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

DIPLOMATIC CONFERENCE TO ADOPT A CONVENTION ON SUBSTANTIVE RULES REGARDING INTERMEDIATED SECURITIES
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Comments

(submitted by the Government of Germany)

The Federal Ministry of Justice, which has lead responsibility in this matter within the German Government, takes the liberty of submitting the following comments to the UNIDROIT Secretariat.

The Federal Ministry of Justice would like to take this opportunity to formally thank UNIDROIT and its Working Groups for the work they have done, and hopes that it will be possible to reach an agreement at the diplomatic Conference which is acceptable to all States. The German delegation still welcomes the fact that this issue, namely the harmonising of substantive rules on intermediated securities, is being addressed in this draft Convention.

1. General aspects

Before addressing more specific issues, the German delegation would like to take the liberty of pointing out that external appliers of the law in particular find the draft Convention very difficult to understand. The submissions made to the Federal Ministry of Justice by interested groups have shown that the draft Convention offers very great scope for interpretation. Due to the functional approach taken, the provisions are formulated in a very neutral manner. The draft Convention also contains numerous references to other provisions in the Convention, and comprehensibility suffers as a result.

The German delegation feels that the Explanatory Report could be of more help in interpreting the text of the Convention. The Explanatory Report often only repeats the text of the Convention in other words and hardly establishes what is meant by the neutral wording in line with the functional approach. From the German point of view, the Explanatory Report should indicate, by differentiation, what is to be understood by the neutral wording in respect of a law of obligations system on the one hand and in respect of a property law system on the other.

The following points in each case address specific articles:

2. Re Article 1

In Article 1(i) the term “insolvency administrator” should be replaced by “insolvency representative”, the term used in the UNCITRAL Legislative Guide on Insolvency Law (p. 5). It also covers those persons who do not exercise administrative powers and powers of disposal over a debtor's assets. Reorganisation proceedings instituted by the debtor under the supervision of an officially appointed person may otherwise be ruled out. This could represent an unintentional deviation from Article 1(h), which is more generally formulated and encompasses this type of reorganisation proceedings.

Further, the definition of "non-Convention law" given in Article 1(m) should be placed before Article 1(k) since the term is first used in Article 1(k).

3. Re Article 3

In the opinion of the German delegation, the positioning of Article 3 should be reconsidered. Since, from a systematic point of view, Article 2 and Article 4 go together, Article 3 should be placed before Article 2. In addition, it would be desirable for the content of Article 3, as per the Explanatory Report, to be more readily understandable based on the text of the provision alone.

4. Re Article 7 and Article 9

From the very beginning is has been very important for the German delegation to reconcile the draft Convention with a system governed by the law of property. In the meantime, however, doubts have also arisen as regards this aspect too. The submissions made to the Federal Ministry of Justice have shown that the key provisions of the draft Convention, in particular Articles 7, 9, 13 and 14, are often open to completely different interpretations. In the opinion of the German delegation, therefore, two points are in need of clarification – at least in the Explanatory Report. *Firstly:* In a system governed by the law of property there must always be an owner, yet there can only ever be *one* owner. It is therefore essential that credit and debit form an inseparable pair of transactions. *Secondly:* In a system governed by the law of property, the rights of the final investor vis-à-vis the issuer can neither be destroyed or (temporarily) multiplied nor can they (temporarily) become ownerless. Only the owner can change, not however the right itself. In a system governed by the law of property the acquisition of the rights must therefore always be linked to a corresponding loss of rights. There is no room for exceptions, be that as part of acquisition in good faith or in other cases. The multiplication of securities would otherwise be the result, something which is inconceivable within a system governed by the law of property.

5. Re Article 9 and Article 10

Article 9(4) raises another problem of the Convention. According to Article 7, Article 9(4) (book entry) and Article 10 (designating entry), the transfer of full ownership and the grant of a limited interest are both possible. Priority is not given to one or other method of transfer, rather both possibilities are to stand side by side on an equal footing. However, the legal consequences of each are different. For that reason, in the opinion of the German delegation, the legal consequences following transfer in accordance with Article 9 and Article 10 should be brought into line.

6. Re Articles 13, 14 and 15

One key point for discussion at the diplomatic Conference will be how to regulate acquisition in good faith in the Convention. The German delegation would, however, like to point out the following in advance: In a system governed by the law of property, credit and debit must be treated equally as regards their effectivity. For that reason the content and text of the provision concerning acquisition in good faith must, in the opinion of the German delegation, clearly indicate that under a property law system multiplication of securities is entirely ruled out.

7. Re Article 17

As in Article 1(i), "insolvency administrator" should here also be replaced by "insolvency representative" (cf. 2 above).

8. Re Article 18 (issues concerning insolvency)

The issues concerning insolvency will certainly also be a key point for discussion at the diplomatic Conference. In the opinion of the German delegation the relationship between the draft Convention and national insolvency legislation is still in need of clarification.

9. Re Article 21

The German delegation is of the opinion that it is too vague to merely say that the intermediary can comply with his duty to hold sufficient securities in accordance with Article 21(2) (e) "by any other appropriate method". That could also be understood to refer to the multiplication of securities, which is not compatible with property law. The provision should therefore be either specified more precisely or deleted.

10. Re Article 24

Instead of the rules of the system, the end of the business day should be relevant for the legal validity of instructions and entries, because it is highly questionable if insolvency law should follow the rules of the system rather than vice versa. The later the resistance to insolvency of the instructions in the system occurs after the opening of the insolvency proceedings, the greater the interference in the basic ratings under insolvency law.

11. Re Article 26

(a) Re Article 26(1)

In the case of Article 26(1), it is questionable whether a distinction should be drawn between trade on an exchange or on a regulated market. In many Contracting States the stock exchange and the regulated market are one and the same. The following phrase would be better: "trade on an exchange or *another* regulated market".

(b) Re Article 26(3) or rather the relationship between the Convention and national company law

Over and above the points already referred to, the German delegation still feels that the relationship of the Convention to national company law is not clearly expressed.

The wordings in the draft appear contradictory. According to Article 26(3) national company law appears to override the Convention. According to Article 7(2)(b) the rights referred to in Article 7(1)(a) may be exercised against the relevant intermediary or the issuer of the securities, or both, in accordance with this Convention, the terms of the securities, and the law under which the securities are constituted, but only *unless otherwise provided in this Convention*. According to this, the Convention appears to override national law. The system applied in the Convention must be clearer here. It must be consistently and unambiguously clear, solely from the wording of the Convention, that national company law overrides the Convention. In the view of the German delegation it would thus make sense to introduce a separate provision - for example following the provisions in respect of the sphere of application (Article 3) - which clearly and unequivocally regulates the relationship between the Convention and national company law.

The Federal Ministry of Justice is looking forward to the discussions at the diplomatic Conference and is confident that an agreement can be reached.

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