



**UNIDROIT COMMITTEE OF GOVERNMENTAL EXPERTS FOR  
THE PREPARATION OF A DRAFT CONVENTION ON  
SUBSTANTIVE RULES REGARDING INTERMEDIATED  
SECURITIES  
Fourth session  
Rome, 21/25 May 2007**

UNIDROIT 2007  
Study LXXVIII – Doc. 86  
Original: French/English  
May 2007

***COMMENTS BY GOVERNMENTS  
AND INTERNATIONAL ORGANISATIONS***

*(submitted by the Government of France)*

The French delegation to the Committee of Governmental Experts for the preparation of a draft UNIDROIT instrument on substantive rules regarding intermediated securities is recommending a debate on the instrument's form, which has not been yet explicitly decided.

**1. An open debate is necessary**

The Committee of Governmental Experts (CGE) group has almost completed its work – the next session in May 2007 will have a short agenda – but the form of the future UNIDROIT instrument on intermediated securities has yet to be determined.

The issue was raised at the early sessions of the CGE. A working group chaired by the Italian delegation was set up to study the question, and the Secretariat published the study's findings<sup>1</sup>. However, the Committee has not properly debated the issue. The consensus view at the March 2006 session seemed to be that "although the inter-sessional work on this subject had been useful, it was too early to make any definitive choice regarding these matters"<sup>2</sup>. The topic did not come up at the November 2006 session.

The time has come to address this issue, first because we should not leave it until the last minute, and second because our decision in this regard will necessarily affect the final wording of the instrument. Our shared goal must be to select the legal form that will maximise the practical effects of the final document.

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<sup>1</sup> Documents 26 and 43, May 2006 Report, Appendix 17.

<sup>2</sup> Doc. 43 cited above, §123-124.

## **2. Review of the options**

Two types of instrument are possible, based on the UNIDROIT statute<sup>3</sup>:

- A binding international convention, designed to apply automatically in preference to a State's municipal law upon completion of all the formal requirements of that State's domestic law for its entry into force;
- General principles, such as the UNIDROIT Principles of International Commercial Contracts, whose preamble states:

*"They shall be applied when the parties have agreed that their contract be governed by them.*

*They may be applied when the parties have agreed that their contract be governed by general principles of law, the lex mercatoria or the like.*

*They may be applied when the parties have not chosen any law to govern their contract.*

*They may be used to interpret or supplement international uniform law instruments.*

*They may be used to interpret or supplement domestic law.*

*They may serve as a model for national and international legislators."*

## **3. Application to the UNIDROIT instrument on substantive rules regarding intermediated securities**

The working group concentrated on the idea of an international convention. It was felt that, since the rights of third parties could be affected, it was necessary to select an instrument that would enable the broadest possible harmonisation with a view to achieving maximum legal certainty. This route has undeniable advantages, set out in Document 43 of May 2006<sup>4</sup>.

But recent changes to the text must be taken into account. References to non-Convention law have increased, a development that has two effects:

- References to non-Convention law could make it harder to incorporate the instrument in domestic legal systems. Most of the Convention's provisions, which are precise and binding, will have to be supplemented by domestic rules to make the Convention provisions consistent with domestic laws. To remedy this problem, the working group proposed including a clause that would eliminate the automatic inclusion of the

<sup>3</sup> Source: UNIDROIT website. "*Factors determining choice of instrument to be prepared*: The uniform rules drawn up by UNIDROIT have, in keeping with its intergovernmental structure, traditionally tended to take the form of *international Conventions*, designed to apply automatically in preference to a State's municipal law upon completion of all the formal requirements of that State's domestic law for their entry into force. However, the low priority which tends to be accorded by Governments to the implementation of such Conventions and the time it therefore tends to take for them to enter into force have led to the increasing popularity of alternative forms of unification in areas where a binding instrument is not felt to be essential. Such alternatives include *model laws* which States may take into consideration when drafting domestic legislation on the subject covered or *general principles* addressed directly to judges, arbitrators and contracting parties who are however left free to decide whether to use them or not. Where the subject is not judged ripe for the drawing up of uniform rules, another alternative consists in the preparation of *legal guides*, typically on new business techniques, types of transaction or on the framework for the organisation of markets both at the domestic and the international level. Generally speaking "hard law" solutions (i.e. Conventions) are needed where rules' scope transcends the bi-polar relationship underlying ordinary contract law and where third parties' or public interests are at stake as is the case in the law of property."

<sup>4</sup> Doc. 43, May 2006 §13 and Appendix 17.

Convention in legal systems by simply requiring Contracting States to make sure that their legislation complies with the Convention<sup>5</sup>;

- References to non-Convention law could stand in the way of achieving harmonisation and legal certainty, because economic agents would be regularly forced to check the provisions of non-Convention law in order to determine the extent of their rights and obligations.

Consequently, it might be worth considering the advantages of a general principles approach. Among other things, it would involve little disruption to domestic legal systems. Further, the provisions are designed as objectives; they are clear and can be simplified and streamlined. In addition, the approach is consistent with the CGE's decision to take a functional approach. And consensus-building would be easier, meaning fewer risks as regards adoption at the diplomatic conference.

Another alternative is to seek a middle way, such as a model law approach.

### **Conclusion**

The French delegation feels it would be detrimental to the instrument itself not to raise the question of its legal form before the negotiations are completed. Our objective is indeed, through such a debate, to maximise the practical effects of the final instrument.

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<sup>5</sup> The proposal is framed slightly differently in the report on the March 2006 session (Doc. 43, §13, cited above): "The Group had concluded that the flexibility inherent in a "soft law" instrument was likely to result in diversity. This was undesirable in the case of a text such as the present draft, the provisions of which might affect the positions of third parties. For this reason the "hard law" route seemed preferable. However, ratification of the draft Convention as it stood could produce technical hurdles to overcome in certain countries. In particular, it could be problematic where a "monist" State's existing law might, although similar in substance, be so drafted from such a different perspective as to appear to be in conflict with the draft Convention. For that reason the Group had reached the conclusion that Contracting States should be offered the opportunity of "re-translating" the text so as to give identical effect to its provisions."