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MÉMORANDUM CONCERNANT LES CLAUSES FÉDÉRALES AVEC DE NOUVELLES PROPOSITIONS DE DISPOSITIONS POUR UNE FUTURE CONVENTION DE LA HAYE SUR LA LOI APPLICABLE À CERTAINS DROITS SUR DES TITRES DÉTENUS AUPRÈS D'UN INTERMÉDIAIRE

préparé par le Bureau Permanent

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MEMORANDUM ON FEDERAL CLAUSES WITH NEW DRAFTING PROPOSALS FOR A FUTURE HAGUE CONVENTION ON THE LAW APPLICABLE TO CERTAIN RIGHTS IN RESPECT OF SECURITIES HELD WITH AN INTERMEDIARY

prepared by the Permanent Bureau

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Mémorandum concernant les clauses fédérales avec de nouvelles propositions de dispositions pour une future Convention de La Haye sur la loi applicable à certains droits sur des titres détenus auprès d'un intermédiaire

préparé par le Bureau Permanent

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Memorandum on federal clauses With new drafting proposals for a future hague convention On the law applicable to certain rights in respect of securities Held with an intermediary

prepared by the Permanent Bureau

Memorandum on Federal Clauses with new drafting proposals for a future Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary

prepared by the Permanent Bureau[1]

Introduction

1. For the last thirty years, specific clauses have been included in HCCH, Unidroit, UNCITRAL and, more recently, ICAO instruments to address the situation where a Contracting State does not have, with respect to private law, a unified system, *i.e.* where a State has two or more constituent units – usually referred to as "territorial units" in international treaties – in which different systems of law apply. This includes in particular situations where the State and one or more of its territorial units have their own substantive rules of law or conflict of laws rules, or where a State has two or more legal systems applicable to different categories of persons. The existence of non-unified systems cause a number of problems in connection with the preparation of conventions on private law. This memorandum intends to identify the specific issues relating to non-unified systems that may arise in the context of the current HCCH project on indirectly held securities and to indicate possible solutions to be included in the future securities Convention. Particular attention will be given to issues relating to the situation where a State is composed of several territorial units in which different systems of law apply. These specific issues are commonly referred to under the heading "federal clauses" (although provisions relating to inter-personal conflicts are sometimes also referred to as federal clauses, it may be more appropriate to place these rules under a separate heading).

2. As for HCCH instruments, the federal clauses have evolved from convention to convention, and their drafting adapted to the purposes of each instrument. In the more recent past of the HCCH *ad hoc* Committees have been set up, frequently during the final Diplomatic Conference and occasionally already during the preparatory Special Commissions, with a view to examine the problems posed by non-unified systems in the context of the discussion in progress. The Permanent Bureau suggests maintaining this practice for the securities project. However, in order to adapt the practice to the characteristics of this project (and in particular to the fact that the Convention is being negotiated on the basis of a fast-track procedure), it is suggested to start a broad consultation process on federal clauses *prior* to the Special Commission meeting scheduled to take place in January 2002. The purpose of this consultation should be to further examine the issues raised in this memorandum and to examine the set of provisions suggested therein. The provisions eventually agreed upon as a result of this consultation should be submitted in advance to all the experts attending the Special Commission meeting in January 2002.

[1] This document refers to the numbering of the "annotated July 2001 draft". The provisions suggested in this Memorandum have been inserted in Articles 9 and 10 of the "November 2001 draft".

3. This Memorandum distinguishes between two types of Federal State clauses:

- Federal State extension clauses (I.); and
- Federal State interpretation clauses (II).

I. Federal State extension clauses

4. Federal State extension clauses are designed to solve the problems that can arise because of the distribution of legislative power amongst several territorial units of a State. In some federal States like, for example, Canada, the treaty-making power rests with the federal government, while the treaty-implementing power may be shared, as per the legislative powers between the provincial and federal governments. Without an acceptable federal State extension clause, such federal States may be powerless to enter into international conventions without the support of all their territorial units. At best, this may result in inordinate delay in implementation and, at worst, will entirely prevent a federal State from becoming a party to the Convention. On the other hand, a well-formulated federal State extension clause allows the national government of these States to ratify a private international law convention with respect to one or more of its territorial units and to alter the declaration from time to time as more of its units desire to be brought within the scope of the convention.

5. Typically, such a clause would read as follows:[2]

> "1) If a State has two or more territorial units in which different systems of law are applicable in relation to matters dealt with in this Convention, it may at the time of signature, ratification, acceptance, approval or accession declare that the Convention shall extend to all its territorial units or only to one or more of them and may modify this declaration by submitting another declaration at any time.
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> 2) Any such declaration shall be notified to the depositary and shall state expressly the territorial units to which the Convention applies.
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> 3) If a State makes no declaration under this Article, the Convention is to extend to all territorial units of that State."

[2] See in particular Art. 55 of the *Convention of 13 January 2000 on the International Protection of Adults,* and Art. 59 of the *Convention of 19 October 1996 on Jurisdiction, Applicable Law, Recognition, Enforcement and Co-operation in Respect of Parental Responsibility and Measures for the Protection of Children;* see also Art. 24 of the *Inter-American Convention of 1994 on the Law Applicable to International Contracts*; Art. 18, paras. 1, 2 and 4 of the *Unidroit [Ottawa] Convention of 28 May 1988 on International Financial Leasing*; Art. 14, paras. 1, 2 and 4 of the *Unidroit [Rome] Convention of 24 June 1995 on Stolen or Illegally Exported Cultural Objects*; Art. 93, paras. 1, 2 and 4 of the *United Nations [Vienna] Convention of 11 April 1980 on Contracts for the International Sale of Goods*; Art. 56, paras. 1 and 2 of the *Montreal Convention of 28 May 1999 for the Unification of Certain Rules for International Carriage by Air*.

6. Hence, if for example the Government of Canada becomes a party to a convention and declares that the convention shall extend to provinces "A", "B" and "C", the international legal obligations fall on Canada as a sovereign State and are limited to the three provinces covered by the declaration. This is perfectly consistent with Article 29 of the Vienna Convention of 1969 on the Law of Treaties, which reads as follows: "Unless a different intention appears from the treaty or is otherwise established, a treaty is binding upon each party in respect of its entire territory."

✍✍ *There is no doubt that a clause dealing with the extension of the Convention into States that have distributed their legislative power amongst several territorial units has to appear in the future Hague Convention on indirectly held securities. As a matter of fact, the text quoted above already appears in Art. 16 of the annotated July 2001 draft. It may be that Art. 16 will require minor alterations to address changing concerns among States with a federal structure. It may also be worthwhile to discuss the possibility of renumbering the provision (i.e. to insert it at a different place).*

7. Several Conventions mentioned in footnote 2 2 contain an explicit rule, indicating that if, pursuant to a State's declaration, the Convention extends to some but not to all of the territorial units of that State, and if a relevant connecting factor of the Convention points to that State, this place is considered not to be in a Contracting State, unless it is in a territorial unit to which the Convention extends.[3]

✍✍ *A similar rule does not seem necessary in the future Hague Convention on indirectly held securities, as this Convention is most likely to be of general applicability and hence will apply whether or not the applicable law is that of a Contracting State.*[4]

II. Federal State interpretation clauses

8. These clauses are interpretative or definitional in nature and essential to a clear understanding of the manner in which the convention will apply with respect to a federal State. These clauses interpret or define terms or further refine certain provisions. At least two sub-categories of these clauses need to be distinguished:

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[3] See *e.g.* Art. 18, para. 3 of the *Unidroit [Ottawa] Convention of 28 May 1988 on International Financial Leasing;* Art. 93, paras. 1, 2 and 4 of the *United Nations [Vienna] Convention of 11 April 1980 on Contracts for the International Sale of Goods*.

[4] See *Report on the Meeting of the Working Group of Experts (15 to 19 January 2001) and Related Informal Work Conducted by the Permanent Bureau on the Law Applicable to Dispositions of Securities Held with an Intermediary*, prepared by the Permanent Bureau, Preliminary Document No 13 of June 2001 for the attention of the Nineteenth Session (hereinafter: Report on the Meeting of the Working Group of Experts (15 to 19 January 2001)) ; Art. 7 of the *Tentative Text on Key Provisions for a Future Convention on the Law Applicable to Proprietary Rights in Indirectly Held Securities*, submitted by the Permanent Bureau (annotated July 2001 draft) ; both these documents are available on the website of the Hague Conference on Private International Law (www.hcch.net), under the heading "Work in progress", sub-heading "Indirectly held securities".

A. Clauses on (non-)application of a convention to internal conflicts

9. It is true that a Contracting State in which different systems of law apply in matters covered by a specific convention may, if it wishes to, apply that convention's rules to resolve internal conflicts among these different systems of law. Most international treaties contain a rule that a State with different systems of laws is in no way bound to do so. Numerous Hague Conventions[5] and other international treaties[6] indeed contain a rule along the following lines:

> "A Contracting State in which different systems of law or sets of rules of law apply to the [subject matter of the Convention] shall not be bound to apply the rules of the Convention to conflicts solely between such different systems or sets of rules of law."

10. A similar clause appears in Option A of Art. 10, para. 1, of the "annotated July 2001 draft" for the future Hague Convention on indirectly held securities (see also Option B of Art. 10, para. 1, which is however based on the mechanism of a declaration).

✍✍ *Although there are good reasons for including such provisions in other treaties, it is most likely* not necessary to include a similar provision in the future Hague Convention on indirectly held securities: *Since Article 3 of the annotated July 2001 draft lays down that the Convention only applies 'in international situations' (see the heading of Art. 3, and the opening sentence: "This Convention applies in all cases involving a choice between the laws of different States"),* it is clear that it does not apply to internal conflicts*. Hence, inserting the language quoted above into the future Convention would be redundant. Furthermore, one may recall that the territorial scope of the Convention is defined in a rather broad way in Art. 3, as an international situation will (also) be given if any of the upstream intermediaries through which the securities are held is located in a different State than the account holder, pledgee/outright transferee, the relevant intermediary or the issuer of the securities.*[7] *Hence, there remains little room for a purely domestic situation to arise, for which the language quoted would be relevant. However, should the Member States of the Hague Conference (in particular those States in which different systems of law apply, but where there is no internal conflict of laws provision) wish to take a different approach in addressing the issue of purely domestic situations, a*

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[5] See in particular Art. 20 of the *Convention of 14 March 1978 on the Law Applicable to Agency*; Art. 18 of the *Convention of 14 March 1978 on the Law Applicable to Matrimonial Property Regimes*; Art. 20 of the *Convention of 22 December 1986 on the Law Applicable to Contracts for the International Sale of Goods*; Art. 33 of the *Convention of 25 October 1980 on the Civil Aspects of International Child Abduction*; Art. 21 of the *Convention of 1 August 1989 on the Law Applicable to Succession to the Estates of Deceased Persons*; Art. 38 of the *Convention of 29 May 1993 on Protection of Children and Co-operation in Respect of Intercountry Adoption*; Art. 46 of the *Convention of 19 October 1996 on Jurisdiction, Applicable Law, Recognition, Enforcement and Co-operation in respect of Parental Responsibility and Measures for the Protection of Children;* Art. 44 of the *Convention of 13 January 2000 on the International Protection of Adults*.

[6] See in particular Art. 19, para. 2, of the *Rome Convention of 1980 on the Law Applicable to Contractual Obligations* (Rome I), and Art. 24 of the *Inter-American Convention of 1994 on the Law Applicable to International Contracts*.

[7] See the comments under Art. 3 of the *Annotated July 2001 draft.*

clause similar to the one quoted above could easily be retained. As for the Securities Convention in general, the principal goal of any specific provision on internal conflicts has to be the avoidance of any doubt and the enhancement of ex ante *certainty.*

B. Clauses on the applicable law in particular

11. International treaties instruments often contain specific rules on how to apply the instrument in respect of a State comprising several constituent units (territorial or other governmental units or levels of government) within and among which different systems of law or sets of rules of law apply.

12. With regard to recent Hague Conventions, it appears that different methods have been used to determine the law of the territorial unit which is applicable, where the conflicts rule of the convention designates the law of a State with different systems of law: Certain conventions *directly designate the territorial unit*, the law of which will be applicable;[8] others adopt a two-stage approach and first *refer to the internal conflicts rules* of the State concerned, and, in the absence of such rules, either to the law of the territorial unit with which the situation has the *closest connection*,[9] or to the law of a territorial unit *directly determined* by the Convention.[10]

✍✍ *This disparate picture tends to reveal that the solution eventually embodied in a Convention largely depends on the subject matter and on the preferences of the Member States. Given the rationale of Option B of Art. 10 contained in the annotated July 2001 draft, a system of referring to a State's internal conflicts rules may more likely generate consensus than one that directly designates a territorial unit. Against this background, one may suggest the following language:*[11]

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[8] See Art. 19 of the *Convention of 14 March 1978 on the Law Applicable to Agency*; Art. 17 of the *Convention of 14 March 1978 on the Law Applicable to Matrimonial Property Regimes*; Art. 18 of the *Convention of 14 March 1978 on Celebration and Recognition of the Validity of Marriages*; Art. 19 of the *Convention of 22 December 1986 on the Law Applicable to Contracts for the International Sale of Goods*; Art. 31 of the *Convention of 25 October 1980 on the Civil Aspects of International Child Abduction*; Art. 23 of the *Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition*; Art. 36 of the *Convention of 29 May 1993 on Protection of Children and Co-operation in Respect of Intercountry Adoption*.

[9] See Art. 16 of the *Convention of 2 October 1973 on the Law Applicable to Maintenance Obligations;* Art. 49 of the *Convention of 19 October 1996 on Jurisdiction, Applicable Law, Recognition, Enforcement and Co-operation in respect of Parental Responsibility and Measures for the Protection of Children*.

[10] See Art. 16 of the *Convention of 14 March 1978 on the Law Applicable to Matrimonial Property Regimes*; Art. 19, para. 2, of the *Convention of 1 August 1989 on the Law Applicable to Succession to the Estates of Deceased Persons*; Art. 46 of the *Convention of 13 January 2000 on the International Protection of Adults*.

[11] See Art. 49 of the *Convention of 19 October 1996 on Jurisdiction, Applicable Law, Recognition, Enforcement and Co-operation in respect of Parental Responsibility and Measures for the Protection of Children,* and Art. 46 of the *Convention of 13 January 2000 on the International Protection of Adults*.

"Where, under Article 5, the place of the relevant intermediary is located in a State which comprises two or more territorial units each of which has its own system of law or set of rules of law in respect of matters covered by this Convention, the following rules apply –

a) if there are rules in force in such a State identifying which law or set of rules of law is applicable, that law or set of rules of law applies;

b) in the absence of such rules, any reference in this Convention to the place of the relevant intermediary in such a State shall be construed as referring to the place in a territorial unit."[12]

13. The reference in letter a) to rules "identifying which law or set of rules of law is applicable" is designed to take into account, for example, the situation of federal States, where, depending on the securities at stake, the rules eventually applicable might be either federal law *or* the territorial unit's law. With regard to such States, an explicit reference in letter a) to the law of "a territorial unit" would not be appropriate, as this might be construed as excluding the *federal* rules applicable in the territorial unit.

14. Under the suggested rule, the following fact pattern may raise some concerns: let us assume that the parties have agreed to locate the account in "the [federal] State X", that this federal State X has *no internal conflict of laws provision*, that the intermediary has *offices in several territorial units* of this State X and that the *regulatory supervision* requirement mentioned in Article 5 of the annotated July draft is exercised *by federal authorities or rules only*. In such a situation, letter b) would apply, but be of no help as the intermediary has offices in several territorial units. One might therefore wish to add language to the provision suggested before, indicating that in a situation like the one referred to above, a judge would have to refer to the list of objective fall-back elements enumerated in Article 5, paragraph 3 to determine which of the several offices of the intermediary is to be regarded as relevant. On the other hand, one might also reach the conclusion that this fact pattern is so unlikely that explicit language in the Convention is not necessary and that appropriate explanations in the Explanatory Report would suffice. The same Report should in any case underline that parties agreeing upon a location in a Federal State should always refer to the specific territorial unit they have in mind.

15. Finally, the suggested language seems also to provide a straightforward solution to States which, upon ratification, would find it useful to replace their internal rules on which of their territorial unit's law applies. These States could simply remove the existing rules from their legislation and use the Convention rules according to letter b) of the suggested language.

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[12] In order to align this provision with the new text of Art. 4 contained in the "November 2001 draft", the following amendment to sub-paragraph b) is suggested: "in the absence of such rules, any reference in this Convention to the place of the relevant intermediary's office or branch which maintains the securities account shall be construed as referring to the place in a territorial unit."

16. In some federal States, a special issue may arise where there are federal or national laws and regulations on the one hand (based on federal or central legislative power), *and* laws and rules adopted by and applicable within and among various constituent units on the other hand (based on legislative power of individual territorial units). Such a State, however, is most likely to have a set of rules identifying which law or rule is applicable (*i.e.* exclusively federal rules, exclusively rules of a territorial unit, or a mix of both). In other words, this situation would presumably fall under letter a).

17. Some of the Hague Conventions contain *more elaborate interpretation rules* in order to address the issue dealt with under letter b) in the provision suggested above (*i.e.* where the law of the State designated by the convention does not provide for rules on inter-territorial conflicts). Furthermore, it would appear that the broader the subject matter of the convention is, the more detailed this type of federal interpretation rule has to be. A good example of such a (complex) rule is provided by Art. 45 of the *Hague Convention of 13 January 2000 on the International Protection of Adults,* which reads as follows:

> "In relation to a State in which two or more systems of law or sets of rules of law with regard to any matter dealt with in this Convention apply in different territorial units -
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> a) any reference to habitual residence in that State shall be construed as referring to habitual residence in a territorial unit;
>
> […]
>
> c) any reference to the location of property […] in that State shall be construed as referring to location of property […] in a territorial unit;
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> […]
>
> f) any reference to the law of a State with which the situation has a substantial connection shall be construed as referring to the law of a territorial unit with which the situation has a substantial connection;
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> g) any reference to the law or procedure or authority of the State in which a measure has been taken shall be construed as referring to the law or procedure in force in such territorial unit or authority of the territorial unit in which such measure was taken;
>
> h) any reference to the law or procedure or authority of the requested State shall be construed as referring to the law or procedure in force in such territorial unit or authority of the territorial unit in which recognition or enforcement is sought;
>
> i) […]."

18. In general, HCCH Conventions are designed so as to localise spatial connecting elements favoured by the Convention in the territorial unit of that State.[13] This is probably why Art. 10, para. 2, of Option A in the annotated July 2001 draft contains a similar (although shorter) rule.

✍✍ *As the only connecting factor used in the future Hague Convention on indirectly held securities is the place of the relevant intermediary, the rule contained in letter b) of the provision quoted above seems to be sufficient. In particular, it does not appear necessary to draft similar rules to explain where "the location of the office or branch where the relevant intermediary treats the securities account" is with respect to a federal State (see e.g. Art. 5, para. 3, sub-para. a; see also sub-para. b of the same provision). These rules do not contain "connecting factors" in the true sense, but rather enumerate various elements which are designed to assist in determining the place of the relevant intermediary (i.e. the actual connecting factor). These elements may be regarded as referring to a State or a territorial unit of a federal State. However, it is only for the* ultimate *designation of the law of the place of the relevant intermediary that the future Convention needs a "federal clause" that indicates whether the reference designates the State or one of its territorial units.*

C. Rules on inter-personal conflicts

19. Finally, for the sake of comprehensiveness, one must also mention that there are States which have inter-personal conflicts, that is to say, States which apply separate systems of law or sets of rules to different categories of persons (see para. 1). All the Hague Conventions dealing with a applicable law issue, where the conflicts rules that they set out designate a State of this type, defer to the internal conflicts rules of this State. Certain conventions stop there, without providing a solution for cases in which the State concerned is lacking the internal conflict rules needed to make a determination.[14] Others fill in this gap and refer, in the absence of such rules, to the law of the closest connection.[15]

✍✍ *Given the subject matter of the future Hague Convention on indirectly held securities, it does not seem necessary to include a specific clause on inter-personal conflicts.*

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[13] For example, see Art. 31 of the *Convention of 25 October 1980 on the Civil Aspects of International Child Abduction;* Art. 36 of the *Convention of 29 May 1993 on Protection of Children and Co-operation in Respect of Intercountry Adoption;* Art. 45 of the *Convention of 13 January 2000 on the International Protection of Adults*. See also letter b) of the provision suggested above.

[14] See Art. 20 of the *Convention of 14 March 1978 on Celebration and Recognition of the Validity of Marriages*; Art. 32 of the *Convention of 25 October 1980 on the Civil Aspects of International Child Abduction;* Art. 37 of the *Convention of 29 May 1993 on Protection of Children and Co-operation in Respect of Intercountry Adoption*.

[15] See Art. 16 of the *Convention of 2 October 1973 on the Law Applicable to Maintenance Obligations*; Art. 20 of the *Convention of 1 August 1989 on the Law Applicable to Succession to the Estates of Deceased Persons*; compare Art. 19 of the *Convention of 14 March 1978 on the Law Applicable to Matrimonial Property Regimes*.

In summary, regarding the future Hague Convention on indirectly held securities, the Permanent Bureau suggests the following federal State clauses for further examination (these provisions are intended to replace both Options of Art. 10 included in the annotated July 2001 draft; furthermore, in an effort to restructure the provisions dealing with the federal State issue Art. 16 of the annotated July draft would become a new Art. 10):[16]

Article 10

1) If a State has two or more territorial units in which different systems of law are applicable in relation to matters dealt with in this Convention, it may at the time of signature, ratification, acceptance, approval or accession declare that the Convention shall extend to all its territorial units or only to one or more of them and may modify this declaration by submitting another declaration at any time.

2) Any such declaration shall be notified to the depositary and shall state expressly the territorial units to which the Convention applies.

3) If a State makes no declaration under this Article, the Convention is to extend to all territorial units of that State.

Article 10 bis

Where, under Article 5, the place of the relevant intermediary is located in a State which comprises two or more territorial units each of which has its own system of law or set of rules of law in respect of matters covered by this Convention, the following rules apply –

a) if there are rules in force in such a State identifying which law or set of rules of law is applicable, that law or set of rules of law applies;

b) in the absence of such rules, any reference in this Convention to the place of the relevant intermediary's office or branch which maintains the securities account shall be construed as referring to the place in a territorial unit.

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[16] The provisions suggested have been inserted in Articles 9 and 10 of the "November 2001 draft".