Osaka University Knowledge Archive

Title	Japanese Law as the Applicable Law under The Hague Securities Convention : What Rule of Substantive Law Should Be Applied?
Author(s)	Nomura, Yoshiaki
Citation	Osaka University Law Review. 2010, 57, p. 1-18
Version Type	VoR
URL	https://hdl.handle.net/11094/9006
rights	
Note	

Osaka University Knowledge Archive : OUKA

https://ir.library.osaka-u.ac.jp/

Osaka University

OSAKA UNIVERSITY LAW REVIEW No. 57 (February 2010) 1-18

Japanese Law as the Applicable Law under The Hague Securities Convention:

What Rule of Substantive Law Should Be Applied?

Yoshiaki NOMURA*

Abstract

This article discusses which substantive rules will apply under Japanese law to the resolution of specific issues in the case where Japanese law is determined to be applicable in accordance with the conflict of law rules under the Hague Securities Convention, if this Convention comes into force. In Part II, the development of legal principles regarding securities is briefly looked at from the perspective of visualization and clarification of ownership and the transfer of rights *in personam* (claims). In Part III, this article discusses how the Convention can be explained from the perspective of Japanese private international law, using specific cases relating to the securities settlement system envisaged by the Convention. Lastly, this article discusses, in the case where Japanese law is determined to be applicable under the Convention conflict-of-law rules, whether the conventional theory derived from the interpretation of the Civil Code should be applied, or a new approach embodied in the Act on Book-entry Transfer of Corporate Bonds and Shares and Other Rights should be applied. It is suggested that any issue in question should be explained through the approach taken by the Book-entry Transfer Act.

---

* Professor, Osaka School of International Public Policy (OSIPP) and Osaka University Law School (OULS), Osaka University, Japan. E-mail: nomura@osipp.osaka-u.ac.jp
Official website: http://www2.osipp.osaka-u.ac.jp/~nomura/index.html
This article was originally produced with the assistance of Grants-in-Aid for Scientific Research (Designated field) – "Construction of Japanese-style Financial Transaction Model for Global Users" (Subject number: 16090203), and published under the title of "Hague Shoken Jyoyaku to Nihon-ho [Hague Securities Convention and Japanese Law]" in 37-3 *Kokusai Shoji Homu* 289 (2009). This wholly new version is based on a report presented at the "International Finance Roundtable – A Japanese Perspective" held at Queen Mary School of Law, University of London on February 27, 2009 and rewritten for English readers with new materials and footnotes. The author gratefully acknowledges the dedicated assistance of Mr. John Ribeiro, Research Assistant at the School of International Arbitration, Queen Mary, University of London.

I. Introduction

In December 2002, the *Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary* (hereinafter referred to as the "Hague Securities Convention")[1] was adopted by the Hague Conference on Private International Law,[2] with the intention of harmonizing the rules regarding the determination of the law applicable to certain rights in respect of securities in cross-border security transactions executed under the international securities book-entry transfer and settlement system. If this Convention comes into force, the rules to determine the law applicable to such securities will be clarified, and predictability and legal certainty for the parties involved in cross-border securities transactions will increase. Thus, in Europe, the European Union has been actively pursuing discussions towards ratification of the Convention.[3] Similarly, in Japan, a report recommending ratification of the Convention at a proper time was submitted to the Legislative Council of the Ministry of Justice.[4]

This article discusses which substantive rules will apply under Japanese law to the resolution of specific issues in the case where Japanese law is determined to be applicable in accordance with the conflict of law rules under the Hague Securities Convention, if this Convention comes into force.[5] In Part II, the development of legal principles regarding securities is briefly looked at from the perspective of visualization and clarification of ownership and the transfer of rights *in personam* (claims). In Part III, this article discusses how the Hague Securities Convention can be explained from the perspective of Japanese private international law (based on the conflict of law rules stipulated in the *Act on General Rules on Application of Laws* (hereinafter referred to as the "Act on General Rules"[6]), using specific cases relating to the securities settlement system envisaged by the Hague Securities Convention. Lastly, this article discusses, in the case where Japanese law is determined to be applicable in accordance with the conflict of law rules under the Hague Securities Convention, whether the conventional theory should be applied, namely the theory of deposit of securities in a fungible pool and transfer of co-ownership rights in the pool, derived from the interpretation of the Civil Code,[7] or the provisions of the *Act on Book-entry Transfer of Corporate Bonds and Shares and Other Rights* (hereinafter referred to as the "Book-entry Transfer Act")[8] should be applied.

II. Legal principle of securities for visualization

Suppose that A sold a movable *z* to B. For B to be able to assert against a third party other than A that the ownership of the movable *z* belongs to B, the movable *z*

needs to be delivered to B (see Article 178 of the Japanese Civil Code). If the movable *z* is actually delivered to B, it is clear to all third parties that the movable *z* is actually in the possession of B. Therefore, delivery of a movable functions as means of public notice.

However, in reality, A might be keeping the movable *z* (see Article 181 of the Civil Code) on behalf of its rightful owner, or a warehouse operator C might be keeping the movable *z* for A as A's agent. In these scenarios, the possession of the movable *z* will be transferred to B by "constructive transfer" (Article 183 of the Civil Code) or "by instruction" (Article 184 of the Civil Code). However, even if such transfer is made, in these cases, the movable *z* is, to all appearances, still in the possession of A or C, not B. Since transfer by "constructive transfer" or "by instruction" is merely a legal fiction, such means do not function as public notice.

As explained above, the means of public notice for the transfer of movables, namely delivery, are not quite apparent for third parties in the modern economic society. When it comes to the transfer of claims and rights of shareholders, the subject matter of such rights itself is not physically deliverable. Therefore, the law stipulates that "the assignment of a nominative claim may not be asserted against the applicable obligor or any other third party, unless the assignor gives a notice thereof to the obligor" (or "the obligor has acknowledged the same") (see Article 467, paragraph 1 of the Civil Code). This requirement is, however, problematic as a means of public notice. Even if such notice or acknowledgment is made using an instrument bearing a fixed date (see Article 467, paragraph 2 of the Civil Code), the transfer of rights still does not have high clarity.

Under these circumstances, for higher clarity and easier circulation of claims, the law invented figurative means for the transfer of claims, by using the transfer of goods as a metaphor, through embodiment of claims in a tangible form - paper. This is the legal principle of securities. Transfer or ownership of rights represented by securities can now be clarified by issuance or possession of security certificates (for shares, see Article 128 and Article 131, paragraphs 1 and 2 of the Companies Act; for bonds, see Article 687 and Article 689, paragraphs 1 and 2 of the same).

However, in 1984, a new so-called "Book-entry Transfer System" for shares was legislated. Under this system, the custody of shares is centralized and share certificates are to be stored at custody and transfer organizations. The transfer of shares in the custody of these organizations is made by book-entry of transfers between relevant accounts, not by delivery of share certificates. On the one hand, for practical purposes, this system attempts to clarify the transfer of securities through a book-entry of transfers, but on the other hand, in theory, it relies on the

legal principle of securities, such as delivery and possession. In other words, under this system, persons recorded in the account registry are deemed to be the possessors of share certificates, and recording the account is considered to have the same legal effect as the delivery of share certificates. This explanation is simply an application of the aforementioned fiction concerning the possession and delivery of goods using paper, and is implicit and unclear.

As for the transfer of securities issued in international markets, the system is similar to Japan's Book-entry Transfer System for shares, as they are stored and transferred under the international version of a securities book-entry transfer system. However, differences can be found, as explained in Case I of the following Part III, in that no certificate is issued for each individual right, and only one global certificate, representing the contents of rights to the securities in the same type issued by the same issuer, is issued by each issuer and deposited for safekeeping with the International Central Securities Depository (ICSD). In theory, if only a global certificate is issued and deposited for safekeeping, possession or delivery of an individual security is not possible, even indirectly.

When securities are issued, held in deposit and settled in international markets, the legal nature of rights in or to such securities and the validity of transfer will be determined in accordance with the law of the state specified by the rules of private international law of the forum. In this case, the question arises as to whether the conventional rules of private international law based on *lex rei sitae* (if the forum is in Japan, Article 13 of the Act on General Rules)[9)], that focuses on the place where the property is situated, should be applied.

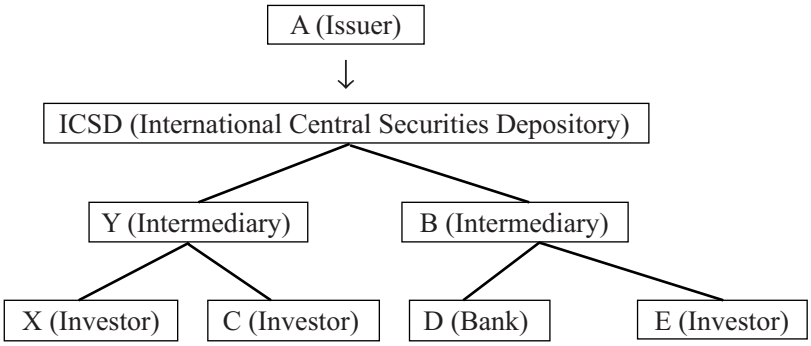
III. Multi-tiered Securities Settlement System and the Hague Securities Convention

The Hague Securities Convention will apply to the rights to the securities held with intermediaries under the international securities book-entry transfer system. The term "securities" is defined in the Convention as "any shares, bonds or other financial instruments or financial assets (other than cash), or any interest therein" (Article 1(1) (a)).

It is already well known from the judgment rendered by the Yamagata District Court on November 11, 1999[10)] that the multi-tiered international securities book-entry transfer and settlement system, as described in Figure 1, has been used for securities involving Japanese investors. To demonstrate differences between the multi-tiered international securities settlement system and the legal relations on which the conventional rules of private international law is based, this article

proceeds with discussions using three simplified cases based on the aforementioned court case: [Case I] (Issues in the vertical levels described in Figure 1); [Case II] (Issues relating to the horizontal transactions in Figure 1); and [Case III] (Determination of the applicable law for each account).

Figure 1: Intermediated Holding System



1. Case I: The Case of a Failed Investor[11)]

X, who is an individual investor residing in Japan, executed a foreign securities account agreement with Y, a Japanese securities firm and Y maintained her foreign securities account within a branch office in Japan. X purchased several foreign currency-based bonds with warrants ("bonds")[12)] issued by A and other Japanese corporations.

With regards to the bonds in this case, an ICSD (Euroclear, a company group primarily consisting of Belgium companies) located in Belgium was used for depository and settlement purposes. Y was a participant of the ICSD, and held an account with the system. For the bonds in this case, individual certificates for each subscription were not issued, and a global certificate representing all of the bonds was issued and held in deposit by the ICSD.

The seller in this transaction, Y, had an account with the ICSD, and to procure the bonds to be sold to X, Y purchased the bonds from another participant B, who had an account with the system. In the process, the purchased amount was withdrawn from B's account, and the same amount was booked into Y's account in the ICSD.

As evidence of the booking in Y's account in the ICSD, Y booked the transaction amount to X's foreign securities account with Y. Per each transaction, Y delivered to X the "transaction statement" and "certificates of deposit" containing

such information as the issuer of the bonds and the amount purchased, but the certificates of the bonds were never delivered. At the time of the transaction, Japanese law required that for the transfer of a bond to be effective, the certificate of the bond had to be delivered.[13)]

Which state's law will apply in determining whether or not X acquired rights to the securities and, if rights were acquired by X, precisely what rights did X acquire?

[Case II]

C, who is an individual investor residing in Japan, wishes to provide D, a bank located in State X, with the securities owned by C as security to obtain a loan from D. Which state's law will apply in determining what rights D will acquire through this transaction?

Which state's law will apply in determining the transfer of rights relating to securities that are held internationally and indirectly, such as in Case I? If we focus on the legal effect of the holding in deposit and the book-entry transfer of the global certificate by ICSD and the transfer of rights from B to Y to X, under Japanese private international law, the legal nature of such rights can be determined to be that of real rights. If such rights are real rights, the law applicable to such rights is the law of the place where the property is situated, as stipulated in Article 13 of the Act on General Rules for Applicable Law. In such case, Belgium Law may apply.

In the case of share certificates, whether the rights (shareholders' rights) represented by paper (share certificates) are transferred by the transfer of the right to control such paper is determined in accordance with the law applicable to such rights (shareholders' rights). In other words, the law governing the company (under Japanese private international law, it is interpreted to be the law under which the company was incorporated) will apply. Similarly, in the case of rights to bonds represented by bond certificates, the law applicable to the relevant bond agreement will apply to such rights. In contrast, the law of the place where the securities are located will apply to issues concerning the execution and effect of transfer and pledge of the paper (share certificates).[14)] However, in reality, security certificates could be kept at the place of incorporation or the place of the headquarters of the issuer or in a safe of the custodian bank participating in the Euroclear system (immobilized). More fundamentally, are the global certificates that are said to represent the rights of bondholders regarded as securities under Japanese Law?

In Case I, it will be extremely difficult to determine where certain securities are actually located, since "securities"[15)] indirectly held are deposited or re-deposited

and held in a manner commingled with other securities. However, in reality, one global certificate representing the rights to the entire amount of bonds with warrants of the same kind is issued by the issuer, and this global certificate is held in deposit by Euroclear. Thus, the explanation that certificates of bonds with warrants are deposited with Y and then re-deposited with Euroclear itself is fictitious.

In this case, even if the global certificate representing each bond with warrant is held in deposit in Belgium, it seems to be circuitous and impractical to say that the issue of whether investor X validly acquired the rights to the bonds should be determined in accordance with Belgium Law. Furthermore, it appears to be a conceptual contradiction to discuss the issue of the location of securities for bonds with no certificates (paperless securities) on which the Book-entry Transfer Act[16)] is based.

The Hague Securities Convention was developed to remove the legal uncertainties regarding securities under the *lex rei sitae* test, as explained above. Article 4(1) of the Hague Securities Convention states as follows:

> Article 4 Primary rule
>
> 1. The law applicable to all the issues specified in Article 2(1) is 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 law designated in accordance with this provision applies only if the relevant intermediary has, at the time of the agreement, an office in that State, which –
>
> 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
>
> iii) is otherwise engaged in a business or other regular activity of maintaining securities accounts; or
>
> b) is identified by an account number, bank code, or other specific means of identification as maintaining securities accounts in that State.
>
> …[omitted]…

The rule stated in Article 4 of the Securities Convention is that the law applicable to the issues specified in Article 2(1) (explained below) is "the law in

force in the State expressly agreed in the account agreement as the State whose law governs the account agreement." Of course, regarding the law applicable to issues specified in Article 2(1) explained below, if the parties agree on an applicable law different from the law applicable to the account agreement, then such other law would apply.

In case where the applicable law cannot be determined under Article 4, the Hague Securities Convention contains precautionary provisions in Article 5. Article 5 stipulates that if the applicable law cannot be determined under Article 4, the applicable law is the law in force in the territorial unit under whose law the relevant intermediary is incorporated or in which the relevant intermediary has its place of business, or if the intermediary is not incorporated, the territorial unit under whose law the intermediary is organized.[17)] Further, in Article 6, the Convention specifically excludes determination of the applicable law by considering the law of the place where the securities are located. It does so by stipulating that the place where the issuer is incorporated, the place where certificates are located and the place where the register of holders of securities is located should not be taken into account.[18)]

In Case I, the issue in question is whether X acquired rights to the securities held with the intermediary Y, and if so, what rights X acquired. Thus, the Hague Securities Convention will apply in accordance with Article 2(1) of the Convention (explained below). Whether or not the applicable law as determined under the Convention regards the rights of investor X as direct rights against the issuer A (i.e., X as a bond holder) is irrelevant to the application of the Convention.[19)]

According to Article 4 of the Hague Securities Convention, if X and Y expressly agreed in their account agreement upon the law that governs the account agreement, the issues in Case I will be determined by such law. The aforementioned decision of the Yamagata District Court states, in terms of the nature of X's demand, that X's demand is "of a nature of a claim (rights *in personam*) arising from invalidation of a sales agreement or termination of an agreement due to default" and "the law applicable to the validity of the agreement and termination thereof will be primarily determined based on the intent of the parties." The Court then ruled that although the Court did not accept the existence of express intent of the parties, the law of Japan should be the applicable law based on the implicit intent of the parties in accordance with Article 7, Paragraph 1 of the Rules Concerning the Application of Laws prior to the revision (currently Article 7 of the *Act of General Rules*).[20)]

In this decision, the Court recognized that as Y transferred to X the possession (indirect and joint possession) of the global certificate deposited with Euroclear, Y

transferred to X co-ownership interest in the warrants corresponding to the number of warrants transferred, based on the fiction illustrated in Part III that the "transfer" took place through the transfer of possession by instruction (Article 184 of the Civil Code) and constructive transfer (Article 183 of the Civil Code). It is suggested that, in this case, the legal nature of the rights in question should have been regarded as that of real rights instead of claims. However, the Court's ruling that the law of Japan should be the applicable law by focusing on the relationship between the investor and the securities company, not on the place where the certificates are located as stipulated in Article 10 of the Rules Concerning the Application of Laws prior to its revision (currently Article 13 of the Act of General Rules), is consistent with the outcome of the case if Article 4 (or Article 5 if there is no express agreement) of the Hague Securities Convention would have been applied.

The Hague Securities Convention will apply to issues relating to, among others, ownership, transfer, and pledge of rights to securities, if the legal nature of the rights is regarded as that of real rights under the conventional rules of private international law, as described above. The Convention itself, however, does not use the term "real rights" and stipulates the scope of application of the Convention as follows:

> *Article 2 Scope of the Convention and of the applicable law*
>
> 1. This Convention determines the law applicable to the following issues in respect of securities held with an intermediary –
>
> *a)* the legal nature and effects against the intermediary and third parties of the rights resulting from a credit of securities to a securities account;
>
> *b)* the legal nature and effects against the intermediary and third parties of a disposition of securities held with an intermediary;
>
> *c)* the requirements, if any, for perfection of a disposition of securities held with an intermediary;
>
> *d)* whether a person's interest in securities held with an intermediary extinguishes or has priority over another person's interest;
>
> *e)* the duties, if any, of an intermediary to a person other than the account holder who asserts in competition with the account holder or another person an interest in securities held with that intermediary;
>
> *f)* the requirements, if any, for the realisation of an interest in securities held with an intermediary;

> *g)* whether a disposition of securities held with an intermediary extends to entitlements to dividends, income, or other distributions, or to redemption, sale or other proceeds.
>
> 2. This Convention determines the law applicable to the issues specified in paragraph (1) in relation to a disposition of or an interest in securities held with an intermediary even if the rights resulting from the credit of those securities to a securities account are determined in accordance with paragraph (1)(a) to be contractual in nature.
>
> 3. Subject to paragraph (2), this Convention does not determine the law applicable to –
>
> *a)* the rights and duties arising from the credit of securities to a securities account to the extent that such rights or duties are purely contractual or otherwise purely personal;
>
> *b)* the contractual or other personal rights and duties of parties to a disposition of securities held with an intermediary; or
>
> *c)* the rights and duties of an issuer of securities or of an issuer's registrar or transfer agent, whether in relation to the holder of the securities or any other person.

For this Convention to apply, the issues in question should: (1) be in respect of securities held with an intermediary; and (2) fall under the inclusive and exhaustive list of issues stipulated in Article 2(1). Since the issues listed in Article 2(1) of the Convention are not mutually exhaustive and can be overlapped, this section should be examined in totality in relation to the issue in question. If the issue in question for which applicable law needs to be determined does not fall under any of the issues listed in Article 2(1) of the Convention, the Convention will not apply to such issue.[21)]

As explained earlier, whether or not the applicable law determined under the Hague Securities Convention regards the rights of the investor X as direct rights against the issuer A (i.e., X as a bond holder) is irrelevant to the application of the Convention. For example, if the applicable law is determined to be the law of Japan, the investor will be regarded as the direct right holder, and if the applicable law is determined to be the law of the United States, then the investor will be regarded as the person having a security entitlement against the intermediary who has the rights and property interest with respect to financial assets held by the intermediary.[22)] However, how the applicable law will regard the rights of investors will have no effect on the application of the Convention.[23)]

According to Article 2(1)(a) of the Hague Securities Convention, the Convention determines the law applicable to "the legal nature and effects against the intermediary and third parties of the rights resulting from a credit of securities to a securities account." Thus, the kind of rights D acquires through the provision of security by C to D in Case II can be ascertained by the applicable law as determined by this Convention. If securities are credited to D's account, the legal nature and effect of D's rights as against third parties will be determined under "the law in force in the State expressly agreed … as the State whose law governs the account agreement" in the account agreement between D and D's intermediary B, in accordance with Article 4 of the Convention. If the law applicable to the account agreement is the law of State X, D's rights will be determined under the law of State X, and if the applicable law agreed upon is the law of Japan, then the law of Japan shall be consulted; the effect of which is examined in the following case.

2. Case III : Non Payment Case (C v. E in Figure 1)[24)]

C makes a disposition of securities to D, who immediately transfers them to E but fails to pay C. The dispositions are effected by a series of debits and credits to securities accounts maintained by a chain of intermediaries between C and D and another chain between D and E, including a debit to a securities account maintained for C by its intermediary Y and a credit to a securities account maintained for E by its intermediary B. C's account agreement is expressly governed by Japanese law, E's account agreement is expressly governed by Utopian law. Suppose that under the law determined by Article 4(1) of the Convention (see above) with respect to E's account (in this case Utopian law), E takes the securities credited to E's account free from all (including C's) adverse claims; and that under the law determined by the Convention with respect to C's account (in this case Japanese law[25)]), the debit to C's account is subject to reversal because D failed to pay for the securities.

In Case III, if Japanese law applies to the transaction between C and E, E will acquire the rights, and if Utopian law applies, C will not lose its rights, resulting in conflicting outcomes for the same rights. The Hague Securities Convention that aims to resolve the issue of applicable law for each account may only provide solutions relative to each account. This is because the primary principle of the rules of private international law provided by the Hague Securities Convention is to ensure that "… a person's rights resulting from a credit of securities to a particular securities account are governed by the Convention law determined with respect to that account."[26)] If this principle is literally interpreted, in Case III, since the securities are debited from C's account and credited to E's account, it can be

interpreted, by focusing on E's account, that Utopian law, which is the law applicable to E's account, shall apply.[27] However, the Hague Securities Convention does not intend to eliminate any risk arising from the situation where the applicable law varies depending on the party, as in Case III.[28] The Report concerning the Securities Convention explains this point as follows:

> The Convention does not attempt to eliminate this risk, but it does make it easier for intermediaries to identify, reallocate or manage this risk by making it clear which State's laws govern all the Article 2(1) issues with respect to each securities account.[29]

In Case III, it is difficult to determine a single applicable law even under the private international law rules of Japan (Article 13 of the Act on General Rules), which adopts the *lex rei sitae* principle (the law of the place where the certificates are located). This is because, under the international multi-tiered securities transfer and settlement system on which Case III is based, there is no definitive answer as to the precise location of the certificates.

The ultimate risk suggested by Case III lies in the differences in the contents of applicable laws. Therefore, unified rules of private international law such as the Securities Convention cannot eliminate such risk, and unification of substantial laws must be achieved. In this regard, the adoption of the UNIDROIT *Convention on Substantive Rules for Intermediated Securities*[30] in 2009 is particularly noteworthy.

The method stipulated in Article 4 of the Hague Securities Convention, that is, to determine the applicable law in relation to the aspect of the securities having the nature of real rights, even with some restrictions, based on the agreement between the parties, is similar to the practices of securities companies and the idea behind the U.C.C. in the United States. U.C.C. 8-100(b) and (e) provide that the law agreed in an account agreement is the law governing the securities intermediary.[31] However, such rules of private international law accepting "party autonomy" have not yet gained international support.

As described below, the European Community focuses on more objective factors, such as the place where the intermediary is located or the account is held.[32]

Article 9 of the 1998 Directive of the EC on Settlement Finality in Payment and Securities Settlement Systems[33] stipulates the following rules of private international law: "Where securities (including rights in securities) are provided as collateral security to participants and/or central banks of the Member States …[omitted]…, and their right (or that of any nominee, agent or third party acting on their behalf) with respect to the securities is legally recorded on a register, account

or centralised deposit system located in a Member State, the determination of the rights of such entities as holders of collateral security in relation to those securities shall be governed by the law of that Member State."

The scope of application of this Directive however is, unlike the Hague Securities Convention, limited to securities companies and central banks.

Article 9 of 2002 Directive on Financial Collateral Arrangements[34)] states: "Any question with respect to any of the matters specified in paragraph 2 (such as (a) the legal nature and proprietary effects of book entry securities collateral, (b) the requirements for perfecting a financial collateral arrangement relating to book entry securities collateral or (c) whether a person's title to or interest in such book entry securities collateral is overridden by or subordinated to a competing title or interest, or a good faith acquisition has occurred;) arising in relation to book entry securities collateral shall be governed by the law of the state in which the relevant account is maintained."

If rules of private international law that focus on the place where an account is held, not on the agreement of the parties, as in the case of the EC, are adopted, the applicable law in Case I will be the law of Japan even without express agreement on the applicable law by the parties (see Article 5 of the Hague Securities Convention).

IV. Conclusion

The aforementioned judgment rendered by the Yamagata District Court on November 11, 1999, that is the model of Case I, states "we cannot deny the fact that in relation to the method of transfer of warrants in the sales agreement in question, there is a lack of clarity as to the criteria for recognition of constructive transfer, procedures for the exercise of preemptive rights, contents concerning protection of real rights to the warrants and other relevant issues, and such issues are best clarified through legislation." Thus, on the one hand, even if the applicable law in Case I is determined to be Japanese law under the Hague Securities Convention, it is possible that the applicable Japanese law will be interpreted as providing the legal structure supported by the Yamagata District Court as well as the appeal court, that is: "deposit of securities in a fungible pool and transfer of co-ownership rights in the pool."

On the other hand, if the rules under the Book-entry Transfer Act can be applied as the rules under the applicable Japanese law, then the ownership of rights to bonds (see Article 163 and subsequent articles for "warrants") will be determined based on the statements or records on the transfer account book (Article 66[35)]) and

transfer and pledge of bonds cannot be effected unless a credit of the amount of such transfer or pledge is stated or recorded in the Holding section of the account of the transferee or pledge (Article 73[36)]).[37]

If the Hague Securities Convention is in force and applicable and Japanese law is determined to be the applicable law, the question arises, in determining the ownership and transfer of rights, as to whether such determination should be based on the notion of "deposit of securities in a fungible pool and transfer of co-ownership rights in the pool", or on simply the statements or records in the account, which is the approach adopted by the Book-entry Transfer Act.[38)]

Under the international securities settlement system to which the Hague Securities Convention is intended to apply, an issuer issues one global certificate representing the rights to all securities of the same kind and deposits such global certificate with the International Central Securities Depository (ICSD), and the settlement of such securities between the participating financial institutions or lower-level financial institutions is done by recording of such transactions in the account of the securities held by the intermediary. This type of international securities settlement system is closer to the book-entry transfer and settlement system under the new Book-entry Transfer Act, which is based on the idea of no certificate and paperless securities, than to the conventional securities custody and book-entry transfer system under which share certificates representing individual rights are immobilized.

The legal principle of securities was a legal technique introduced to facilitate the circulation of rights to securities by giving greater clarity to the ownership and transfer of rights represented by certificates through the issuance and possession of the certificates, and consequently visualizing the transfer of rights to securities. There is no need to make the rights of the parties involved unclear by applying the theory of "deposit of securities in a fungible pool and transfer of co-ownership rights in the pool" to the international settlement system, which aims to clarify the ownership and transfer of rights by focusing on the records in the account.[39)] Visibility is the key to identifying and managing the risks underlying the transactions in the context of an interdependent and international system such as the intermediated holding system.

Where the Hague Securities Convention is applicable and Japanese Law is determined to be the applicable law, it is suggested that any issue in question should be explained through an approach taken by the Book-entry Transfer Act.

Notes

1) *Convention on the Law Applicable to Certain Rights in respect of Securities Held with an Intermediary*. For full text of the Convention, see the following website of the Hague Conference on Private International Law: http://www.hcch.net/index_en.php
2) See Hideki Kanda & Yoshihisa Hayakawa, "Koza Kanri Kikan ni yotte Hoyusareru Shoken ni tsuite no Kenri no Junkyohou ni kansuru Jyoyaku [*Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary*]" in 5 *Kokusai Shiho Nenpo* 230 (2003) and Hideki Kanda, "Toshi Shoken no Kokusaiteki Torihiki [International Transactions of Investment Securities]" in Kenjiro Egashira and Yoshihiro Masui (eds), *Shijyo to Soshiki* (Vol.3 of Tokeru Sakai Koeru Ho Series) (2005). Report on the Convention was published in 2005. See Roy Goode, Hideki Kanda & Karl Kreuzer - with the assistance of Christophe Bernasconi, *Explanatory Report on the 2006 Hague Securities Convention* (2005).
3) See *infra*, note 29.
4) The February 13, 2008 Recommendation entitled "Report on Results of Deliberation Concerning Consultation No. 57" states, "Japan should ratify the Convention at a proper time upon careful observation of the outcome of reviews of the Convention by the EU."
5) For in-depth research on the issues addressed in this article, see Tetsuo Morishita, "Kokusaiteki Shoken Furikae Kessai no Hoteki Kadai (1) – (5)-Kan [Legal Issues Surrounding the International Book-entry Securities Transfer and Settlement System: (1) to (5)-Final" in 44-1 *Sophia Law Review* 1; 44-3 *Sophia Law Review* 35; 45-3 *Sophia Law Review* 149; 50-4 *Sophia Law Review* 45; and 51-1 *Sophia Law Review* 13 (2000 – 2007). Regarding activities internationally, see Morishita's article (*ibid*.) and Midori Narazaki, "Shoken Tanpo-ka no Teishoku-ho Mondai to Hague Shoken Jyoyaku [Issues of Conflict of Laws relating to Collateralization of Securities and the Hague Securities Convention]" in 63 *Shoken Keizai Kenkyu* 77 (2008). For discussions concerning the Draft Securities Convention, see Naohiro Kitasaka, "Kansetsu Hoyu Sareta Yuka Shoken no Kenri Kankei no Junkyo-ho – 2002-nen EU Shirei, U.C.C. oyobi Hague Jyoyaku Soan no Apurochi ni Tsuite [Law Applicable to the Rights of Securities Indirectly Held: Approaches taken by 2002 EU Directive, U.C.C. and the Draft Hague Convention]" in 52-3/4 *Handai Hogaku* 899 (2002).
6) *Act on the General Rules of Application of Laws* [Hō no Tekiyō ni Kansuru Tsūsokuhō], Law No. 10 of 1898 (as newly titled and amended 21 June 2006). For an English translation of the Act, see the following website: "Group of International Finance Law" in *the Transparency of Japanese Law Project.* http://www2.osipp.osaka-u.ac.jp/~nomura/project/inter_finance/eng/index.html. See also Kent Anderson and Yasuhiro Okuda, "Translation of Japan's Private International Law", 23 *Journal of Japanese Law* (2007) 227.
7) For an English translation of Civil Code, see the following website: http://www.japaneselawtranslation.go.jp/law/detail/?re=02&yo=%E6%B0%91%E6%B3%95&ft=2&ky=&page=1
8) The original title of the *Act on Book-entry Transfer of Corporate Bonds and Shares* (Act No. 75 of 27 June 2001) at the time of enactment, "*Act Concerning the Book-entry Transfer of Corporate Bonds and Other Securities*", was changed to the current title by the *Act for Partial Revision of Act Concerning the Book-entry Transfer of Corporate Bonds and Other Securities for Rationalization of Settlement Relating to Transactions of Shares and Other Securities* (Act No. 88 of 9 June, 2004) due to addition of provisions concerning conversion

of current shares to paperless shares. For an English translation of the Act, see the following website: "Group of International Finance Law" in *the Transparency of Japanese Law Project.* http://www2.osipp.osaka-u.ac.jp/~nomura/project/inter_finance/eng/index.html

9) Article 13 [Rights *in Rem* and Rights Requiring Registration]
(1) Rights *in rem* to movables and immovables and any other rights requiring registration shall be governed by the law of the place where the property is situated (*lex rei sitae*).
(2) Notwithstanding the preceding paragraph, the acquisition and loss of the rights mentioned in the preceding paragraph shall be governed by the place where the property is situated (*lex rei sitae*) at the time when the events causing the acquisition or loss were completed.

10) Yamagata District Court, judgment, November 11, 1999, 1098 *Kinyu Shoji Hanrei* 45; Sendai High Court, judgment, October 4, 2000, 1106 *Shoji Hanrei* 47 (appeal dismissed, final judgment). See Tetsuo Morishita, "Kyo-shaku [Case Commentary]" in 25 *Kokusai Shiho Hanrei Hyakusen* (2007). For an English translation of the decision, see *The Japanese Annual of International Law* 193, No. 44 (2001) and the following website: "Group of International Finance Law" in *the Transparency of Japanese Law Project*, Court Cases page, http://www2.osipp.osaka-u.ac.jp/~nomura/project/inter_finance/eng/index.html.

11) Case I is based on Sendai High Court, Judgment, October 4, 2000; K.H. (1106) 47 affirming the judgment of the lower court, Yamagata District Court Sakata Branch, judgment, November 11, 1999; K.H. (1098) 45. See the website of the "Group of International Finance Law" in *the Transparency of Japanese Law Project*, Court Cases page, *available at:* http://www2.osipp.osaka-u.ac.jp/~nomura/project/inter_finance/eng/index.html.

12) The real case of Sendai High Court Judgment of October 4, 2000 dealt with the sales of warrants, which were considered more speculative and the case was one of the many cases filed by individual investors against securities firms over various transactions.

13) According to the new Companies Act amended in 2005, delivery is required only for the bond for which the issue of the certificate was stipulated (Companies Act Art. 687). For an English translation of Companies Act, see http://www.japaneselawtranslation.go.jp/law/detail/?re=02&yo=%E4%BC%9A%E7%A4%BE%E6%B3%95&ft=2&ky=&page=1.

14) This explanation is cited from: Yoshiaki Nomura, *Keisu de Manabu Kokusai Shiho* (Understanding Private International Law Through Case Law), (Horitsu-bunka-sha 2008) 222-223.

15) Hague Securities Convention Art. 1(1)(a) defines "securities" as "any shares, bonds or other financial instruments or financial assets (other than cash), or any interest therein."

16) See *supra*, note 8.

17) For relevant provisions, see the website of the Hague Conference on Private International Law, *supra*, note 1.

18) For relevant provisions, see the website of the Hague Conference on Private International Law, *supra*, note 1.

19) See Explanatory Report 48, *supra*, note 2.

20) For the relationship between the Rules Concerning the Application of Laws prior to the revision and the current Act of General Rules for Applicable Law, see Yoshiaki Nomura, "Harmonization and Diversification of Contract Conflicts," 51 *Japanese Yearbook of International Law* 341 (2008).

21) See Explanatory Report 47, *supra*, note 2.

22) See *Uniform Commercial Code* (hereinafter referred to as "U.C.C.") Art. 8, "Part 5 Security Entitlements." For U.S. law, see Morishita (1) in 44-1 *Sophia Law Review* 31, *supra*, note 5. When explaining these two rights, a figurative expression - whether their relations are "cut relations" - is sometimes used. See Kanda 90, *supra*, note 2.
23) See Explanatory Report 48, *supra*, note 2.
24) Modified from Example 4-12 of Explanatory Report, see, *supra*, note 2.
25) For example, Book-entry Transfer Act Art. 77 (Acquisition without Knowledge) provides:
A Participant who has received an entry or record of a credit of a specific Issue of Book-entry Corporate Bonds in his account (…[omitted]…) pursuant to application of book-entry transfer shall acquire the rights to the entry or record of the credit of the Issue of Book-entry Corporate Bonds, provided, however, this shall not apply when the Participant has knowledge or is grossly negligent.
26) See Explanatory Report 84, *supra*, note 2.
27) See the opinion presented by Japan in Kanda 92, *supra*, note 2.
28) See Morishita 5-Final 39-40, *supra*, note 5.
29) See Explanatory Report 87, *supra*, note 2.
30) *The UNIDROIT Convention on Substantive Rules for Intermediated Securities,* UNIDROIT 2009 CONF. 11/2 – Doc. 42, 9 October 2009. For 2006 Draft Convention, see Morishita (5-Final) 46, *supra*, note 5.
31) 8-110(b) provides that the local law of the securities intermediary's jurisdiction governs (1) acquisition of a security entitlement from the securities intermediary and (4) whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement or interest therein from an entitlement holder. 8-110(e) provides for the rules to determine a "securities intermediary's jurisdiction" and one of the rules stipulated in (1) is: If an agreement between the securities intermediary and its entitlement holder specifies that it is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.
32) The Commission of European Communities is recommending, in its 2006 Report, that Member States should sign the Hague Securities Convention. Commission Staff Working Document, Legal Assessment of Certain Aspects of the Hague Securities Convention, Brussels, 03.07.2006, SEC (2006) 910. However, as of November 2009, no agreement has been reached among EU members. 2009 Amendments to the 1998 and 2002 Directives mentioned in this article, contain no changes with regard to the international private law rules. See Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims (Text with EEA relevance),OJ L 146/37, 10.6.2009 .See also Amendments to Settlement Finality Directive and Financial Collateral Directive: Frequently Asked Questions, MEMO/08/267, Brussels, 24 April 2008.
33) Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on Settlement Finality in Payment and Securities Settlement Systems.
34) Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on Financial Collateral Arrangements.
35) Article 66 provides: Except in the case referred to in paragraph (2) of the next Article, the ownership of rights (…[omitted]…) in relation to the following corporate bonds (hereinafter referred to as "Book-entry Corporate Bonds" in this Chapter) shall be prescribed in the entry

or recording in the registry of book-entry transfer accounts pursuant to this Chapter.

36) Article 73 provides: The transfer of Book-entry Corporate Bonds (…[omitted]…) shall not be effective unless the transferee receives the entry or record of the credit in the amount pertaining to such transfer in the Hold Column (…[omitted]…) of his account pursuant to an application for book-entry transfer.

37) For the Book-entry Transfer Act, see Tetsuo Morishita, "Nihon no Shasai Kabushiki Furikae Seido no Gaiyo to Kadai [An Outline of Japan's Book-entry Transfer System for Corporate Bonds and Shares and Surrounding Issues]" in Seoul National University *BFL*, JAN 2009, 82-88; and "Shoken Kessai [Securities Settlement]" in 1842 Kinyu Homu Jijyo 65 (2008).

38) In conflict of laws parlance, this question is discussed as the scope of reference, i.e., the question of what substantive legal rule in the applicable legal order is designated (or referred to) by a particular conflict of law rule.

39) In the multi-tiered system, what is difficult to see from the outside is the operating system of the Book-entry Transfer Act, which gives investors direct rights against issuers.