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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

Response to the questionnaire concerning acquisition by an innocent person

(submitted by the Greek delegation)

The Greek delegation takes the opportunity to thank and congratulate the Chairman of the Working Group and the remaining drafters of Document 96 for the clarity thereof and has the pleasure to answer as follows 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?*

Law 2198/94 on government securities in book entry form provides in Article 7 for a rule protecting the good faith acquirer of dematerialised government securities held with the System for Monitoring Transactions in Securities in Electronic Book-Entry operated by the Bank of Greece (BoGS).

For all other securities in book entry form, i.e. for the securities held with the Dematerialised Securities System (DSS) operated by the Hellenic Exchanges (HELEX), there is no special rule on "innocent/good faith acquisition" for book entry securities.

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

The existence of a special provision as to the safeguarding of the *bona fide* acquisition in terms of securities held with the BoGS, should not be taken as leading - through the use of a contradistinction argument - to the non protection of the *bona fide* acquisition as to the securities held with the DSS. On the contrary, it could give rise to the opposite conclusion - i.e. for the protection of the *bona fide* acquirer also of securities held with the DSS - as it will be analysed below.

In order to respond to the question posed, one must, first, take into consideration a) the provisions of law 2396/1996, subject of which is the legal character of rights as to the dematerialised securities held with the DSS and b) the provisions of the Hellenic Civil Code (HCC), which touch upon the *bona fide* acquisition of ownership over chattels.

Rights of "ownership" in the dematerialised shares held with the DSS are created through registration of the securities in the accounts held through Operators within the DSS. Law 2396/1996 (as modified by Law 2533/97 and Law 2651/1998) states that vis-à-vis the issuer, the beneficiary-shareholder is the person registered in the records of the DSS. Additionally, Article 8b para. 7 of law 2190/1920 on *sociétés anonymes*, as recently amended, defines that the transfer of dematerialised shares is effectuated through a relevant registration in the register, in which the securities are held; as for registered shares the person registered in the securities' register is considered vis-à-vis the issuer the shareholder. In that respect, according to the aforementioned provisions, the registration within an account of the DSS is proof of the rights emanating from the relevant securities. Therefore, it could best be interpreted that this registration is a constitutive one and that the account holder's rights are originally created at the moment when his account is credited with the securities in question. Nonetheless, this interpretation has not been judicially confirmed. It could not be excluded that the general principles of law as to that no person may transfer a more extensive entitlement than that which is vested in them (*nemo dat quod non habet* or rather *nemo plus juris ad alium transferre potest quam ipse habet*), apply also in particular circumstances.

One must, thus, examine also the relevant provisions of the HCC, which protect the acquirer of a chattel in case that the latter has been transferred by a non domino, unless this acquirer is acting in bad faith, i.e. if it "*knows or ignores due to gross negligence*" that the chattel does not rightfully belong to the seller (Articles 1036 and 1037 HCC). Such a protection is not given in case that the chattel has been the object of theft (Article 1038 HCC).

In order to protect transactions' certainty and market integrity, the HCC sets the acquirer's protection one step further by protecting the acquirer in good faith of cash or bearer titles even if such goods have been stolen from their rightful owner or lost. The same protection is applicable for any movable sold through auction or in a market (Article 1039 HCC).

The question raised, however, in the particular case, is which rules apply to dematerialised securities in book-entry form: those pertaining to chattels or those applicable in the case of immaterial rights? In other words, do securities in book entry form constitute chattels in accordance with the HCC or is it possible that they entail the character of intangible property - immaterial rights? Albeit in the legal theory predominates the view that concerning dematerialised securities in book-entry form the rules pertaining to chattels apply, even the opposite view is represented and no relevant case law exists.

If, however, it was to be accepted that dematerialised securities in book-entry form held with the DSS should be considered as chattels – an opinion that we consider more appropriate and one that dominates in theory – then the wide protection of the *bona fide* acquisition of ownership in any case of transfer of securities in a market (regulated market, MTF or through a market maker), ought to be accepted.

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 is no case law regarding dematerialised securities on this point of law.

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 proposed provision of Article 14 is not in conflict with the provisions of the Greek law, given that:

a) The definition found in Article 1037 HCC concerning the protected good faith of the acquirer does not contradict with the proposed provision.

b) The general protection awarded by Article 1039 second indent of the HCC is not in conflict with the draft content of the suggested provision, having also in mind the provision of Article 13 of the draft Convention (see comments of the Working Group on Article 14, Doc. 96, under I.3.e). Namely, from the combination of Articles 13 and 14 of the draft Convention a stronger and objective protection of the acquirers of intermediated securities, especially in cases of transactions effectuated in a market may not be excluded.

(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 are of the opinion, nonetheless, that it is appropriate to make clear - either in the text of the draft Convention or through a clarifying footnote or in the report - that where an acquisition of intermediated securities by a person not covered in Article 14 (e.g. because he acts in bad faith or acquires gratis) (1st transfer), has preceded and such person transfers further to a person (account holder) acting in good faith and acquiring validly in accordance with Article 14, the defective 1st transfer does not influence the acquisition in the 2nd transfer. That is to say that it should not be possible to bring forward an argument against the *bona fide* acquirer in the 2nd transfer as to that his title springs from a defective (invalid) acquisition (1st transfer), affecting the status of his title.

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.*

(ii) Regarding the definition of defective entry, a reference to the rules of the SSS would seem useful by ensuring clarity of this provision. This could be done by either referring to the rules of the Securities Settlement System in the text of paragraph 4(a) or by adding, next to paragraph 2, paragraph 4(a) in the text of paragraph 5.

(iv) The relation of Article 14 with the transparent / direct holding systems – where functions of relevant intermediary are shared by more than one person – should be also examined alongside with the already proposed impact of Article 14 on Article 13.

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.*

An additional solution which could assist in surmounting, at least in the majority of cases, the issues connected with the definition of good faith, through an objective approach of the matter, would be the inclusion of a clause determining that the acquisition of intermediated securities through a transaction effectuated in a stock exchange (or a market being subject of rules and supervision) in accordance with the rules applicable therein, shall always be valid. We stress that as for transactions in stock exchanges a) these are executed always on the basis of a sale and not gratis (so the case of para. 3 of Article 14 is covered), b) it is rather difficult, in most cases, to ascertain the assignor, i.e. the person disposing of the securities, and c) an intermediary intervenes, independently liable vis-à-vis the person, the account of which has been debited with no legal cause, in which case the latter is entitled to seek protection on the basis of the rules governing its relationship with the intermediary.

The *bona fide* principle shall apply – pursuant to Article 14 – in any other case of securities' transfer.

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.*

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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 smooth functioning of the system - and the confidence on which it depends - requires some effort of coordination of different national legal systems as regards the protection of the good faith acquirer.

However, the notion of good faith may be considered as one of the cornerstones of any legal system and its relation to the sociologic perception of ethics of the social group which lives by the laws of a given legal system cannot be contested.

For this reason the approach of a minimum harmonisation general rule affirming the principle of protection of the good faith acquirer seems wise, in so far as it provides for a margin of adaptability of each system regarding the standard of care, especially paragraph 4(b) of the proposed text. However, we are of the opinion that - as already mentioned under 5a - an additional clause providing that the acquisition of securities in a market is considered always valid, would strengthen substantially the safety of transactions and release the contracting parties from the need to argue for and prove the existence of good faith.

Subject to Article 13 which allows for an even more intensive protection of the contracting parties, all of the above aims to ensure the certainty of transactions.

Consequently, a minimum harmonisation rule affirming the principle of protecting the "good faith acquirer" accompanied by an opt out mechanism according to which the Contracting States could i) opt out and refer the characterisation of "good faith" to the national law and ii) (through reference to Article 13) allow for more intensive protections as to the validity of transactions seems the best

possible solution, between neutrality and functionality, in order to ensure the goals of this Convention without jeopardising its success in the diplomatic session.

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

No. However, it would be perhaps useful to take into consideration a project initiated also by UNIDROIT in the period 1979-1984, concerning the drafting of a Convention on the protection of the *bona fide* acquirer, to supplement the 1964 UNIDROIT Convention relating to a Uniform Law on the International Sale of Goods. Even though such project was never finalised, a relevant preparatory report had been drafted by Professor Sauveplane which could be of assistance. Accordingly, please also look into the explanatory report of Ms Reichelt on the UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects where a reference is made in relation thereto.