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Section I

PRIVATE INTERNATIONAL LAW AND INTERNATIONAL CIVIL PROCEDURE

The intermediated securities system: Brussels I breakdown

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Abstract

This article investigates a question of private international law through the prism of a multiple cross-border securities transaction within the European Union. Several issues are examined through a baseline hypothetical, predicated on a real transaction, and variations on that hypothetical, to pursue problems outside the parameters of the baseline. The main inquiry is to determine the correct forum to resolve the dispute in the absence of a contractual forum selection clause.[1] Three principal legal instruments are applied: Council Regulation (EC) No 44/2001 (Brussels I), the Convention on the law applicable to contractual obligations (Rome 1980), and the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary.[2] The authors conclude that present law is incapable of providing a solution to a jurisdictional question even one that is based on a relatively simple transaction. As stock exchanges merge, become de-nationalised, and rely to a greater degree on electronic trading systems, current legal instruments will be rendered obsolete and totally inadequate to resolve private international law questions in the international market for the exchange of securities. Assuming private international law remains committed to the "place" as a determining factor, the latter will, if it has not already, become increasingly irrelevant to legal questions grounded in the indirect holding and centralised clearing and settlement systems, and lead to artificial constructs to solve legal issues thereby cementing uncertainty in the legal regime and producing disparate and likely inconsistent decisions.

The Hypothetical

The hypothetical is based on cross-border securities transactions involving three Member States of the European Union (EU): the United Kingdom, the Kingdom of Sweden, and the Republic of Finland.[3] The three parties are: (1) UK Co, an "investment firm" established in the United Kingdom in the City of London, (2) SWED Co, an "investment firm" established in Sweden in the City of Stockholm, and (3) the Helsinki Stock Exchange (HSE), a "regulated exchange" owned by OMX Group, a publicly held Swedish company, that owns and operates several exchanges in the Nordic and Baltic re-

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1 In his compelling article, Professor Rogers aptly notes the limitations of examining the indirect holding system through the medium of hypotheticals as facts convenient to the solution simply are stipulated to produce the desired outcome. The authors attempt to address this shortcoming by having created the problem based on a "live" transaction and by referring to the rules and regulations of a specific exchange. James Steven Rogers, *Conflict of Laws for Transactions in Securities Held Through Intermediaries*, 39 Cornell Int'l L.J. 285, 295 (2006).

2 Traditional private international law analysis is forfeited as authorities have established its inadequacy in this field. Roy Goode, Hideka Kanda, Karl Kreuzer, *Hague Securities Convention, Explanatory Report*, 16-25 (2005).

3 The hypothetical is loosely based on actual litigation implicating entities in these member States, thereby demonstrating the possibility, if not probability, of similar problems arising in the future.

gion.[4] To the extent necessary, OMX member and trading rules, including those specific to the Helsinki Stock Exchange, are used to give the hypothetical the impression of realism.

Facts: Primary

UK Co provides a range of investment services to third party clients for whom it accepts, receives, and executes buy and sell orders for securities, defined here as equity, debt and derivatives. The clients of UK Co are both institutional and individual. SWED Co performs similar services for its range of clients. UK Co is not a member of the HSE and therefore as a non-member cannot execute trades on that exchange. However, SWED Co is a member of the HSE and has the right to execute trades on that exchange for its own account and for that of its clients. Several clients of UK Co – both natural and juridical persons – want access to securities listed on the HSE.[5]

Since UK Co is not an HSE member and therefore is prohibited from executing orders on the HSE, UK Co enters into negotiations with SWED Co, a member of HSE, to establish an arrangement whereby SWED Co agrees to execute securities transactions on behalf of UK Co. The parties agree that SWED Co shall execute securities transactions on the HSE as explicitly instructed by UK Co. The agreement specifies that the parties shall use an electronic communication system to exchange information related to orders and executions, clearance and settlement. The parties exchange legal documents to constitute their agreement; however the parties neither sign any written agreement nor object to any term in either agreement. Nevertheless, in the absence of a single signed contract, the parties begin to do business.

Several months later, a failure in the electronic communication system established between the respective investment firms results in SWED Co's failure to execute securities transactions as instructed by UK Co. For purposes of the hypothetical, the system failure is a fact issue to be determined in the course of litigation. As a result of the failure, SWED Co does not buy or sell as instructed for a period of three trading days, and, as a result, clients of UK Co incur losses and file claims for compensation. UK Co and SWED Co do not engage in any new activity, except for the management and resolution of previous transactions held in the account of UK Co under the agreement. UK Co demands compensation from SWED Co for failure to execute trades as instructed; SWED Co refuses.

Facts: Secondary

The OMX Group AB is a Swedish publicly owned company that owns and operates the following OMX exchanges: Copenhagen Stock Exchange, Helsinki Stock Exchange, Riga Stock Exchange, Stockholm Stock Exchange, Iceland Stock Exchange, Tallinn Stock Exchange and Vilnius Stock Exchange. In addition, OMX has a strategic Alliance with the Oslo Børs. Collectively, the matrix of linked exchanges is known as the Nordic and Baltic Exchanges, or for short, "Norex." Members of these exchanges are governed by the Norex Alliance Member Rules.

"Trading on the Norex Exchanges takes place in the common trading system SAXESS." The system gives members access to an electronic order book for each financial instrument traded within or outside the order book. Membership in any Norex exchange requires participation in a clearing and settlement organisation. "Settlement and registration of cash trading takes place in Sweden and Finland via the Nordic Central Securities Depository (NCSD), and in Denmark and Iceland via the VP and ISD securities depositories, respectively".[6] Members trade on the exchanges through authorized Exchange Traders. Members may use "automatic order routing" defined as "the process by which a Member, through the use of Internet connections or other computer connections between it and its client, electronically and automatically transmits orders registered by the client directly to the Trading System".[7] In case of "automatic order routing," The Norex Member Rules, under sec, 4.9 set forth the requirements for the Member, one of which is the execution of an agreement with its client governing the terms and conditions of the automatic order routing. In general, the domestic law of the respective Norex Exchange determines the applicable law and method of dispute resolution.[8] With respect to the HSE, two provisions are relevant:

3.9.9 Any disagreement or dispute between the Member and the Helsinki Stock Exchange related to the interpretation and performance of the provisions of the Norex Member Rules shall be adjudicated in accordance with Finnish Law and be determined by arbitration in accordance with the Arbitration Rules of the Finnish Central Chamber of Commerce.

3.9.10 Unless otherwise agreed by the parties, any disagreement or dispute between Members on the Helsinki Stock Exchange with respect to trading on the Helsinki Stock Exchange shall be adjudicated in accordance with Finnish Law and be determined by arbitration in accordance with the Arbitration Rules of the Finnish Central Chamber of Commerce.

In addition, a Member that breaches Finnish law, or other

[4] The terminology of "investment firm" is taken from Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC (OJ 2004, L 145 at 1) (hereafter MiFid) to simplify the hypothetical and place it in the context of the EU's latest measure to regulate investment activity in financial instruments. An "investment firm" means "any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis", Art. 4(1)(1).

[5] If direct access to trading is required to an OMX exchange, membership to that exchange or group of exchanges is required. OMX has established membership requirements consistent with MiFid. Cash members are required to hold reserves of EUR 730 000, have appropriate technical capacity compatible with OMX, and meet all membership requirements set forth in NOREX Member Rules 4.1.8. Norex Member Rules Version 1.8 (March 2007); updates, if available, are found at http://www.omxgroup.com/nordicexchange, last visited 18 September 2007.

[6] OMX Shareholders Report 2007, p. 25.

[7] Norex Member Rules, *supra* sec.2.

[8] *Id*. At 3.9.

statutes or regulations governing Members' operations on the Helsinki Stock Exchange is subject to disciplinary action under Rule 4.11.16.

The Nordic Central Securities Depository (NCSD), or NCSD Group, "currently includes VPC and APK, the Swedish and Finnish CSDs, to which all major actors on the Nordic capital markets are directly or indirectly affiliated". NCSD provides "long-term, secure and cost effective services to issuers, intermediaries and investors, as regards the issuance and administration of financial instruments, as well as clearing and settlement of trades on these markets". [9] APK (the Finnish Central Securities Depository) operating under the joint name of NCSD Group serves a major part of the Finnish equities market, while VPC (the Swedish Central Securities Depository) operating also under the joint name of NCSD serves a major part of the Swedish equities market.[10] Securities of issuers may be held directly by owners or held indirectly through nominees. APK operates under the supervision of the RATA, the Finnish Supervisory authority, and is authorised as a central securities depository and clearinghouse.

Facts: The Trades

The hypothetical assumes that under the arrangement between UK Co and SWED Co trades are made in equities and other financial instruments traded on the HSE by "automatic order routing", and other permitted forms of trading such as "internal crossing". It is further assumed that the communications between UK Co and SWED Co that resulted in failure to trade as instructed involved ten listed companies, combining both sale and purchase orders, and market and limit orders. It is further assumed that all parties used the indirect holding system for securities, that is, shares at the depository were held by the nominee SWED Co. In the indirect holding system, the investor and the issuer do not have a direct relationship. Rather, one or more intermediaries stand between them. In our hypothetical, the NCSD holds dematerialised securities on behalf of all issuers whose securities are involved in the trades executed by SWED Co required by Norex rules to maintain a participation in NCSD in the securities in which it deals.[11] Thus, in the hypothetical, SWED Co maintains an account in NCSD; SWED Co maintains securities accounts for its customers – here UK Co – and UK Co maintains securities accounts for its customers, both institutional and individual. A securities account has the function of an agreement; the securities governed by that agreement have a physical existence only by entry in an electronic record keeping system.

Facts: The Filed Claim

UK Co files a claim for breach of contract and recovery of damages against SWED Co in a court in the United Kingdom arguing that the application of relevant jurisdictional and private international law rules lead to the jurisdiction of that court. SWED Co enters an objection arguing that application of the same rules leads to the courts of Sweden. The UK court first must decide if it has jurisdiction over the matter. The hypothetical hence raises the question: where an intermediary in one Member State undertakes trading in securities on behalf of its customers through an intermediary in another Member State and that second intermediary executes trades on an exchange located in a third Member State, which Member State has jurisdiction when damages allegedly are suffered by the first intermediary through the error of the second intermediary. The issue is discussed in terms of sounding in contract; though it may sound in tort, the authors defer discussion of this issue as outside the scope of this article.

Analysis

Since the parties never executed a written contact, the first question to be answered, for purposes of private international law, is the question of "characterisation" of the parties' transaction. There would appear to be no doubt that the relationship between the parties constituted a civil and commercial matter. Nevertheless, for purposes of the Brussels I Regulation, and of the resolution of the hypothetical, it must be determined whether the parties' conduct created a contractual relationship, though the parties never executed a single and signed formal contract. Support for finding that the parties had an "implied contract in fact" or "quasi-contract" derives from widely recognized and deeply rooted principles of general contract law. The most fundamental function of contracts in a market economy is an exchange of resources based on a set of promises, a principle rooted in English law.[12] Williston defines an "implied contract in fact" as one where the parties have manifested assent to enter into a contract, as opposed to an "implied contract in law" or "quasi-contract" where the courts create a fiction to provide a remedy for the injured party in circumstances where consent is absent.[13] The hypothetical supports the former: the parties' actions demonstrated that they intended to enter into a contract by the fact that they began to perform mutual obligations according to their unwritten agreement. UK Co sent instructions for trades to SWED Co, and SWED Co acted on the instructions received from UK Co to buy and sell securities on the Helsinki Stock Exchange.

Further support for this conclusion is found in the Principles of European Contract Law (PECL).[14] While the PECL is

[9] See, http://www.ncsd.eu/369_ENG_ST.htm, last visited 3 October 2007.

[10] Since December 2004, VPC AB has owned its Finnish counterpart APK OY. See http://www.ncsd.eu/594_ENG_ST.htm, last visited 3 October 2007.

[11] Dematerialised securities are distinguished from immobilised securities, though, for purposes of the hypothetical, that distinction lacks legal effect. Dematerialisation means that the securities do not take a physical form in the sense of physical certificates – they are electronic book entries only; by contrast, immobilised securities are issued as global physical certificates but kept in a vault such as a CSD or ICSD, that is, the securities represented by the global certificate never move. As a practical matter, the difference is one of formalism.

[12] H.G. Beale, W.D. Bishop and M.P. Furmston, *Contracts Cases and Materials* (4th ed. Butterworths, 2001).

[13] 1 Williston on Contracts sec. 1.6 (4th ed.)(a contract "implied in fact" exists where the parties have manifested by reason of words or conduct"). A "quasi-contract" is not per se a contract, but a form of restitution. The Statute of Frauds is inapplicable.

[14] The Principles of European Contract Law 2002, found at http://www.jus.uio.no/lm/eu.contract.principles.parts.1.to.3.2002/, last visited 22 October 2007.

not law, but a Community level project to identify a method to harmonise European contract principles, it constitutes an influential secondary source authority. Art. 2:101 provides that a contract is concluded if the parties intended to be legally bound and reached "sufficient agreement without any further requirement". That the parties intended to be legally bound and had reached sufficient agreement is determined by their conduct and performance of mutual obligations. That the parties failed to execute a physical document with signatures is a fact of no legal consequence under the PECL.[15] Analysis of the issue under the Restatement (Second) of the Law of Contracts produces an identical conclusion.[16] Therefore, the question of characterization is answered as follows: the parties had either a contract as traditionally understood or had a contract implied in fact. For purposes of the hypothetical, the distinction does not control the subsequent sequence of analysis to determine the question of jurisdiction.

Having established that the matter in dispute is within the sphere of civil and commercial matters, and poses an issue of breach of contract, the UK court is bound to apply "Council Regulation (EC) No 44/2001 on jurisdiction and the recognition and enforcement of judgements in civil and commercial matters" [Brussels I] to determine the question of jurisdiction. However, first, the UK court must decide, in the absence of a written document, the terms of the contract before it may proceed further in its analysis. Under the facts provided by the hypothetical, the court may find that the parties' contract contained an exchange of mutual promises reduced to the following formulation. UK Co committed to deliver instructions related to buy and sell orders of securities traded on the HSE, and SWED Co, in exchange for an agreed upon compensation to be paid by UK Co, committed to act on those instructions and execute the orders to buy or sell securities on the HSE. Should it be necessary to supply an additional term, the court would resort to default rules of the applicable contract legal regime.

The default jurisdictional rule of Brussels I is contained in Article 2: "Subject to this Regulation, persons domiciled in a Member State shall, whatever their nationality, be sued in the courts of that Member State". SWED Co is a registered company established in Sweden and having its headquarters in Sweden. Therefore, under a direct application of Article 2, the UK court is bound to find that it lacks jurisdiction. Under this scenario, the Swedish judicial system would have jurisdiction.

However, the UK court cannot stop its analysis at this point since Brussels I contains exceptions to the Article 2 default rule. Brussels I provides rules permitting a defendant to be sued in a Member State where the defendant does not have its domicile. In this hypothetical, the rules in derogation of the default rule and applicable to the circumstances are entitled "Special jurisdiction" and are contained in Article 5. Article 5, subpart (1) provides:

"A person domiciled in a Member State may, in another Member State, be sued:

1. (a) in matters relating to a contract, in the courts for the place of performance of the obligation in question;

(b) for the purpose of this provision and unless otherwise agreed, the place of performance of the obligation in question shall be:

-in the case of the sale of goods, the place in a Member State where, under the contract, the goods were delivered or should have been delivered,

-in the case of the provision of services, the place in the Member State where, under the contract, the services were provided or should have been provided,

(c) if subparagraph (b) does not apply then subparagraph (a) applies".

Confronted with this provision, the UK court first must interpret the meaning of subparagraph (b) as it was introduced to obviate the difficulty of applying subparagraph (a), to determine whether indent one or two is capable of identifying the "place of performance of the obligation in question".

In an earlier article, one of the authors established that the term "services" contained in subparagraph (b) second indent comprehends "financial services".[17] Without repeating the reasoning of that position and its evidential support, further support for that position has developed since the date of the article's publication. Paragraph 18 of the Prefatory Note set forth in "Directive 2006/123/EC of 12 December 2006 on services in the internal market" explicitly excludes "financial services" from the ambit of the Services Directive, not because financial services are not services. To the contrary, the exclusion is based on the principle of special law priming general law: financial services are governed by specific Community legislation that supplants the "Services Directive" for financial services. Logically, it follows that "financial services" are services within the meaning of Article 5, paragraph 1(b) second indent. There is no support for reaching a contrary interpretation, particularly when an instrument such as Brussels I requires an autonomous and uniform interpretation of its terms. Hence, the hypothetical implicates a provision of Brussels I that has the potential to posit jurisdiction in a Member State other than Sweden.

The UK court must deconstruct the meaning of the second indent to determine its applicability, since neither the European Court of Justice nor authoritative secondary sources have provided interpretative guidance. The second indent may be divided into three component parts found in the following phrases: (1) "in the case of the provision of services", (2) "where, under the contract", and (3) "the services were provided or should have been provided." Phrase one is satisfied as it has been earlier demonstrated: the term "service" includes "financial services". Part of the second phrase, "under the contract," is equally met since it has been established that the parties had made a contract. Although the exact terms of the contract must be found by the court based on submission of evidence, the facts undeniably show, as previously stated, that

[15] *Id*. at Art. 2:101(2). That the parties may dispute their particular obligations is a matter not dispositive of the existence of the contract.

[16] Restatement (Second) of Contracts, sec. 265.

[17] John JA Burke, *Brussels I Regulation (EC) 44/2001: Application to Financial Services under Article 5(1)(b)*, 10 Column. J. Eur. L. 527 (2004). Neither Brussels I nor the Explanatory Report defines the term services. The term also has not been the subject of an ECJ decision.

SWED Co agreed, "under the contract", to execute trades on the HSE on behalf of its client UK Co. The devilish question to be resolved is the third part of the test: "where … the services were provided or should have been provided".

To answer this question requires a resolution of two separate issues: (1) what exactly constituted the "service", and (2) where, under the contract, were the services provided or should have been provided. In the financial services area, the questions lead the court unto uncharted territory. From one perspective, the facts demonstrate that the service was the buying and selling of securities on the Helsinki Stock Exchange. The HSE is an electronic trading area where buyers and sellers orders are matched either automatically or by negotiation. The Norex rules provide that only a Member may trade on the HSE and that Members are subject to disciplinary action that can be taken by the HSE. The HSE also has its own specific rules within the general rules of the Norex alliance. Regarding disputes between a Member and the exchange, the HSE rules provide for the application of Finnish law and dispute resolution by arbitration in Finland. The identical approach applies to disputes between Members of the HSE. In addition, the HSE is a regulated exchange and Finnish officials are the regulatory authority. Further, the VPK arm of the NCSD serves most Finnish equity trades, provides services to Finnish issuers of securities, and is regulated by the RATA. Therefore, although the HSE may not have a tangible physical existence in the sense of a physical trading floor, the best answer is that the Helsinki Stock Exchange is located in Finland and that trades in securities of Finnish companies on that exchange take place in Finland.

Even under this interpretation of the nature of the service, the question still remains: where was the service provided to UK Co or where, as in the hypothetical, should the service have been provided. There are only three choices: United Kingdom, Sweden or Finland, and only two of them are plausible: Sweden or Finland. Two factors support identifying Sweden as the place of provision of the service. They are: (1) SWED Co most likely maintained a securities account for UK Co in Sweden, that is, an electronic book entry record of transactions and positions held in that account, and (2) SWED Co may have initiated trades electronically from its physical office in Stockholm, for example, by keying in data. However, this choice of location for purposes of the second indent of Article 5(1)(b) contains inherent ambiguities, casting doubt on this conclusion. First, an account does not have a physical existence; it is the creation of agreement between SWED Co and UK Co thereby rendering it a flimsy basis upon which to predicate jurisdiction where the umbrella rule is: "where the services were provided." Second, the "core" of the service appears unlikely to constitute a keyboard entry, a telephone call, or a physical visit to Helsinki to execute the orders of UK Co. Rather, the "core" service constituted the execution of orders, that is, trades on the HSE. Consequently, following this chain of reasoning, Sweden is not the Member State where, under the contract, the services were provided or should have been provided. Rather, Finland satisfies all elements of Article 5 subparagraph (1)(b) second indent, and therefore is the place of performance of the obligation in question. Since the requirements of subparagraph (1)(b) are met, no reference to subsection (c) is required, and the "fiendish difficulty" of determining the place of performance of the obligation in question under subsection (a) is avoided.[18] Under this analysis, the UK court ought to enter an order that it lacks jurisdiction over the matter in dispute.

However, if this analysis is followed, the court has produced an absurd result by positing jurisdiction in the Member State with the least connection with the terms of the dispute between SWED Co and UK Co. Neither the HSE nor the NCSD would have any record of non-executed trades. Finland also would not be the location where witnesses and relevant evidence would be found to assist the court in determining the substantive question of the dispute, regardless of which law it were to apply. It also is unclear whether Finnish law or an HSE mandatory exchange rule were violated under the hypothetical in order to substantiate a decision to posit jurisdiction in Finland. In addition, considerations of judicial economy and efficiency are completely ignored, as most, if not all, witnesses and documentary evidence would be located in the United Kingdom or Sweden. Further, the conclusion leads to unacceptable logical consequences should the ruling establish a precedent for the resolution of similar disputes.

A simple variation of the hypothetical is illustrative of this point. Assume that the contract between UK Co and SWED Co authorized SWED Co to execute buy and sell orders not only on the HSE but also on any exchange owned by OMX Group, or any exchange on which SWED Co was a member. Under this scenario, if there were a failure to execute trades as instructed on multiple exchanges, the "where" question of service provision would lead to a requirement that UK Co initiate actions in several jurisdictions stemming from a breach of contract between it and SWED Co. This consequence produces economic waste, frustrates judicial economy and the administration of justice, and produces an irrational result. The UK court should not ignore the practical consequences of its decision and reject its initial formal analysis.

The UK court may circumvent this result by finding that the "service" constituted the initiation of trade execution, that is, whatever steps SWED Co would take in Sweden to execute a trade on the HSE. By shifting its focus from what appears to constitute the heart of the service – execution of trades – to data entry and order instruction, the court may reason that the services were to be provided in Sweden and therefore the case falls squarely, though arguably artificially, within Article 5(1)(b) second indent and posits jurisdiction in Sweden.[19] Fur-

[18] The Explanatory Report of the Hague Securities Convention, dealing with one aspect of the indirect holding system, and Professor Rogers make it clear that it is meaningless in the context of the contemporary securities market to speak of "places" and "locations" as they are inapposite to commercial practices. Nevertheless, trading in securities does not defy the law of physics and, though difficult, courts must make decisions in hard cases by using the routine tools of the profession. In the hypothetical, the court must construct an audit trail of the transaction by defining what was the "service" and second where was the service provided or where should it have been provided.

[19] It must be noted that if the court were to base its decision upon administrative convenience, the location would be a toss-up, as there is likely to be as many witnesses and as much evidentiary support located in the UK as in Sweden. However, Sweden has the connecting factor of "place of performance".

ther support for the court's ruling may be found if the court were to determine that the policy underlying the Brussels I Regulation were to posit jurisdiction in a court in the best position to resolve the dispute. While Swedish courts may not have any substantial advantage over UK courts in terms of availability of witnesses and location of evidence, Sweden is in as good a position as the United Kingdom for purposes of producing evidence required to resolve the dispute.

Finally, the UK court must consider whether there is a basis to find under the Article 5 rule of special jurisdiction whether the service should have been provided in the United Kingdom, thereby conferring jurisdiction to the UK court. There appears to be only one rationale available to posit jurisdiction in the UK. Under the hypothetical, the investors that suffered damage were investors holding accounts with UK Co. It therefore follows that the nature of the service to be provided was to confer a service on UK Co account holders, that is, to execute their orders as instructed. This result has the merit of positing jurisdiction in a single court for all transactions and provides the advantages of judicial economy in the resolution of the dispute. However, the analysis appears to stretch the facts as the service to be provided is directly connected to the obligations of SWED Co to perform all necessary steps to comply with UK Co's instructions to execute buy and sell orders of securities traded on the HSE. There also is no privity of contract between UK Co individual account holders and SWED Co. While it is undeniable that the actions of SWED Co were ultimately for the benefit of account holders of UK Co, the provision of the service is better interpreted as occurring in Sweden as opposed to the United Kingdom. This result is consistent with the contract and with the best interpretation of Brussels I, particularly Art. 5(1)(b) second indent. However, in the absence of a contractual term identifying the place of performance of the obligation, the hypothetical demonstrates the difficulty of locating "financial services" in a particular place.

Analysis under Article 5(1)(a)

Article 5(1) provides that, "A person domiciled in a Contracting State may, in another Contracting State, be sued: (1)(a) in matters relating to a contract, in the courts for the place of performance of the obligation in question". The language of Article 5(1)(a) leaves undefined "matters relating to the contract" and the law according to which the place of obligation is to be determined. In line with Convention's silence, the European Court of Justice has resisted providing a simple and practical interpretation of the terms contained in Article 5(1)(a) by shifting the burden of interpretation onto national courts and their respective conflict of laws rules. The key judgments of the ECJ on Article 5(1)(a) are *Tessili* and *De-Bloos*.[20] To determine the "place of performance of the obligation in question" under *Tessili*, the national court before which the matter is pending "must determine in accordance with its own rules of conflict of laws, the law applicable to the legal relationship in question and define in accordance with that law the place of performance of the contractual obligation in question."[21] The procedure involves at least three steps. A court before which a matter is brought must first determine what constitutes "the obligation in question" in "matters relating to the contract" independently of provisions in national law.[22] Secondly, the court must identify the law that applies to the "obligation" on which the claim is based using its own conflict of laws rules. Finally, the place of performance is determined in accordance with that law, which in turn either confirms or rejects the jurisdiction of the court.

Where there is a valid contract with clearly defined rights and obligations of the parties, including an unambiguously specified choice of law provision, the *Tessili* formula will yield uniform and predictable results. However, where these factors are absent, as they are absent in the hypothetical, questions of conflict of laws become "a matter of fiendish difficulty." Pursuant to the first step of *Tessili*, a court must determine the contractual obligation in question. Using the prior analysis, despite the absence of a written executed contract, the court is assumed to find that the parties have a contract containing explicit rights and obligations. Accordingly, the court has two alternatives: (a) submit a reference for a preliminary ruling to the Court of Justice or (b) analyze the circumstances of the case, taking into account the nature of the relationship in question. Applying the latter alternative, the court would determine the place of performance of the obligation in question by determining the law applicable to the parties' contractual relationship. That undertaking requires the court to analyze 'the performance' characteristic of the relationship between the parties.[23]

The second step of *Tessili* requires the court to determine the law applicable to the legal relationship in question. In absence of an international legal instrument intended for participants of the indirect holding systems, the court must apply its own rules of private international law, namely, in case of England, Sweden or Finland, the Rome Convention of 19 June 1980 on the Law Applicable to Contractual Obligations. According to Article 3(1) of the Rome Convention, "[a] contract shall be governed by the law chosen by the parties". Since the parties did not expressly or impliedly select the law applicable to their relationship, the primary rule, based on freedom of contract, of the Rome Convention does not apply to the hypothetical. Article 4(1) states: "To the extent that the law ap-

[20] ECJ 6 October 1976 – Case 12/76 – *Industrie Tessili Italiana Como v. Dunlop A.G.*, 1976 E.C.R. 1473; ECJ 6 October 1976 – Case 14/76 – *de Bloos v. Bouyer*, 1976 E.C.R. 1473.

[21] *Id.* Case 12/76, [1977], 1 C.M.L.R. 26 para. [13]; ECJ 29 June 1994 – Case C-288/92 – *Custom Made Commercial Ltd v. Stawa Metallbau GmbH*, [1994] E.C.R. I-2913, [1994] I.L.Pr. 516.

[22] ECJ 22 March 1983 – Case 34/82 – *Martin Peters Bauunternehmung GmbH v. Zuid Nederlandse Aannemers Vereniging*: [1983] E.C.R. 987, [1984] 2 C.M.L.R. 605, paras [9] and [10]; ECJ 8 March 1988 – Case 9/87– *Arcado Sprl v. Haviland S.A.*: [1988] E.C.R. 1539, [1989] E.C.C. 1, paras [10] and [11], and ECJ 17 June 1992 – C-26/91 – *Jakob Handte & Co. GmbH v. Traitements Mecano-Chimiques des Surfaces S.A.*: [1992] E.C.R. I-3967; [1993] I.L.Pr. 5., para. [10].

[23] Shifting this burden to the national court appears to require an examination of the matter in detail greater than that intended by Convention that "requires an interpretation of Article 5 enabling the national court to rule on its own jurisdiction without being compelled to consider the substance of the case." Nor does the depth of the analysis appear to have a limit; given the highly technical and therefore abstract nature of obligation in the hypothetical, the national court may have be inclined to turn to ECJ thereby defeating the objective of Brussels I to provide a predictable and clear set of rules for resolving jurisdictional questions.

plicable to the contract has not been chosen in accordance with Article 3, the contract shall be governed by the law of the country with which it is most closely connected".

The connection test is determined in accordance with Article 4(2), providing:

"Subject to the provisions of paragraph 5 of this Article, it shall be presumed that the contract is most closely connected with the country where the party who is to effect the performance which is characteristic of the contract has, at the time of conclusion of the contract, his habitual residence, or, in the case of a body corporate or unincorporated, its central administration".

Under the facts of the hypothetical, SWED Co is the party to effectuate the performance characteristic of the contract - the execution of instructions from UK Co to buy and sell securities on the HSE. Since SWED Co is located in the Kingdom of Sweden, the contract is most closely connected with that country. Under this analysis, Swedish law is applicable and therefore the courts of Sweden have jurisdiction under a *Tessili* analysis. By identifying the home jurisdiction of the party that is to "effect" the performance of the contract, Article 4(2) of the Rome Convention in fact points back to Article 2 of the Brussels Convention bringing the analysis back full circle. However, the presumption of Article 4(2) is subject to the provisions of Article 4(5) of the Rome Convention that makes the following exception: "Paragraph 2 shall not apply if the characteristic performance cannot be determined, and the presumptions in paragraphs 2, 3 and 4 shall be disregarded if it appears from the circumstances as a whole that the contract is more closely connected with another country". As already argued, since the securities are traded in Finland on the HSE exchange, and are held in the central depository located in the territory of Finland, it appears from the circumstances as a whole that the contract is most closely connected with Finland, and not connected with the domicile of the party to effect performance. The question arises which paragraph of Article 4 to accord the greatest weight. The question is not easily settled as evidenced by the lack of useful guidance provided by the Giuliano-Lagarde Report, which notes that, "The judge's discretion with respect to disregarding the presumption [of paragraph 2] is comparable to the judge's power in exceptional cases to sever a part of the contract…"[24]

For example, the English courts have created two divergent interpretations of the relationship between the presumption of paragraph 2 and the effect of paragraph 5.[25] "The first [interpretation] states that the presumption in paragraph 2, which is expressly made subject to paragraph 5, is weak and will more readily be displaced when the place of performance differs from the place of business of the performer". The second adopts a narrower view of the 'exception' to the presumption in paragraph 5 and recognizes the dominance of the presumption in paragraph 2."[26] Both interpretations have been applied and therefore have created inconsistent case law.[27] The discretion of the judge swings the issue in one direction or another. Consequently, in the absence of a contractual choice of law clause, and particularly within the context of the indirect holding system for securities, the Rome Convention does not produce a predictable conflict of law resolution. Although the UK court is required only to determine whether it has jurisdiction, for simplifying purposes, the UK court, given the options under Article 4, would apply the considerations previously identified to resolve the jurisdictional issue: the place of the party or geographic location of the service. In any event, the legal construct fails to provide certainty and is likely to produce disparate decisions.

Regardless of whether paragraph 4(2) or 4(5) is applied, Brussels I is applicable, which in turn requires the court to apply the *Tessili* principles again, only from the point of view of the foreign law and with particular attention to the details of the case. As Judge Advocate Colomer has noted, "At best, all this effort will have served to confirm the jurisdiction of the court before which the matter has been brought or, at worst, to rule out the application of Article 5 or to confer jurisdiction upon the courts of another Member State which, if a new case is brought before them, will nevertheless have to go through the same procedure to verify their jurisdiction."[28] In either instance, the decision would be neither predictable nor uniform. Nevertheless, previously identified considerations support the UK court's decision to posit jurisdiction in Sweden under an Article 5(1)(a) analysis.

Hague Securities Convention

The Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held With an Intermediary responds to commercial developments in the securities market and establishes a set of conflict of law rules for a narrow set of securities transactions. Historically, legal rules governing securities transactions were based on the direct holding system, whereby the holding, transferring, and pledging of securities was conducted through the physical possession of securities certificates or the recording of registered ownership or other interests on the issuer's books. Commercial developments have abandoned the direct holding system in favour of the indirect holding system of securities. In intermediated holding systems, securities are dematerialised that is, they are recorded in electronic book entry form in a central depository, and ownership or other rights in securities are held by tiers of intermediaries standing between the investor and the issuer, based on maintaining securities accounts for the intermedi-

[24] Report of Mr Giuliano and Mr Lagarde on the Rome Convention: *[1980] O.J. C282/1.*

[25] *Caledonia Subsea Ltd v. Micoperi Srl* 2002 S.L.T. 1022 1 Div, para 26.

[26] *Definitely Maybe (Touring) Ltd v Marek Lieberberg Konzertagentur GmbH* at [2001] 4 All ER, p 286, para. 9.

[27] For weak interpretation, see *Definitely Maybe, Id; Credit Lyonnais v New Hampshire Insurance* [1997] 2 Lloyd's Rep 1, 5, 10. For s strong interpretation, see *Sierratel v Barclays Bank* [1998] 2 All ER 821: *Samcrete Egypt Engineers and Contractors v Land Rover Exports Ltd* [2001] EWCA Civ 2019, [2002] CLC 533, [41]. On the Continent, both Dutch and German Courts have favoured a strong interpretation. See, e.g., *Nouvelle des Papéteries de l'Aa v Machinefabriek BOA Hoge Raad*, 25 September 1992; *Machinale Glasfabriek de Maas BV v Emaillerie Alsacienne SA* [1984] ECC 123 (Dutch District Court), and *Re Claim under a Building Contract* [2001] ILPr 395 (Bundesgerichtshof) (both applying the presumption).

[28] Para. 31.

ary's direct customers. With few exceptions, physical certificates are not used to represent securities; rather, securities are electronic book entries held within a securities' intermediary account. The trilogy of immobilisation, dematerialisation and intermediation have rendered legal rules based on the direct holding system inapt to an industry that conducts transactions exceeding $2 trillion per day.

The Hague Securities Convention rejects the traditional *lex rei sitae* principle that applies the law of the place where the securities are located at the time of the transfer to determine the effectiveness of securities transactions. Because of the difficulty of identifying the location of securities in the intermediated system, traditional conflict analysis was deemed unsuitable to the indirect holding system, and the Hague Securities Convention produced a new rule reflecting the structure and economic realities of the indirect holding system. That approach is called the "Place of the Relevant Intermediary Approach" (or PRIMA) where the law governing a transaction effected through book entries is decided solely by the relationship between the intermediary and the rights holder, without accounting for the geographic or physical location of securities, since, in effect, the notion of "place" has become inscrutable and meaningless in the intermediated system.

The Hague Securities Convention is not considered law anywhere as the required number of ratifications has not been reached to make the treaty effective. Nevertheless, the Convention and its Explanatory Report are a treasure trove of information and analytical narrative capable of informing by analogy potential resolutions to jurisdictional questions such as those raised by the hypothetical. The Hague Securities Convention is discussed in this article in the context of the hypothetical as "soft law." Although the hypothetical likely does not come within the scope of the Hague Securities Convention as defined under Article 2, nevertheless the novel scheme for establishing a conflicts rule for the indirect holding system functions as a guide.

PRIMA

The primary rule of the Hague Securities Convention is defined in Article 4(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 the state, which ...(a)(i) effects or monitors entries to securities account…."

This approach is commonly known as "agreement plus reality test."[29] The "reality" test derives from the requirement that the intermediary at the time of the agreement has a "qualifying office" in the selected State identified in the account agreement. If the applicable law cannot be determined under the primary rule of Article 4, then Article 5 provides a series of "fall-back" rules. Each fall back rule effectively specifies the law of the State where the intermediary either resided during conclusion of the account agreement (Article 5.1); if not, then where the intermediary was incorporated during conclusion of the account agreement or opening of the account (Article 5.1); and, if not, then where the intermediary had its place of business during conclusion of the account agreement or opening of the account (Article 5.3).

In the circumstances of the hypothetical, Article 4 cannot determine the applicable law since the contract, whether implied in fact or not, did not specify a selected State. Hence, the UK court would have to resort to Article 5 and apply a "fall-back" rule. The most suitable "fall-back" rule, given the facts of the hypothetical, is Article 5.2 that provides: "If the applicable law is not determined under paragraph (1), that law is the law in force in the State, or the territorial unit of a Multi-Unit State, under whose law the relevant intermediary is incorporated or otherwise organised at the time the written account agreement is entered into or, if there is no such agreement, at the time the securities account was opened…." Since SWED Co is the securities intermediary in question and is the PRIMA at the centre of dispute, and since the company is organised under the laws of Sweden, it is a Swedish juridical person. Consequently, Article 5.2 determines that the law of Sweden is the applicable law to all issues arising with respect to the securities held with SWED Co. However, the Hague Securities Convention does not directly resolve the question of jurisdiction.

Back to Brussels I

Assuming that the law governing the contract between the parties is defined according to the Convention, that is, the law of Sweden where SWED Co is organised, the court still must decide the question of its jurisdiction. Private international law provides that the determination of the competent court is independent of the determination of the applicable law. Consequently, the Hague Securities Convention does not effect the decision of the court as to the determination of its jurisdiction. However, the *Tessili* judgment established a correlation between the applicable law and the determination of jurisdiction under Article 5 of Brussels I. Applying the fall-back rule contained in Article 5.2 of the Hague Securities Convention to the present hypothetical points to the law of Sweden as the applicable law governing the relationship between the parties. Applying the special rule of Brussels I contained in Article 5(1) thus confers jurisdiction on the Swedish courts. The application of the alternate rule contained in the second indent of Article 5(1) explicitly constructed for "services," of which "financial services" is a subset, would not lead to a contrary result using the Hague Securities Convention as a matter of "soft law."

However, it raises one thorny question. While the Hague Securities Convention applies to financial services by the definition of transactions found within the scope of its domain under Article 2, the Hague Securities Convention uses the term "maintenance of securities account". The Hague Securities Convention rejected the use of the "place of securities ac-

[29] Rogers, *supra* note 1 at 14.

count" to determine the applicable law, as accounts are legal relationships and do not have a physical location. It is conceivable, but highly unlikely, that the UK court would determine that the term services used in Article 5(1) covered financial services, including securities transactions, but then create an additional standard for measuring where services were provided respecting securities transactions based on where the securities account was maintained.[30] The creation of an additional category within the term "financial services" as used in the second indent of Article 5 (1)(b) is unnecessary and defeats the policy underlying the provision.

Account: Illusory or Not

The argument that an "account" does not have a physical location is predicated on the view that it is a legal relationship between two parties having no physical location. In theory, there appears to be a consensus on this point. However, in reality, commercial practice provides a basis to re-open the issue. A confluence of factors, notably obligations of financial institutions to comply with anti-money laundering and anti-terrorism laws, not to mention tax legislation, often makes the opening of an "account" definitively tied to a physical place and comprises several formalities.[31] There are measurable and quantifiable events in the opening of an account, for example, (1) legalisation of documents, (2) production of documents identifying the real beneficial owner of the account, (3) signature on a card for authenticity and authorisation purposes, and (4) a signed paper agreement. Banking law generally favours the principle of location of the branch office where the account was opened as determinative of the law applicable to a dispute regarding the liability of the bank, that is, whether the bank has incurred a liability to pay the owner of the account.[32] Therefore, an account opened at the Bank of America in the City of New York is deemed located in the State of New York, even though the Bank of America conducts business worldwide and the "account" in New York in terms of debits and credits may actually exist on a server located in North Dakota. The "account" approach is a fiction. The question remains: is the PRIMA approach any less a fiction than the "account" approach often used in banking law. All indications suggest that both are fictions.[33] As securities exchanges become more integrated and denationalised, central depositories increasingly cross-border, and investment firms outsource their services to firms located in different jurisdictions, there will be no more meaningful physical attributes to a PRIMA than to an account. Both will be equally arbitrary.

A "consequentialist" or pragmatic view favours the arbitrary rule yielding the most efficient and predictable results for commercial transactions in securities. The important decision from a policy-making perspective is to select a workable rule based upon one of the fictitious choices streaming across the range of possibilities. The factors that should matter are: clarity, predictability, and uniformity, the hallmarks of commercial law. Efforts to establish a choice of law rule or a choice of jurisdiction rule based on links to "real location" in the context of the intermediated securities system is doomed from the start. A comprehensive Treaty or Convention, like the Convention of the International Sales of Goods, to cover transactions in the indirect holding system for securities is needed as a substantive law convention obviates private international law. Authorities maintain that an agreement on a treaty is politically impossible because jurisdictions take a different view on what is the nature of a right in a security: (1) a property right, (2) contractual right, or (3) bundle of rights or "security entitlement." Admittedly, this is a serious political debate among countries and legal professionals. However, the disagreement reminds one of the memorable quotations in the movie "My Cousin Vinny" that takes place in a dialogue between Mona Lisa Vito and Vinny Gambini concerning the pants he should wear on a deer hunt.[34]

An analogous argument may be made about whether the relationship between the issuer and investor is denominated a property, contract, or securities entitlement right. The victims of this debate in terms of having to rely upon uncertain legal principles would yield to the pragmatic conclusion: it does not matter. The same analogy would apply to where the relevant securities intermediary is located. Policy makers must strive to break the deadlock of provincial differences and create a rule, arbitrary or not, that achieves the well-accepted principles of commercial law.

Conclusion

Commercial developments in the securities industry have outpaced legal rules designed to provide certainty to securities transactions. Many legal rules remain predicated on a commercial infrastructure that no longer exists. In the context of jurisdiction, an application of Brussels I to a cross-border transaction in securities does not produce uniform and predictable results, unless, in the absence of a contractual forum clause, the Article 2 default rule applies. It is doubtful whether the revision of the Brussels Convention that led to Brussels I and the Article 5 amendment contemplated the effects of the term "service" in the financial services sector. Without legislative clarification, courts confronted with questions of jurisdictional choice likely will resort to artificial legal constructs to produce a judgment. Given differences of judicial temperament and philosophy, this lacuna in the law likely will lead to non-uniform decisions.

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30 The "account approach" is used by the Settlement Finality Directive [98/26/EC] and Collateral Directive [2002/47/EC] but was rejected by the drafters of the Hague Securities Convention.

31 E.g., Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2006 on the prevention of the use of the financial system fort the purposes of money laundering and terrorist financing [requring financial instiutions, when opening an account, to carry out „customer due diligence" including verification of identity of customer and disclsoure of benefical owner of account] (OJ 2006, L 309 at 15).

32 Joseph H. Sommer, *Where is a Bank Account*, 57 Md. L. Rev. 1, 4 (1998) [sketching a strong argument for localising bank liabilities based on the law of money, and providing an interpretive method to salvage statutes related to bank liability from incoherence].

33 The "qualifying office" requirement found in Article 4(1) comprises criteria that arguably are equally applicable to identify a bank account thereby conferring no superior benefit.

34 See, http://www.imdb.com/title/tt010495/quotes, last visited 22 October 2007.