



INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
INSTITUT INTERNATIONAL POUR L'UNIFICATION DU DROIT PRIVE

**UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS
FOR THE PREPARATION OF A DRAFT CONVENTION ON
SUBSTANTIVE RULES REGARDING INTERMEDIATED
SECURITIES
INFORMAL WORKING GROUP ON ARTICLE 14 OF THE
DRAFT CONVENTION**

UNIDROIT 2007
Study LXXVIII – Doc. 98
English only
December 2007

Informal Working Group on Article 14 of the draft Convention
Comments on the questionnaire concerning “good faith acquisition”
(submitted by the German delegation)

The German delegation would like to make the following comments on the questionnaire:

(a) On the situation of your national law

1. Special provision. *Does your legal system have a special rule on “innocent/good faith acquisition” for book entry securities?*

No (for an exception see 1b below).

1.a *If the answer is no, does it mean that the traditional “good faith clause” applies?*

Yes. Since securities, including intermediated securities in book entry form, are treated as movable property (bewegliche Sachen), it is the general provisions that apply with regard to good faith acquisition of movable property (sections 929, 932 et seq. of the Civil Code – CC and sections 366, 367 of the Commercial Code).

The key provision is the legal definition of “good faith” in section 932 para 2 CC:

“The acquirer is not in good faith, if he knows or, due to gross negligence on his part, does not know that the movable property (i.e. the security) does not belong to the seller.”

Section 935 CC excludes a good faith acquisition if the movable property has been stolen or lost or otherwise been taken away; this limitation, however, does not apply in case of money or bearer securities.

Section 366 Commercial Code extends the good faith principle of the Civil Code to the authorization of a merchant acting within its trade to sell or pledge a movable property (i.e. a security).

What constitutes “gross negligence” is not defined by law, but left to the interpretation by the courts.

1.b *If the answer is yes,*

(i) *What is the standard of care chosen, a general clause (e.g., “reasonable commercial standards”) or a more rigorous one (e.g. collusion, actual knowledge, wilful blindness, gross negligence, etc.)?*

As mentioned above the general rules on good faith acquisition apply on intermediated securities as if the holding consisted of physical certificates. This holds true even in case of Government Bonds (Bundesanleihen) which are issued since 1972 in dematerialized form only (Debt Register Claims – Schuldbuchforderungen). Normally, the German CSD (Clearstream Banking) is registered in the Federal Debt Register to hold the issue as trustee for the investors in order to be able to trade such bonds as fungible securities on the markets (Sammelschuldbuchforderung). In that case, the “traditional” good faith rule applies.

However, it is also possible for the individual investor to be personally registered for his holding in the Federal Debt Register. For this case there are special provisions regulating such Individual Debt Register Claims (Einzel Schuldbuchforderung) which are no longer being treated as movable property but as claims, including a rule for good faith acquisition. Individual Debt Register Claims are debt securities arising by virtue of their entry in the Federal Debt Register (section 7 of the Act to Regulate Federal Debt - ARFD).

The Federal Debt Register is subject to the presumption of accuracy. An individual Debt Register claim can be acquired in good faith by a registered book creditor. Good faith acquisition is ruled out in circumstances where, at the time of his acquisition, the new creditor knew, or did not know because of gross negligence on his part, that the creditor to date was not entitled to the claim, or was not entitled to the claim to the extent concerned, or that the creditor to date was subject to a limitation of his right of disposal, or that the claim itself was encumbered by virtue of a right vested in a third party (section 8 subsection [2] ARFD). Good faith acquisition of a security interest or of usufruct in respect of a Debt Register claim is possible on the same conditions (section 8 subsection [3] ARFD). However, Individual Debt Register Claims would not fall within the scope of the draft Convention (since they are not credited to an account held with an *intermediary*). The “special rule” is therefore presented for academic purposes with no practical implications.

(ii) *What are the situations contemplated by the special rule (protection vis-à-vis an adverse claim, protection vis-à-vis a defective entry, etc.)?*

A good faith acquirer becomes the holder (owner) of the claim. Third party rights in respect of the claim, as well as limitation of the rights of disposal vested in the creditor to date, shall only be effective vis-à-vis the new creditor so far as they have been entered in the Federal Debt Register (section 8 subsection [2], second sentence, ARFD).

(iii) *Does it contain a special provision for organisations? If so, please describe.*

Here there is only a general provision, in the law governing agency, which deals with imputed knowledge (sections 164 et seq. Civil Code - CC). Regarding knowledge, or grossly negligent lack of knowledge, of certain circumstances, the person to whom reference will be made is not the principal but the agent (section 166 subsection [1] CC), unless the agent is acting in compliance with his principal's instructions (section 166 subsection [2] CC).

In regard to the imputed knowledge of organisations, there is an extensive corpus of past court decisions on the subject of so-called “knowledge typically held on file”. The idea behind this is that no disadvantage should arise for the other contracting party in cases where the knowledge in question is spread amongst several persons in the organisation. Such knowledge will be imputed in circumstances where the other contracting party could count on its being forwarded to the individual responsible.

2. Case law. *In your country or abroad, are you aware of any real cases in which the “good-faith/innocent acquirer clause” has been applied in relation to intermediated securities? If so, please summarise (if possible).*

No.

3. Other issues. *Please comment on any other point or issue that, in relation to your national law, you consider relevant for the purpose of this paper.*

(b) On Article 14 of the Convention

4. Article 14: current text

4.a *Do you agree with the description of Article 14 of the Draft Convention made in this paper (supra para. n° 2)? If not, please elaborate your answer.*

We agree with the description.

4.b *Leaving aside the standard of care issue, do you have any problems with the current text of that provision, e.g.: (i) as to the differences between the situations described in paragraph 1 and 2, including the reference to article 10 and the special provisions of SSS and account agreements (which are referred to in the second paragraph but not in the first paragraph), (ii) the definition of “defective entry”, (iii) the special rule for organisations, (iv) the relationship of Article 14 with other provisions of the Convention, etc.? Please elaborate your answer.*

While we are of the opinion that the current version of Art. 14 contains most elements inherent in the German concept of good faith acquisition, we still disagree with the (current) relationship between Art. 9 and 10 on the one hand and Art. 14 and 15 on the other. Art. 14 (2) is applicable to both methods of transfer, while Art. 14 (1) is only applicable to transfers by way of book entry. We still hold this distinction to be unwarranted, leading as such to arbitrary results and meaning that the question whether there is actual acquisition under 14 (1) or subjection to a prior interest will be dependent on a mere formality. If the book entry is made on the same account (= designating entry) there is subjection to prior interests; if the book entry is made on another account, there can be acquisition in good faith. This is especially troublesome with regard to the designating entry, which is a modern method of transferring possession without the somewhat cumbersome process of opening and then debiting and crediting different accounts. A rule such as the one proposed would greatly diminish the practical value of a designating entry. A way forward could be to include Art. 10 methods in Art. 14 (1) or to move “designating entry” from Art. 10 to Art. 9.

5. Standard of care: Theoretical approaches

5.a *Do you agree with the description of the possible approaches to the "innocent/good faith acquirer issue" made in this paper (supra para. n° 5-6)? Can you think of other solutions? If so, please describe them.*

Yes. Other solutions are not apparent.

5.b *Do you agree with the summary of the pros and cons of each approach made in this paper? Can you think of other arguments? If so, please describe them.*

We do not agree that a good faith acquisition could lead to a "win/win" situation. In particular, we would like to express our disagreement with an understanding (interpretation) of the Convention as presently stated in footnote 14, which seems to be saying that as a result of this Convention, an inflation of securities would occur as a necessary consequence. Our reading of the matter is that the account holder would not lose its interest by the unauthorised debit of the account according to Art. 13.

However, he would lose such right, due to the subsequent good faith acquisition by operation of law, thereby leaving the integrity of the issue unaffected. It should be noted that it would be very unfortunate (assuming the interpretation as presented in footnote 14 were indeed correct) if an international instrument such as this introduced problems where there have been none so far, and that Germany would consequently be very reluctant to introduce such an instrument.

5.c *In particular, which approach do you consider more adequate to the world of electronic book-entries? Which one do you consider more neutral and functional?*

A uniform approach applying to all countries seems better suited in the field of electronic book entries. The more neutral course would, however, be to make a reference to domestic laws.

5.d *Are you aware of international instruments that, on the acquisition of assets, contain a rule for innocent/bona fide purchaser?*

No.