague Securities Convention pursuant to Article 18(1) of the Convention.

The second option would be for the OHADA Member States to individually accede to the Hague Securities Convention. However, since each country might accede to the Convention at different times, this solution might lead to more legal uncertainty; at some point, the Convention would be applicable in some Member States and not in others. This difficulty is illustrated by the Member States’ experience implementing the criminal sanctions contemplat-

ed in the Uniform Acts. Though most of the Uniform Acts encompass and define criminal offenses, criminal law is considered to be closely linked to the sovereignty of the Member States; and the OHADA Treaty therefore provides that determining criminal sanctions for these offenses is left for each Member State to regulate in a domestic act. Unfortunately, as of January 2021, Senegal is the only Member State which has enacted criminal sanctions in line with Article 5 of the OHADA Treaty. If acceding to the Hague Securities Convention is left to each Member State, it would thus appear inevitable that the Convention at some point would apply in some Member States and not in others. This will result in even more legal uncertainty within the OHADA region.

A third option is for the Council of Ministers to revise the Uniform Act on Security Interests to add new conflict of laws provisions in respect of pledges of securities accounts. These rules could be modelled on those of the Hague Securities Convention. The disadvantage of this option, however, is that the rules thereby adopted would be restricted to pledges of securities accounts. Other issues contemplated in Article 2(1) of the Hague Securities Convention (and which could arise in the OHADA region) would not be ameliorated under these rules. Therefore, as a fourth option, the Council of Ministers could simply adopt the rules of the Hague Securities Convention as a new “Uniform Act on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary” (*see* Appendix C). Adoption of the rules of the Hague Securities Convention as a domestic legislative text went through in Mauritius even before the Hague Securities Convention entered into force. Similarly, the Hague Securities Convention was incorporated into the Swiss Private International Law Act through a new Article 108c which referred directly to the Hague Securities Convention in order to determine the law applicable to rights in intermediated securities. More particularly, Article 108c of the Swiss Private International Law Act allowed the direct application of the Hague Securities Convention as national law in Switzerland even before the Convention entered into force at the international level. In the case of OHADA, the adoption of the rules of the Hague Securities Convention in the form of a Uniform Act would ensure that they will be directly applicable and overriding in all the Member States pursuant to Article 10 of the OHADA Treaty. Moreover, this option would allow the rules of the Hague Securities Convention to apply to issues beyond security interests in intermediated securities which are contemplated under Article 2(1) of the Hague Securities Convention. But since modern financial markets and the issues the Hague Securities Convention addresses are both global in scope, acceding to the Hague Securities Convention as an international instrument (the first option) is by far the most satisfactory option in order to ensure more legal certainty and predictability in the OHADA region.

Appendix

A. Indicative List of the Travaux Préparatoires for the Financial Collateral Directive

1. European Commission, 'Financial Services: Implementing the Framework for Financial Markets: Action Plan', Communication of the Commission, COM(1999) 232, 11 May 1999.
2. European Commission (Internal Markets DG, Financial Services, Financial Transactions and Payment Securities), 'Working Document on Collateral from the Commission to Relevant Bodies for Consultation – First Preliminary Draft Proposal for a Directive' C4/PN D (2000), Brussels (15 June 2000).
This initial consultation paper from the Commission included as appendices:
 - (i) A draft proposal of legislative provisions to be included in a Directive;
 - (ii) A Mission Statement of the Forum Group on Collateral; and
 - (iii) A list of its Members.These following six papers were also included as annexes:
 - (i) 'Position Paper on the Taking of Securities as Collateral in the European Union' by Guy Morton and Richard Potok (Annex A) (13 December 1999);
 - (ii) 'Securities Collateral: Security Interest Structure and "Rights of Use" by Guy Morton and Richard Potok (Annex B) (28 January 2000);
 - (iii) 'Types of Collateral/Assets into the Scope of the Exercise. Real Estate' by Robert Vikstrom (Annex C) (12 September 1999);
 - (iv) 'Note on "Netting"' by Guy Morton (Annex D) (20 March 2000);
 - (v) 'Position Paper on How Cash Could be Covered by the Directive' by Mrs Araceli Leyva Leon (Annex E) (26 January 2000);
 - (vi) 'Proposal for an EU Directive on Collateralisation' by the European Financial Market Lawyers Group (Annex F) (June 2000).
3. Proposal for a Directive of the European Parliament and the Council on Financial Collateral Arrangements / *COM/2001/0168 final – COD 2001/0086* / Official Journal 180 E, 26 June 2001, 312–318.
4. Proposal for a Directive of the European Parliament and of the Council on Financial Collateral Arrangements / *COM/2001/0168 final – COD 2001/0086*/ Explanatory Memorandum.
5. Opinion of the European Central Bank of 13 June 2001 at the Request of the Council of the European Union Concerning a Proposal for a Directive of the European Parliament and of the Council on Financial Collateral Arrangements (CON/2001/13) OJ C 196, 12 July 2001, 10–13.
6. Report on the Proposal for a European Parliament and Council Directive on Financial Collateral Arrangements (COM(2001) 168 C5-0131/2001 2001/0086(COD)). Committee on Economic and Monetary Affairs, 23 November 2001.

7. Opinion of the Economic and Social Committee on the ‘Proposal for a Directive of the European Parliament and of the Council on Financial Collateral Arrangements’, OJ C 48, 21 February 2002, 1–3.
8. Common Position (EC) n° 32/2002 of 5 March 2002 adopted by the Council, Acting in Accordance with the Procedure Referred to in Article 251 of the Treaty Establishing the European Community, with a View to Adopting a Directive of the European Parliament and of the Council on Financial Collateral Arrangements. OJ C 119E, 22 May 2002, 12–26.
9. Recommendation for Second Reading on the Council Common Position for Adopting a European Parliament and Council Directive on Financial Collateral Arrangements (5530/3/2002 C5-0116/2002 2001/0086(COD)). Committee on Economic and Monetary Affairs, 24 April 2002.

B. Indicative List of the Travaux Préparatoires for Directive 2009/44/EC of 6 May 2009

1. European Commission, 'Report from the Commission to the Council and the European Parliament: Evaluation Report on the Financial Collateral Arrangements Directive (2002/47/EC)', COM(2006) 833 final, Brussels (20 December 2006).
2. Opinion of the European Economic and Social Committee on the Directive of the European Parliament and the Council Amending Directive 98/26/EC on Settlement Finality in Payment and Securities Settlement Systems and Directive 2002/47/EC on Financial Collateral Arrangements as Regards Linked Systems and Credit Claims, OJ C 175, 28 July 2009, 78-80.
3. Opinion of the European Central Bank of 7 August 2008 on a Proposal for a Directive Amending Directive 98/26/EC and Directive 2002/47/EC (CON/2008/37), OJ C 216, 23 August 2008, 1-11.
4. 2938th Council Meeting, General Affairs and External Relations, General Affairs, Luxembourg, 27 April 2009, European Press Release – PRES/09/97 27 April 2009.
5. Proposal for a Directive of the European Parliament and of the Council Amending Directive 98/26/EC on Settlement Finality in Payment and Securities Settlement Systems and Directive 2002/47/EC on Financial Collateral Arrangements as Regards Linked Systems and Credit Claims (SEC(2008) 491) (SEC(2008) 492)) / *COM/2008/0213 final – COD 2008/0082* / Brussels, 23 April 2008.
6. Commission Staff Working Document Accompanying the Proposal for a Directive of the European Parliament and of the Council Amending the Settlement Finality Directive and the Financial Collateral Directive – Impact Assessment (COM(2008) 213 final SEC(2008) 492) / *SEC/2008/0491 final*/ Brussels, 23 April 2008.
7. Commission Staff Working Documents – Executive Summary to the Impact Assessment Accompanying the Proposal for a Directive of the European Parliament and of the Council Amending the Directive 98/26/Econ settlement Finality in Payment and Securities Settlement Systems and Directive 2002/47/EC on Financial Collateral Arrangements as Regards Linked Systems and Credit Claims (COM(2008) 213 final SEC(2008) 491) / *SEC/2008/0492 final.
8. 2984th Council Meeting, Economic and Financial Affairs, Luxembourg, 7 October 2008, European Council Press Release – PRES/08/279 07 October 2008.
9. Proposal for a Directive of the European Parliament and the Council Amending Directive 98/26/EC on Settlement Finality in Payment and Securities Settlement Systems and Directive 2002/47/EC on Financial Collateral Arrangements as Regards Linked Systems and Credit Claims – Revised Presidency Compromise ST 11968 2008 REV 2, Council of the European Union, Brussels, 10 September 2008.
10. Report on the Proposal for a Directive of the European Parliament and of the Council Amending Directive 98/26/EC on Settlement Finality in Payment and Securities Settlement Systems and Directive 2002/47/EC on Financial Collateral Arrangements as Regards Linked Systems and Credit Claims (COM(2008) 213 – C6 – 0181/2008 – 2008/0082(COD)), Committee on Economic and Monetary Affairs, 5 December 2008.

C. Proposal of a Uniform Act on the Law Applicable to Certain Rights in Respect of Securities held with an Intermediary

English version

French version

Chapter I – Definitions and scope of application

Chapitre I – Définitions et champ d'application

Article 1

Article 1

Definitions and interpretation

Définitions et interprétation

(1) In this Uniform Act –

1. Dans le présent Acte uniforme :

a) “securities” means any shares, bonds or other financial instruments or financial assets (other than cash), or any interest therein;¹

a) « titres » désigne toutes actions, obligations ou autres instruments financiers ou actifs financiers (autres que des espèces), ou tout droit sur ces titres ;

b) “securities account” means an account maintained by an intermediary to which securities may be credited or debited;²

b) « compte de titres » désigne un compte tenu par un intermédiaire sur lequel des titres peuvent être crédités ou duquel des titres peuvent être débités ;

c) “intermediary” means a person that in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity;³

c) « intermédiaire » désigne toute personne qui, dans le cadre de son activité professionnelle ou à titre habituel, tient des comptes de titres pour autrui ou tant pour autrui que pour compte propre, et agit en cette qualité ;

d) “account holder” means a person in whose name an intermediary maintains a securities account;

d) « titulaire de compte » désigne la personne au nom de laquelle un intermédiaire tient un compte de titres ;

e) “account agreement” means, in relation to a securities account, the agreement with

e) « convention de compte » désigne, pour un compte de titres, la convention avec

¹ This definition of the term “securities” is in line with the provisions of the Uniform Act on Commercial Companies, the Uniform on Security Interests, and the Uniform Act on Bankruptcy.

² The Uniform Act on Security Interests uses the term “securities account” (Articles 146, 147, 148, 149, 150, 151, 152, 153, 154, and 155) without providing with a definition thereof. The definition in Article 1(b) of the Hague Securities Convention is in line with Article 2 of Act n°2014/007 and would complement the provisions of the Uniform Act on Commercial Companies and the Uniform Act on Security Interests.

³ The Uniform Act on Commercial Companies uses the term “intermediary” (Articles 81-2, 81-3, 83, 85, 93, 650, and 831-1); however, it does not provide a definition thereof. The definition in Article 1(c) of the Hague Securities Convention would complement the provisions of the Uniform Act on Commercial Companies and the Uniform Act on Security Interests.

the relevant intermediary governing that securities account;

f) “securities held with an intermediary” means the rights of an account holder resulting from a credit of securities to a securities account;⁴

g) “relevant intermediary” means the intermediary that maintains the securities account for the account holder;

h) “disposition” means any transfer of title whether outright or by way of security⁵ and any grant of a security interest, whether possessory or non-possessory;

i) “perfection” means completion of any steps necessary to render a disposition effective against persons who are not parties to that disposition;

j) “office” means, in relation to an intermediary, a place of business at which any of the activities of the intermediary are carried on, excluding a place of business which is intended to be merely temporary and a place of business of any person other than the intermediary;

k) “insolvency proceeding” means a collective judicial or administrative proceeding, including an interim proceeding, in which the assets and affairs of the debtor are subject to control or supervision by a court or other competent authority for the purpose of reorganisation or liquidation;⁶

l) “insolvency administrator” means a person authorised to administer a reorganisation or liquidation, including one author-

l’intermédiaire pertinent régissant ce compte de titres ;

f) « titres détenus auprès d’un intermédiaire » désigne les droits d’un titulaire de compte résultant du crédit de titres à un compte de titres ;

g) « intermédiaire pertinent » désigne l’intermédiaire qui tient le compte de titres pour le titulaire de compte ;

h) « transfert » désigne tout transfert de propriété, pur et simple ou à titre de garantie, ainsi que toute constitution de sûreté, avec ou sans dépossession ;

i) « opposabilité » désigne l’accomplissement de toute formalité nécessaire en vue d’assurer le plein effet d’un transfert envers toute personne qui n’est pas partie à ce transfert ;

j) « établissement » désigne, par rapport à un intermédiaire, un lieu d’activité professionnelle où l’une des activités de l’intermédiaire est exercée, à l’exclusion d’un lieu destiné à l’exercice purement temporaire d’activités professionnelles et d’un lieu d’activité de toute personne autre que l’intermédiaire ;

k) « procédure d’insolvabilité » désigne une procédure collective judiciaire ou administrative, y compris une procédure provisoire, dans laquelle les actifs et les activités du débiteur sont soumis au contrôle ou à la supervision d’un tribunal ou d’une autre autorité compétente aux fins de redressement ou de liquidation ;

l) « administrateur d’insolvabilité » désigne une personne qui est autorisée à administrer une procédure de redressement ou de liqui-

⁴ There is not definition of the term “securities held with an intermediary” or “intermediated securities” under OHADA law. A definition can be found in Article 2 of Act n° 2014/007 which is in line with that found in Article 2(f) of the Hague Securities Convention.

⁵ Since there is no provision under OHADA law on the transfer of title by way of security, it may be submitted that this provision may be omitted from the proposed Uniform Act.

⁶ This provision would not be contrary to the definitions enshrined in Article 1-3 of the Uniform Act on Bankruptcy.

ised on an interim basis, and includes a debtor in possession if permitted by the applicable insolvency law;

m) “Multi-unit State” means a State within which two or more territorial units of that State, or both the State and one or more of its territorial units, have their own rules of law in respect of any of the issues specified in Article 2(1);⁷

n) “writing” and “written” mean a record of information (including information communicated by teletransmission) which is in tangible or other form and is capable of being reproduced in tangible form on a subsequent occasion.

(2) References in this Uniform Act to a disposition of securities held with an intermediary include –

a) a disposition of a securities account;

b) a disposition in favour of the account holder’s intermediary;

c) a lien by operation of law in favour of the account holder’s intermediary in respect of any claim arising in connection with the maintenance and operation of a securities account.

(3) A person shall not be considered an intermediary for the purposes of this Uniform Act merely because –

a) it acts as registrar or transfer agent for an issuer of securities; or

b) it records in its own books details of securities credited to securities accounts maintained by an intermediary in the names of other persons for whom it acts as manager or agent or otherwise in a purely administrative capacity.

dation, y compris à titre provisoire, et comprend un débiteur non dessaisi si la loi applicable en matière d’insolvabilité le permet ;

m) « Etat à plusieurs unités » désigne un Etat dans lequel deux ou plusieurs unités territoriales de cet Etat ou cet Etat et une ou plusieurs de ses unités territoriales ont leurs propres règles de droit se rapportant aux questions mentionnées à l’Article 2(1) ;

n) « écrit » désigne une information (y compris celle transmise par télécommunication) qui se présente sur un support matériel ou sous une autre forme de support, qui peut être reproduite ultérieurement sur un support matériel.

2. Toute référence dans le présent Acte uniforme à un transfert de titres détenus auprès d’un intermédiaire comprend :

a) un transfert ayant comme objet un compte de titres ;

b) un transfert en faveur de l’intermédiaire du titulaire de compte ;

c) un privilège légal en faveur de l’intermédiaire du titulaire de compte relatif à toute créance née en relation avec la tenue et le fonctionnement d’un compte de titres.

3. Une personne n’est pas considérée comme intermédiaire au sens de la présente Convention pour la seule raison :

a) qu’elle agit en tant qu’agent de registre ou de transfert d’un émetteur de titres ; ou

b) qu’elle tient dans ses propres livres des écritures portant sur des titres inscrits en compte de titres tenu par un intermédiaire au nom d’autres personnes pour lesquelles elle agit comme gestionnaire, agent ou autrement dans une qualité purement administrative.

⁷ It is important to underscore that the term “multi-unit state” is not used in any Uniform Act under OHADA law. However, the suggested provision would ensure legal certainty in cases involving states within which two or more territorial units, or both the state and one or more of its territorial units, have their own rules of law in respect of any of the issues addressed by the suggested Uniform Act.

(4) Subject to paragraph (5), a person shall be regarded as an intermediary for the purposes of this Uniform Act in relation to securities which are credited to securities accounts which it maintains in the capacity of a central securities depository or which are otherwise transferable by book entry across securities accounts which it maintains.

(5) In relation to securities which are credited to securities accounts maintained by a person in the capacity of operator of a system for the holding and transfer of such securities on records of the issuer or other records which constitute the primary record of entitlement to them as against the issuer, the Member State under whose law those securities are constituted may, at any time, make a declaration that⁸ the person which operates that system shall not be an intermediary for the purposes of this Uniform Act.

Article 2

Scope of the Uniform Act and of the applicable law⁹

(1) This Uniform Act determines the law applicable to the following issues in respect of securities held with an intermediary –

- a) the legal nature and effects against the intermediary and third parties of the rights resulting from a credit of securities to a securities account;
- b) the legal nature and effects against the intermediary and third parties of a disposition of securities held with an intermediary;

4. Sous réserve du paragraphe 5, une personne est considérée, au sens du présent Acte uniforme, comme intermédiaire pour des titres inscrits en compte de titres qu'elle tient en qualité de dépositaire central de titres ou qui sont autrement transférables par voie d'inscription entre les comptes de titres qu'elle tient.

5. Pour des titres inscrits en compte de titres tenu par une personne en qualité d'opérateur d'un système pour la tenue et le transfert de tels titres sur les livres de l'émetteur ou d'autres livres qui constituent l'inscription primaire des droits sur ces titres envers l'émetteur, l'Etat contractant dont la loi régit la création de ces titres peut, à tout moment, faire une déclaration afin que la personne qui opère ce système ne soit n'est pas considérée comme intermédiaire au sens de la présente Convention.

Article 2

Champ d'application matériel de l'Acte uniforme et domaine de la loi applicable

1. La présente Convention détermine la loi applicable aux questions suivantes concernant des titres détenus auprès d'un intermédiaire :

- a) la nature juridique et les effets à l'égard de l'intermédiaire et des tiers des droits résultant du crédit de titres à un compte de titres ;
- b) la nature juridique et les effets à l'égard de l'intermédiaire et des tiers d'un transfert de titres détenus auprès d'un intermédiaire ;

⁸ It is submitted that this provision should be removed since, in line with OHADA's purpose of unifying business law, Member States may not make declarations under the OHADA Treaty or the Uniform Acts. There is however an exception in Articles 14 and 15 of the current Proposal of a Uniform Act on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary.

⁹ Although this study addresses only the conflict of laws issues in respect of security interests in intermediated securities, this study submits that the suggested Uniform Act should not be limited to security interests; instead, it should address several of the issues indicated in Article 2.

- c) the requirements, if any, for perfection of a disposition of securities held with an intermediary;
- d) whether a person's interest in securities held with an intermediary extinguishes or has priority over another person's interest;
- e) the duties, if any, of an intermediary to a person other than the account holder who asserts in competition with the account holder or another person an interest in securities held with that intermediary;
- f) the requirements, if any, for the realisation of an interest in securities held with an intermediary;
- g) whether a disposition of securities held with an intermediary extends to entitlements to dividends, income, or other distributions, or to redemption, sale or other proceeds.
- (2) This Uniform Act determines the law applicable to the issues specified in paragraph (1) in relation to a disposition of or an interest in securities held with an intermediary even if the rights resulting from the credit of those securities to a securities account are determined in accordance with paragraph (1)(a) to be contractual in nature.
- (3) Subject to paragraph (2), this Uniform Act does not determine the law applicable to
- a) the rights and duties arising from the credit of securities to a securities account to the extent that such rights or duties are purely contractual or otherwise purely personal;
- b) the contractual or other personal rights and duties of parties to a disposition of securities held with an intermediary; or
- c) the rights and duties of an issuer of securities or of an issuer's registrar or transfer agent, whether in relation to the holder of the securities or any other person.
- c) les éventuelles conditions d'opposabilité d'un transfert de titres détenus auprès d'un intermédiaire ;
- d) si le droit d'une personne sur des titres détenus auprès d'un intermédiaire a pour effet d'éteindre ou de primer le droit d'une autre personne ;
- e) les éventuelles obligations d'un intermédiaire envers une personne autre que le titulaire de compte qui revendique des droits concurrents sur des titres détenus auprès de cet intermédiaire à l'encontre du titulaire de compte ou d'une autre personne ;
- f) les éventuelles conditions de réalisation d'un droit sur des titres détenus auprès d'un intermédiaire ;
- g) si le transfert de titres détenus auprès d'un intermédiaire s'étend aux droits aux dividendes, revenus, ou autres distributions, ou aux remboursements, produits de cession ou tous autres produits.
2. Le présent Acte uniforme détermine la loi applicable aux questions mentionnées au paragraphe 1 concernant un transfert de titres ou d'un droit sur ces titres détenus auprès d'un intermédiaire, même si les droits résultant du crédit de ces titres à un compte de titres sont déterminés, conformément au paragraphe 1 a), comme étant de nature contractuelle.
3. Sous réserve du paragraphe 2, le présent Acte uniforme ne détermine pas la loi applicable :
- a) aux droits et obligations résultant du crédit de titres à un compte de titres, dans la mesure où ces droits et obligations sont de nature purement contractuelle ou autrement purement personnelle ;
- b) aux droits et obligations contractuels ou personnels des parties à un transfert de titres détenus auprès d'un intermédiaire ; et
- c) aux droits et obligations d'un émetteur de titres ou d'un agent de registre ou de transfert d'un tel émetteur, que ce soit à l'égard du titulaire des droits sur les titres ou de toute autre personne.

Article 3

Internationality

This Uniform Act applies in all cases involving a choice between the laws of different States.

Chapter II – Applicable law

Article 4

Primary rule

(1) The law applicable to all the issues specified in Article 2(1) is the law in force in the State expressly agreed in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law. The law designated in accordance with this provision applies only if the relevant intermediary has, at the time of the agreement, an office in that State, which –

a) alone or together with other offices of the relevant intermediary or with other persons acting for the relevant intermediary in that or another State –

i) effects or monitors entries to securities accounts;

ii) administers payments or corporate actions relating to securities held with the intermediary; or

iii) is otherwise engaged in a business or other regular activity of maintaining securities accounts; or

b) is identified by an account number, bank code, or other specific means of identification as maintaining securities accounts in that State.

(2) For the purposes of paragraph (1) a), an office is not engaged in a business or other regular activity of maintaining securities accounts –

Article 3

Caractère international d'une situation

Le présent Acte uniforme s'applique à toutes les situations comportant un conflit entre les lois de différents Etats.

Chapitre II – loi applicable

Article 4

Rattachement principal

1. La loi applicable à toutes les questions mentionnées à l'Article 2(1) est la loi en vigueur de l'Etat convenue expressément dans la convention de compte comme régissant celle-ci ou, si la convention de compte désigne expressément une autre loi applicable à toutes ces questions, cette autre loi. La loi désignée conformément à la présente disposition ne s'applique que si l'intermédiaire pertinent a, au moment de la conclusion de la convention, un établissement dans cet Etat, qui :

a) soit seul, soit avec d'autres établissements de l'intermédiaire pertinent ou d'autres personnes agissant pour l'intermédiaire pertinent, dans cet Etat ou dans un autre Etat :

i) effectue ou assure le suivi des inscriptions en comptes de titres ;

ii) gère les paiements ou les opérations sur titres relatifs à des titres détenus auprès de l'intermédiaire ; ou

iii) exerce autrement à titre professionnel ou habituel une activité de tenue de compte de titres ; ou

b) est identifié comme tenant des comptes de titres dans cet Etat au moyen d'un numéro de compte, d'un code bancaire ou d'un autre mode d'identification spécifique.

2. Pour les besoins du paragraphe 1 a), un établissement n'exerce pas, à titre professionnel ou habituel, une activité de tenue de comptes de titres :

a) merely because it is a place where the technology supporting the bookkeeping or data processing for securities accounts is located;

b) merely because it is a place where call centres for communication with account holders are located or operated;

c) merely because it is a place where the mailing relating to securities accounts is organised or files or archives are located; or

d) if it engages solely in representational functions or administrative functions, other than those related to the opening or maintenance of securities accounts, and does not have authority to make any binding decision to enter into any account agreement.

(3) In relation to a disposition by an account holder of securities held with a particular intermediary in favour of that intermediary, whether or not that intermediary maintains a securities account on its own records for which it is the account holder, for the purposes of this Uniform Act –

a) that intermediary is the relevant intermediary;

b) the account agreement between the account holder and that intermediary is the relevant account agreement;

c) the securities account for the purposes of Article 5(2) and (3) is the securities account to which the securities are credited immediately before the disposition.

Article 5

Fall-back rules

(1) If the applicable law is not determined under Article 4, but it is expressly and unambiguously stated in a written account agreement that the relevant intermediary entered into the account agreement through a particular office, the law applicable to all the issues specified in Article 2(1) is the law in force in the State, or the territorial unit of a Multi-unit State, in which that office was then located, provided that such

a) au seul motif que les installations de traitement de données ou de comptabilité de comptes de titres y sont situées ;

b) au seul motif que des centres d'appel pour communiquer avec des titulaires de compte y sont situés ou exploités ;

c) au seul motif que le courrier relatif aux comptes de titres y est organisé ou que des dossiers ou des archives s'y trouvent ; ou

d) lorsque cet établissement remplit exclusivement des fonctions de représentation ou administratives, autres que celles se rapportant à l'ouverture ou à la tenue de comptes de titres, et qu'il n'a pas le pouvoir de conclure une convention de compte.

3. En cas d'un transfert de titres détenus par un titulaire de compte auprès d'un intermédiaire effectué en faveur de ce dernier, que celui-ci tienne ou non dans ses livres un compte propre, pour les besoins de la présente Convention :

a) cet intermédiaire est l'intermédiaire pertinent ;

b) la convention de compte entre le titulaire de compte et cet intermédiaire constitue la convention pertinente ;

c) le compte de titres visé à l'Article 5(2) et (3) est le compte auquel les titres sont crédités immédiatement avant le transfert.

Article 5

Rattachements subsidiaires

1. Si la loi applicable n'est pas déterminée en vertu de l'Article 4, mais qu'il ressort expressément et sans ambiguïté d'une convention de compte écrite que celle-ci a été conclue via un établissement particulier de l'intermédiaire pertinent, la loi applicable à toutes les questions mentionnées à l'Article 2(1), est la loi en vigueur dans l'Etat, ou dans l'unité territoriale de l'Etat à plusieurs unités, dans lequel cet établissement était

office then satisfied the condition specified in the second sentence of Article 4(1). In determining whether an account agreement expressly and unambiguously states that the relevant intermediary entered into the account agreement through a particular office, none of the following shall be considered –

- a) a provision that notices or other documents shall or may be served on the relevant intermediary at that office;
- b) a provision that legal proceedings shall or may be instituted against the relevant intermediary in a particular State or in a particular territorial unit of a Multi-unit State;
- c) a provision that any statement or other document shall or may be provided by the relevant intermediary from that office;
- d) a provision that any service shall or may be provided by the relevant intermediary from that office;
- e) a provision that any operation or function shall or may be carried on or performed by the relevant intermediary at that office.

(2) If the applicable law is not determined under paragraph (1), that law is the law in force in the State, or the territorial unit of a Multi-unit State, under whose law the relevant intermediary is incorporated or otherwise organised at the time the written account agreement is entered into or, if there is no such agreement, at the time the securities account was opened; if, however, the relevant intermediary is incorporated or otherwise organised under the law of a Multi-unit State and not that of one of its territorial units, the applicable law is the law in force in the territorial unit of that Multi-unit State in which the relevant intermediary has its place of business, or, if the relevant intermediary has more than one place of business, its principal place of business, at the time the written account

alors situé, si celui-ci remplissait la condition prévue à la deuxième phrase de l'Article 4(1). Afin de déterminer s'il ressort expressément et sans ambiguïté d'une convention de compte que celle-ci a été conclue via un établissement particulier de l'intermédiaire pertinent, les éléments suivants ne peuvent pas être pris en considération :

- a) une clause stipulant qu'un acte ou tout autre document peut ou doit être notifié à l'intermédiaire pertinent à cet établissement ;
- b) une clause stipulant que l'intermédiaire pertinent peut ou doit être assigné en justice dans un Etat particulier ou dans une unité territoriale particulière d'un Etat à plusieurs unités ;
- c) une clause stipulant qu'un relevé de compte ou tout autre document peut ou doit être fourni par l'intermédiaire pertinent depuis cet établissement ;
- d) une clause stipulant qu'un service peut ou doit être fourni par l'intermédiaire pertinent depuis cet établissement ;
- e) une clause stipulant qu'une opération ou fonction peut ou doit être accomplie par l'intermédiaire pertinent à cet établissement.

2. Si la loi applicable n'est pas déterminée en vertu du paragraphe 1, cette loi est la loi en vigueur dans l'Etat, ou dans l'unité territoriale d'un Etat à plusieurs unités, dont la loi régit la constitution ou, à défaut, l'organisation de l'intermédiaire pertinent au moment de la conclusion de la convention de compte écrite, ou en l'absence d'une telle convention, au moment de l'ouverture du compte de titres ; toutefois, si l'intermédiaire pertinent est constitué ou, à défaut, organisé en vertu de la loi d'un Etat à plusieurs unités, mais non pas en vertu de la loi d'une unité territoriale de cet Etat, la loi applicable est la loi en vigueur dans l'unité territoriale de cet Etat à plusieurs unités dans laquelle il exerce son activité et, en l'absence d'un lieu unique, la loi de l'unité territoriale dans laquelle est situé son prin-

agreement is entered into or, if there is no such agreement, at the time the securities account was opened.

(3) If the applicable law is not determined under either paragraph (1) or paragraph (2), that law is the law in force in the State, or the territorial unit of a Multi-unit State, in which the relevant intermediary has its place of business, or, if the relevant intermediary has more than one place of business, its principal place of business, at the time the written account agreement is entered into or, if there is no such agreement, at the time the securities account was opened.

Article 6

Factors to be disregarded

In determining the applicable law in accordance with this Uniform Act, no account shall be taken of the following factors –

- a) the place where the issuer of the securities is incorporated or otherwise organised or has its statutory seat or registered office, central administration or place or principal place of business;
- b) the places where certificates representing or evidencing securities are located;
- c) the place where a register of holders of securities maintained by or on behalf of the issuer of the securities is located; or
- d) the place where any intermediary other than the relevant intermediary is located.

Article 7

Protection of rights on change of the applicable law

(1) This Article applies if an account agreement is amended so as to change the applicable law under this Uniform Act.

principal lieu d'activité, au moment de la conclusion de la convention de compte écrite, ou en l'absence d'une telle convention, au moment de l'ouverture du compte de titres.

3. Si la loi applicable n'est déterminée ni en vertu du paragraphe 1 ni en vertu du paragraphe 2, cette loi est la loi en vigueur dans l'Etat, ou dans l'unité territoriale d'un Etat à plusieurs unités, dans lequel l'intermédiaire pertinent exerce son activité et, en l'absence d'un lieu unique, l'Etat, ou l'unité territoriale d'un Etat à plusieurs unités, dans lequel est situé son principal lieu d'activité au moment de la conclusion de la convention de compte écrite, ou en l'absence d'une telle convention, au moment de l'ouverture du compte de titres.

Article 6

Critères exclus

Pour déterminer la loi applicable en vertu de la présente Convention, il ne peut être tenu compte des éléments suivants :

- a) le lieu de constitution ou, à défaut, d'organisation ou du siège social de l'émetteur des titres, de son administration centrale ou de son lieu ou principal lieu d'activité ;
- b) les lieux où sont situés les certificats représentant les titres ou constituant la preuve de l'existence de ceux-ci ;
- c) le lieu où est tenu, par ou pour le compte de l'émetteur des titres, un registre des titulaires des titres ;
- d) le lieu de tout intermédiaire autre que l'intermédiaire pertinent.

Article 7

Protection des droits en cas de changement de la loi applicable

1. Le présent Article s'applique lorsqu'une convention de compte est modifiée de manière à changer la loi applicable en vertu de la présente Convention.

(2) In this Article –

a) “the new law” means the law applicable under this Uniform Act after the change;

b) “the old law” means the law applicable under this Uniform Act before the change.

(3) Subject to paragraph (4), the new law governs all the issues specified in Article 2(1).

(4) Except with respect to a person who has consented to a change of law, the old law continues to govern –

a) the existence of an interest in securities held with an intermediary arising before the change of law and the perfection of a disposition of those securities made before the change of law;

b) with respect to an interest in securities held with an intermediary arising before the change of law –

i) the legal nature and effects of such an interest against the relevant intermediary and any party to a disposition of those securities made before the change of law;

ii) the legal nature and effects of such an interest against a person who after the change of law attaches the securities;

iii) the determination of all the issues specified in Article 2(1) with respect to an insolvency administrator in an insolvency proceeding opened after the change of law;

c) priority as between parties whose interests arose before the change of law.

(5) Paragraph (4) c) does not preclude the application of the new law to the priority of an interest that arose under the old law but is perfected under the new law.

2. Pour les besoins du présent Article :

a) la « nouvelle loi » désigne la loi applicable en vertu de la présente Convention après le changement ;

b) « l’ancienne loi » désigne la loi applicable en vertu de la présente Convention avant le changement.

3. Sous réserve du paragraphe 4, la nouvelle loi régit toutes les questions mentionnées à l’Article 2(1).

4. Sauf à l’égard d’une personne ayant consenti au changement de la loi, l’ancienne loi demeure applicable :

a) à l’existence d’un droit sur des titres détenus auprès d’un intermédiaire né avant le changement de la loi ainsi qu’à un transfert de ces titres rendu opposable avant le changement de la loi ;

b) s’agissant d’un droit sur des titres détenus auprès d’un intermédiaire né avant le changement de la loi,

i) à la nature juridique et aux effets d’un tel droit à l’égard de l’intermédiaire pertinent et de toute personne partie à un transfert de ces titres effectué avant le changement de la loi ;

ii) à la nature juridique et aux effets d’un tel droit à l’égard d’une personne qui, après le changement de la loi, procède à une saisie sur ces titres ;

iii) à la détermination de toutes les questions mentionnées à l’Article 2(1) à l’égard d’un administrateur d’insolvabilité dans une procédure d’insolvabilité ouverte après le changement de la loi ;

c) à la priorité entre parties dont les droits sont nés avant le changement de la loi applicable.

5. Le paragraphe 4 c) n’écarter pas l’application de la nouvelle loi concernant la priorité d’un droit né sous l’ancienne loi mais qui a été rendu opposable en vertu de la nouvelle loi.

Article 8

Insolvency

(1) Notwithstanding the opening of an insolvency proceeding, the law applicable under this Uniform Act governs all the issues specified in Article 2(1) with respect to any event that has occurred before the opening of that insolvency proceeding.

(2) Nothing in this Uniform Act affects the application of any substantive or procedural insolvency rules, including any rules relating to –

a) the ranking of categories of claim or the avoidance of a disposition as a preference or a transfer in fraud of creditors; or

b) the enforcement of rights after the opening of an insolvency proceeding.

Chapter III – General provisions

Article 9

General applicability of the Uniform Act

This Uniform Act applies whether or not the applicable law is that of a Member State.¹⁰

Article 10

Exclusion of choice of law rules (renvoi)

In this Uniform Act, the term “law” means the law in force in a State other than its choice of law rules.

Article 11

Public policy and internationally mandatory rules

(1) The application of the law determined under this Uniform Act may be refused only if the effects of its application would

Article 8

Insolvabilité

1. Nonobstant l'ouverture d'une procédure d'insolvabilité, la loi applicable en vertu de la présente Convention régit toutes les questions mentionnées à l'Article 2(1) en rapport avec tout événement intervenu avant l'ouverture de cette procédure.

2. Le présent Acte uniforme ne porte pas atteinte à l'application de toute règle de droit matériel ou de procédure en matière d'insolvabilité, telle que celle relative :

a) au rang des catégories de créances ou à la nullité d'un transfert effectué au mépris des règles sur la période suspecte ou effectué en fraude des droits des créanciers ; ou

b) à l'exercice de droits à compter de l'ouverture d'une procédure d'insolvabilité.

Chapitre III – Dispositions générales

Article 9

Applicabilité générale de l'Acte uniforme

Le présent Acte uniforme est applicable même si la loi qu'elle désigne est celle d'un Etat qui n'est membre de l'OHADA.

Article 10

Exclusion du renvoi

Au sens du présente Acte uniforme, le terme « loi » désigne le droit en vigueur dans un Etat, à l'exclusion des règles de conflit de lois.

Article 11

Ordre public et lois de police

1. L'application de la loi déterminée en vertu de la présente Convention ne peut être écartée que si elle conduit à un résultat

¹⁰ This provision is similar to Article 571 of the OHADA Preliminary Draft of the Uniform Act on the Law of Obligations in the OHADA Region.

be manifestly contrary to the public policy of the forum.

(2) This Uniform Act does not prevent the application of those provisions of the law of the forum which, irrespective of rules of conflict of laws, must be applied even to international situations.

(3) This Article does not permit the application of provisions of the law of the forum imposing requirements with respect to perfection or relating to priorities between competing interests, unless the law of the forum is the applicable law under this Uniform Act.

Article 12

Determination of the applicable law for Multi-unit States

(1) If the account holder and the relevant intermediary have agreed on the law of a specified territorial unit of a Multi-unit State –

a) the references to "State" in the first sentence of Article 4(1) are to that territorial unit;

b) the references to "that State" in the second sentence of Article 4(1) are to the Multi-unit State itself.

(2) In applying this Uniform Act –

a) the law in force in a territorial unit of a Multi-unit State includes both the law of that unit and, to the extent applicable in that unit, the law of the Multi-unit State itself;

b) if the law in force in a territorial unit of a Multi-unit State designates the law of another territorial unit of that State to govern perfection by public filing, recording or registration, the law of that other territorial unit governs that issue.

manifestement contraire à l'ordre public du for.

2. La présente Convention ne porte pas atteinte aux dispositions de la loi du for dont l'application s'impose même aux situations internationales, quelle que soit la loi désignée par les règles de conflit de lois.

3. Les dispositions de la loi du for imposant des conditions relatives à l'opposabilité ou se rapportant aux priorités entre droits concurrents ne peuvent être appliquées en vertu du présent article, sauf si la loi du for est la loi applicable en vertu du présent Acte uniforme.

Article 12

Détermination de la loi applicable en relation avec un Etat à plusieurs unités

1. Si le titulaire de compte et l'intermédiaire pertinent ont convenu que la loi applicable est la loi d'une unité territoriale d'un Etat à plusieurs unités,

a) la référence à « l'Etat » dans la première phrase de l'Article 4(1) vise cette unité territoriale ;

b) les références à « cet Etat » dans la deuxième phrase de l'Article 4(1) visent l'Etat à plusieurs unités concerné.

2. Pour l'application du présent Acte uniforme :

a) la loi en vigueur dans une unité territoriale d'un Etat à plusieurs unités vise aussi bien la loi de cette unité territoriale que, dans la mesure où elle est applicable dans cette unité territoriale, la loi de l'Etat à plusieurs unités concerné ;

b) si la loi en vigueur dans une unité territoriale d'un Etat à plusieurs unités désigne la loi d'une autre unité territoriale du même Etat comme étant la loi régissant l'opposabilité par voie de dépôt public, d'inscription publique ou d'enregistrement public, la loi qui régit cette question est la loi de cette autre unité territoriale.

(3) A Multi-unit State may, at the time of signature, ratification, acceptance, approval or accession, make a declaration that if, under Article 5, the applicable law is that of the Multi-unit State or one of its territorial units, the internal choice of law rules in force in that Multi-unit State shall determine whether the substantive rules of law of that Multi-unit State or of a particular territorial unit of that Multi-unit State shall apply.

(4) A Multi-unit State may, at any time, make a declaration that if, under Article 4, the applicable law is that of one of its territorial units, the law of that territorial unit applies only if the relevant intermediary has an office within that territorial unit which satisfies the condition specified in the second sentence of Article 4(1). Such a declaration shall have no effect on dispositions made before that declaration becomes effective.

Article 13

Uniform interpretation

In the interpretation of this Uniform Act, regard shall be had to its international character and to the need to promote uniformity in its application.

Chapter IV – Transition provisions

Article 14

In a Member State, the law applicable under this Uniform Act determines whether a person's interest in securities held with an intermediary acquired after this Uniform Act entered into force for that State extin-

3. Un Etat à plusieurs unités peut, au moment de la signature, de la ratification, de l'acceptation, de l'approbation ou de l'adhésion, faire une déclaration énonçant que si, en vertu de l'Article 5, la loi applicable est la loi de cet Etat à plusieurs unités ou de l'une de ses unités territoriales, les règles de conflit internes en vigueur dans cet Etat à plusieurs unités détermineront si ce sont les règles de droit matériel de cet Etat à plusieurs unités ou d'une unité territoriale spécifique de cet Etat à plusieurs unités qui s'appliquent. Un Etat à plusieurs unités qui fait une telle déclaration doit communiquer les informations relatives au contenu de ces règles de conflit internes au Bureau Permanent de la Conférence de La Haye de droit international privé.

4. Un Etat à plusieurs unités peut, à tout moment, faire une déclaration précisant que si la loi applicable en vertu de l'Article 4 est la loi de l'une de ses unités territoriales, la loi de cette unité territoriale s'applique uniquement si l'intermédiaire pertinent a un établissement dans cette unité territoriale qui remplit la condition prévue à la deuxième phrase de l'Article 4(1). Une telle déclaration n'a aucun effet sur un transfert effectué avant que la déclaration ne prenne effet.

Article 13

Interprétation uniforme

Pour l'interprétation du présent Acte uniforme, il sera tenu compte de son caractère international et de la nécessité de promouvoir l'uniformité de son application.

Chapitre IV – Dispositions transitoires

Article 14

Dans un Etat Membre, la loi applicable en vertu du présent Acte uniforme détermine si le droit d'une personne sur des titres détenus auprès d'un intermédiaire acquis après l'entrée en vigueur du présent Acte uni-

guishes or has priority over another person's interest acquired before this Uniform Act entered into force for that State.

Article 15

(1) References in this Uniform Act to an account agreement include an account agreement entered into before this Uniform Act entered into force. References in this Uniform Act to a securities account include a securities account opened before this Uniform Act entered into force.

(2) Unless an account agreement contains an express reference to this Uniform Act, the courts of a Member State shall apply paragraphs (3) and (4) in applying Article 4(1) with respect to account agreements entered into before the entry into force of this Uniform Act for that State. A Member State may, at the time of entry into force of the present Uniform Act for that State, make a declaration that, for a period of two years¹¹ following the entry into force of this Uniform Act, its courts shall not apply those paragraphs with respect to account agreements entered into after the entry into force of this Uniform Act in accordance with Article 19(1) but before the entry into force of this Uniform Act for that State in accordance with Article 19(2). If the Member State is a Multi-unit State, it may make such a declaration with respect to any of its territorial units.

(3) Any express terms of an account agreement which would have the effect, under the rules of the State whose law governs that agreement, that the law in force in a particular State, or a territorial unit of a particular Multi-unit State, applies to any of the issues specified in Article 2(1), shall

forme pour cet Etat, a pour effet d'éteindre ou de primer le droit d'une autre personne acquis avant l'entrée en vigueur du présent Acte uniforme pour cet Etat.

Article 15

1. Toute référence dans le présent Acte uniforme à une convention de compte vise également une convention de compte conclue avant l'entrée en vigueur du présent Acte uniforme. Toute référence dans le présent Acte uniforme à un compte de titres vise également un compte de titres ouvert avant l'entrée en vigueur du présent Acte uniforme.

2. A moins qu'une convention de compte ne contienne une référence expresse au présent Acte uniforme, les tribunaux d'un Etat Membre contractant appliqueront les paragraphes 3 et 4 pour les besoins de l'application de l'Article 4(1) aux conventions de compte conclues avant l'entrée en vigueur du présent Acte uniforme dans cet Etat. Un Etat contractant peut, au moment de l'entrée en vigueur du présent Acte uniforme pour cet Etat, faire une déclaration selon laquelle ses tribunaux, pour une période de deux ans après l'entrée en vigueur du présent Acte uniforme, n'appliqueront pas lesdits paragraphes aux conventions de compte conclues après l'entrée en vigueur du présent Acte uniforme, mais conclues avant l'entrée en vigueur du présent Acte uniforme dans cet Etat. Si l'Etat contractant est un Etat à plusieurs unités territoriales, il peut faire une telle déclaration pour l'une de ses unités territoriales.

3. Toute clause expresse d'une convention de compte qui conduirait en vertu des règles de l'Etat dont la loi régit cette convention, à appliquer la loi en vigueur dans un Etat, ou dans une unité territoriale d'un Etat à plusieurs unités, à toute question mentionnée à l'Article 2(1), aura pour effet

¹¹ This transition period of two years is inspired by Article 908 of the Uniform Act on Commercial Companies.

have the effect that such law governs all the issues specified in Article 2(1), provided that the relevant intermediary had, at the time the agreement was entered into, an office in that Member State which satisfied the condition specified in the second sentence of Article 4(1). A Member State may, at the time of entry into force of the present Uniform Act for that State, make a declaration that, for a period of two years following the entry into force of this Uniform Act, its courts shall not apply this paragraph with respect to an account agreement described in this paragraph in which the parties have expressly agreed that the securities account is maintained in a different State. If the Member State is a Multi-unit State, it may make such a declaration with respect to any of its territorial units.

(4) If the parties to an account agreement, other than an agreement to which paragraph (3) applies, have agreed that the securities account is maintained in a particular State, or a territorial unit of a particular Multi-unit State, the law in force in that State or territorial unit is the law applicable to all the issues specified in Article 2(1), provided that the relevant intermediary had, at the time the agreement was entered into, an office in that State which satisfied the condition specified in the second sentence of Article 4(1). Such an agreement may be express or implied from the terms of the contract considered as a whole or from the surrounding circumstances.

Chapter V – Final clauses

Article 16

Entry into force

This Uniform Act shall be published in the Official Journal of OHADA within a period of sixty days from the date of its adoption. It shall also be published in the States Parties, in the Official Journal. It shall become applicable ninety days from the

que cette loi régit toutes les questions mentionnées à l'Article 2(1), si l'intermédiaire pertinent avait, lors de la conclusion de la convention, un établissement dans cet Etat Membre remplissant la condition prévue à la deuxième phrase de l'Article 4(1). Un Etat Membre peut, au moment de l'entrée en vigueur du présent Acte uniforme pour cet Etat, faire une déclaration selon laquelle ses tribunaux, pour une période de deux ans après l'entrée en vigueur du présent Acte uniforme, n'appliqueront pas le présent paragraphe aux conventions de compte visées au présent paragraphe et dans lesquelles les parties ont expressément convenu que le compte de titres est maintenu dans un autre Etat. Si l'Etat Membre est un Etat à plusieurs unités territoriales, il peut faire une telle déclaration pour l'une de ses unités territoriales.

4. Lorsque les parties à une convention de compte, autre que celles visées au paragraphe 3, ont convenu que le compte de titres serait maintenu dans un Etat ou dans une unité territoriale d'un Etat à plusieurs unités, la loi en vigueur dans cet Etat ou cette unité territoriale s'applique à toutes les questions mentionnées à l'Article 2(1), si l'intermédiaire pertinent avait, lors de la conclusion de la convention, un établissement dans cet Etat remplissant la condition prévue à la deuxième phrase de l'Article 4(1). Un tel accord peut être exprès ou résulter de manière implicite des dispositions du contrat dans son ensemble ou des circonstances extérieures à celui-ci.

Chapitre V – Clauses finales

Article 16

Entrée en vigueur

Le présent Acte uniforme sera publié au Journal Officiel de l'OHADA dans un délai de soixante (60) jours à compter de son adoption. Il sera également publié au Journal Officiel des Etats Parties. Il entre en vigueur quatre-vingt-dix (90) jours à comp-

date of its publication in the Official Journal of OHADA pursuant to Article 9 of the Treaty on the Harmonisation in Africa of Business Law, signed in Port Louis on 17 October 1993, as revised in Quebec City on 17 October 2008.

ter de sa publication au Journal Officiel de l'OHADA conformément à l'Article 9 du Traité sur l'Harmonisation en Afrique du Droit des Affaires, signé à Port-Louis le 17 octobre 1993, tel que révisé au Québec le 17 octobre 2008.

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