



**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
Response to the questionnaire concerning acquisition by an innocent person**
(submitted by the delegation of France)

(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?*

The French Civil Code recognises, and French law generally has always recognised, the protection of the third party good faith purchaser, as provided by Article 2279 of the French Civil Code. There is currently no specific provision under French law which protects a good faith acquirer of securities.

However, a law reform project, currently in consultation on the Minister for the Economy and Finance website, introduces such a provision in the following terms:

Art. L. 211-13.- No one may claim ownership, for any reason, of a security whose ownership was acquired in good faith by the holder of the account in which those securities are registered.

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

No, the French Supreme Court (Cour de Cassation) refuses the benefit of the traditional protection to the acquirer in good faith, which results in Article 2279 of the Civil Code – “the fact of possession of asset is good title” (Article 2279 : “En fait de meuble, possession vaut titre”) – for the purchaser of an intangible asset.

Indeed, since the dematerialization of securities, financial instruments are considered as intangible assets not covered by Article 2279 of the French Civil Code.

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.)?*

(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.)?*

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

The law reform project makes reference to the concept of “good faith” and aims to protect the purchaser against any demand.

The content of the idea is a longstanding one in case law regarding tangible assets and the intention of the law reform project is to refer to that notion as construed and interpreted by case law.

Pursuant to the terms of this case law:

Is in good faith the one who, at the date of the acquisition, ignored the defects which affected the relevant act supposed to create its right; good faith is “the belief of the purchaser, at the time of the acquisition, that he is obtaining the item from the true owner”, “the belief of having contracted with the true owner”.

Conversely, is in bad faith, someone who had knowledge of the defects affecting the act or who even has acquired an asset from someone knowing that this last person was only a precarious holder.

However, French case law considers that good faith is incompatible with doubt. If the purchaser had any doubt as to the propriety of the other party, it can't be said to be in good faith. This rule is applied strictly by courts: they don't only consider the doubt that the purchaser effectively had, but also the doubt which he should have had; the mere fact that the purchase was made in suspect circumstances excludes good faith.

There is a presumption of good faith, it's up to whoever is contesting the purchaser's right to prove that he knew or that he could not ignore the defect affecting his right.

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).*

Given that the French Court of Cassation refuses the benefit of art. 2279 of the Civil Code to the purchaser of intangible assets (see *infra*), there is no decision interpreting or applying the notion of good faith in this context.

For an illustration from an other jurisdiction of the negative effects of the non-recognition of Article 2279 in respect of financial instruments; see the Maxwell jurisprudence, and particularly the judgment of Millett J, *Macmillan Inc v Bishopsgate Trust plc and others* [1995] 1 W.L.R. 978 – Court of Appeal [1996] W.L.R. 387.

On the other hand, there are decisions in French law which apply the *nemo plus juris* rule (Cass. Com. 24 janvier 1989, Bull. July 1989, 266) and authorise the *versus domino* to claim the securities from the sub-acquirer.

The uncertainty deriving from this case law has resulted in the inclusion, in the law reform project, of a specific rule designed to protect the good faith purchaser against any claim (see *infra*).

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 interest and purpose of the rule of the protection of the good faith purchaser must be specified in French law.

Since 2004, the transfer of ownership of securities is no longer made on a *solo consensu* basis but results from the registration of the securities to the credit of the purchaser's account.

That system limits the risks of conflicts of property rights, reducing in that way interest in a rule for protection of a good faith purchaser. Indeed, if a seller sells his securities twice, only the purchaser whose account was credited can prevail from a property right over those securities. The other purchaser, even coming first chronologically, only has a right of debt against the seller, and no legal claim is available against the purchaser to the account of whom the securities are registered.

The only circumstance where there could be a conflict of rights is where there has been a double registration on the account. This seems to have resulted only from an error (unlikely) or clerical fraud of the intermediary (more plausible), which situation cannot be resolved by the rule of protection of the good faith purchaser. For an illustration of fraud having led to civil and penal penalties, see "Cassation, chambre criminelle," 30 May 1996, *revue Banque et Droit* n°48, July-August 1996, p. 30, F Peltier and H. de Vauplane – H de Vauplane, JP Bornet, "Droit des marchés financiers", Litec, 3^{ème} édition, n° 1150 : in this questionable ruling, in the argument rather than the outcome, the High Court considered that the contract of custody of securities constituted a contract of deposit in order to retain the existence of the offence of abuse of confidence ("abus de confiance").

On the other hand, the rule of protection of the good faith purchaser is still necessary to protect the purchaser against a previous defective registration. Indeed, the registration in the account does not give rise to a right, it only operates so as to transfer the right and does not clear the right of the defect which might affect it.

(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.

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.

Like the German delegation, we are facing difficulties to understand § 8.b) in fine:

"in many legal systems and in relation to intermediated securities, the good faith principle may even lead to the result that both parties win".

According to us, there could not be two winners: the conflict between the *verus domino* and the good faith purchaser is resolved in favour of the purchaser. The *verus domino* will not be able to make a useful claim in respect of the securities, he will only have a claim against the relevant unscrupulous seller or intermediary. The intermediary could be ordered by a court to indemnify

through a non monetary compensation, but the securities will be registered in the account of the *verus domino* only by way of a non monetary compensation based on a liability suit, and not by way of a procedure of claim.

Besides, the special rule relating to legal entities doesn't seem clear to us. Does it introduce a specific temporal element – a date of assessment of knowledge different to the date of assessment set out in 14(1)? Does it determine the "physical" person in which the knowledge has to be assessed? Does it settle the question of how to combine responsibilities of the legal entity and of its management bodies?

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.

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 presentation of these arguments.

The French delegation remains most unsupportive of the insertion of a test as referred to in Article 14(4)(b).

➤ We're not against the substance: the content of the notion of bad faith insofar as it results from French case law is close to the idea expressed in the UNIDROIT project – it is bad faith for someone who knew of a defect or who had or could not be supposed not to have, taking account of the circumstances, suspicions about the nature or the quality of the right of the other party.

➤ We're opposed to the form:

1. The insertion of such a test is incompatible with our legal system.

(a) The French legal system is built on general principles and concepts laid down by the legislator, and interpreted by courts. This generality gives our legal system some flexibility and allows it to evolve easily to adapt to new realities. The insertion of the test would appear like a wart, an aberration...

(b) On the other hand, French law is designed as a coherent package. The test would introduce a split between the regime governing tangible assets and the regime governing intangible assets, leading to believe that the difference in nature would prevent applicability to intangible assets of principles applicable to tangible assets, depriving us of reasoning and solutions tested for a long time.

2. The insertion of such a test seems to be contrary to the choice expressed, to our knowledge, at the European level: the French delegation is very attached to the consistency of work conducted at European and international level, and it seems to be an agreement that if a good-faith purchaser rule is essential part of the legal European framework for book-entry securities, a harmonised good-faith test would be considered unnecessary.

If this choice is confirmed, it doesn't seem productive to us to have a different solution in the UNIDROIT project. Conversely, such a dichotomy would create legal uncertainties for participants.

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?*

The rule regarding the protection of the good faith purchaser is old and tested. We don't see any reason to reconsider it: it doesn't seem to us to be inadapted to the domain of intangible instruments; registration plays the role for intangible assets that possession plays for tangible ones.

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

No.