INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
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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

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Informal Working Group on Article 14 of the draft Convention

Comments on the questionnaire concerning "good faith acquisition"

(submitted by the Czech delegation)

The Czech 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?*

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.)?

Section 96 para 3 of the Capital Market Undertakings Act, No. 256/2004 Coll. provides for a rather rigorous test of good faith, stating that „Unless stipulated otherwise by a special legal regulation, the person to whom a book-entry security is being transferred shall become the owner of such a security even if the transferor did not have the right to transfer the book-entry security; the same shall not apply if the person to whom a book-entry security is being transferred **knew or must have known that the transferor did not have such a right at the time of transfer**. In respect of doubts, good faith shall be presumed.". Because this rule is very similar to the one applying both to certificated securities and other movable assets, it can be said, it is a general rule, expressly provided for in the above mentioned act. This principle deals mainly with actual knowledge and gross negligence.

(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 owner of the securities or the interests credited to his account. However, in the case of an adverse claim (no matter whether resulting from violation of third party's rights or a defective entry), the acquirer must prove its good faith.

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

There is no special rule for good faith of legal persons, only general provisions regarding agency.

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. nº 2)? If not, please elaborate your answer.*

Yes, we agree.

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.*

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. nº 5-6)? Can you think of other solutions? If so, please describe them.*

Yes, we agree. We are not aware of other solutions.

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 agree with the summary of the advantages and drawbacks mentioned in this paper. Thinking of other arguments, as regards the win-win situation (referring to doc. 96 submitted by the German delegation) we understand the situation in the following way. While the innocent acquirer is protected under Art. 14 and maintains the acquisition, the original holder protected under Art. 13 has a claim against his intermediary who is obliged to displace the lost securities by purchasing them elsewhere. The one who loses is the entity that made the unauthorised debit, i.e. the relevant intermediary because it breached its duty.

Referring back to the comments of the ECB „Do you recall why there is a limitation to par. (2)? I take it that Art. 14(1)(c) in fine would still permit a reversal on a motivation other than merely the third party's right?" we understand it the same way. In a case when an error occurs during the settlement, rights of third parties are not violated and the reversal may be permitted.

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 provision for a uniform world-wide rule seems to be a more functional approach which seems to be more suitable.

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

No.