INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW
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DIPLOMATIC CONFERENCE TO ADOPT A CONVENTION ON SUBSTANTIVE RULES REGARDING INTERMEDIATED SECURITIES
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Comments

(submitted by the Government of India)

I. COMMENTS PER ARTICLE OF THE DRAFT CONVENTION

Article 1, Definitions

Definitions are not arranged in alphabetical order.

Article 1, Clause (a) - Definition of Securities

"Debentures" and "Units" of Collective Investment / Mutual Fund schemes may also be added.

Article 1, Clause (b) - Definition of Intermediated Securities

It is not clear why securities debited to a securities account are not included in the definition of Intermediated Securities. Considering that there are various general provisions in the draft Convention for regulating intermediated securities the definition of Intermediated Securities needs to be revisited.

Article 1, Clause (d) - Definition of Intermediary

It gives the impression that a securities account can be maintained even with an unregistered intermediary. This definition needs to be amended to save non-Convention law. If it is assumed that an intermediary will begin to offer its services after following the procedure of the country (registration etc.) where the service is being offered, same may be clarified in the explanatory materials relating to the Convention.

Article 1, Clause (k)(ii) - Compliance with the instructions of third party in the case of control agreement

The clause provides that the intermediary shall be obliged to comply with any instructions of the person (to whom the control is given) without any further consent of the account holder. This should be subject to prior notice to the account holder.

Article 1, Clauses (n) and (o) – Definition of Securities Settlement / Securities Clearing System

Sub-clause (ii) should provide for any other body other than a central bank as may be recognized by the non-Convention law.

Article 7 - Intermediated securities

This Article provides certain rights to the holder of intermediated securities. However, the draft Convention is silent about the obligations consequent to the holding of intermediated securities. The same may be included.

Article 10 - Grant of interests in intermediated securities

The words 'by other methods' is not necessary and may be deleted.

Article 12 - Evidential requirements

The Article provides that the non-Convention law determines the evidential requirements in respect of the matters referred to in Article 9 and 10 only. Article 11 (which provides for other methods under non-Convention law for the acquisition or disposition of intermediated securities) should also be included.

Article 14 - Acquisition by an innocent person of intermediated securities

In the Indian context, Section 10(3) of The Depositories Act, 1996 treats the security holder as the owner of the securities. The article under reference attempts to protect the interests of persons who have received credits in good faith. In law, if a person who has received a credit of securities in good faith and is subsequently deprived of his holdings due to adverse claims raised by a third party, this person is indemnified by the seller to the extent of replacement of securities. The right should be made available subject to the provisions in the non-Convention law.

In the Indian context, it means that an interest that has been created by an account holder in the securities held in the account but has not been notified to the intermediary will not have priority of claim. *I.e.*, if a pledge is not created as per Section 12 of the Depositories Act, 1996, then the depository or the participant need not take notice of it. Priority under Article 13 may be subjected to such requirements as laid down in Section 12 of the Depositories Act.

Article 18 - Effects of insolvency

The result of this provision is that all insolvency provisions of national laws are over-ridden with the exception of the carve-outs laid down in the said Article.

Article 23 - Loss sharing in case of insolvency of the intermediary

As per Article 7 all the rights belong to the account holder. However, as per Article 23, the account holder is being made liable to bear the shortfall in case of insolvency of the intermediary. There should be a mechanism that would indemnify the account holder in such cases. Indian laws provide for such indemnity under section 16 of the Depositories Act, 1996.

Article 28 - Definitions of Chapter VI

The definitions in clause 2 of the above Article may be arranged in alphabetical order.

Article 29 - Recognition of title transfer collateral agreements

It is not clear whether title transfer collateral agreement shall take effect in accordance with the terms of the law of a Contracting State or in accordance with the terms of the collateral agreement. If it is intended that the terms and conditions of the collateral agreement shall prevail, the Contracting State would have to ensure that the law is made accordingly to protect the interest of the collateral taker [*i.e.* the lender]. It should also ensure compliance to the requirements of Section 12 of Depositories Act with regard to registration of pledge.

Article 30, Clause 2(b) - Enforcement

Collateral securities may be realized and a close-out netting provision may be operated notwithstanding the commencement or continuation of an insolvency proceeding in respect of the collateral provider or the collateral taker. This should be subject to the condition that there is no fraudulent preference.

Article 31, Clause 1 - Right to use collateral securities under security collateral agreement

If and to the extent that the terms of a security collateral agreement so provide, the collateral taker shall have the right to use and dispose of the collateral securities as if it were the owner of them. This should be made subject to the provisions of non-Convention law as for instance, such acquisition in India attracts application of the Takeover Code.

II. COMMENTS ON THE PAPER SUBMITTED BY THE CHAIR OF THE INFORMAL WORKING-GROUP ON INSOLVENCY-RELATED ISSUES (CONF. 11 – DOC. 9)

The UNIDROIT Committee of Governmental Experts in its fourth session established a post–sessional Working Group chaired by UK to consider various insolvency–related issues arising from the text of the draft Convention on Substantive Rules regarding Intermediated Securities.

The Group has submitted its paper vide Study LXXVII - Doc. 97 in December 2007, which has been circulated by the UNIDROIT Secretariat for comments. This has resulted in a Report by the Chairman of the informal Working Group (CONF. 11 – Doc. 9).

Article 18 sets out the principal insolvency-related provision. It *inter alia* provides that nothing in the Convention affects any rules of law applicable in insolvency proceedings relating to the avoidance of a transaction as a preference or a transfer in fraud of creditors or rules of procedure relating to property under the control of an insolvency administrator. Further, Article 18 contains two specific reservations or caveats from the general rule, *i.e.* effects of debits, credits and instructions on insolvency operator or participant in securities settlement system (Article 24) and top-up or substitution of collateral (Article 33).

It appears that the text of this provision was taken from the terms of the Cape Town Convention on International Interests in Mobile Equipment. The result of this provision is that all insolvency provisions of national laws are over-ridden with the exception of the carve-outs laid down in the said Article. It is therefore necessary to examine the scope of carve-outs *vis a vis* the national insolvency law beyond those carve outs.

The paper has extensively discussed the scope of the aforesaid provision under Article 30(3) of the Cape Town Convention – Official Commentary on the meaning of the carve-outs, the justification for the current wording of Article 18 and other alternative approaches to the current

text, *i.e.* blanket protection of national insolvency law and extension of carve-outs. The Working Group observed that Contracting States should consider every provision of what might be termed as their general insolvency law so as to be satisfied that those provisions should be disapplied irrespective of whether or not their application is otherwise mandatory under their national legal frameworks. Contracting States should therefore, by ratifying / acceding to the Convention recognize the primacy of the rules of such a system, as regards irrevocability of instructions and finality of settlement. This is irrespective of what would otherwise be the effect of any rules of insolvency proceedings commenced in relation to such a participant if incorporated in their jurisdiction. The Group at the end concluded that the effect of the specific provisions of the Articles of the Convention cannot be ensured / made certain without first addressing the meaning / scope of Article 18 generally. Comments of countries on this paper are expected to be discussed in detail in the ensuing diplomatic Conference.

Indian Law on Insolvency:

The object of insolvency law is distribution of the effects of a debtor in the most expeditious, equal and economical mode and liberation of his person from the demands of his creditors when he has made a full surrender of his property. The Presidency Towns Insolvency Act, 1909 has jurisdiction of insolvency over the High Courts at Mumbai, Madras and Calcutta.

The Presidency Towns Insolvency Act exhaustively lays down as to what are the acts of insolvency, the powers of Courts to adjudicate a person as insolvent, restriction on the jurisdiction of the Court annulment of adjudication proceedings, consequences of an order of adjudication, submissions of a proposal for a composition in satisfaction of debts or for a scheme of arrangement of the affairs of the insolvent, conditions in which composition and schemes of arrangement are approved by the Court, control over the person and property of insolvent, discharge of insolvent, administration and distribution of the property of the insolvent, properties which would be available for payment of debts, realization of the insolvent property, appointments, duties, powers and functions of an Official Assignee and other insolvency-related procedural matters.

The provisions of the above Act are applicable to intermediated securities as well. As per said Act a debtor commits an act of insolvency in each of the following cases:

(a) if he makes a transfer of all or substantially all his property to a third person for the benefit of his creditors generally;

(b) if he makes a transfer of his property or of any part thereof with intent to defeat or delay his creditors;

(c) if he makes any transfer of his property or of any part thereof, which would, under this or any other enactment for the time being in force, be void as a fraudulent preference if he were adjudged an insolvent;

(d) if, with intent to defeat or delay his creditors, - (i) he departs or remains out of the States, (ii) he departs from his dwelling-house or usual place of business or otherwise absents himself, (iii) he secludes himself so as to deprive his creditors of the means of communicating with him;

(e) if any of his property has been sold or attached for a period of not less than twenty-one days in execution of the decree of any Court for the payment of money;

(f) if he petitions to be adjudged an insolvent;

(g) if he gives notice to any of his creditors that he has suspended, or that he is about to suspend, payment of his debts;

(h) if he is imprisoned in execution of the decree of any Court for the payment of money.

Akin to that of the Presidency Towns Insolvency Act, 1909 is the Provincial Insolvency Act, 1920 providing for the law relating to insolvency in places other than the aforesaid three presidency towns.

Corporate Insolvency:

In the context of corporate insolvency laws, the word "insolvency" has neither been used nor defined in the Indian legal framework governing Companies. However, Section 433(e) of the Companies Act of 1956, considers a company, which is "unable to pay its debts", and this becomes a ground for winding up of the company. Inability on the part of the Company to pay its debts would be a case where, a company's entire capital is lost in heavy losses; and no accounts are prepared; and filed; and no business is done for one year. In such circumstances, the Registrar of Companies makes out a clear case of “inability to pay debts”. These debts however, only include debts, incurred after the legal incorporation of the Company. Inability to pay debts has even been amplified in Section 434 of the Companies Act, 1956, wherein, a creditor, with a due of Rs. 1,000,000 or more serves a demand by registered post and the company neglects to pay, secure or compound the same in 3 weeks; and in cases where the execution of a decree returns unsatisfied; and also where the Court is otherwise satisfied that the company is unable to pay its debts.

It is clear from the above that the insolvency law in India provides for acts of insolvency beyond insolvency proceeding relating to the avoidance of a transaction as a preference or a transfer in fraud of creditors. Therefore, if the proposed text is accepted, the Convention will override the provisions of our insolvency laws.

We may therefore, while agreeing with the comments of the Working Group, request for redrafting of Article 18 to save the non-Convention law.

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