



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 acquisition by an innocent person**  
*(submitted by the delegation of South Africa)*

The delegation of South Africa 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?*

Yes. Section 91A of the Companies Act 61 of 1973 deals with uncertificated securities (“book entry securities”) and it contains a special rule on good faith acquisition. Please note that the Companies Act only deals with equities (shares) and debentures and protects the *bona fide* purchaser on the relevant register. The section of the Companies Act does not apply to all levels of the holding chain. Note further that this section does not apply to other financial instruments or other securities, such as bonds and money market instruments. In the case of bonds, the South African common law applies and in the case of dematerialised Money Market Securities, the CSD rules contain a similar rule as the one contained in the Companies Act for equities for the protection of the *bona fide* purchaser.

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

Not applicable to shares, etc. But, the common law rule applies to other securities that do not fall under the Companies Act.

**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.)?*

The standard of care is more strict: Section 91A(3)(c) provides: “Transfer of ownership and membership in accordance with paragraphs (a) and (b) shall occur notwithstanding any fraud or illegality which may affect the uncertificated securities in respect of which the transfer was effected or which may have

resulted in the transfer being effected: Provided that a transferee who was a party to or had notice of the fraud or illegality may not rely on this paragraph." (my own emphasis).

(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.)?*

The section contemplates protection vis-à-vis an "adverse claim", unauthorised claim, specifically a fraudulent claim or an illegal claim.

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

There is no special provision for organisations.

**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).*

There exists no South African case law on intermediated uncertificated securities on this point, but there is case law on the common law rule that applies to certificated securities.

*Oakland Nominees (Pty) Ltd v Gelria Mining & Investment Co (Pty) Ltd* 1976 (1) SA 441 (A): The plaintiff was seeking to vindicate his scrip out of the possession of a *bona fide* purchaser or holder. At the time, the *bona fide* purchaser of registered securities did not enjoy, by means of either the common law or statutory law, protection equal to that pertaining to negotiable instruments (*Kahn v Volschenk* 1986 (3)SA 84(A)). If, in fraud of the true or beneficial owner, the nominee disposed of them to an innocent third party, such owner might vindicate the shares unless the third party could establish an estoppel against him. Thus, subject to all the requisites for estoppel being established, the certificate operated to estop the company from denying the correctness of any statement contained in it. The limited protection afforded to the *bona fide* purchaser and the uncertainty of certificated transfers following the case of *Oakland* has since been successfully addressed in section 91A of the Companies Act.

**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.*

The CSD, Strate Ltd, provides simultaneous, final and irrevocable "delivery" versus payment (DvP) which ensures the legal transfer of ownership with simultaneous secure transfer of value.

Transfer of ownership happens on a register which is prima facie evidence of any matters directed or authorised to be entered therein by the Companies Act.

The CSD Participant is responsible for entering the required information on the register and for ensuring the correctness of all transfers of uncertificated securities effected by the Participant (s 91A(3)(c)).

Only a CSD Participant may effect the transfer in the register it maintains (s 91A(5)(a)).

The CSD Participant will only do the transfer on the receipt of an instruction to transfer sent and properly authenticated in terms of the CSD rules or by order of court (s 91A(5)(b)).

Besides the legislative protection offered to a *bona fide* purchaser in section 91A(4)(c) of the Companies Act, another protective rule applies with regard to the rectification of the uncertificated registers by the courts. A section in the Companies Act (s 91A(4)(cA)) excludes rectification orders on electronic registers evidencing the holders of uncertificated securities. It provides that a court may not order the name of a member to be removed from a register, unless such person was a party to or had notice of fraud or illegality as contemplated in section 91A(4)(c) [the *bona fide* rule].

The South African Companies Act therefore weakens the position of the dispossessed owner with regard to the remedies of vindication and rectification of the register. It does so for a compelling policy reason. The reason, in essence, is that in balancing the rights of the dispossessed owner with those of the *bona fide* purchaser for value, the rights of the latter must prevail over the former.

Where unauthorised transfer takes place, the owner will have recourse against the CSD Participant for breach of contract, unless the fraud took place through his or her own negligence. The amount of compensation paid to the dispossessed owner can therefore be used to buy in new, but similar, securities.

The Companies Act does not affect any of the common law remedies available to the original owner, namely the action for damages, action on negligence, and the criminal claim against the thieves or perpetrators of fraud. The Companies Act also creates an additional remedy for damages.

**(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.

Yes.

**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)

It is submitted that paragraphs 1 and 2 could be combined in one paragraph. It is substantially the same and the conditions are similar. The specific differences can be combined in one paragraph to simplify the section. It is not necessarily clear, without reading the commentary, that any person ("another person") in paragraph 1 does not also include the intermediary and that paragraph 2 deals with that scenario. Also, the "defective entry" applies in fact to both paragraphs 1 and 2. It is implied that where an "interest" in paragraph 1 is erroneously or otherwise reflected and where the credit "violates the rights" of the other person, the credit entry is defective in one way or the other. If the purpose of the split of the two paragraphs is to ensure that the *bona fide* rule applies to the whole intermediary chain, I would submit it is expressly stated.

The inclusion of article 14(3) with regard to gifts remains interesting. The Convention deals primarily with the securities side and the "credit" of securities", (as opposed to the "credit and debit" entry); I do not believe in principle that the protection rule should be excluded where "no value" was given. I am aware that the article attempts to incorporate the "for value" principle of the standard common law protection, but it is submitted that a separate clause referring to gifts is confusing. The principle should either be included in paragraphs 1 and 2, or discarded. The "for value" principle limits the protection where gifts are made and is not equitable, since the *causa* of the "gift" or "gratuitous" transaction is completely valid en legal.

It is submitted that the reference to the account agreement or rules of a securities settlement system should apply to both scenarios.

(ii) *the definition of “defective entry”*

The definition of “defective entry” is in order.

(iii) *the special rule for organisations*

The special rule for organisations may be unnecessary. “Any” person includes organisations and the attribution of “knowledge” could follow normal interpretation of the relevant legal jurisdiction.

(iv) *the relationship of Article 14 with other provisions of the Convention, etc.?*

No comment.

**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.

**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.*

No further comment.

**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?*

I would prefer the second option (*a harmonised standard or clause in the Convention*) above the first option (*a reference to domestic law*) for the reasons as set out in the document. The third option of an autonomous test which functions as a safe harbour is most desirable. I agree that the wording could be more explicit.