



**DIPLOMATIC CONFERENCE TO ADOPT A
CONVENTION ON SUBSTANTIVE RULES
REGARDING INTERMEDIATED SECURITIES**
Geneva, 1 to 13 September 2008

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Comments

(submitted by the Government of the Republic of Korea)

COMMENTS RELATING TO ACQUISITION BY AN INNOCENT PERSON

The Korean delegation would like to express thanks to the Chair of the Working Group on Article 14 for preparing the Preliminary Note (Study LXVIII – Doc. 96) and the Summary Report (CONF. 11 – Doc. 8) and is pleased to submit the following comments.

1. General Comments

The Korean delegation shares the understanding that the innocent acquirer issue is of great importance in promoting the legal certainty of intermediated securities, which is the main objective of this Convention.

With regard to the suggested possible approaches of the Preliminary Note (Study LXVIII – Doc. 96), we believe that the Working Group has listed every possible approach and generally support the autonomous or Conventional test, which functions as a safe harbour (section III-9): the Convention's definition of innocent acquirers does not impede Contracting States from expanding the same protection to other persons under their national law. We find Article 14 applicable to our domestic situation regarding good-faith acquirer protection. We are not opposed to the opt-out alternative, either, for, if the present draft brings disharmony to any legal systems, it is reasonable that the Contracting States make a declaration to opt out of the Conventional test and refer to their domestic laws.

2. Scope of Innocence

In respect of the Conventional test approach (section III-9), we believe that it is reasonable for the Convention to concretize a stricter standard than national legislations. In this context, we would like to bring into focus the difference of the innocence test between an individual and an organization in the present draft.

According to Article 14(4)(b), the test of innocence applied to an individual requires his/her awareness of “a significant probability that the interest or fact exists” and that he/she “deliberately avoids information”, which implies gross negligence. On the other hand, Article 14(4)(c), which is applied to an organization, requires that the information “is or ought reasonably to have been brought to the attention of the individual responsible”, which implies simple negligence.

From our perspective, there is no ground, at least in the legislation phase, for the different treatment between an individual and an organization, although the burden of proof in gross negligence between an individual and a gigantic organization might be different in a court trial.

Therefore we suggest that Article 14(4) be modified so as to apply the requirements of subparagraph (b) to an organization in the same way.

3. Effect of Innocent Acquisition

Paragraph 1 of Article 14 describes the effect of innocent acquisition against the previous holder, and paragraph 2 describes the effect against third parties. According to the latter paragraph, which reads as follows, it is unclear whether the term “third parties” includes issuers of the securities or not:

“2. Where securities are credited to the securities account of an account holder, or an interest becomes effective against third parties under Article 10, at a time when the account holder or the person to whom the interest is granted does not know of an earlier defective entry:

(a) the credit of interest is not rendered invalid, ineffective against third parties or liable to be reversed as a result of that defective entry; and

(b) the account holder, or the person to whom the interest is granted, is not liable to anyone who would benefit from the invalidity or reversal of that defective entry.”

This paragraph does not entirely exclude the possibility that the term “third parties” includes issuers of securities and that an innocent acquirer might thereby contend his/her rights to the issuers of securities which he/she has acquired. What we need to remember is that the purpose of innocent acquisition is to protect the trade aspect of the securities. For example, if an intermediary makes a defective entry by amplifying the existing 100 shares to false 1000 shares (900 shares is not valid in relation to the issuer) and the 1000 shares are acquired by an innocent acquirer, the acquisition could be protected by Article 14, but the effect to the issuer should be regulated by the non-Convention law. The exclusion of issuers from the third parties of paragraph 2 therefore needs to be clarified in the Convention.

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