Conflict of Laws for Transactions in Securities Held Through Intermediaries

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James Steven Rogers†

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Introduction

Decades ago, the pattern of securities holding was fairly simple. Owners had possession of certificates. They transferred ownership by delivery of the certificates, plus, in the case of registered securities, surrender of the certificate to the issuer for registration of transfer. They pledged the securities by delivery of the certificates from the borrower to the lender. These practices also made issues concerning conflict of laws fairly simple. For debt securities in bearer form, possession was the key to ownership, and delivery of possession was the key to transfer or pledge. Thus, for purposes of conflict of laws, bearer certificates could be treated in the same fashion as any other tangible moveable object of property. The law governing a transaction involving a bearer certificate was determined by the

† Professor, Boston College Law School. The author served as a member of the United States Delegation to the Hague Convention and as a member of the Drafting Group for the Convention. The views expressed in this article, however, are solely the author's personal views. Thanks to Ingrid Hillinger and Harry Sigman for helpful comments on an earlier draft.
location of the certificate, an approach commonly referred to as *lex situs* or *lex rei sitae.* The law was only slightly more complicated for registered securities, for which the governing law was generally determined by the location of the issuer or transfer agent that maintained the official record of securities holding.2

In recent decades, conditions have changed dramatically. Although some individual investors still take possession of certificates, or are directly recorded on the books to the issuers of the securities as the holders, that is now the exception rather than the rule. Investors typically hold through accounts with brokers or banks. Brokers and banks, in turn, hold through accounts with other intermediaries, and, ultimately, through accounts maintained by central securities depositories.3 The change in patterns of securities holding poses challenges for the domestic substantive law. Different countries have responded to that challenge in different ways.4 The diversity of patterns of substantive law poses a particular problem for transnational securities holding. Traditional principles of conflict of laws indicated that the location of either the certificates or the issuer determined the governing law. That traditional approach is unworkable for modern indirect securities holding. Accordingly, the Hague Conference on Private International Law has undertaken a project to formulate a new set of conflict of laws rules for securities held through intermediaries.

The basic principle of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary5 is that where securities are held through an intermediary, the law that governs a transaction effected by entries made on the books of a securities intermediary is determined solely by the relationship between the investor and the intermediary. The Hague Convention rejects any approach under which the law governing a transaction in indirectly-held securities is determined by reference to connecting factors affecting the underlying securities.6 In

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2. Id. at 930-31.
6. ROY GOODE ET AL., EXPLANATORY REPORT ON THE HAGUE CONVENTION ON THE LAW APPLICABLE TO CERTAIN RIGHTS IN RESPECT OF SECURITIES HELD WITH AN INTERMEDIARY 18-19 (HCCH 2005) [hereinafter EXPLANATORY REPORT].
the initial stages of the discussion leading to the Convention, the thought was that the basic rule might be described as the “Place of the Relevant Intermediary Approach” or “PRIMA” rather than the “look through” approach.\(^7\)

Ultimately, however, the drafters of the Convention were forced to adopt a variant of the basic PRIMA approach. After long discussion in many fora, the drafters concluded that one could not really give coherent meaning to the notion of a “place” of the relevant intermediary. There was never any real dispute over the basic point that the law governing transactions in securities held with an intermediary should be determined solely by reference to factors involving the relationship between the investor and intermediary. However, the Convention ultimately adopted the principle that the law governing a transaction effected on the books of an intermediary is, in general, determined by the law selected by the intermediary and customer.\(^8\) This decision has proved somewhat controversial. A good deal of discussion of the wisdom of the approach taken in the Hague Convention has, regrettably, misidentified the issue as a choice between some version of a \textit{lex situs} approach and an approach based on party autonomy.\(^9\) That is simply a misunderstanding.

To see the point, suppose that Borrower borrows money from Lender, and, as collateral for the loan, grants Lender a mortgage on certain real estate owned by Borrower. Traditional conflict of laws principles would say that while Lender and Borrower can, by agreement, select the law that governs their own contractual duties, they cannot select the law that determines whether the mortgage is effective. The latter is a matter that affects the rights of others, such as other creditors of Borrower, and as such is not an appropriate subject for determination by agreement between Borrower and Lender. Rather, the law governing the effectiveness of the mortgage is determined by the location of the property.

Now suppose that Borrower holds securities through an account with Intermediary and wishes to pledge that securities position to Lender as collateral for a loan. It would indeed be unusual to say that Borrower and Lender can, by private agreement, determine the law governing the effectiveness of the pledge. Such an approach might aptly be called a “party autonomy” approach to third parties’ rights, and might well be criticized on those grounds. But, that is not what the Hague Convention does. The Hague Convention does not say that Borrower and Lender can select the law that will govern the proprietary effects of the transaction. Rather, the Convention says that the law selected by agreement between Borrower and

\(^7\) Id. at 19-20.

\(^8\) Hague Convention, \textit{supra} note 5, art. 4; \textit{Explanatory Report}, \textit{supra} note 6, at 19-20.

Intermediary—if that selection meets certain criteria—will govern any transaction between Borrower and Lender.

This article considers some of the basic issues that must be resolved in any effort to devise appropriate modern rules for conflict of laws for indirectly-held securities. It discusses in detail some of the provisions of the Hague Convention and some of the drafting history of that convention. It does not, however, attempt a detailed discussion of all of the elements of the Convention. At present, it remains uncertain whether the proposed Hague Convention will be widely ratified. Whether or not ratification occurs, the problems treated in the Convention will remain real. Accordingly, the issues confronted and solutions proposed in the Convention will be an essential part of the analysis of any lawyer or judge called upon to consider conflict of laws issues for indirectly-held securities.

The analysis begins in Part I by exploring the pervasive nature of conflict of laws problems in this field. Part II notes that the problems are particularly difficult because the key lawyer role in this area is planner rather than litigator. Part III outlines some of the problems presented by the tendency to use abstract hypothetical fact patterns in exploring problems in this field. Part IV explores the difference between conflict of laws problems and substantive law problems, demonstrating that the approach adopted by the Hague Convention is genuinely neutral—that is, it works regardless of the characterization of securities holding through intermediaries followed by various systems of substantive law. Part V describes the difficulties confronted in the Hague Convention drafting process in giving specific content to the notion that the governing law is determined by factors relating solely to the relationship between the intermediary and its customer. In particular, Part V explains why it is inaccurate to describe the Hague Convention as adopting a party autonomy approach to conflict of laws problems involving third parties' rights. The article concludes with an examination of matters that are not the subject of the Hague Convention. Part VI explains why regulatory issues are unaffected by the Convention, and Part VII examines in some detail the difference between the issues of property that are the subject of the Convention and the issues of contract that are unaffected by the Convention.

I. The Problem of Non-Uniformity of Conflict of Laws Rules

Suppose we are representing either Borrower or Lender in a proposed transaction in which a loan is to be secured by a pledge of a security held by the borrower through an account with a broker or bank (Intermediary). For simplicity, suppose that however we might define “location,” each of Borrower, Lender, and Intermediary are located in a certain jurisdiction,


11. For convenience the term “pledge” is used herein to refer to any form of security interest in securities, whether held directly or indirectly, rather than in the narrower sense of a possessor interest in a securities certificate.
"Atlantis." Suppose further that the substantive law of Atlantis is quite clear and settled on how one establishes an effective pledge of securities held through an intermediary. On these assumptions, any litigation concerning the pledge is bound to involve only parties located in Atlantis. Given these simplifying assumptions, one would think that no difficult conflict of laws issues would arise. The substantive law of Atlantis should determine whether the pledge is effective, that is whether the transfer from Borrower to Lender of the rights that Borrower had is effective against Borrower and Borrower's creditors. Oddly, traditional conflict of laws principles make it unlikely that these questions would be determined by Atlantis law, at least other than by fortuity.

Under traditional conflict of laws principles, these questions are matters of proprietary rights in the collateral, and the securities are the collateral. Thus questions concerning the pledge would be determined by the substantive law of the jurisdiction in which the securities are located. That location may vary somewhat depending on the nature of the securities. If the securities are represented by certificates in bearer form, the location will be the physical location of the certificates. If the securities are in registered form, the location is probably the location of the issuer or of the transfer agent that maintains the registry. If these jurisdictions happen to be Atlantis, then there is no conflict of laws problem. But, if Borrower holds securities of a non-Atlantis issuer, or securities for which the certificate may be located outside of Atlantis, then the transaction cannot be safely implemented on the basis of Atlantis law alone. Rather, the parties would have to consider how to implement a pledge under the law of the jurisdiction where the securities are considered to be located.

The problem becomes even more severe if the collateral is to be a collection of securities issued by issuers in different locations. Suppose that Borrower proposes to pledge to Lender all of the securities carried through the account, or, what comes to the same thing, the account itself. Suppose that Borrower carries through the account securities of dozens or hundreds of different issuers and that the issuers of the securities are located in dozens of different jurisdictions around the globe. The traditional conflict of laws approach would regard the proposed transaction as a pledge of a variety of items of property and would analyze the conflict of laws issue security by security. Thus, the parties could not implement the transaction with any degree of confidence unless they felt relatively sure that the method of pledge would be effective under the law of each of the jurisdictions where the underlying securities would be regarded as being located.

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12. Some jurisdictions have already revised their own conflict of laws rules to take account of these problems. For example, if litigation occurs in one of the states of the United States, and an issue arises concerning the law that governs the effectiveness of a security interest in indirectly-held securities, current U.S. law, adopted as part of the U.C.C. Article 8 revision project, provides that the governing law is determined by the agreement between the account holder and intermediary. See U.C.C. §§ 8-110(b), (e), 9-305(a)(3) (2004).
Thus far we have made the simplifying assumption that Borrower, Lender, Intermediary, and any other parties who might have an interest in the effectiveness of the pledge are located in Atlantis. Now, suppose that any or all of Borrower, Lender, and Intermediary are engaged in activities in jurisdictions other than Atlantis. Suppose that a lawyer implementing the proposed transaction is asked "Which state's law will determine the effectiveness of the pledge?" The answer, distressing as it may be, is that that question cannot be answered.

II. Conflict of Laws—Litigator Versus Planner

Consider how the subject of conflict of laws is typically presented. A standard American treatise on the subject begins as follows:

What is the subject matter of the conflict of laws? A fairly neutral definition . . . is that the conflict of laws is the study of whether or not and, if so, in what way, the answer to a legal question will be affected because the elements of the problem have contacts with more than one jurisdiction . . .

A classic conflicts problem will help clarify this rather abstract definition. A husband and wife reside in state X. They go for a short pleasure drive into state Y. While in state Y, because of the husband's negligence, the automobile runs off the road and the wife is injured. Under the law of state X, a wife may sue her husband to recover damages that she has suffered because of his negligence. State Y, however, does not permit such suits between wives and husbands.\(^\text{13}\)

Note what is implicit in that description: the events have occurred, a lawsuit has been brought or is contemplated, and the question is which state's law the forum court will apply. Law is seen through the eyes of the lawyer as litigator.

Recall the scenario with which we began. Borrower wishes to borrow from Lender and offers as collateral securities held through an account with Intermediary. The lawyer is called upon not to initiate or defend a lawsuit, but to decide whether the transaction can be done with a fair degree of safety and, if so, how to implement the transaction. The key lawyer role is planner. If the lawyer cannot, with a reasonable degree of certainty, determine the legal consequences of the proposed implementation, the advice is likely to be that the deal should not be done. Consider the following anecdote recalled by the prominent Canadian business lawyer, Bradley Crawford:

[A] few years ago I was unable to complete a transaction for a short-term secured loan by a Canadian bank to a Canadian life insurance company after a week of trying to piece together the legal advice necessary to do the deal. The security for the loan was to be bonds of a foreign issuer that had been deposited into Cedel (now Clearstream) in Luxembourg. The physical certificates were actually being held in safekeeping in the Cayman Islands, for tax reasons, and could not be moved. The bonds were owned not by the Canadian life company directly, but by its French subsidiary, which had its chief executive offices in Paris. Five law firms struggled for a week to figure out

\(^{13}\) RUSSELL J. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS 1 (2d ed. 1980).
To the lawyer as litigator, lawsuits are the world. To the lawyer as planner, a lawsuit is the underworld. The question is not what happens once we have crossed the Styx, but how to stay on this side.

Consider the steps in conflict of laws analysis from the standpoint of lawyers playing various different roles, such as judge, litigator, and planner. The judge has the easiest task. A lawsuit has been filed in the judge's court. That fact alone resolves the question of which state's conflict of laws rules to apply. Of necessity, a forum court always applies its own conflict of laws rules. To be sure, there may be difficulties in the application of those conflict of laws rules, but at least the judge knows which rules to apply.

The litigator has a slightly more difficult task. For defense counsel, the problem is basically the same as that of the judge. The lawsuit has been filed, and the forum court's conflict of laws rules will determine which state's substantive law will be applied. For plaintiff's lawyer, the task is a bit more difficult. Plaintiff's lawyer must first consider where to file suit. For example, in the simple case of the husband and wife who reside in State X but were involved in an automobile accident in State Y, the wife's lawyer must decide whether to sue in State X or State Y. As part of that decision, the lawyer will consider the conflict of laws rules that would be applied by courts in States X and Y.

Now consider the issue from the standpoint of lawyer as planner. Suppose that before any accident has occurred, Wife asks whether it is safe to drive with Husband. Realistically, the answer is that it depends on how good a driver Husband is. But, passing that point, suppose that Wife says that she is willing to run the risk of Husband's poor driving, so long as she will be able to sue him in the event that his negligence causes an accident. A litigator would ask, "Where did the accident take place?" Wife, of course, would say "I don't know, I hope there isn't any accident." The litigator might persist and ask, "But if there is an accident, where will it take place?" Wife, becoming more frustrated, might respond, "We are planning an automobile trip that will take us all around the globe, through several hundred countries."

The lawyer will have to set aside the litigator role in favor of the planner role, and will have to proceed through several steps. First, the planning lawyer must surmise what sorts of things might go wrong that would lead to litigation. Second, the planning lawyer must consider where litigation might be brought. That depends not only on what happens but also on the rules of various jurisdictions concerning personal jurisdiction. Third, for

each possible forum location, the planning lawyer must consider what con­

flict of laws rules the courts of that jurisdiction would apply. Fourth, the
planning lawyer must consider what result would be reached applying the
substantive law determined by the answers to the previous questions.

Now, return to the scenario of Borrower who wishes to pledge to
Lender securities held through an account with Intermediary. Assume that
Borrower, Lender, and Intermediary are each engaged in activities in multi­
ple jurisdictions. The question that a lawyer planning the transaction
wants to ask is “Which state’s law will determine the effectiveness of the
pledge?” But as the simple hypothetical of Husband and Wife illustrates,
there really is no answer to that question.

First, the planning lawyer must consider what sorts of litigation might
arise in which the question of the effectiveness of the pledge might be
raised. Next, the planning lawyer must consider where such litigation
might arise. In the insolvency context, that would depend on the nature of
Borrower’s business, the states in which it conducts operations, and the
law of all of those potential states concerning the jurisdiction of the insol­
vency courts of that state. Having made what can only be termed an edu­
cated guess about the possible places where litigation concerning the
effectiveness of the pledge might be brought, the planning lawyer must
then consider the conflict of laws rules that would be applied by the courts
of each of those states. If any of those states follows the approach to con­
flict of laws under which the question of the effectiveness of a pledge is
determined by the location of the property, then the planning lawyer must
determine the likely location of the pledged securities. If the proposed col­
lateral is to be all securities carried through the account, and if Borrower
has a diverse international portfolio, then there may well be dozens or hun­
dreds of jurisdiction to consider.

Note that a significant element in the conflict of laws analysis is pre­
dicting the likely fora. In a case of the sort we have been imagining, where
a single borrower is contemplating a pledge to a single lender, the number
of possible jurisdictions that must be considered can probably be deter­
mined by considering the nature of the borrower’s business. But, consider
another scenario in which the conflict of laws issue is even harder to
resolve. Suppose that the planning lawyer is advising Intermediary. Inter­
mediary has customers in a large number of different states. Suppose that
the timing of purchases of securities by Intermediary’s customers is not
exactly simultaneous with the payment for those purchases. Intermediary
then faces some degree of risk that it will not receive payment for
purchases that have been credited to the account. As a business matter, the
solution to that problem is simple. The agreement between Intermediary
and its customers will say that if the customer does not make final pay­
ment, then Intermediary can reverse any credit that was made to the
account. As a legal matter, however, it is not so simple to categorize Inter­
mediary’s right.

One possibility is to say that Intermediary has credited the account,
but that Intermediary has a security interest in the positions to secure the
customer's obligation to pay. Another possibility is to say that Intermediary has not "really" credited the account, but has just made some provisional entries that will "actually" result in a credit to the account only if customer makes payment. If Intermediary knows which jurisdiction's law would determine its rights, and if that jurisdiction has simple rules on security interests, then Intermediary can safely proceed. If, however, there is doubt about the effectiveness of such a security interest, then Intermediary might conclude that it is worthwhile to go through the accounting and documentation nuisance that may be required to support an argument that any credits made for unpaid positions were only provisional.

How can the planning lawyer decide whether to advise Intermediary that it is safe in relying on a security interest structure or to make the effort that may be required to support a "provisional credit" argument? Suppose that the law is clear in Intermediary's home jurisdiction that the security interest structure works. That conclusion does no good unless the planning lawyer can safely conclude that the law of Intermediary's home jurisdiction would be applied. Suppose that the planning lawyer finds that courts in Intermediary's home jurisdiction would apply a conflict of laws rule under which the effectiveness of the security interest is determined by the law of Intermediary's home jurisdiction. That is nice, but it is not particularly helpful unless the planning lawyer can predict with fair confidence that litigation on the matter will occur in the courts of Intermediary's home jurisdiction. If Intermediary has a significant international customer base, there is no way that the planning lawyer can reach that conclusion. The most likely forum in which the issue might arise would be an insolvency proceeding for the customer. The most likely forum for such a proceeding would be the customer's home jurisdiction, not the intermediary's jurisdiction. Thus, it is very hard for the planning lawyer to make an intelligent choice about how to structure its systems and documentation without knowing what conflict of laws rules would be applied by courts in every jurisdiction in which its customers are located.

Thus, if we think of conflict of laws questions for securities held through intermediaries from the perspective of a planning lawyer, we see that lack of consistency in the rules that would be applied by courts around the globe is a particularly pernicious problem. To be sure, it would be nice if the substantive laws of all countries around the globe were sufficiently consistent on these matters that the conflict of laws issues would be insignificant. It is, however, most unlikely that that will ever happen. There are genuine fundamental differences of approach to the basic structure of the substantive law of securities holding through intermediaries. In addition, there are major differences in how the law of securities holding through intermediaries is integrated into the rest of the corpus of the law. That issue might be treated as part of the commercial law, quite separate from the law governing other aspects of the internal operations of the intermediary. Or, the issue might be treated as part of the corporate or other law governing the activities of the entities that are engaged in the business. A jurisdiction might draw a sharp line between the commercial law of
securities holding and the regulatory law governing the activities of the entities that are permitted to engage in the business of maintaining securities accounts. Or, a jurisdiction might locate the law defining the rights of Customer and Intermediary in the regulatory law governing the business of securities intermediaries. It is unlikely that sufficient consensus on all of these matters can be achieved anytime in the foreseeable future.¹⁵

A striking example of the problem is provided by the recent experience of the United States and Canada. It would be hard to imagine two countries with more closely linked economies and legal traditions. The United States revised its substantive law of indirect securities holding in the early 1990s in revised Article 8 of the U.C.C. Shortly thereafter, a project was initiated to revise Canadian law in a fashion consistent with the U.S. revised Article 8.¹⁶ Extremely capable, diligent, and committed people have worked on the Canadian project for over a decade. But, it has proven to be a significant task to achieve an approach that is true to the rest of Canadian domestic law as well as consistent with the laws of the United States. There are, for example, significant differences between the United

¹⁵. Unidroit has recently undertaken a project to draft a Convention on Harmonised Substantive Rules Regarding Securities Held with an Intermediary. See UNIDROIT, Intermediated Securities - Study LXXVIII, http://www.unidroit.org/english/ work-programme/study078/item1/main.htm (last visited Feb. 22, 2006). While that project will certainly be useful in educating lawyers around the globe about the problems of the substantive law of indirect securities holding, and might provide a model for countries that have not yet undertaken any legislative action in the field, in the opinion of the present author there is no realistic prospect that any such convention will be widely adopted. Countries that have established capital markets have had to go through the difficult process of adapting their domestic law to the challenges of the modern indirect holding system. It is hard to see why any country that has already undertaken that task would go through the process again, yet that is what would be required to ratify any international convention on substantive law. As I have elsewhere noted:

[1]Implementing these fundamental principles within the domestic legal systems of particular states is perhaps the most challenging aspect of the task of modernizing the commercial law of the securities holding and transfer system. Here, as in any other branch of the law, general principles can be implemented in various ways in different legal systems. There has probably never been a legal system that did not proscribe murder and theft, yet one would hardly suppose that the existence of consensus on these fundamental points means that the law of major crimes is uniform among all nations or that a lawyer experienced in the law of crimes and criminal procedure in one nation could deal readily with another nation's laws on these matters. For essentially the same reasons, reaching consensus on the fundamental principles that should guide the modernization of the law of securities holding through intermediaries will necessarily be the beginning not the end of the effort to achieve a workable level of international harmonization. Differing local conditions and history are likely to make it necessary to implement the basic principles in different ways, because these basic principles cannot stand alone but must instead be integrated into the general corpus of each nation's own domestic law.


States and Canada on the division between federal and state or provincial authority and between matters that are treated as part of commercial law and corporate law. The experience of the United States and Canada strongly suggests that when attention is shifted to a broader global horizon, seeking uniformity on conflict of laws is a far more realistic objective than seeking comprehensive harmonization of substantive law.

Finally, it is important to remember that the principal users of this body of law are not litigators or judges. Planning, not litigation, is the key lawyer act that calls for resolution of issues of conflict of laws and substantive law on securities holding through intermediaries. The transactions commonly involve very large sums of money and therefore warrant careful planning. The key legal question may not be simply whether the pledge is effective, but whether a competent lawyer can give an opinion of counsel asserting that the pledge is effective. Competent lawyers do not give opinions on foreign law, and that is true even if the result that would be reached under foreign law is probably the same as would be reached under the law of the opining lawyer's home jurisdiction. Thus, if the rules on conflict of laws for securities holding through intermediaries are not relatively certain, it is likely that transactions either will not be implemented, or will be implemented only at a higher cost.

III. Reality Versus Hypotheticals

In considering conflict of laws issues for indirectly-held securities, it is probably inevitable that one will begin with a set of hypothetical facts. Consider, for example, the scenario described in the introductory portion of the Explanatory Report on the Hague Convention:

Shares of Illinois, Inc., a corporation organized under the laws of the state of Illinois in the United States, are held through an account at Depository Trust Company in New York. Part of the block of Illinois Inc. shares are shown on DTC's books as being held for the account of New York Bank. New York Bank's records in turn show that it holds part of those shares for the account of European ICSD, organized, let us say, under Belgian law. European ICSD's books show that part of its position is held for French Bank, located in Paris. French Bank's books show that part of its position is held for the account of Australian Investor.

Discussing these problems in the context of hypotheticals presents a subtle but quite significant obstacle to understanding the issues. When we discuss such hypotheticals, it is easy to lose sight of a simple question. How do we know the information about the chain of holdings described above? The answer is that the facts are simply stipulated.

Let us shift to the messy world of reality. Suppose that Australian

18. EXPLANATORY REPORT, supra note 6, at 11-12.
19. The following presentation is a shortened version of the discussion set out in James Steven Rogers, Of Normalcy and Anomaly: Thoughts on Choice of Law for the Indi-
Investor wishes to borrow money from Australian Bank and offers as collateral the securities positions that it holds through the account with French Bank. Imagine the task that would confront Lawyer asked by Australian Bank to implement the transaction. If this is Lawyer’s first venture into such transactions, he might naively ask Australian Investor to bring the certificates to the office so that he can examine them. Quickly, though, Lawyer will learn that the only records of Australian Investor’s position are the periodic account statements Australian Investor receives from French Bank. Lawyer now makes a phone call to France to speak with the person at French Bank who handles Australian Investor’s account. Lawyer says, “My client tells me that he leaves his securities with you, could you please fax me a copy of the certificates?” After some difficulties in finding someone who understands what Lawyer is talking about, Lawyer eventually succeeds in learning that all of the securities of Illinois Issuer held by French Bank for its own account and for its customers are carried through an account with European ICSD.

Lawyer still has no useful information to permit even an intelligent guess about the governing law under the “look through” approach. Rather, the task that Lawyer faced with respect to French Bank is replicated with respect to European ICSD. Lawyer must somehow find out how European ICSD holds its position. Actually, it understates the task to suggest that Lawyer must start all over asking European ICSD the questions previously put to French Bank. In the dealings with French Bank, Lawyer could at least insist that he was representing a client who was a customer of French Bank. At European ICSD, Lawyer is asking questions on behalf of someone who is a total stranger. European ICSD’s records do not show any customer by the name of “Australian Investor.” All that European ICSD’s records show is an account for French Bank. Why would anyone at European ICSD be willing to answer any questions for Lawyer? But, let us press on and assume that Lawyer somehow learns that European ICSD holds through an account with New York Bank.

By now, the reader can easily fill in the script of Lawyer’s phone calls to New York Bank, but let us continue with the assumption that Lawyer’s budget of time and phone charges is limitless so that he ultimately learns that all of New York Bank’s position is held through an account at DTC, and that DTC’s position is recorded in the records of Illinois Inc. in the form of a “jumbo” certificate representing all of the units of Illinois Issuer’s securities held through DTC. Now, at long last, Lawyer would seem to have found the source of the factual information needed to decide how an Australian court would decide the conflict of laws issue. “All” that Lawyer needs to do is examine the certificate to see whether it is the type of writing that is treated as a complete reification, such that the location of the certificate is the key, or the type of writing that is treated as mere evidence of title, such that the jurisdiction of the issuer is the key. Alas, in practice

Lawyer may find that the problem has shifted from the realm of factual impracticality to that of logical impossibility. In a common form of arrangement between a clearing corporation and transfer agents, a single certificate represents the aggregate holdings of the clearing corporation and on its face says only that the clearing corporation is the holder of record of the indicated number of shares as noted in the computerized accounting records maintained by the transfer agent. Whether that constitutes a certificated or uncertificated security is a question upon which one could imagine learned disagreement.  

Thus far, we have explored the plausibility of actually trying to apply the “look through” approach on the assumption that there is indeed a single simple chain of securities holding at each level from Australian Investor to Illinois Inc. Determining the facts needed to trace that path might be extremely difficult, but at least if we had access to all the relevant facts, we would probably be able to decide what route to pursue. That confidence, however, may be nothing more than a product of the artificial simplicity of our assumed hypothetical. At each step in our path, we have assumed that there is a single answer to the question of how this entity holds its position. Thus, we have assumed that all of French Bank’s position was held through an account with European ICSD, that all of European ICSD’s position was held through an account with New York Bank, that all of New York Bank’s position was held through DTC, and that all DTC’s position was held through a single jumbo certificate or entry on the books of Illinois Inc. There is no reason to believe that will always be the case.

Suppose the position that Australian Investor wishes to pledge to Australian Lender is $100,000 worth of debt securities and that these bonds were issued by Illinois Inc. some years ago, in the era when debt securities were commonly represented by definitive bearer certificates issued in relatively small denominations. Over time, the great bulk of the certificates have come to be lodged in the vaults of DTC but there are still some certificates held by individuals or by firms. Suppose that in the aggregate, French Bank holds $10,000,000 worth of Illinois Issuer bonds. $9,500,000 of that position is held in the fashion described above: through accounts with European ICSD, New York Bank, and DTC, ultimately represented by bearer certificates located in DTC’s vault in New York. But, suppose that French Bank has found that some of its customers and counterparties want to take physical delivery of this issue. French Bank therefore keeps some certificates in inventory so that it can readily supply them as needed. Hence, French Bank’s $10,000,000 position is held in two parts: (1) $9,500,000 through the accounts with European ICSD, New York Bank, and DTC seriatim, and (2) $500,000 in bearer certificates in its own vault in France. The choice of how French Bank holds the position has nothing to do with the identity or particular positions of its custodial cus-

20. Indeed, at one point during the course of the Article 8 revision project in the United States, Professor Mooney, one of the principal participants in the drafting process, aptly observed that questions of this sort lie more within the expertise of a faculty of theology than of law.
tomers, such as Australian Investor. Rather, French Bank simply makes a business judgment about the most convenient method of holding its aggregate position so that it will best be able to settle whatever transactions may occur from time to time.

Consider the task faced by Lawyer in seeking the information needed to predict how an Australian court would apply the *lex situs* rule. Lawyer needs to determine the location of the certificate that represents Australian Investor's $100,000 position. If Australian Investor's $100,000 position is "part of" the $500,000 held by French Bank in physical form in its vault in France, then our transaction is governed by French law. If Australian Investor's $100,000 position is "part of" the $9,500,000 held by French Bank through the accounts with European ICSD, New York Bank, and DTC seriatim, then our transaction is governed by New York law. But at this point, no amount of factual investigation will supply an answer. There is no answer to the question whether the Australian Investor's position is part of one mass or the other. The question is not factually difficult, it is metaphysically absurd.

IV. Achieving Neutrality—Conflicts Issues Versus Substantive Issues

If we are to achieve a workable approach to conflict of laws for securities held through intermediaries, there is no realistic alternative to an approach under which the applicable law is determined by factors relating solely to the relationship between the intermediary and the account holder. In the drafting process for the Hague Convention, consensus on that basic approach was achieved quite early. It is, however, important to bear in mind that we are dealing only with the conflict of laws analysis. Keeping the conflict of laws issues separate from the substantive law issues is made somewhat more difficult by the fact that there is a strong similarity between the principal options for a conflicts rule and the principal options for substantive law. In some jurisdictions the substantive law describes the investor's property interest as a package of rights against the intermediary and the property held by the intermediary. In other jurisdictions, the substantive law describes the investor's property interest as a direct interest in the underlying securities, treating all of the intermediaries as legally transparent, under concepts of agency, bailment, trust, etc. In some ways, that difference in the substantive law mirrors the difference in conflict of laws between the "look through" and the PRIMA approaches. That is, in a jurisdiction that describes the account holder's substantive property rights as a package of rights against the intermediary and the property held by the intermediary, it seems quite natural to adopt a conflict of laws approach under which the applicable law is determined by factors limited to the arrangement between the intermediary and the account holder. By contrast, in a jurisdiction whose substantive law describes the account holder's interest as a direct property interest in the

21. For a comprehensive survey of the variety of approaches taken to the substantive law of indirect securities holding, see *Cross Border Collateral* supra note 4.
underlying securities, it seems much more plausible to adopt a conflict of laws approach under which the applicable law is determined by factors concerning the underlying securities.

The question then arises whether adoption of the Hague Convention can really be neutral as to the substantive law. Suppose it were the case that the Hague Convention could work well only in jurisdictions where the substantive law describes the account holder's property interests as a package of rights against the intermediary and the property held by the intermediary. That is, suppose that jurisdictions where the substantive law describes the account holder's interest as a direct property interest in the underlying securities would have considerable difficulty operating under the Hague Convention. If that were the case, then the project to draft a pure conflict of laws convention has failed.

It is important to bear in mind that the reason for selecting PRIMA over the "look through" approach is not that the investor's property interest really is better described as a package of rights against the intermediary. That is a matter of substantive law. If one limits attention to conflict of laws, there is a certain appeal to describing the problem in a way that seems to limit the shift needed in traditional approaches to conflict of laws. Traditional conflicts rules tell us that the issues of proprietary rights that are the subject of the Hague Convention are determined by the location of the property—lex situs. Yet if that principle is applied to the underlying securities, one ends up with a completely unworkable approach. So, as an initial matter, one considers shifting from an approach that regards the relevant property as the underlying securities to an approach that regards the relevant property as the account. Now, without any change in basic concepts or principles of conflict of laws, one can achieve a sensible result that remains consistent with lex situs.

But, if one says that all that is needed to solve the conflict of laws problem is a redescription of the nature of the property, then one has stepped across the line separating the conflict of laws questions from the substantive law questions. To a lawyer from a jurisdiction where the substantive law regards the property interest of the investor as a package of rights against and interests in the property held by the intermediary, it seems only natural to say that the conflict of laws analysis should focus on the investor-intermediary relationship. This is, after all, what such a lawyer would say is really the investor's property interest. But the matter would not seem so simple to a lawyer from a legal system in which the substantive law treats the investor as having some form of direct interest in the underlying securities. It would seem jarring at the least to say to that lawyer, "You can keep your substantive law; you just have to acknowledge that it is fundamentally wrong, because the property really is the account, and that's why the conflicts rule should be determined by reference to the account."

That is not the basis of the Hague Convention project. The project was careful to preserve the line between conflict of laws issues and substantive law issues. The reason for the conflict of laws approach taken in the Convention is not that one view of the substantive law is better than the other.
Rather, the reason for the Hague Convention project is that, viewed purely as a matter of conflict of laws, the approach of determining the substantive law by facts limited to the investor-intermediary relationship is the only approach that can work in the modern world.

It may be useful to consider in some detail how the Hague Convention works without regard to the nature of the substantive law. Suppose that Able, located in Atlantis, wishes to transfer an interest in certain indirectly-held securities to Baker, located in Batavia. Before the transaction, Able maintains its securities in an account with Atlantis Firm. Baker maintains its securities in an account with Batavian Firm. Accordingly, the transaction is implemented by having the securities transferred from Able's account with Atlantis Firm to Baker's account with Batavian Bank. The transaction between Atlantis Firm and Batavian Bank is settled by debits and credits on the books of Securities Depository, located in Ruritania.

Consider legal risks that the transaction might pose. First, suppose that another party, Claimant, asserts that it, not Able, was the true owner of the securities and that its ownership interest can be asserted against Baker. The issue is whether Claimant's interest can be asserted against Baker, or whether Baker is protected under adverse claim cut-off rules of the sort commonly referred to as "bona fide purchaser" rules. A second type of legal issue would be whether the transaction has been properly effectuated so that the property interest in question has effectively been transferred from Able to Baker. That issue is most likely to be significant for pledges, since the law of pledge varies considerably from jurisdiction to jurisdiction.

Now, consider the conflict of laws analysis that would apply to either of these two issues. Under the Hague Convention, both the question whether the pledge is effective and the question whether Claimant can assert an adverse claim against the transferee are governed by the law of the securities intermediary's jurisdiction. Thus, in our example, both issues are determined under Batavian law.

Consider how that approach to conflicts meshes with the substantive law. First, suppose that the substantive law determined under the Hague Convention—the law of Batavia in our example—describes the investor's property interest as a package of rights against the intermediary and the property held by the intermediary. Both the adverse claim issue and the effectiveness of pledge issue are likely to be resolved in a fairly simple fashion in such a jurisdiction. The question whether Baker takes free from or subject to Claimant's interest can presumably be answered solely by examination of the facts concerning the arrangement between Baker and its intermediary, Batavian Bank. 22

Now suppose that Batavian substantive law describes the account holder's interest as a direct property interest in the underlying securities. Under that form of substantive law, a lawyer might have to analyze the series of steps that resulted in the securities being credited to Baker's securities account. It would probably strike the Batavian lawyer as odd to imagine that such issues could be answered solely by asking questions about the Batavian Bank-Baker aspect of the transaction, without giving any consideration to the prior stages in the series of events, beginning with the acts of Able directing its intermediary, Atlantis Firm, to initiate the transfer. The Batavian lawyer may say that neither the question whether Baker takes free from adverse claims, nor the question whether Baker has received an effective security interest can be answered without considering the Able side of the transaction.\textsuperscript{23}

Thus, under Batavian substantive law, one must analyze all of the events from Able to Baker. First, one analyzes the step in which Able gave the instructions to Atlantis Firm. Second, one analyzes the step in which Atlantis firm gave the instruction to Securities Depository in Ruritania to move the designated quantity of securities from the account of Atlantis Firm to the account of Batavian Firm. Third, one analyzes the step in which Securities Depository in Ruritania credited the securities to Batavian Firm’s account. Finally, one analyzes the step in which Batavian Firm credited the securities to Baker’s account. Presumably the same steps are required in the analysis under Batavian substantive law of the question whether Baker received an effective pledge from Able.

The fact that Batavian substantive law requires that each step in the transaction be analyzed is not relevant to the conflict of laws analysis. The Hague Convention provides that Batavian substantive law determines whether Baker takes free from or subject to any adverse claims and whether Baker has received an effective pledge. The Hague Convention says nothing about how Batavian substantive law is to determine those issues. It is entirely up to Batavian substantive law to decide whether those questions can be answered solely by reference to facts concerning the relationship between Batavian Firm and Baker, or whether those questions can be answered only by considering other steps that resulted in the credit of the securities to Baker’s account with Batavian Firm. Even if Batavian substantive law says that the questions cannot be answered without considering

\textsuperscript{23} Personally, I am somewhat skeptical of the contention that under any form of substantive law the question whether Baker takes free from of subject to adverse claims cannot be answered without considering the Able side of the transaction. As is noted below, see infra text accompanying note 62, in the routine transaction in which securities are purchased in an ordinary market transaction, the buyer will have absolutely no information about the identity of the seller. Thus, if it were really true that one could not decide whether a buyer got good title without analyzing the seller side of the transaction, then one would be forced to the conclusion that no one ever knows whether a buyer receives good title in an ordinary market transaction. But, for purposes of this article, it is unnecessary to consider whether there really are any countries whose law takes this form. Rather, we can consider the conflict of laws issues on the assumption that there are such countries.
the steps involving Able, Atlantis Firm, and Securities Depository, the Hague Convention provides that all of those questions are to be determined under the substantive law of Batavia. The Hague Convention says that the legal issue is determined by Batavian substantive law. It says nothing about what facts Batavian law will consider in resolving that legal issue. An easy way to express the result of application of the Hague Convention in this case is to say that once the Hague Convention has determined that Batavian substantive law applies, the issue is resolved in the same fashion as Batavian law would resolve the issue if all of the relevant events and facts took place within Batavia, and it is up to Batavian substantive law to decide what events and facts are relevant.

Part of the potential confusion on this point may be attributable to the same problem that has been encountered before. The explanatory materials accompanying the Hague Convention necessarily discuss, at a fairly abstract level, the question of which law applies to a variety of questions. A common description that one will find in explanations of the application of the Hague Convention to our hypothetical transaction proceeds more or less as follows: 24 under the Hague Convention, the relationship between Able and Atlantis Firm is governed by the law of the securities intermediary's jurisdiction, presumably that of Atlantis. The relationship between Atlantis Firm and Securities Depository, and the relationship between Batavian Firm and Securities Depository, is governed by the law of the securities intermediary's jurisdiction, presumably that of Ruritania. The relationship between Batavian Firm and Baker is governed by the law of the securities intermediary's jurisdiction, presumably that of Batavia. From such a description one might be misled into thinking that if Batavian substantive law says that a question about Baker's rights requires analysis of prior stages in the transaction, then a court applying Batavian law could not answer the question without considering the law of Atlantis and Ruritania. But, that is not what the Hague Convention says.

The litigation that we are imagining is not a case in which everyone that might have been involved in the chain of events is suing everyone else. Rather, one must consider a specific lawsuit posing a specific issue. We have been thinking of two such cases. In the first, Claimant brings an action against Baker asserting that Baker is obligated to Claimant because Baker now has an item of property in which Claimant has superior rights. In the second, an insolvency proceeding concerning Able is pending, and a dispute has arisen between Able's insolvency administrator and Baker about whether Baker's claim of rights as a pledgee is or is not to be respected.

Here, we are not considering a lawsuit between Able and Atlantis Firm. We are not considering a lawsuit between Atlantis Firm and Securities Depository. We are not considering a lawsuit between Securities Depository and Batavian Firm. We are not considering a lawsuit between Batavian Firm and Baker. If we were imagining any such lawsuit, then we

would proceed through the analysis of conflict of laws and then substantive law for that lawsuit. But the Hague Convention, like any conflict of laws rule, necessarily treats the question of what jurisdiction's law applies to a specific lawsuit. Neither this, nor any other conflicts rule can ever answer, in the abstract, the question of what jurisdiction's law applies to "a transaction." Rather, we must first consider who is suing whom for what. Only then can we decide which jurisdiction's law should be applied to that dispute.

Once one understands this fundamental point, one can see that the Hague Convention solution to the conflict of laws question truly is neutral on the substantive law. One begins by identifying the specific legal issue being considered. In the previous example, that is either an assertion by Claimant that Baker now has an item of property in which Claimant has superior rights, or a dispute in Able's insolvency proceeding about whether Baker's claim of rights as a pledgee is to be respected. Under the Hague Convention, questions about Baker's rights are determined under the law of Baker's securities intermediary's jurisdiction, that is, Batavia. Once that determination has been made, the conflict of laws analysis is concluded. One then turns to the substantive law of Batavia. That substantive law will determine what facts are relevant to the analysis of the legal issues. Batavian substantive law might say that the question can be answered by considering only facts about the relationship between Batavian Firm and Baker. Or, Batavian substantive law might say that the question cannot be answered without considering other facts, such as facts about the relationships between Able and Atlantis firm, between Atlantis Firm and Securities Depository, or between Securities Depository and Batavian Firm. So far as the Hague Convention is concerned, it makes no difference what facts Batavian law deems relevant. That is a question of substantive law. But, the Hague Convention does mean that once any court in a jurisdiction where the Convention is in force has decided that Batavian substantive law applies, that court will decide all the questions made relevant by Batavian substantive law in accordance with Batavian substantive law, regardless of whether those facts concerned events that took place in Batavia or elsewhere.

V. Determining the Intermediary's Jurisdiction—the Hard Part

The most important conceptual shift made by the Hague Convention is the move from the approach that would determine the applicable law by reference to the location of the underlying securities to an approach that would determine the applicable law by reference solely to factors concerning the relationship between the investor and the intermediary. That is a shift that is, in essence, dictated by necessity. Under modern conditions, the "look through" approach is simply not feasible. At first blush, it would seem that the hard step is rejecting "look through" and agreeing upon

25. As discussed in more detail below, see infra text accompanying notes 61-62, the notion that there is a single "transaction" in such a case is itself quite problematic.
"PRIMA." Then, one has only to deal with the detail of specifying what counts as the relevant law determined by reference to the relationship between the investor and its intermediary. Alas, that matter of detail proves to be remarkably difficult.

A. The "Account Approach"

The early drafts of the Hague Convention followed what might be termed the "location of account" approach. The draft produced at the first full session of the Working Group of Experts at The Hague in January 2001 provided that the matters covered by the Convention were to be determined by the law of the place of the "relevant securities intermediary" and then stated that that place was "the place where the securities account is maintained." The appeal of the "account approach" is that it seems to provide a way of describing the Hague Convention that makes it consistent with traditional conflict of laws principles. One can retain the basic concept that the governing law is determined by the location of the property—the traditional lex situs rule—and merely shift the identification of the relevant property from the underlying securities to the securities account.

However, there is a problem. An account does not have a location. Period. There is no way around that fact. An account is an abstract legal relationship between two entities. Abstract relationships do not have locations. Consider another old conflicts problem—whose law determines the validity of a marriage. There are many ways of resolving that problem. But there is one approach that would make absolutely no sense: decide the conflict of laws question by deciding where the marriage is located. People have locations, though they change those locations quite frequently. Events, like marriage ceremonies, take place at locations, but marriages do not have locations. Neither do accounts.

Thus, the "account approach" is fundamentally flawed, and some other approach must be found. Unfortunately, the law in at least one major area of the world, the European Union, has been caught in the trap produced by what initially seemed like an appealing approach to conflicts in the Hague Convention drafting process. At the same time that the Hague Convention process was ongoing, the European Union undertook several related initiatives. The Settlement Finality Directive of 1998 governing certain pledges of indirectly-held securities provides that the law governing the pledge is to be the law of the jurisdiction where the "register, account or centralised deposit system [is] located." Similarly, the Collat-

27. Id. art. 4(1).
28. That approach, however, is inconsistent with the important principle that the Hague Convention must be neutral on the substantive law characterization of indirect securities holding. See supra Part IV.
30. Id. art. 9(2).
eral Directive of 2002\textsuperscript{31} provides that questions concerning pledges covered by the Directive "shall be governed by the law of the country in which the relevant account is maintained."\textsuperscript{32} Both formulations essentially come to the same point: the governing law is that of the jurisdiction where "the account" is located.

Yet as the Hague Convention work proceeded, it became apparent that it simply made no sense to speak of the location of an "account" or even the location where the account is "maintained." The annoying reality is that abstract relations simply do not have a location. Thus, at present, the law in the European Union is stuck in the situation of having adopted a conflict of laws rule that those who have examined the matter carefully have determined simply will not work.

B. The "Branch/Office Approach"

The conceptual and practical problems with the account approach led the Hague project to develop an alternative that came to be known as the "branch/office approach." Under this approach, the governing law would be determined by the location of the branch or office of the intermediary that actually carried out the functions of maintaining the account. As was explained by the Permanent Bureau in mid-2001:

Because an account is an intangible legal relationship, it cannot, literally, have a geographical location. Rather, in speaking of the location of an account, one typically has in mind particular activities that an intermediary carries out in connection with maintaining the legal relationship of a securities account. Although stating the rules on governing law in terms of location of an account may provide the easiest route of transition from traditional \textit{lex rei sitae} rules for simple certificated securities held directly, it may be that retaining the concept of geographical location of an account causes more difficulties than it solves.\textsuperscript{33}

Although the "branch/office approach" avoids the metaphysical absurdity of trying to specify the location of an account, it cannot eliminate serious practical problems. To be sure, in some cases it may be relatively easy to identify the location of the office that maintains the account. But it would make no sense to adopt an approach to conflict of laws that would only work in the simplest cases. Operations of intermediaries in the modern world are dispersed across many jurisdictions. The \textit{Explanatory Report} contains a good illustration of the problem:

In modern global trading, the various activities involved in the maintenance of securities accounts are indeed often dispersed among offices in different countries. By way of illustration, assume an intermediary incorporated under the laws of the State of New York agreed with its client that the client's securities account is maintained in Tokyo because it is the place where the account was initially opened and where the first credit of securities to the

\textsuperscript{32} \textit{Id.} art. 9.
\textsuperscript{33} \textit{Prel. Doc. No. 3, supra} note 5, at 13.
account was effected. The intermediary sends all its account statements to the client from an office in Dublin. The client receives dividends administered and sent from an office in Hong Kong and obtains advice as to the ongoing status of the account from an office near the client's main office in Singapore. All the intermediary's operations relating to each of its securities accounts (including the entries effectuated) are backed-up and monitored by two separate computer systems run from its New Delhi and San Francisco offices respectively. Finally, the client regularly accesses the information relating to the relevant securities account from a laptop while travelling around the world.

In such a situation, if the criterion for determining the applicable law were the location of the securities account or the location of the office where the securities account is maintained, no certainty could be achieved and such a test would invite litigation in which courts would be required to make fact-intensive inquiries. The risks and burdens presented to a potential collateral taker are readily apparent.

Given this reality, the project faced the difficulty of specifying how one is to determine which branch or office should be considered as the one that maintains the account. Theoretically, the Convention might simply have refused to provide any guidance on that issue. The Convention would just say that the governing law is determined by the location of the office or branch that maintains the account, leaving it to surmise and litigation to determine how one decides what counts as maintaining an account. At one point, motivated by what might be termed a combination of frustration and puckishness, the Drafting Committee actually listed this as one possible option. The draft produced at the Drafting Committee meeting in Brussels in December 2001, listed three options for a rule, the last of which was: “The place of the relevant intermediary is the place of the office or branch that the account holder and the relevant intermediary have agreed will maintain the securities account, provided that the securities account is in fact held by that office or branch.”

Not surprisingly, no one took that tongue-in-cheek proposal seriously. Rather, the project struggled with the task of finding some way of specifying the office or branch that maintains the account.

Another approach would be to attempt some listing of the activities that do and do not count as maintaining the account. Perhaps one might have some success with specifying certain activities that do not in themselves count as maintaining an account, such as maintaining back-up computer facilities, but the affirmative task would be far more difficult. Realistically, any listing of activities that supposedly constitute maintenance of an account is bound to be incomplete or inaccurate. That is true even if one confines attention to current practices. If one wishes to draft a convention that has any prospect of enduring vitality, the task is hopeless. Change is perhaps the only constant in the various methods of maintaining business information.

34. Explanatory Report, supra note 6, at 20.
C. Agreement

One approach to the problem would be for the Convention to allow an agreement between the intermediary and investor to specify which jurisdiction would count as the intermediary's jurisdiction. In the strongest version of that approach, the agreement would be conclusive, that is, there would be no further inquiry into the extent or nature of the activities of the intermediary in that location. That approach was laid out as an option in one of the drafts produced by the Drafting Committee,36 but it never attracted sufficient support to become a viable option. Rather, as is described below, the approach taken in the Convention was to give effect to an agreement only if the jurisdiction selected met certain other tests, which came to be known as the "reality test."

Before turning to the approach ultimately adopted in the Convention, it is important to be clear on what such a pure agreement approach would and would not entail. In that regard, the terminology commonly used in discussion of other issues of conflict of laws can be rather problematic. When speaking of the law that governs a bilateral relationship, it is common to use a phrase such as "party autonomy" to refer to an approach that permits the parties to that relationship specify the law that governs their rights and duties. But, the phrase "party autonomy" is quite misleading in the context of the issues governed by the Hague Convention.

The basic situation covered by the Convention involves three parties. For simplicity, let us consider a pledge transaction, so that the parties would be Borrower, Lender, and Intermediary. The phrase "party autonomy" suggests that Borrower and Lender could select the law governing the transaction and that selection would be binding upon third parties. No one ever suggested this, and the final text of the Convention does not adopt any such approach. Rather the suggestion was that in deciding what counts as the intermediary's jurisdiction, effect, conclusive or partial, should be given to an agreement between the intermediary and the account holder. That is a very different thing from any suggestion that an account holder and a transferee can agree on the law that will affect third parties' rights. Under the approach of allowing an agreement between an account holder and its intermediary to determine the intermediary's jurisdiction, once the intermediary and the investor have agreed upon the governing law, that law would determine the proprietary effects of transactions effected on the books of that intermediary. If Borrower is borrowing from Lender, and granting Lender a security interest in positions held through Intermediary, the law selected in the agreement between Borrower and Intermediary determines the effectiveness of the pledge, regardless of whether the Lender likes that or not.

Part of the objection to a pure agreement approach may be attributable to a fear that if the intermediary and account holder could specify the intermediary's jurisdiction by agreement, then an intermediary might, willy-nilly, enter into lots of different agreements with different customers.

36. Id. art. 4, Option X.
specifying lots of different jurisdictions. That is probably an unrealistic concern. Suppose, for example, that a plausible argument could be made that the activities of the intermediary that constitute maintenance of the account occur in three jurisdictions. It is easy to see that the intermediary would select the law of one of these three. Is it plausible to suppose that the intermediary would select the law of some other completely unrelated jurisdiction? Hardly. After all, by entering into the agreement the intermediary is, in effect, admitting that it has some contact to that jurisdiction. That being so, any competent lawyer advising the intermediary would fear that by agreeing to the law of a certain jurisdiction for purposes of the Hague Convention, the intermediary is running the risk of subjecting itself to the jurisdiction of regulatory authorities in that jurisdiction. No sensible intermediary is going to take such action lightly. Nor is it plausible to suppose that any careful intermediary would blithely enter into agreements with different customers specifying different jurisdictions' laws to govern their relationships. The whole point of having standardized agreements is to simplify legal analysis. Why would a competent intermediary enter into agreements with different customers specifying different governing law, when by doing so it is multiplying its own legal costs and uncertainties?

D. Agreement plus “Reality Test”

Whatever arguments might be advanced in favor of an approach that permitted unrestricted selection of governing law, that approach never had any realistic chance of success in the Hague Convention project. Although the delegation of the United States from time to time mentioned that possibility, it was always fairly clear that the suggestion could not garner sufficient support to be a viable option. Accordingly, virtually all of the work in the drafting process was concentrated on a different approach, which came to be known as “agreement plus reality test.” In essence, the approach is to say that an agreement specifying the governing law is effective only if the jurisdiction selected bears a sufficient relationship to the activities of the intermediary. The difficulty, of course, is filling in the details of what counts as a sufficient relationship.

The initial thought for a reality test drew upon the fact that the activity of maintaining securities accounts tends to be subject to regulatory authority. Various early drafts said that a selection of governing law is effective provided that the intermediary’s activities of maintaining the account, or accounts generally, is subject to regulatory supervision in the jurisdiction selected.\(^{37}\) The difficulty is that patterns of regulatory supervision vary so

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\(^{37}\) In the first full draft, produced at the January 2001 meeting in The Hague, the test was that a selection of law was effective provided that at that place “the securities intermediary has an office or branch and the securities intermediary allocates the securities account to that office or branch for purposes of reporting to its account holders or for regulatory, tax or accounting purposes.” \textit{Prel. Doc. No. 2, supra note 5, art. 4(2).}

A more precise formulation was set out in the draft produced by the Drafting Committee at its meeting in Paris in May, 2001. Under that approach, the selection would be effective provided that “the intermediary’s maintenance of the securities account is subject to regulatory supervision in the place so agreed,” or, in a slightly different test,
significantly from jurisdiction to jurisdiction that it proved infeasible to formulate any form of regulatory nexus test that was both sufficiently precise to have any real content and sufficiently flexible to accommodate all existing patterns of regulation. Ultimately, it was concluded that any form of regulatory nexus test was flawed. Perhaps the best explanation for this conclusion is found in comments submitted by the Association of German Banks:

In principle, it is to be welcomed that another tangible element must exist alongside the presence of an office or branch. Supervision of the maintenance of the account is not a suitable criterion, however, and should therefore be dropped. . . . Custodians who are active on a cross-border basis, in particular, are often subject to the supervision of several countries. In the European Union, solvency supervision is normally determined by the home country and market supervision by the host country, though a certain amount of overlap cannot be excluded. On top of that, the creation of the European single market for financial services may also result in the establishment of a pan-European regulatory authority. Reference to the supervisory situation when determining the applicable law therefore introduces an element of uncertainty. The parties involved in dispositions of securities would first have to clarify comprehensively which authority was responsible for supervision—assuming that complete clarification of this point would be at all possible. Furthermore, it seems incongruous to make the PIL issue of determining the law applicable to a cross-border situation dependent on a previous clarification of supervisory questions. Determining the relevant location on the basis of regulatory criteria is therefore to be fundamentally rejected. 38

Once the regulatory nexus approach was dropped, it was necessary to devise some other form of reality test. The basic drafting structure ultimately followed in the Convention had its origins in the draft produced at the Special Commission meeting in The Hague in January 2002. In that draft, the basic rule, set out in Article 4(2), was that a selection of the governing law would be effective only if the intermediary "has an office within that State engaged in a business or other regular activity of maintaining securities accounts . . . ." 39

Standing alone, that general rule was thought to pose an unacceptable high risk of uncertainty. Thus, another Article set out a fairly extensive "safe harbor" list of activities that would constitute "engaging the business of maintaining accounts." 40 That extensive "white list," however, was added late in the Special Commission meeting in January 2002, and was provided that the place selected "is a place where the intermediary is subject to regulatory supervision." Prel. Doc. No. 3, supra note 5, at 14.

For another variation on this basic theme, see Prel. Doc. No. 6, supra note 5, at 7-9.


39. Prel. Doc. No. 8, supra note 5, art. 4(2). As is the case in the final version, the test is satisfied if the office in question either itself is engaged in that business, or does so together with other offices of the intermediary in that or another State. Id.

40. Id. Article 4 bis(1) provided that that the "reality test" would be satisfied if the agreed office engaged in any of the following activities:

(a) contracts regarding securities accounts are executed at such office or received by such office;
intended more as a “place holder” for a concept to be further developed than as an actual drafting suggestion.41

Discussions of the “white list” continued in a variety of fora throughout the 2002 year.42 The result of those discussions was a dramatic shortening of the “white list.” By the time of the drafting of the final text at the December 2002 meeting at The Hague, the “white list” was down to two specific elements:

- effects or monitors entries to securities accounts; or
- administers payments or corporate actions relating to securities held with the intermediary;43

With the “white list” so significantly shortened, a drafting simplification was made. Rather than state the general rule of “engaging in the business of maintaining accounts” in one section and then following that with another section setting out a non-exclusive “white list” or “safe harbor” rule in another section, the two different sorts of rules were combined into a single provision in Article 4(1)(a). That provision states that the applicable law is the law of the jurisdiction agreed on by the intermediary and account holder, provided that the intermediary has an office in the State selected and that that office

(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
(b) account holders can communicate with the intermediary at such office with regard to securities accounts;
(c) legal, regulatory, auditing, position monitoring, or account-holder-support functions of the intermediary relating to securities accounts occur at such office;
(d) account statements bear an address of that office or are prepared at that office;
(e) entries to a securities account by the intermediary are made, stored, or managed at that office, such as the booking, recording, transferring, or pledging of interests in securities;
(f) technology supporting bookkeeping or data processing for securities accounts is located at such office;
(g) a single account number, bank code, or other means of identification exists that identifies such office as maintaining securities accounts at that office;
(h) . . .

41. As was explained by the Permanent Bureau, “due to lack of time Art. 4 bis had not been discussed extensively by the Plenary in January 2002 and was merely inserted so as to provide the basis for further consideration. Against this background, the Special Commission mandated the Drafting Committee to assess this preliminary version of Art. 4 bis and, if needed, to submit new suggestions.” Prel. Doc. No. 10, supra note 5, at 7 n.1.
42. See id.; Prel. Doc. No. 14, supra note 5, at 17-19; Prel. Doc. No. 13, supra note 5; Prel. Doc. No. 15, supra note 5; Prel. Doc. No. 16, supra note 5.
(iii) is otherwise engaged in a business or other regular activity of maintaining securities accounts;\textsuperscript{44}

The result is a simpler piece of text, but it is important to realize that no substantive change was made. It remains the case that Article 4(1)(a) contains two quite different rules. On the one hand, there is the general rule under which the "reality test" is satisfied if one concludes, on the basis of a more wide-ranging analysis, that the office is "engaged in a business . . . of maintaining securities accounts." On the other hand, there are the "safe harbor" rules in Article 4(1)(a)(i) and (ii) under which the "reality test" is, without any further inquiry, satisfied if the office either effects entries or administers payments or other corporate actions.\textsuperscript{45}

E. "Identification Code" Provision

Another provision of the Convention—the "identification code" provision found in Article 4(1)(b)—plays essentially the same role as the "effecting entries" and "administering payments" tests listed in Article 4(1)(a)(i) and (ii). Under Article 4(1)(b), a selection of governing law is effective provided that the intermediary has an office in the selected State that "is identified by an account number, bank code, or other specific means of identification as maintaining securities accounts in that State."\textsuperscript{46} If this "identification code" test is satisfied, there is no need to consider whether the intermediary's office in the selected jurisdiction is "engaged in a business or other regular activity of maintaining securities accounts."\textsuperscript{47}

\textsuperscript{44} Hague Convention, \textit{supra} note 5, art. 4(1)(a).

\textsuperscript{45} One way of seeing the difference between the specific rules in Article 4(1)(a)(i) and (ii) and the general rule in Article 4(1)(a)(iii) is by examining the role of Article 4(2). That article provides that "for purposes of paragraph 1(a)," performing various functions, such as maintaining call centers or computer facilities, does not constitute "engag[ing] in a business or other regular activity of maintaining securities accounts." Although the introductory language to Article 4(2) refers generally to "paragraph (1)(a)" the listing in Article 4(2) speaks only to whether an office is "engaged in a business or other regular activity of maintaining securities accounts." That question arises only if one is relying on the general test in Article 4(1)(a)(iii). If the case falls within either of the specific rules in Article 4(1)(a)(i) or (ii), then there is no need to consider whether the office is or is not "engaged in a business or other regular activity of maintaining securities accounts." Accordingly, there is no need to consider the listing of ineligible functions in Article 4(2). Similarly, if the office in question meets the "identification code" test in Article 4(1)(b), there is no need to consider the listing of ineligible functions in Article 4(2).

\textsuperscript{46} The "identification code" provision was suggested by representatives from Germany, \textit{see Prel. Doc. No. 5, supra note 5, at 31 (Comments of Association of German Banks); id. at 45 (proposed German draft), and first appeared in the November 2001 draft, as one of a long list of possible approaches to stating some form of reality test. \textit{See Prel. Doc. No. 6, supra note 5, at 8}. It appeared throughout the various 2002 drafts as one item on the "white list" of activities that, without more, qualified as engaging in the business of maintaining securities accounts. \textit{See Prel. Doc. No. 8, supra note 5, at 6-7; Prel. Doc. No. 10, supra note 5, at 7, 17; Prel. Doc. No. 13, supra note 5, at 6; Prel. Doc. No. 15, supra note 5, at 6.}

\textsuperscript{47} There is a slight difference in drafting structure between the Article 4(1)(a)(i) and (ii) "effects entries or administers payments" tests, on the one hand, and the Article 4(1)(b) "identification code" test, on the other hand. However, there appears to be no substantive difference in the role played by between the two. Suppose that an agreement
The "identification code" provision presents significant interpretive issues. Read literally, Article 4(1)(b) says that the "reality test" is satisfied in any case where the intermediary has an office in the State whose law is selected, and that office is "identified" by any "specific means of identification" as "maintaining securities accounts in that State." Suppose that all of an intermediary's activities concerning securities accounts are conducted in Germany, and that all of the intermediary's customers are located in Germany. Suppose, however, that the intermediary does have an office in New York, but that the activities of the New York office are concerned exclusively with other businesses.

The whole point of the elaborate rules of the Convention on the "reality test" is that the intermediary in this example should not be permitted to select New York law because all of the actions that might be regarded as associated with the maintenance of the securities accounts are conducted in Germany. Suppose, though, that the agreement between the intermediary and its customers says that the Article 2(1) issues will be governed by New York law. Read literally, Article 4(1)(b) says that the selection of New York law is effective as long as the New York office is "identified by an account number, bank code, or other specific means as maintaining securities accounts in" New York. One might argue a bit about the precise meaning of "account number" or "bank code," but, read literally, Article 4(1)(b) is satisfied as long as some "specific means" of identification designates the New York office. If one believes that there is a significant risk that intermediaries might select "inappropriate" jurisdictions' law, Article 4(1)(b) would seem to be the perfect vehicle for them to do so. All that the intermediary need do is identify the New York office by some "specific means"—whatever that may mean.

Inasmuch as, taken literally, the "identification code" provision of Article 4(1)(b) would vitiate the general structure of agreement plus reality test, one can only conclude that the "identification code" provision must be read more narrowly than its literal language. The difficulty, of course, is figuring out how one would narrow the scope of the language. Presumably, the thought is that the association between the maintenance of the account and the identification of "an account number, bank code, or other specific means" reflects not simply an arbitrary action by the intermediary, but some regular practice, perhaps reinforced or required by regulatory

selects a certain jurisdiction's law as the law governing the Article 2(1) issues, and that the intermediary has an office in that State. The selection of governing law is effective, without any further inquiry, if the office in question is designated by an "identification code" pursuant to Article 4(1)(b). Alternatively, the selection of governing law is effective if the designated office (alone or with others) either "effects entries" Article 4(1)(a)(i), or "administers payments," Article 4(1)(a)(ii). If the selected office does not meet the Article 4(1)(b) "identification code" test, it remains possible that the selection of governing law is still effective under the general rule of Article 4(1)(a)(iii)—or even under the other specific tests in Article 4(1)(a)(i) or (ii). Similarly, if the selected office does not meet the "effects entries or administers payments" tests of Article 4(1)(a)(i) and (ii), it remains possible that the selection of governing law is still effective under the "identification code" test of Article 4(1)(b), or under the general rule of Article 4(1)(a)(iii).
requirements. But, the text does not identify what sort of regular practice or regulatory requirement is necessary. As was discussed above, the possibility of some form of "regulatory nexus" test was considered extensively in the drafting process, but no satisfactory language to capture that thought was ever devised. Thus, as a matter of prudence, one might well conclude that it is not safe to rely on the "identification code" provision in Article 4(1)(b) in any case where one would not feel confident that the office selected would meet the general test in Article 4(1)(a)(iii), that is, the office is "engaged in a business or other regular activity of maintaining securities accounts."

F. Agreement Simpliciter Versus Agreed Location

One final point warrants discussion. In the early drafts of the Convention, the governing law was determined by the law of the "place of the relevant intermediary." Then the drafts provided that the place of the relevant intermediary would be deemed to be the place agreed on by the intermediary and account holder, provided that the place selected met the "reality test." In the final text of the Convention, the phrase "place of the relevant intermediary" does not appear. Rather the governing law is determined by agreement of the intermediary and account holder, provided that the place selected meets the "reality test." The shift is merely a matter of drafting convenience, having no substantive effect.

The initial drafting approach could be described as follows:

- **Step One** The governing law is determined by the law of the "place of the relevant intermediary."
- **Step Two** The law of the "place of the relevant intermediary" is the law agreed on by the intermediary and account holder, provided that the selection meets the "reality test."

As has been seen, the participants in the drafting process agreed at the outset that the governing law should be determined by the reference to facts solely concerning the relationship between the intermediary and account holder. That was the meaning of the early agreement on "PRIMA," and corresponding rejection of "look through." Then the participants in the drafting process struggled for several years to find a way of giving sufficient certainty to the concept of "place of the relevant intermediary." As has been seen, the conclusion was that the only way to accomplish that objective was to state that the "place of the relevant intermediary" was determined by agreement of the intermediary and account holder, provided that the agreement meets the "reality test." Once that decision was reached, it became apparent that the phrase "place of the relevant intermediary" did not play any substantive role.

In the two-step process described above, the phrase "place of the relevant intermediary" in Step One is merely a placeholder. All of the substantive content is carried by the agreement plus reality test formulation set out in Step Two. Without any change of meaning, one could substitute any phrase one likes for "place of the relevant intermediary." Since the phrase
itself carries no substantive significance, the drafting could be simplified by eliminating it. Thus, the two step process described above becomes a single step:

Step One The governing law is determined by the law of the “place of the relevant intermediary.” The law of the “place of the relevant intermediary” is the law agreed on by the intermediary and account holder, provided that the selection meets the “reality test.”

That change has no substantive significance. It is simply a drafting simplification. The advantage of the simplification is that it avoids the risk that parties or judges called upon to interpret the Convention will read into the phrase “place of the relevant intermediary” some substantive content that it should not bear. The disadvantage is that a bit more care is required to avoid the misunderstanding that the Convention has somehow adopted party autonomy for conflicts involving third party rights.

G. Primary Rule and Fallback Rules

The essence of the basic rule, set out in Article 4 of the Convention, is that the governing law is the law selected by the intermediary and account holder, provided that the “reality test” is met. To be a bit more precise, Article 4(1) provides that the matters covered by the Convention, as spelled out in Article 2(1), are determined by “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.” The complexity of that rule is made necessary by the possibility that the parties to an account agreement might, in some circumstances, select the law of a certain jurisdiction as the law governing the purely “contractual” aspects of the agreement between the intermediary and account holder, without intending that the law of that jurisdiction should determine the “proprietary” issues that are the subject of the Convention.

Under the formulation of the final text of Article 4(1), the intermediary and account holder could provide in the account agreement that the matters listed in Article 2(1) of the Hague Convention are governed by the law of State One, while the other aspects of the agreement are governed by the law of State Two. That complexity is, perhaps, unfortunate, but it is made necessary by the reality that such agreements are, in fact, common. For example, suppose that a given jurisdiction—Atlantis—has a relatively underdeveloped law of contract. An account agreement between an intermediary located in Atlantis and its customers also located in Atlantis might say that contractual matters that are a major subject of the agreement are to be determined in accordance with the laws of a jurisdiction having a well-developed contract law, such as the United Kingdom. The parties, however, would not intend by that agreement that the “proprietary” matters covered by the Hague Convention should be determined by the laws of the United Kingdom. Rather, they intend that those issues be governed by the laws of Atlantis. Under the formulation of Article 4(1), the intermediary
and account holder could provide that the matters listed in the Hague Convention are governed by the law of Atlantis, while other aspects of the agreement are governed by the law of the United Kingdom.

Note that the formulation in Article 4(1) contains the word "expressly." That is intentional. It means that parties who wish to take advantage of the conflicts rule set out in the Hague Convention should have their agreements refer specifically to the Hague Convention, by language along the lines of "it is agreed that the matters covered by Article 2(1) of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary are governed by the law of Atlantis." The rule permits maximum certainty for agreements entered into, or revised, after the Hague Convention becomes effective. It might, however, pose some potential problems for agreements entered into before the Convention becomes effective, or even agreements entered into after the Convention becomes effective if those agreements are not carefully drafted. To meet those needs, the Convention contains several subsidiary rules. For pre-effective date agreements, there are a series of somewhat complex rules set out in Article 16 of the Convention. For all agreements, whenever executed, there is a rule in Article 5, under which a provision in an account agreement that "expressly and unambiguously state[s] that the relevant intermediary entered into the agreement through a particular office" will have the same effect as an express selection of the law of that jurisdiction under Article 4.48

Even with the benefit of these rules, it is possible that agreements between an intermediary and its account holders will not contain a provision that triggers the basic rule in Article 4. That could happen either because the agreement did not contain the necessary selection of governing law provision, or because the agreement did select the law of a given jurisdiction for purposes of the Convention, but that selection did not meet the "reality test" set out in Article 4(1). In that case, Article 5(2) provides a further fallback rule, under which the governing law is determined by the place of incorporation of the intermediary. Finally, for the extremely unlikely scenario of an intermediary that is not a corporation or similar entity, Article 5(3) provides a final fallback rule, directing one to the place of business, or principal place of business, of the intermediary.

Given the unfortunate but unavoidable complexity of these rules, the Convention adds another provision to drive home the basic point. Article 6 provides that questions concerning the law governing the matters covered by the Convention are not to be determined by such factors as the place of incorporation of the issuer, the location of the certificates, or the location of intermediaries other than the investor's own intermediary. This provision was included to provide a simple, convenient, explicit piece of text to cite for the basic provision that the Convention completely rejects the "look

48. Article 5 then goes on to specify further that in deciding whether an account agreement "expressly and unambiguously" states that it was entered into through a particular office, no account shall be taken of various enumerated provisions.
through” approach. Opinions differed on whether it was a good idea to include this provision or not. One might say that given the detailed rules contained in Articles 4 and 5, no one could possibly think that the governing law was determined by such factors as the location of the underlying certificates. On the other hand, the main point of the Convention is to put the nail in the coffin for the traditional “look through” approach. Article 6 ensures that no one could miss that point. In essence, Article 6 says “Yes, we really mean it.”

VI. Limiting the Subject—Regulation Versus Private Law

While the matters covered by the Hague Convention are of great importance to modern securities transactions, it is perhaps equally important to bear in mind what is not covered by the Convention.

Consider a routine transaction in which Investor purchases securities through Firm. If the investment turns sour, Investor might well get into a fight with Firm, such as a dispute about advice or information that Firm gave Investor. Much of the modern law of securities trading is concerned with the information provided to investors and the practices of firms involved in the securities business. Moreover, governmental authorities are often concerned with information about securities holding and trading, whether for reasons of the fair operation of the securities markets themselves, or for reasons of policing against money laundering or the like.

The securities intermediary business is, in most jurisdictions, a highly regulated business. The patterns of regulation and the territorial scope of regulation vary significantly from jurisdiction to jurisdiction. If an intermediary is engaged in operations in multiple jurisdictions or if it solicits business from customers in multiple jurisdictions, it will have to determine whether its activities in a given jurisdiction are such that it subjects itself to the regulatory authority of that jurisdiction.

For example, the law of the United States prohibits anyone from engaging in business as a broker or dealer unless that person registers with the Securities and Exchange Commission (SEC).49 Whether the U.S. regulatory law applies to transnational activities is a complex question generally thought to turn on the nature of conduct of the firm or effects on investors located within the territory of the United States.50 Suppose that

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49. 15 U.S.C. § 78o(a)(1) (2005) (“It shall be unlawful for any broker or dealer . . . to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security . . . unless such broker or dealer is registered in accordance with subsection (b) of this section.”).

50. 5 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION §§ 17.4[1]-17.4[12] (5th ed. 2005).

The SEC explains the matter as follows:

The SEC generally uses a territorial approach in applying registration requirements to the international operations of broker-dealers. Under this approach, all broker-dealers physically operating within the United States that induce or attempt to induce securities transactions must register with the SEC, even if their activities are directed only to foreign investors outside of the United States.
an intermediary is conducting affairs that subject it to regulation by the SEC. Now, suppose that the Hague Convention becomes effective in the United States, and suppose that the intermediary and its account holders enter into an agreement stating that "it is agreed that the matters covered by Article 2(1) of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary are governed by the law of Mexico." What effect would that agreement, and ratification of the Hague Convention by the United States, have on the regulatory authority of the SEC?

None.

The question of the scope of the Hague Convention has nothing to do with questions of the regulatory jurisdiction. Obviously the law that determines regulatory jurisdiction is not going to say that a party whose activities would otherwise subject it to regulatory authority in the state can eliminate that authority by agreement.

At one point early in the drafting process for the Hague Convention, the delegation of the United States, motivated by the excess of caution that American lawyers commonly feel about the possibility that lawyers might advance absurd arguments, suggested including in the text of the Convention a provision explicitly saying that the Convention "does not determine the law applicable to . . . the regulation of a securities intermediary."51 The Permanent Bureau and the Drafting Committee, however, felt that this was unnecessary, noting that "[w]e have not . . . included the suggested references to regulatory laws since these seemed to be different in kind from those listed and to be very unlikely to be regarded as affected by a private law convention."52 The final Explanatory Report does, however, note the point quite clearly that "the Convention has no impact on regulatory schemes relating to the issue or trading of securities, regulatory requirements placed on intermediaries, or enforcement actions taken by regulators."53

But, lest there be any doubt on this issue, let us suppose that under the regulatory law of some jurisdiction, an agreement entered into under the Hague Convention might somehow have some effect on regulatory jurisdiction. There are two possible consequences. First an intermediary that is currently operating on the assumption that it is subject to the regulatory

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53. Explanatory Report, supra note 6, at 23.
jurisdiction of Country A might conclude that if it enters into an agreement with some or all of its account holders selecting the law of Country B for Hague Convention purposes, then this might cause problems for the intermediary by subjecting it to multiple inconsistent regimes of regulation. The solution is pretty obvious. Do not enter into such an agreement. If the customer wants the intermediary to do so, the intermediary just refuses. If the customer is unhappy, the intermediary’s business people will have the convenient universal explanation that “The lawyers made us do it.”

Alternatively, suppose that the intermediary wants to enter into the agreement selecting Country B law for Hague Convention purposes because it somehow thinks that doing so will eliminate the regulatory authority of Country A. The solution is equally simple. The regulatory authorities in Country A—which, by hypothesis, have jurisdiction absent the agreement—simply adopt a regulation prohibiting an intermediary subject to their jurisdiction from entering into any agreements selecting another country’s law for Hague Convention purposes.

In sum, the Hague Convention simply has no bearing on questions of regulatory jurisdiction.

VII. Limiting the Subject—Contract Issues Versus Property Issues

Not only is the Hague Convention limited to matters of private law, it is also limited to what might be termed “property law” issues, as distinguished from “contract law” issues. Seeing the implications of this limitation is not easy. In part, the problem is another instance of the difficulty of distinguishing reality from hypotheticals. It is tempting to discuss problems of securities holding through simple examples in which a seller in one country sells securities to a buyer in another country. But that form of presentation obscures important consequences of the fact that securities trading occurs through complex institutions involving multiple entities. Even more important, simple hypotheticals tend to obscure the significant difference between securities trades and settlement of securities trades. Without a firm understanding of these matters it is difficult to understand the approach to conflict of laws adopted by the Hague Convention.

Consider a version of what came to be known in the Hague Conven-

54. The qualification “roughly” is needed because in some systems of law, including that of the United States, the term “property law” is somewhat problematic as applied to the analysis of the rights of parties in the indirect securities holding system. For present purposes, however, the important point is the distinction between contract issues and “whatever,” so that no harm will come from using the simple, familiar terms “property” and “contract.”

The discussion of property and contract issues in this section is adapted from a paper presented by the author at an international symposium on the Hague Securities Convention, hosted by Rikkyo University, Tokyo, Japan, in October 2004. Papers from that symposium are available at http://law.rikkyo.ac.jp/ribls/symposium/2004hague/hague.htm
tion drafting process as "the page 37 problem." Suppose that Seller, located in Atlantis, holds shares of Issuer through an account with Atlantis Firm, also located in Atlantis. Seller sells the shares to Buyer, located in Batavia. Buyer holds through an account with Batavian Firm, located in Batavia. The transaction between Atlantis Firm and Batavian Firm is settled by entries on the books of Securities Depositary, located in Ruritania. Under the Hague Convention, the relationship between Seller and Atlantis Firm is governed by the securities intermediary’s jurisdiction’s law, presumably that of Atlantis. The relationship between Atlantis Firm and Securities Depositary, and the relationship between Batavian Firm and Securities Depositary, is governed by their securities intermediary’s jurisdiction’s law, presumably that of Ruritania. The relationship between Batavian Firm and Buyer is governed by the securities intermediary’s jurisdiction’s law, presumably that of Batavia. The so-called “page 37 problem” can be described as follows: “We seem to have a simple transaction between Buyer and Seller, albeit effected through their firms and the clearing agency, but why can’t a single body of law describe the transaction? Why complicate matters by dividing the transaction up into various subcomponents and then saying that a different body of law might apply to each subcomponent?”

Answering that puzzle requires that we consider more carefully what it could mean to say that there is a “transaction” in which securities are sold from Buyer to Seller. Suppose that Buyer goes to Batavian Firm and places an order to purchase 1000 shares of Acme Inc., a publicly traded corporation. Batavian Firm carries out the transaction, and Buyer receives a confirmation informing it that the trade was “executed” on a certain date at a certain price. The most important thing to Buyer is the price of the transaction, and that will be determined by the price at which Batavian Firm executed the trade. For most legal purposes, it makes perfect sense to focus on the trade, in the sense of the transaction that Batavian Firm entered into on Buyer’s behalf to purchase the securities.

The subject matter of the Hague Convention, however, is the operation of the system through which securities transactions are settled, not the system through which trades are executed. What it means to say that “Buyer’s Firm executed the trade” is that the firm entered into a contract for purchase of the 1000 shares of Acme Inc. The terms of that contract will be set by the practices and rules of the securities market or exchange through which the contract was made. Among those terms will be provisions concerning how and when the contract is to be performed by the actual delivery of securities and payment of the purchase price. Thus, there are three aspects to what might loosely be called “the transaction.” First, there is the contract for purchase and sale of the securities. Second, there is the process by which one side of that contract is performed by payment of the purchase price. Third, there is the process by which the other side of that contract is

55. The moniker “page 37 problem” comes from the fact that the issue was prompted by discussion of an example that appeared on page 37 of Prel. Doc. No. 1., supra note 5.
performed by delivery of the securities. The Hague Convention deals only with the law governing the third aspect—the process by which the securities side of the contract is performed.

Separating the contract issues from the performance issues is quite important in understanding the Hague Convention, but the separation is not really unique to securities transactions. Consider an analogy from the setting of tangible goods, such as a sale of coal from Seller, located in Atlantis, to Buyer, located in Batavia. Suppose that Buyer happens to be in Atlantis and sees that Seller has coal for sale. Buyer enters into a contract, signed at Seller’s place of business in Atlantis, to buy a certain quantity of coal. Assume further that the contract calls for the Seller to deliver the coal to the Buyer’s place of Business in Batavia one month after the contract is signed.

Suppose that before the time for performance, Seller learns that there is another supplier of coal, Supplier, who has coal for sale in Batavia. To save shipping expense, Seller buys from Supplier, directing Supplier to deliver to Buyer. Supplier does so. Unless the contract between Seller and Buyer required Seller to deliver “the coal that B saw at Seller’s plant in Atlantis,” Seller can satisfy its obligations under the contract by causing Buyer to receive delivery of coal of the specified grade. It doesn’t matter—so far as Seller’s contractual obligations go—how Seller causes that to occur.

However, issues of property law may depend on how Seller performed its contract. Nothing can change the fact that the coal that Seller causes to be delivered to Buyer is either (a) the coal that Buyer saw at Seller’s plant in Atlantis, or (b) the coal that Seller bought from Supplier. Suppose Seller performed by causing Supplier to deliver to Buyer. Suppose further that Supplier had stolen the coal from Owner. Owner learns what happened to the coal and brings an action against Buyer. Buyer says “I have no idea what you are talking about, who you are, or who Supplier is. I didn’t deal with you; I dealt with Seller. So I don’t have to worry about your claim that Supplier stole coal from you.” But, Buyer is wrong about that. Either Buyer does or does not have the coal that Supplier stole from Owner. That’s a question of physics, not law.

The relevant law might, or might not, say that Buyer gets good title. That is an issue on which substantive laws vary. Under Anglo-American law, a person who comes into possession of stolen goods must give them back to the owner—it makes no difference whether the person paid good value for the stolen goods or had any reason to be suspicious of their origin. By contrast, under many civil law systems, Buyer would take free from Owner’s claim, provided that Buyer paid value and lacked notice of the theft.

So, we may well have a conflict of laws question that must be answered before we can determine whether Owner can or cannot recover the stolen coal from Buyer. It is important to note that the resolution of that conflict of laws question is not going to be determined by the fact that the sales contract was the contract between Seller and Buyer. Rather the conflict of laws question is likely to be determined by the situs of the coal. The law of Atlantis, the place of business of the Seller in the sales contract, has nothing to do with the issue. The relevant conflict of laws question is whether the issue is governed by Batavian law or some other law. For example, if Supplier stole the coal from Owner in Carolia, then there might be a dispute about whether the property question is governed by the law of Batavia or by the law of Carolia.58

Now return to the setting of securities transactions, in which Seller in Atlantis enters into a contract for sale of certain securities to Buyer in Batavia. For the moment, assume that it makes sense to talk about a contract for sale of securities between Seller and Buyer. Even so, the contract law issues, and the issues of conflict of laws that might arise preliminary to resolution of the contract law issues, have nothing to do with the property law issues that might arise if there is some question about the interest that Buyer receives. So too, if there are conflict of laws questions on the property side, the resolution of those issues will have nothing to do with the contract between Seller and Buyer. To see the point, suppose that Seller in Atlantis enters into a contract for sale of designated securities to Buyer in Batavia. Suppose that, for whatever reason, Seller performs by having Firm deliver a certificate for the appropriate securities to Buyer. Suppose further that it turns out that Firm stole that certificate from Owner. Owner discovers the facts and brings an action against Buyer.

The scenario is essentially the same as the coal case considered above. The fact that a securities certificate was delivered to Buyer in performance of a sales contract between Seller and Buyer is pretty much irrelevant to resolution of the property law issue. If Owner can show that the securities certificate delivered to Buyer was the same certificate that was stolen by Firm from Owner, then Owner presumably can make out a prima facie case. One must then decide whether Buyer takes free from or subject to Owner's claim. That may, in turn, pose a conflict of laws issue if the rules of the various jurisdictions are different on the question whether, or in what circumstances, a buyer is protected against adverse claims. One point that is completely irrelevant to that conflict of laws question is the ques-

58. To be sure, contract law issues arising out of the contract for sale between Seller and Buyer may become relevant again after the property issues have been determined. If, under whatever law is determined to govern Owner’s claim against Buyer, it is determined that Buyer received good title, free from Owner's claim, then Seller will have satisfied its obligations under the contract. On the other hand, if it is determined that Buyer does not take free from Owner's claim, then Buyer will presumably have a right to pursue Seller for breach of the sales contract. That will be a question of the rights and obligations of Buyer and Seller among themselves, and thus any conflict of laws issues involved will appropriately be resolved by reference to connecting factors arising out of the relationship between Buyer and Seller.
tion of what law governs the sales contract between Seller and Buyer. The issue is whether Owner—not Seller—can succeed in its action against Buyer once Owner shows that Buyer has the same certificate that Firm stole from Owner.

Suppose that Owner is located in Carolia, and that Firm stole the certificate from Owner in Carolia, and that Firm delivered the certificate to Buyer in Batavia. The jurisdictions whose law might determine whether Buyer takes free from Owner’s claim are Carolia (the location of Owner and the theft), Batavia (the location where the certificate was delivered to the buyer), and the jurisdiction where the issuer of the securities was organized. One jurisdiction that we can rule out is Atlantis. The fact that the problem started with a contract for sale of securities from Seller in Atlantis to Buyer in Batavia has nothing to do with the determination of the conflict of laws question about whether Buyer takes free from or subject to the claim of Owner.59

We should also explore a bit more deeply the implicit assumption that it makes sense to talk about “a” contract for sale of securities between Seller and Buyer. In reality, what happens is that Seller calls its securities firm, Atlantis Firm, and directs Atlantis Firm to sell. At about the same time, Buyer calls its securities firm, Batavian Firm, and instructs Batavian Firm to buy. Atlantis Firm and Batavian Firm enter into a contract for sale of the securities through the facilities of some securities market or exchange. Each of the firms then confirms to its customer that the trade has been “executed.” Note, however, one piece of information that would be completely irrelevant to both Seller and to Buyer, and would, in fact, never be disclosed to either—the identity of the other. Seller neither knows nor cares who Buyer is, or who Buyer’s Firm is. Buyer neither knows, nor cares, who Seller is, or who Seller’s Firm is. All that either Seller or Buyer care about is that its firm has confirmed that the transaction has occurred.

Let us, then, consider the contract law analysis a bit more deeply. Specifically, let us consider whether there really is, in any useful sense, “a” contract for sale from Seller to Buyer.

In part, the answer will depend on the roles that Seller’s firm and Buyer’s firm play in the particular transaction. One possibility is that the transaction is actually a “dealer” transaction rather than a “broker” transaction. In that case, Atlantis Firm, acting as principal, buys the securities from Seller. Then, Atlantis Firm sells the securities to Batavian Firm, where Batavian Firm is also acting as a principal. Then, Batavian Firm, again acting as principal, sells the securities to Buyer. If both Atlantis Firm and Batavian Firm are acting as principals, then there simply is no contract between Seller and Buyer. Instead, there are three separate sales contracts: (1) Seller to Atlantis Firm, (2) Atlantis Firm to Batavian Firm, and (3) Bata-

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59. As in the coal case considered above, if Buyer loses to Owner, then Buyer presumably has a breach of contract claim against Seller, and we may have a conflict of laws question in connection with that contract issue, but that has nothing to do with the question whether Buyer took free from or subject to Owner’s claim, nor with any conflict of laws questions that may arise in connection with that property law issue.
vian Firm to Buyer. In that case, even if we confine our attention to the contract law issues, which as noted above are not the subject of the Hague Convention, the notion that there are separate transactions that might be governed by separate bodies of law is not at all anomalous. Then, when we turn from the contract issues to the property issues that might arise in connection with performance of those contracts, the result that different bodies of law apply to the three entirely distinct transactions is hardly surprising.

Suppose that the firms act as brokers in the transaction rather than as dealers. Does that really make any significant difference in the analysis? When Atlantis Firm and Batavian Firm meet through the facilities of some securities market or exchange, they enter into a contract for sale of securities, with each party acting as agent for an undisclosed principal. They would never reveal the identity of their respective principals, both because that information is entirely irrelevant to the transaction, and because, for competitive reasons, neither firm is interested in revealing information about the identity of its customers. So, looking only at the contract analysis, we have a situation in which Atlantis Firm (acting as agent for Seller as an undisclosed principal) enters into a contract for sale of securities to Batavian Firm (acting as agent for Buyer as an undisclosed principal). Consider what body of law governs the various relationships. As between Seller and Atlantis Firm, the question is what law governs the rights and duties of a principal and an agent who enters into a transaction on behalf of the principal, doing so as agent for an undisclosed principal. That is a question of the rights and duties as between Seller and Atlantis Firm, albeit rights and duties that arose in connection with a transaction that Atlantis Firm entered into with someone else. But it seems clear that the question of the rights and duties as between Seller and Atlantis Firm would be determined by the law proper to their relationship. In the simple example where both are located in Atlantis, and where the agreement between them is governed by Atlantis law, that would be the law of Atlantis. If one were to say that the law governing the relationship between Seller and Atlantis Firm is determined by the law that might apply to a direct contract between Seller and Buyer, then one would end up with the odd conclusion that the contractual relationship between a securities firm and its customer is not determined by a single body of law, but varies, transaction by transaction, depending on the identity and location of the ultimate counterparty to the trade.

There is now no need to examine in detail the question of the law that would govern the contractual relationship between Buyer and Batavian Firm. The situation is exactly the same as the analysis of the contractual relationship between Seller and Atlantis Firm. Thus, the relationship between Batavian Firm and Buyer would be governed by the law of Batavia.

Now, consider what body of law would govern the contract law analysis of the relationship between Atlantis Firm (acting as agent for an undisclosed principal) and Batavian Firm (acting as agent for an undisclosed principal). Once again, it makes no sense to suppose that the law gov-
erning this relationship is determined by anything having to do with either Seller or Buyer. To suppose the contrary would again mean that neither Atlantis Firm nor Batavian Firm could determine what law governs the contractual relationship between them, because each is acting as agent for an undisclosed principal. Accordingly, neither securities firm knows the identity of the other's customer. Rather, the answer must be that the law governing the contractual relationship between Atlantis Firm and Batavian Firm is determined by facts arising out of the relationship between them. In any transaction effected through the facilities of an organized securities market or exchange, that question will invariably be resolved by the rules and practices of the market or exchange in question. For example, if the contract between Atlantis Firm and Batavian Firm is made through the facilities of a securities exchange in Atlantis, it will undoubtedly be governed by the law of Atlantis. If the contract is made through the facilities of a securities exchange in Batavia, it will undoubtedly be governed by Batavian law. If the contract between Atlantis Firm and Batavian Firm is made through the facilities of a securities exchange in another country, it will undoubtedly be governed by the law of that country.

Thus, whether the securities firms in question are acting as dealers or as brokers, it is not possible that a single body of law will govern all of the contractual relationships involved in the transaction between Seller, Atlantis Firm, Batavian Firm, and Buyer. Rather, even on the contractual side, the conflict of laws analysis must proceed in a step by step fashion. It makes no sense to suppose that the conflict of laws analysis should be determined by the happenstance that the transaction can—from the standpoint of lawyers' hypotheticals, rather than actual cases—be described as a sale from Seller to Buyer.

Thus far we have been considering the conflict of laws analysis that would apply to the contractual relationships among the parties. Now let us turn to the matters that are actually the subject of the Hague Convention—the property law side. The basic points developed in the contractual analysis described above remain significant. In particular, it is important to note the very odd consequences that would follow from the notion that an ordinary international securities market transaction could appropriately be described as one in which a property interest in the securities passes from Seller to Buyer, through the vehicles of Atlantis Firm, Securities Depository, and Batavian Firm. That consequence is as follows: No one would ever know whether he got good title. If the only way of concluding that Buyer got good title is to determine that title passed from Seller, then no buyer would ever know whether or not he got good title. For the reality is that in an ordinary market transaction, no buyer would ever know who the seller is.

Indeed, the problem is worse than one of access to information. We have been supposing that it makes sense to regard the performance stage of a securities contract as a process by which the individual securities that are the subject of the sales contract pass from Seller to Buyer, through the vehicles of the securities firms and settlement system. That is possible, but it
is, in fact, relatively unlikely. In modern securities markets, settlement
does not generally occur on an individual trade by trade basis. Rather, all
of the trades made through the securities firms on a given market or
exchange are commonly reduced to a single net deliver or receive position.
Settlement then occurs on an aggregate basis.

Suppose, for example, that our hypothetical Seller-Buyer trade is made
on the Ruritanian Stock Exchange, and that the members of the Ruritanian
Stock Exchange settle among themselves on a net basis. That means that at
the end of a given day’s trading, all of the obligations of the participants are
netted to a single deliver or receive position. Once that occurs, it really
makes no sense to talk about how settlement of “the Seller to Buyer” trade
takes place. There never is any individual movement of securities from
Seller to Buyer, not even from Atlantis Firm to Batavian Firm. Rather, there
is simply a movement of securities to or from Atlantis Firm and the clear­
ing system, and a movement of securities to or from Batavian Firm and the
clearing system.

The simplest way of seeing why it makes no sense to ask how the indi­
vidual Seller-Buyer trade is settled is to suppose that in the aggregate Atlan­
tis Firm has a net receive position for that day’s trades and Batavian Firm
has a net deliver position. Thus although Seller is selling through Atlantis
Firm, and Buyer is buying through Batavian Firm, there will be no move­
ment of securities from Atlantis Firm to Batavian Firm. Rather, the oppo­
site will occur; securities will move from Batavian Firm to Atlantis Firm.
Or it might happen that the positions of each of our two securities firms
with respect to all other members of the settlement system happen to be
such that no securities move to or from either firm when the final settle­
ment obligations are determined for that day’s trading. If no securities
pass from Atlantis Firm to Batavian Firm, a legal analysis that insists that
the only way the Seller-Buyer transaction can be described is a passage of a
property interest from Seller to Buyer produces the odd consequence that
whether Buyer does or does not get good title depends of the fortuity of
what other trades happen to be made through the firms that day.

Thus far we have been assuming that our basic hypothetical scenario
is one in which Seller in Atlantis sells securities through Atlantis Firm to
Buyer in Batavia, acting through Batavian Firm, and that “the transaction”
between Atlantis Firm and Batavian Firm occurs through Securities Depos­
itory located in Ruritania. Let us think a bit more carefully about the dif­
ference between the contract analysis of the sales contract and the property
law analysis of the process through which the sales obligations are per­
domed. One question is what law governs the sales contract between
Atlantis Firm (acting as agent for Seller as undisclosed principal) and Bata­
vian Firm (acting as agent for Buyer as undisclosed principal). Another
question is what law governs the property law issues that might arise in
connection with performance of that sales contract. Most often the same
law will govern both the contract issues and the property issues, but there
is no reason that must be the case. Suppose, for example that the contract
between Atlantis Firm and Batavian Firm is made on the Ruritanian Stock
Exchange, but that the rules of the Ruritanian Stock Exchange provide that settlement either must or might be made on the books of the Erewhon Securities Depository. The rules of the Ruritanian Stock exchange undoubtedly will provide that the contract between Atlantis Firm and Batavian Firm is governed by the law of Ruritania. But, the rules of the Erewhon Securities Depository will undoubtedly provide that the right of participants arising out of movements of securities through the Erewhon Securities Depository are governed by the law of Erewhon. The contract issues and the property issues are simply different. There is no reason to suppose that they must be governed by the same body of law.

Thus far, we have been considering a transaction for the sale of securities. Let us now turn to pledge transactions. Suppose, for example, that Borrower, located in Atlantis, wishes to grant a security interest in certain indirectly-held securities to Lender, located in Batavia. Before the transaction, Borrower maintains its securities in an account with Atlantis Firm. Lender insists that securities that are collateral for loans made by it be transferred into a special pledge account that it maintains with its intermediary Batavian Bank. Borrower and Lender sign a loan and security agreement. They also arrange for the securities to be transferred from Borrower's account with Atlantis Firm to Lender's account with Batavian Bank. The transaction between Atlantis Firm and Batavian Bank is settled by debits and credits on the books of Securities Depository, located in Ruritania. How does the fact that we have a pledge rather than a sale change the conflict of laws analysis?

The main difference is that the pledge transaction is simpler than the sales transaction with respect to the contractual side. As we have seen, in a securities sales transaction, it really doesn’t make much sense to talk about “a” contract between Seller and Buyer. Rather, all of the questions that matter deal with the separate contractual relationships between seller and its securities firm, between the securities firms, and between buyer and its securities firm. By contrast, in a secured lending transaction, there will be a direct contractual relationship between borrower and lender. Thus, the contractual side of the conflict of laws analysis is likely to be simpler for a pledge than for a sale. But that difference is only a matter of the contractual relationship and, as we have seen, the Hague Convention has nothing to do with the contractual relationship.

On the property law side—which is the matter governed by the Hague Convention—there really isn’t any significant difference between the sales transaction and the pledge transaction. How the movement of securities in settlement of the pledge transaction is effected is a matter of the rules of the relevant securities depository. It is entirely possible that Securities Depository in our example would treat a movement of securities in settlement of a pledge under the same system as a movement in settlement of a sale or any other transaction. In that case, we might well have scenarios of the sort considered above in which the net changes of position between Atlantis Firm and Batavian Bank bear no relationship to the individual transaction in which Batavian Bank’s position is to be credited and Atlantis
Bank's position is to be debited. Even if the transaction between Atlantis Firm and Batavian Bank is settled on a gross basis (that is, transaction by transaction) it remains the case that all of the significant questions on the property law side will be answerable only by reference to the individual relationships between customers and their intermediaries.

For example, in our hypothetical transaction, all that Lender in Batavia cares about is that the designated securities show up in the designated pledge account on the books of Batavian Bank. It shouldn't make any difference to Lender whether Borrower caused that to occur by a transaction that started with a debit to Borrower's account at Atlantis Firm, or a debit to another account that Borrower maintains with Carolia Firm, or to an account maintained by an entity somehow related to Borrower that happens to be maintained with Erehwon Firm. What matters to Lender is that the required collateral appears in the specified account at Batavian Bank. From the standpoint of conflict of laws, what matters is that Lender be assured that if Batavian law says that the appearance of the collateral in that account suffices to give Lender a perfected security interest, then Lender need not worry about the secured transaction law of any of the other jurisdictions that might have somehow been involved in the series of related transactions.

Consider, for example, a scenario somewhat like that in the well-known Maxwell case.60 Borrower tells Lender that it will pledge Acme Inc securities to Lender as collateral for the loan. The Acme securities are transferred from an account maintained in the name of an entity related to, but legally distinct from, Borrower. As it happens, Borrower is acting wrongfully against that related entity in causing the Acme securities to be pledged to Lender. Suppose that those Acme securities happened to have been maintained by the entity related to Borrower in an account with Erehwon Firm in Erehwon. Indeed, suppose that Lender has no idea where those securities came from, but knows only that Borrower somehow caused the securities to end up in the designated pledge account that Lender maintains with Batavian Bank. The important thing is that Lender knows what body of law will determine whether it takes its pledge interest free from or subject to the claim of the related entity. International pledge transactions can only be effected in a safe and efficient manner if Lender can know with certainty that this question will be determined under a single, knowable body of law. And, whether we like it or not, the only knowable body of law is the law of a jurisdiction determined by factors arising out of the relationship between Lender and its intermediary, Batavian Bank.

Conclusion

The Hague Convention on the Law Applicable to Certain Rights in Respect of Securities makes a significant advance in thinking about conflict

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60. Macmillan Inc. v. Bishopsgate Investment Trust plc (No. 3) [1996] 1 All E.R. 585 (Eng.).
of laws for this important area. The problems that the Convention treats will not go away. It is highly unlikely that there will ever be uniformity on the substantive law in this area.\(^{61}\) The Convention adopts an approach to these problems that responds to the realities of the current marketplace. One of the challenges that the Convention poses is that lawyers must be willing to abandon certain traditional concepts in dealing with these problems. For example, such shopworn phrases as "lex situs" or "party autonomy" do not capture the issues that must be confronted in this area.\(^{62}\) Use of such phrases only obscures the real issues. So too, it will not suffice to adopt a partial solution. It is, at first blush, tempting to say that all one needs to do is say that the law governing transactions in securities held through an intermediary should be determined by the "location of the account." Yet that concept is meaningless. Accordingly, to state the conflict of laws rules in such terms is to ensure that the rules will not work in any hard case, and hard cases are where the rules are needed. The experts who worked for several years on these problems considered with great care a host of different approaches to the problem of giving specific content to the general idea that the governing law should be determined solely by reference to the relationship between the intermediary and its account holders. Ultimately, the conclusion was reached that the only realistic way to solve that problem was the "agreement plus reality test" formulation adopted in the Convention.

\(^{61}\) See supra notes 16-17 and accompanying text.

\(^{62}\) See supra Introduction.