

Effect of the Hague Securities Convention on Perfection and Priority of a Security Interest in Indirectly Held Securities



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The Hague Securities Convention (the "Convention"), an international multilateral treaty, effective in the United States on April 1, 2017, applies whenever securities¹ credited to a securities account² held with an intermediary³ involve parties or property from more than one nation.⁴ The Convention provides choice-of-law rules among such nations with respect to the nature of the rights acquired by the account holder⁵ in such securities and the nature and effects against third parties of a disposition⁶ of such securities, including the duties of an intermediary to the account holder and third parties asserting an interest in such securities, perfection⁷

1 Pursuant to Convention Article 1, "securities" means any shares, bonds or other financial instruments or financial assets (other than cash), or any interest therein." The Convention does not define "financial assets."

2 Pursuant to Convention Article 1, "securities account" means an account maintained by an intermediary to which securities may be credited or debited."

3 Pursuant to Convention Article 1, "intermediary" means a person that in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity."

4 See Convention Article 3. For example, if the account holder, the issuer of the securities, the relevant intermediary, any party to a disposition of the securities or the securities account, or an interest in either (including an adverse claimant), is located in a different nation, the Convention is likely to apply.

5 Pursuant to Convention Article 1, "account holder" means a person in whose name an intermediary maintains a securities account."

6 Pursuant to Convention Article 1, "disposition" means any transfer of title whether outright or by way of security and any grant of a security interest, whether possessory or non-possessory."

7 Pursuant to Convention Article 1, "perfection" means completion of any steps necessary to render a disposition effective against persons who are not parties to that disposition."

and priority.⁸ This article focuses on the choice-of-law rules for the perfection and priority of a security interest in such indirectly held securities⁹ under the Convention. These rules must be considered because the Convention (i) is applicable to all such existing and new transactions, (ii) pre-empts certain of the choice-of-law rules in Articles 8 and 9 of the Uniform Commercial Code as adopted in New York or any other applicable state (the UCC) and (iii) under certain circumstances, provides that a law other than the law applicable under the UCC governs perfection and priority of such security interest. It is necessary to be familiar with the Convention so that the proper action is taken to perfect the security interest in indirectly held securities.

Part A: The New Choice-of-Law Rules—The Primary Rule and the Fall-Back Rules

We first examine the basic technical choice-of-law rules and then apply them to typical situations in Part B (issues) and Part C (no issues). Pursuant to the Convention, perfection and priority of interests in indirectly held securities will be determined by either: (i) the substantive law of the jurisdiction whose law governs the account agreement¹⁰ between the intermediary and the account holder; or (ii) if so provided in the account agreement, a different jurisdiction,¹¹ provided that, in each case, the intermediary maintains an office that is “engaged in a business or other regular activity of maintaining securities accounts”¹² (the “Qualifying Office”)

8 Convention Article 2(1) sets forth all the issues within the scope of the Convention. If an issue is not specified in Convention Article 2(1), it does not fall within the scope of the Convention.

9 Indirectly held securities are securities held through a broker, custodian, bank or other intermediary, rather than directly on the issuer’s books.

10 Pursuant to Convention Article 1, “‘account agreement’ means, in relation to a securities account, the agreement with the relevant intermediary governing that securities account.” See Convention Article 4(1).

11 See Convention Article 4(1). The parties can select one law to govern the account agreement and another law to govern all Convention Article 2(1) issues.

12 See Convention Article 4(1)(a)(iii).

in such jurisdiction¹³ (the intermediary does not have to maintain the securities account related to the relevant account agreement in such jurisdiction), as determined when the express agreement on the account agreement governing law is made or amended (or, if governing law is determined pursuant to the fall-back provisions, when the account agreement is effective, or if there is no account agreement, when the securities account is opened). If the chosen law is the law of a jurisdiction in a Multi-unit State,¹⁴ the Qualifying Office requirement is satisfied if the intermediary maintains a Qualifying Office in any jurisdiction in the Multi-unit State. If the Qualifying Office requirement is not satisfied, the account agreement does not set forth a governing law, or there is no account agreement, the following cascading fall-back rules¹⁵ determine the governing law: (i) first, the law of the location of the office expressly and unambiguously identified in a written¹⁶ account agreement, as the office through which the relevant intermediary¹⁷ entered into the account agreement¹⁸ (but only if the Qualifying Office requirement is satisfied), (ii) second, the law of the place of organization of the relevant intermediary¹⁹ and (iii) third, the law of the principal place of business of the relevant intermediary.²⁰ The Convention specifically excludes

13 See Convention Article 4(1).

14 Pursuant to Convention Article 1, the United States is a “Multi-unit State,” defined as “a [nation] within which two or more territorial units of that [nation], or both the [nation] and one or more of its territorial units, have their own rules of law in respect of any of the issues specified in [Convention] Article 2(1).”

15 See Convention Article 5. The Convention’s fall-back rules differ from the rules that determine the securities intermediary’s jurisdiction under UCC 8-110(e).

16 Pursuant to Convention Article 1, “‘written’ mean[s] a record of information (including information communicated by teletransmission) which is in tangible or other form and is capable of being reproduced in tangible form on a subsequent occasion.”

17 Pursuant to Convention Article 1, “‘relevant intermediary’ means the intermediary that maintains the securities account for the account holder.”

18 See Convention Article 5(1).

19 See Convention Article 5(2).

20 See Convention Article 5(3).

cash from its definition of “securities” and does not include the option provided for under the UCC, for the parties to agree that any asset held in the securities account is a financial asset.²¹

Part B: Perfection Issues Due to New Choice-of-Law Rules

Although in most instances the outcome of the Convention choice-of-law provisions will be the same as under the UCC choice-of-law provisions, the following common situations lead to a different outcome under the Convention:

1. Perfection by control where the law of a non-UCC jurisdiction is the chosen law in the account agreement and the securities intermediary’s jurisdiction is chosen for purposes of the UCC in the control agreement. For example, an English law governed account agreement (Qualifying Office requirement is satisfied) that provides that New York is the “securities intermediary’s jurisdiction” for purposes of the UCC: Prior to April 1, 2017, perfection and priority by control is governed by New York substantive law.²² Effective on April 1, 2017, perfection and priority is governed by English substantive law.²³ The selection of the securities intermediary’s jurisdiction is not relevant under the Convention. The law governing the account agreement is the relevant fact that determines the law governing perfection and priority under the Convention.

2. Perfection by filing where the law of a non-UCC jurisdiction is the chosen law in the account agreement and the debtor is located (as determined by UCC 9-307) in a UCC jurisdiction. For example, an English law governed account agreement (Qualifying Office requirement is satisfied) and debtor is a New York corporation: Prior to April 1, 2017, the correct place to file a financing statement is with the Secretary of State of the State of New York.²⁴ Effective on April 1, 2017, English law determines where the secured party should file

or otherwise perfect.

3. Perfection by filing where the law of a UCC jurisdiction is the chosen law in the account agreement and the debtor is located (as determined by UCC 9-307) in a non-UCC jurisdiction that provides public notice of non-possessory security interests as a condition to priority over the rights of a lien creditor with respect to the collateral. For example, a New York law governed account agreement (Qualifying Office requirement is satisfied) and debtor is an Ontario, Canada corporation with its chief executive office in Toronto: Prior to April 1, 2017, the correct place to file a financing statement is in Ontario.²⁵ Effective on April 1, 2017, the correct place to file a financing statement is in New York.²⁶

Part C: No Perfection Issues Due to New Choice-of-Law Rules

Although in some instances, as in the examples provided in Part B above or if the Qualifying Office requirement is not met, the Convention may designate the law of a jurisdiction other than the jurisdiction designated by the UCC, in most transactions, the Convention choice-of-law rules require a financing statement to be filed in the same location designated by UCC 9-307 to perfect a security interest in indirectly held securities. The Convention provides that if the law in force in a territorial unit of a Multi-unit State designates the law of another territorial unit of the Multi-unit State to govern perfection by filing, the law of the specified territorial unit of such Multi-unit State governs that issue.²⁷ In other words, if you have an account agreement that is governed by New York law and a debtor that is formed under the laws of Delaware or the laws of a jurisdiction that does not

²¹ See UCC 8-102(a)(9)(iii).

²² See UCC 9-305(a)(3).

²³ See Convention Article 4(1).

²⁴ See UCC 9-305(c)(1) and UCC 9-307(e).

²⁵ See UCC 9-305(c)(1) and UCC 9-307(b) and (c)

²⁶ Convention Article 12(2)(b) provides that if New York law designates a jurisdiction outside of the United States to perfect, New York law governs perfection. New York UCC 9-501(a)(2) provides that if New York law governs perfection of a security interest, the office in which to file a financing statement to perfect the security interest is the office of the New York Secretary of State.

²⁷ See Convention Article 12(2)(b).

provide public notice of non-possessory security interests as a condition to priority over the rights of a lien creditor with respect to the collateral, New York law in both cases sends you to a jurisdiction in the United States (either Delaware or the District of Columbia) and such law complies with the Convention choice-of-law rules. In practice, satisfying the Qualifying Office requirement will be easy in the United States because this requirement is satisfied if, at the applicable time, the relevant intermediary has an office in any jurisdiction in the United States that, alone or with another office or third party, serves certain functions relating to the maintenance of securities accounts, or is identified, by any specific means, as maintaining securities accounts in the United States. This Qualifying Office requirement will generally be an issue only if the chosen law does not relate to the transaction (e.g., an intermediary that has offices only in England choosing the law of any United States jurisdiction to govern the account agreement).

Practice Points and Conclusion

Because under the Convention (i) it is the law governing the account agreement that determines perfection and priority (not the jurisdiction of the securities intermediary as provided under the UCC) and (ii) “securities” is defined differently than it is under the UCC, the law governing perfection and priority of indirectly held securities should be designated in the account agreement pursuant to both the Convention and the UCC. All new transactions should include, and any existing transaction that falls within one of the three examples set forth above should be amended to include, the following provision in the account

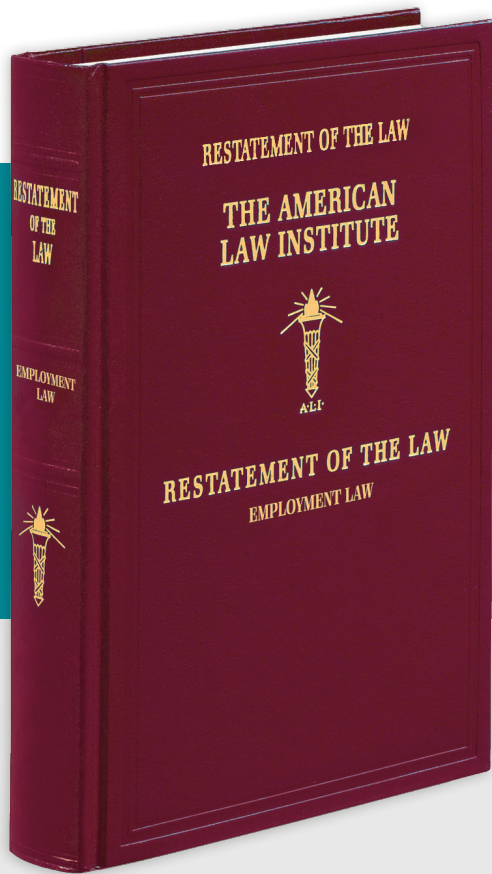
agreement (or, if included in a control agreement, provide that “the account holder and intermediary agree the account agreement is amended as follows”):

“The State of [New York] is the securities intermediary’s jurisdiction for purposes of the [New York] UCC, and the law in force in the State of [New York] is applicable to all issues specified in the Hague Securities Convention Article 2(1).”

It may be prudent to assume that the Convention will apply because (i) an entirely domestic transaction will be subject to the Convention if, for example, (a) a foreign person asserts an adverse claim to any of the securities credited to the applicable securities account or (b) securities issued by a foreign issuer are later credited to the applicable securities account and (ii) the Convention applies whether or not the applicable law is that of a jurisdiction that has adopted the Convention (although the Convention itself is the law only of a jurisdiction that adopted the Convention).

To date, only Mauritius, Switzerland and the United States have ratified the Convention but other countries are expected to follow. While the UCC has international conflict-of-law rules, such rules are not sufficient because they may not be applied in a foreign forum since they are only domestic conflict-of-law rules. The purpose of the Convention is to resolve this deficiency. It is prudent to consult the Convention to ensure the proper action is taken to perfect a security interest in indirectly held securities.

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