The Hague Securities Convention

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Outline

• Background of the Convention
• Scope
• Terminology
• Primary rule
• Fall-back rule
• Transition
• Opinion practice
Background – history

- Promulgated in 2006 by the Hague Conference on Private International Law
- Signed by the U.S. in 2006
- U.S. Senate advice and consent given in September 2016
- Instrument of ratification was submitted to the Netherlands on December 15, 2016
- April 1, 2017 – goes into effect
  - On the first business day after the three-month period following submission of the instrument of ratification by the third adopting country
  - U.S. and other adopting countries – currently Mauritius and Switzerland
  - Other countries expected to follow
- Convention will become effective in the U.S. on April 1, 2017
Background – rules concerning conventions

• ‘... an international agreement is to be interpreted in good faith in accordance with the ordinary meaning to be given to its terms in their context and in the light of its object and purpose.’ Sanchez-Llamas v. Oregon, 548 U.S. 331, 346 (2006)

• Treaties and conventions prevail over state law, Ware v. Hylton, 3 U.S. (3 Dall.) 15 199 (1796).
Background materials


• Forthcoming PEB Commentary, including amendments to UCC Official Comments, https://www.ali.org/permanent-editorial-board-ucc/
‘International’ aspect

- Convention by its terms ‘applies in all cases involving a choice of law between the laws of different States’ (Article 3)
- Examples: When any of the following are located in a different nation the choice-of-law rules of the Convention are likely to be implicated:
  - The account holder
  - An issuer of any of the securities
  - Any party to a transfer of securities
  - Any intermediary
  - Location of security certificates
  - Any adverse claimant (including those arising after closing)
- Applies whether or not the applicable law is that of a jurisdiction that has adopted the Convention (Article 9)
- Transacting parties should always consider the possibility that the Convention will apply
Terminology (Article 1)

- ‘securities’ – any shares, bonds or other financial instruments or financial assets (other than cash) or any interest therein
- ‘securities held with an intermediary’ – the rights of an account holder resulting from a credit of securities to a securities account
- ‘intermediary’ – a person that in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity.
  - Note that the definition of ‘intermediary’ includes a person that maintains securities accounts for itself – accommodates a title transfer arrangement common in the London market
Terminology (Article 1)

• ‘account agreement’ – agreement with intermediary governing the securities account
  ▪ May consist of more than one document

• ‘disposition’ – includes sales and creation of a security interest
Presentation

• ‘State’ (with an upper case ‘S’) refers to a nation
• ‘state’ (with a lower case ‘s’) refers to a unit of a multi-unit State (e.g., New York)
• ‘Article’ in this presentation refers to an article of the Convention, unless preceded by ‘UCC’
• All emphasis is added
Basic scope – choice of law and intermediated securities only

• Provides only choice-of-law rules, not substantive law (Article 2)
• Applies only to securities credited to a securities account held with an intermediary
No renvoi (except for the exception)

• Disapplies choice-of-law rules of applicable jurisdiction (renvoi) (Article 10)
  ▪ Akin to the UCC’s reference to “local law” of the securities intermediary’s jurisdiction
  ▪ Exception for multi-unit States and filing issues (discussed below)
Issues as to which Convention’s choice-of-law rules determine applicable law (Article 2(1))

- Package of issues, including:
  - Nature of the rights acquired in securities held with an intermediary
  - Nature and effects *against the intermediary and third persons* of a disposition of, or the creation or transfer of an interest in, securities held with an intermediary
    - Includes perfection, priority and duties of an intermediary to third parties asserting an interest in securities held with that intermediary
  - Requirements for realisation of an interest in intermediated securities
Limits on applicability

• No applicability to:
  ▪ Rights or obligations of issuers and transfer agents (Article 2(3))
  ▪ Contractual rights of parties to a disposition (Article 2(3)(b))
  ▪ Directly-held securities

• Does not provide choice-of-law rules for other types of collateral
Scope – comparison to UCC Articles 8 + 9

• These issues largely (but not completely) coincide with the issues set forth in UCC § 8-110(b) and UCC § 9-305(a)(3) that are governed by the ‘local law of the securities intermediary’s jurisdiction’ as defined in UCC § 8-110(e)
  ▪ The rights acquired in respect of securities held with an intermediary
  ▪ Issues involving perfection, the effect of perfection or non-perfection and the priority of a security interest in securities held with an intermediary
Scope – choice of law for creation of a security interest?

• Convention:
  ▪ ‘disposition’ defined to include ‘security interest’
    o ‘disposition of securities held with an intermediary extends to entitlements to dividends, income or other distributions, or to redemption, sale or other proceeds.’ Article 2(1)(g)
  ▪ Article 2(1) refers expressly to ‘perfection’ and ‘priority’
  ▪ Convention does not determine the law applicable to ‘contractual or other personal rights and duties of parties to a disposition of securities held with an intermediary’ Article 2(3)(b)
Scope – choice of law for creation of a security interest?

- *Explanatory Report:*
  - ‘For example, the granting of a security interest in securities held with an intermediary is a disposition within Article 2(1)(b), and, accordingly, the Convention determines the law applicable to the “effects against the intermediary and third parties” of the security interest.’
  - Convention does not govern ‘contractual relationship between ... parties to a disposition inter se.’
  - Convention governs ‘exercise of ... power’ to sell collateral upon default
Scope – choice of law for creation of a security interest?

• Conclusion: Secured party’s property interest in the collateral *as against the debtor* is determined under non-Convention law, *i.e.*, the UCC
  ▪ Third party effects of the property interest are governed by the law applicable under the Convention
  ▪ Enforcement always governed by Convention rules

• Common creation opinion given under UCC choice-of-law rules
Article 4(1) – Primary Rule – part 1 – the account agreement

• ‘The law applicable to all the issues specified in Article 2(1) [Scope] is the law in force in the State expressly agreed in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law.’
  ▪ See Explanatory Report, ¶ 4-15 for discussion of meaning of ‘in force’ and its equivalence with the ‘law of’
• Similar (but not identical) to choosing the ‘securities intermediary’s jurisdiction’ under UCC § 8-110(e)(1) and (2)
  ▪ (e)(1): jurisdiction can differ from general governing law clause
  ▪ (e)(2): general governing law clause itself chooses the jurisdiction
  ▪ Note: Convention’s use of ‘in the account agreement’ v. UCC § 8-110 ‘an agreement . . . governing the securities account’

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Article 4(1) Primary Rule (cont’d)

• Suggested language to select the applicable law under the Convention (which must be part of the account agreement itself)
  ▪ ‘[New York law] [The law of New York] [the law in force in New York] governs all issues referred to in Article 2(1) of the Hague Securities Convention.’
  ▪ Can be made part of account agreement through an amendment to the account agreement
Article 4(1) Primary Rule (cont’d)

• Suggested language to select both UCC Articles 8 and 9 and the Convention in the account agreement (or an amendment):
  ▪ ‘The state of New York is the securities intermediary’s jurisdiction for purposes of the Uniform Commercial Code, and the [law in force in] [the law of] the state of New York is applicable to all issues specified in Article 2(1) of the Hague Securities Convention.’
  o Note that unless certain the securities account has only ‘securities’ covered by the Convention, the appropriate UCC language should always also be included
Article 4(1) Primary Rule (cont’d)

- Suggested language to select the applicable law under the Convention by an *amendment* to the account agreement (which may be in the control agreement):
  - ‘[Intermediary] and [account holder] agree that the [account agreement] is hereby *amended* to provide that [the law of [state]] [the law in force in [state]] applies to all issues referred to in Article 2(1) of the Hague Securities Convention.’
  - ‘[Intermediary] and [account holder] agree that the [account agreement] is hereby *amended* to provide that the state of New York is the securities intermediary’s jurisdiction for purposes of the Uniform Commercial Code, and [the law of the state of New York] [the law in force in the state of New York] is applicable to all issues specified in Article 2(1) of the Hague Securities Convention’
Article 4(1) Primary Rule (cont’d)

• Alternatively, the following formulation in the account agreement or an amendment works for the Convention and the UCC
  ▪ ‘The [account agreement] is governed by [New York law] [the law of New York] [the law in force in New York].’
Primary Rule – part 2 – Qualifying Office test

• The law designated in accordance with the Primary Rule applies only if the relevant intermediary has, at the time that the account agreement [or choice-of-law amendment] is entered into, a physical office in that State specified in the account agreement, that –
   a) alone or together with other offices of the relevant intermediary or with other persons acting for the relevant intermediary in that or another State –
      i) effects or monitors entries to securities accounts
      ii) administers payments or corporate actions relating to securities held with the intermediary; or
      iii) is otherwise engaged in a business or other regular activity of maintaining securities accounts; or
   b) is identified by an account number, bank code, or other specific means of identification as maintaining securities accounts in that State
Qualifying office test (cont’d)

• UCC does not have a counterpart
• Qualifying Office test – as applied in the U.S.
  ▪ How test is satisfied for a multi-unit country like the U.S. (Article 12(1))
    o The intermediary need only have an office in the country (‘State’), not the particular unit (state) whose law is chosen
    o E.g., if a securities intermediary has its sole office in Atlanta and the account agreement chooses the law of New York, the test is satisfied
Recognition of UCC Article 9 filing rules

• Convention Article 12(2)(b):
  ‘if the law in force in a territorial unit of a Multi-unit State designates the law of another territorial unit of that State to govern perfection by public filing, recording or registration, the law of that other territorial unit governs that issue.’

• Example: New York law account agreement; perfection is by filing
  ▪ Assume debtor is located in U.S. under UCC § 9-307’s rules
    o e.g., individual principally residing in New Jersey
    o e.g., Texas registered organization
  ▪ Suppose litigation in a New York forum
    o Result: NYUCC § 9-301(1)’s place-of-filing and ‘location’ rules are still good
Recognition of UCC Article 9 filing rules

• Note that under UCC § 9-305 the ‘securities intermediary’s jurisdiction’ – not the debtor’s location – always determines the effect of perfection or non-perfection and priority of a security interest in a security entitlement or securities account whether the method of perfection of the security interest is by filing or by some other method

  ▪ *Where to file* is governed under the UCC under the usual debtor location rules
Article 9 filing rules are recognized when debtor ‘located’ in U.S.

- **New York law** account agreement (Qualifying Office test met with office in U.S.); debtor is organized in **Delaware**
  - Under UCC, §§ 9-307(c) and 9-301(1) say to file in Delaware
  - Under Convention, start with Primary Rule (Article 4(1)): New York law applies, and
  - Under Convention Article 12(2)(b), Delaware is ‘another territorial unit of [the same] State [as New York]’
    - Result: Delaware filing is recognized
Article 9 filing rules are recognized when debtor ‘located’ in U.S.

• **New York law** account agreement (Qualifying Office test met with office in U.S.); debtor is organized under **German** law (German law does not ‘generally require[]’ filing for perfection (UCC § 9-307(c))
  ▪ Under UCC, §§ 9-307(c) and 9-301(1) say to file in District of Columbia
  ▪ Under Convention, start with Primary Rule (Article 4(1)): New York law applies, and
  ▪ Under Convention Article 12(2)(b), D.C. is ‘another territorial unit of [the same] State [as New York]’
  ○ Result: District of Columbia filing is recognized
Article 9 filing rules are recognized when debtor ‘located’ in U.S.

• Similarly for:
  - Registered organization organized under United States law, UCC § 9-307(f)
  - Branches or agencies of banks not organized under United States or State law, UCC § 9-307(f) and (i)
  - Foreign air carriers, if process agent is in U.S., § 9-307(j)
Treasuries, Fannies, Freddies, etc.

- Issuers’ regulations have their own choice-of-law and perfection-by-filing rules; e.g., 31 C.F.R. pt. 357.11
- Generally mirror UCC §§ 8-110(e) and 9-305(a)(3) and (c)(1), but does the Convention affect the regulations as it does UCC Article 9?
- Convention is later in time and self-executing
  - Whitney v. Robertson, 124 U.S. 190, 194 (1888)
  - See also Congressional Research Service, International Law and Agreements: Their Effect upon U.S. Law at 15 (Feb. 18, 2015)
Limits to recognition of UCC Article 9 filing rules: non-U.S. account agreement

- **English law** account agreement (Qualifying Office test met with office in England); debtor is Texas corporation
  - UCC § 9-307(e) says debtor is ‘located’ in Texas
    - If UCC choice of law applied: file in Texas per UCC § 9-305(c)(1)
  - Under Convention, start with Primary Rule (Article 4(1)): English law applies
    - Result: Convention means that U.S. forum looks to English law on where to file
      - Not to any jurisdiction’s Article 9 rules
      - Does not matter if England has U.S.-style filing system under UCC § 9-307(c)
Limits to recognition of article 9 filing rules (2): non-U.S. debtor

- **New York law** account agreement (Qualifying Office test met with office in U.S.); debtor is Ontario, Canada corporation with chief executive office in Toronto
  - Under UCC, § 9-307(e) is not applicable; § 9-307(b) and (c) say debtor is located in Ontario (because Ontario has good filing system)
    - Result under UCC: file in Ontario per § 9-305(c)(1)
  - Under Convention, start with Primary Rule (Article 4(1)):
    - New York law applies:
      - UCC §§ 9-307 and 9-305 say to file in Ontario, but Convention Article 12(2)(b) accommodates this **only** ‘if the law in force in a territorial unit [here New York] of a Multi-unit State [U.S.] designates the law of another territorial unit of that State [which Ontario is not] to govern perfection by public filing . . .”
      - Result: file with **New York** Secretary of State under Primary Rule
Fall-back Rules

• If the applicable law is not determined by the ‘Primary Rule’, a series of ‘Fall-back Rules’ (Article 5) come into play:
  ▪ Largely similar to UCC § 8-110(e)(3), (4) and (5)
Transition

• April 1, 2017: Convention applies immediately, even to pre-Convention deals
  ▪ Convention Article 16(1)
  ▪ Alternative would be lack of certainty
• Convention preserves pre-April 1 account agreement designations
  ▪ Convention Article 16(3)
  ▪ Must have Qualifying Office in designated State
• Convention preserves UCC Article 9 place-of-filing rules for filings within the U.S.
  ▪ Convention Article 12(2)(b)
  ▪ But the devil may be in the details
Transition – control (1)

- Perfection is by control; pre-April 1 account agreement designates New York
  - Under either UCC § 8-110(e)(1) or (e)(2)
  - Assume Qualifying Office in U.S.
  - No need to amend the agreement
    - Even if UCC § 8-110(e)(1) formulation was used instead of ‘Article 2(1) issues’
    - Convention Article 16(3) preserves ‘terms of an account agreement which would have the effect, under the rules of the State whose law governs that agreement [here, New York], that the law in force in a particular State [here, New York]’ is the applicable commercial law
  - If no Qualifying Office in U.S., Article 16(3) is inapplicable by its own terms
    - Fall-back rules would apply
Transition – control (2)

- Perfection is by control; pre-April 1 account agreement designates non-U.S. law, e.g. English law, under UCC § 8-110(e)(2)
  - But New York is designated as the ‘securities intermediary’s jurisdiction’ under UCC § 8-110(e)(1)
  - Assume Qualifying Office in the non-U.S. jurisdiction [here, England]
  - Result: in a U.S. forum after April 1, the non-U.S. choice of law will be determinative – it’s a question of English law in this case – we don’t know the answer!
    - Convention Article 16(3) preserves only
      - ‘terms of an account agreement which would have the effect, under the rules of the State whose law governs that agreement [here, England], that the law in force in a particular State’ is the applicable commercial law
Transition non-Issues – control (3)

- Perfection is by control; pre-April 1 account agreement designates *non-U.S. law* under UCC § 8-110(e)(1)
  - But the governing law clause provides for U.S. law:
    - *e.g.*, "‘Securities intermediary’s jurisdiction’ is England, but New York is otherwise governing law."
  - Result: the non-U.S. choice of law is preserved
    - *Convention Article 16(3)* preserves
      - ‘terms of an account agreement which would have the effect, under the rules of the State whose law governs that agreement [here, New York] that the law in force in a particular State [here, England]’ is the applicable commercial law
  - Assume qualifying office in non-U.S. State
Transition – filing

- Account agreement chooses U.S. law; pre-April 1 perfection is by filing
  - Assume debtor is ‘located’ in U.S. under UCC § 9-307’s rules
    - e.g., Individual residing in New Jersey
    - e.g., Texas registered organization
    - e.g., German entity ‘located’ in District of Columbia (UCC § 9-307)
  - Suppose litigation in a New York forum
  - Result: the familiar Article 9 filing continues to be recognized
    - Convention Article 12(2)(b):
      ‘if the law in force in a territorial unit of a Multi-unit State [here, New York] designates the law of another territorial unit of that State [here, New Jersey or Texas or D.C.] to govern perfection by public filing, recording or registration, the law of that other territorial unit governs that issue.’
Transition – filing (1): non-U.S. account agreement

- **English law** account agreement; debtor is Texas corporation
  - Suppose that before April 1, secured party correctly filed in Texas per UCC § 9-305(c)(1)
  - Does secured party continue to be protected on and after April 1, as evaluated by a U.S. forum?
    - As to April 1 and later completing claimant, start with Convention Primary Rule (Article 4(1)): U.S. forum looks to English law
    - Secured party’s status vis-à-vis an April 1 and later competing claimant is evaluated under English law
      - Convention Article 16(3) applies to pre-April 1 agreements but likely not filings
      - English perfection and priority rules apply
Transition – filing (1) non-U.S. account agreement (cont’d)

- Convention Article 15:
  ‘In a Contracting State [i.e. the U.S.], the law applicable under this Convention [i.e. English law] determines whether a person’s interest in securities held with an intermediary acquired after this Convention entered into force for that State [i.e. the post-April 1 competing claimant] extinguishes or has priority over another person’s [i.e. secured party’s] interest acquired before this Convention entered into force for that State.’

- Result:
  o Article 9 provisions are likely not directly relevant
  o U.S. parties will likely want English law advice on practical steps to take before April 1
Transition – filing (2): non-U.S. debtor

- **New York law** account agreement; debtor is Ontario, Canada corporation with chief executive office in Toronto
  - Suppose that before April 1, secured party correctly filed in Ontario per UCC § 9-307(b) and (c)
  - Does secured party continue to be protected after April 1, as evaluated by a U.S. forum?
    - Start with Convention Article 4(1): New York law applies
    - Next, Convention Article 12(2)(b) accommodates the existing Ontario filing only ‘if the law in force in a territorial unit of a Multi-unit State [here, New York] designates the law of another territorial unit of that State [which Ontario is not] to govern perfection by public filing . . .’
Transition – filing (2): non-U.S. Debtor (cont’d)

• Secured party’s status vis-à-vis a competing claimant is evaluated under New York law
  ▪ Here too Convention Article 16(3) applies to pre-April 1 agreements but likely not filings
  ▪ Convention Article 15 again

• Result: New York law on continuity of perfection and priority apply
  ▪ For perfection, should one borrow the 4-month grace periods under UCC § 9-316(a)(2) and(f)?
  ▪ For priority, UCC § 9-322(a), should one sometimes borrow UCC § 9-325?

• Filing in New York before April 1 is likely advisable
Opinions

• Any choice-of-law comfort starting April 1, 2017 will need to consider whether Hague Convention applies
• References to Federal law will include the Hague Convention starting April 1, 2017
• When the collateral includes intermediated securities, give consideration to whether the effect of the Hague Convention could render a particular UCC-limited opinion ‘misleading’ (e.g. providing a perfection by filing opinion under a clearly inapplicable UCC jurisdiction’s law)
Opinions – sample language for complete exclusion

‘We express no opinion as to the applicability or effect of the choice-of-law rules of the Hague Securities Convention for matters governed by Article 2(1) of that Convention.’
Opinions – goal: when possible have usual UCC rules apply

• If all of the following is true, UCC applies:
  ▪ Primary Rule applies
    ○ Account agreement (or amendment) chooses U.S. state, and

  ▪ At time account agreement (or amendment as to choice of law) entered into, there was a Qualifying Office in the U.S., and

  ▪ Choice-of-law rules in chosen state provide that ‘location’ of debtor for filing purpose is in U.S.
Opinions – sample assumption language starting April 1 – account agreement choice of law

• ‘We assume that ... the [account agreement] between [Intermediary] and [Debtor] provides that [add]:
  ▪ ‘[[New York] law] [the law of NY] [the law in force in NY] governs all issues referred to in Article 2(1) of the Hague Securities Convention.’
  ▪ ‘[[New York] law] [the law of NY] [the law in force in NY] governs the [account agreement]’
• Note: stated in present tense
Opinions – alternatives to assumption on account agreement choice of law

• Obtain certified copy of account agreement
• Rely on warranty or certificate from intermediary as to this provision of account agreement (presumably in control agreement)
  ▪ Rely on same from account holder?
• Amend account agreement (presumably in control agreement)
Opinions – sample assumption language starting April 1 – Qualifying Office

• ‘We assume that ... at the time that the [account agreement] [amendment to account agreement] was entered into the Intermediary had a physical office in [the United States] that [add]:
  ▪ ... met/satisfied the criteria set forth in Art. 4(1)(a) or (b) of the Convention’ [or]
  ▪ ... effected [or monitored] entries to securities accounts’ [or]
  ▪ ... engaged in a business or other regular activity of maintaining securities accounts’

• Note: stated in \textit{past tense} to coincide with effective date of account agreement or amendment setting choice of law
Opinions – alternatives to assumption on Qualifying office

• Take field trip and visit Qualifying Office (at time account agreement entered into)

• Rely on warranty or certificate from intermediary as to existence of Qualifying Office at time account agreement was entered into (presumably in control agreement)
Practice tip

• Obtain agreement of intermediary and debtor that they will not (further) amend the account agreement to change relevant choice of law provisions.