

# Investment Securities

By Carl S. Bjerre\*

The chief development examined in this portion of the survey is a decision by the Eleventh Circuit involving control of securities accounts. Other developments relate to security interests in units of an LLC, the exclusion of securities from U.C.C. Article 2, and progress toward the effectiveness of the Hague Securities Convention.

## WHAT COUNTS AS A CONTROL AGREEMENT?

Last year's survey discussed an interesting U.S. district court opinion concerning whether the purchaser of an interest in securities accounts had control under U.C.C. section 8-106(d)(2) so as to defeat the interest of a judgment creditor.<sup>1</sup> The case, *Smith v. Powder Mountain, LLC*,<sup>2</sup> has now been addressed by the U.S. Court of Appeals for the Eleventh Circuit. The district court had concluded that the purchaser did not have control,<sup>3</sup> and the court of appeals has now reversed that conclusion,<sup>4</sup> though there remain valuable thoughts in the district court opinion.

In *Smith*, a charitable foundation sued Arnold Mullen in state court alleging theft from the foundation, and in settlement of the lawsuit, Mullen agreed to transfer his interest in certain securities accounts to PFP Asset Recovery LLC ("PFP"), the foundation's designee. One of the foundation's co-trustees contacted Mullen's securities intermediary (Fidelity Investments) and requested that the assets be transferred to PFP's account, and in the ensuing two weeks, PFP's law firm and the intermediary's in-house counsel exchanged a somewhat tangled series of e-mails. The e-mails generally show PFP pressing for rapid action on the co-trustee's request, and the intermediary moving cautiously by seeking the signature of a second co-trustee. During this period and before the signature matter was resolved, an entity having a judgment against Mullen from a separate federal court lawsuit swooped in and served the intermediary with writs of garnishment.

---

\* Wallace and Ellen Kaapcke Professor of Business Law, University of Oregon School of Law.

1. Howard Darmstadter, *Investment Securities*, 67 BUS. LAW. 1299, 1307-08 (2012).

2. Nos. 08-80820, 08-81185, 2011 WL 2457906 (S.D. Fla. June 16, 2011), *rev'd*, 492 F. App'x 981 (11th Cir. 2012).

3. *Id.* at \*7-9.

4. *Smith v. Powder Mountain, LLC*, 492 F. App'x 981, 984-85 (11th Cir. 2012).

In post-judgment proceedings in the federal court action, PFP moved to dissolve the writs of garnishment, and the judgment creditor, FDB II Associates, LP (“FDB”), cross-moved for a final judgment of garnishment against the intermediary.

The chief issue, as litigated, was whether PFP satisfied the elements of U.C.C. section 8-106(d)(2) at the time FDB’s writs of garnishment were served.<sup>5</sup> This section provides that “[a] purchaser has ‘control’ of a security entitlement if . . . the securities intermediary *has agreed* that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder.”<sup>6</sup> If PFP did have control, then it would hold its interest in Mullen’s securities accounts free of FDB’s rights pursuant to section 8-510(a), which provides that:

an action based on an adverse claim to a financial asset or security entitlement, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who purchases a security entitlement, or an interest therein, from an entitlement holder if the purchaser gives value, does not have notice of the adverse claim, and obtains control.<sup>7</sup>

Regarding the elements of section 8-510(a) other than control, the parties agreed that PFP was a purchaser as defined in Article 1,<sup>8</sup> gave value, and did not have notice of an adverse claim by FDB at the time it gave value.<sup>9</sup>

The district court granted summary judgment for FDB on the grounds that PFP did not have control.<sup>10</sup> In the district court’s view, the intermediary had not “agreed” to follow PFP’s entitlement orders because that word as used in section 8-106(d)(2) requires “a meeting of the minds resulting in a contractual undertaking between the securities intermediary and the creditor/purchaser of the securities entitlement.”<sup>11</sup> The court bolstered its interpretation of the control statute by reference to Article 1’s definition of “agreement”<sup>12</sup> and to the statute’s and

---

5. *Smith*, 2011 WL 2457906, at \*6.

6. U.C.C. § 8-106(d)(2) (2011) (emphasis added).

7. *Id.* § 8-510(a). On the facts of the case there would have been room to question whether FDB was in fact an adverse claimant, given that FDB’s asserted interest had arisen after PFP’s rather than before it. *See id.* § 8-102(a)(1).

8. U.C.C. § 1-201(b)(29) (2011) (defining “purchase” as any voluntary transaction creating an interest in property); *id.* § 1-201(b)(30) (defining “purchaser” as one that takes by “purchase”). The settlement agreement was a voluntary transaction on Mullen’s part. *Smith*, 2011 WL 2457906, at \*1.

9. *Smith*, 2011 WL 2457906, at \*6. The court of appeals erroneously referred to a person meeting all of the elements of section 8-510(a) as a “protected purchaser.” *See Smith*, 492 F. App’x at 984. This term actually applies only to purchasers of securities under Article 8’s direct holding system, *see* U.C.C. § 8-303(a) (2011), not to purchasers of an interest in security entitlements in the indirect holding system. Purchasers of security entitlements or of an interest therein under section 8-510(a) are indeed “protected” in the ordinary English sense of the word from actions based on adverse claims, but section 8-303’s defined term is different from the ordinary syntactic connecting of an adjective and a noun. (The district court had committed the same error, as noted in last year’s survey. Darmstadter, *supra* note 1, at 1307 n.64.)

10. *Smith*, 2011 WL 2457906, at \*9.

11. *Id.* at \*8.

12. *Id.* (citing U.C.C. § 1-201(b)(3)). The court also relied on Florida cases to establish that an “agreement” requires offer, acceptance, and consideration. *Id.*

the Code's purposes of promoting clarity and predictability in commercial relationships.<sup>13</sup> Interpreting the record most favorably to PFP, the court concluded that the intermediary had, at best, given "a preliminary indication of its willingness to acquiesce with PFP entitlement orders once certain essential terms and conditions were met,"<sup>14</sup> notably the co-trustee's signature, which had not been supplied before FDB's writs were served.<sup>15</sup> The court characterized PFP as arguing that section 8-106(d)(2) is satisfied by an intermediary's "mere[] . . . expression of a willingness to comply with entitlement orders"<sup>16</sup> or "simple gratuitous assent"<sup>17</sup> without legal enforceability, and the court pointed out that, on this view, PFP could gain and lose control "dozens of times a day"<sup>18</sup> depending on the intermediary's "whim and arbitrary 'agreeability' to [PFP's] directions at any given moment in time."<sup>19</sup> Of course such a view does not square with the statutory purpose of promoting commercial certainty.

The court of appeals reversed—not only undoing the summary judgment in favor of FDB but also ordering summary judgment in favor of PFP.<sup>20</sup> In the view of the court of appeals, PFP had had control despite the intermediary's continuing insistence on the second co-trustee's signature.<sup>21</sup> The court based this ruling solely on Comment 7 to section 8-106, which explains, "There is no requirement that the purchaser's powers be unconditional, provided that further consent of the entitlement holder is not a condition."<sup>22</sup> The condition of a second co-trustee's signature is different from a condition of consent by Mullen.<sup>23</sup> Case closed.

This outcome is a strong and welcome affirmation of the basic idea behind control agreements, which are designed to assure a third party of access to an entitlement holder's securities account provided that the conditions, if any, to such access do not include the further consent of the entitlement holder. (The only role for the entitlement holder's consent is in initially embracing the prospective terms of the control agreement, and not in having any say as to the third party's later exercise of its rights pursuant thereto.) As Comment 7 makes clear and the court of appeals rightly recognizes, other conditions not including the entitlement holder's further consent are perfectly welcome in control agreements. Indeed the careful and flexible crafting of such conditions is part of what makes the control mechanism so commercially useful.

As applied to the facts of this case, on the other hand, the court of appeals decision may have been somewhat too brisk. While the court is probably right

---

13. *Id.*

14. *Id.* at \*9.

15. *Id.*

16. *Id.* at \*8.

17. *Id.* at \*6.

18. *Id.* at \*8.

19. *Id.*

20. *Smith v. Powder Mountain, LLC*, 492 F. App'x 981, 985 (11th Cir. 2012).

21. *Id.* at 984–85.

22. *Id.* (quoting U.C.C. § 8-106 cmt. 7).

23. *Id.* at 985.

that the minimum boundaries of a control agreement are broader than those articulated by the district court, the boundaries are also probably narrower than those the court of appeals seems to suggest. Control agreements should not be limited to those that are classically “contractual” in the sense of offer and acceptance and consideration, because alternative grounds of enforceability such as third-party beneficiary or the purchaser’s reasonably foreseeable reliance should be recognized too.<sup>24</sup> However, Comment 7 to section 8-106 should not be over-read as exempting control agreements from all considerations of legal enforceability. It seems important to differentiate between two broad types of “conditions” to a purchaser’s rights: conditions to the *exercise* of an extant legally enforceable control right, and conditions to the *creation* of such a control right in the first place. An example of the first type of condition would be where the intermediary has unambiguously committed, in a legally enforceable manner, to follow the purchaser’s entitlement orders, but only on the condition that the purchaser has certified that the entitlement holder has defaulted on a secured loan from the purchaser.<sup>25</sup> An example of the second type of condition would be where the intermediary has only offered to commit to following the purchaser’s entitlement orders, with the as yet unmade commitment itself being contingent on, say, the purchaser using the intermediary’s own form of control agreement or the purchaser consenting to the intermediary’s fee arrangements.

From a contract law point of view it is odd to think of the second type as a “condition” at all, but because the court of appeals apparently did so<sup>26</sup> we can use that terminology for the sake of argument. Both types of “condition” free the intermediary from acting until the condition is fulfilled, but the second type may depending on the facts also keep the purchaser from having a legally enforceable commitment at all. Comment 7 itself explains that “[t]he key to the control concept is that the purchaser *has the ability* to have the securities sold or transferred without further action by the transferor.”<sup>27</sup> Absence of further consent by the transferor (that is, the entitlement holder, where section 8-106(d)(2) is concerned) is necessary but not sufficient to the purchaser having this ability.

---

24. The tail end of the court of appeals opinion tends to support this idea. Part of FDB’s argument had been that PFP could not have control without having given consideration to the intermediary, and the district court had not reached this argument, but the court of appeals briefly held that the argument failed. *Id.* In a similar vein, the district court’s relatively simple invocation of the term “agreement” may have been misplaced. See Darmstadter, *supra* note 1, at 1308 & n.75.

25. This condition is one of the classic ones given in Example 11 to U.C.C. section 8-106 cmt. 7, also quoted by the court of appeals:

Example 11. Debtor grants to Alpha Bank a security interest in a security entitlement that includes 1000 shares of XYZ Co. stock that Debtor holds through an account with Able & Co. Able agrees to act on the entitlement orders of Alpha, but Alpha’s right to give entitlement orders to the securities intermediary is conditioned on the Debtor’s default. Alternatively, Alpha’s right to give entitlement orders is conditioned upon Alpha’s statement to Able that Debtor is in default. Because Able’s agreement to act on Alpha’s entitlement orders is not conditioned on Debtor’s further consent, Alpha has control of the securities entitlement under either alternative.

U.C.C. § 8-106 cmt. 7, ex. 11 (2011), *quoted in Smith*, 492 F. App’x at 985.

26. *Smith*, 492 F. App’x at 984–85.

27. U.C.C. § 8-106 cmt. 7 (2011) (emphasis added).

Concededly the drafters of Comment 7 did not explicitly place the second type of condition out of bounds, but there are commonsense limits to even the most scrupulous drafting. And to ignore the distinction between the two types of condition, as the court of appeals seems to have done,<sup>28</sup> is to overlook the district court's important point that a control agreement must be legally enforceable, so that a purchaser's control status cannot fluctuate dozens of times a day.<sup>29</sup>

The conditions in the *Smith* case are arguably instances of the second type rather than the first, or at least one wishes that the court of appeals had looked at the facts as carefully as the district court did. The court of appeals treated some elements of the intermediary's in-house lawyer's after-the-fact deposition testimony as being dispositive of the control issue, while ignoring other deposition testimony tending to indicate that control had not yet been created.<sup>30</sup> A closer analysis by the court of appeals of the nature of the intermediary's request would have been very helpful in properly delineating the reach of the rule created by this case.

Fortunately, most transactions do not involve facts that are as difficult to categorize as the ones in this case. The courts had to grapple with these perplexing questions only because of inadequate transactional lawyering at the outset of the deal. In the vast majority of control arrangements, the intermediary's agreement is straightforward and the enforceability of that agreement is unmistakable.

## SECURITY INTERESTS IN UNITS OF AN LLC

*In re Brown*<sup>31</sup> is an "Article 8½" case involving the interplay between U.C.C. Articles 8 and 9. At issue was whether a secured party was attached and perfected in the debtor's units of a limited liability company, which in turn depended on whether those units were securities.<sup>32</sup> The court ably discerned that, although the secured party had wrongly characterized the units, the security interest was nonetheless attached—"just barely"<sup>33</sup>—and perfected—"if only by a hair."<sup>34</sup>

The debtor, Dr. Michelle Brown, owned seven units of Kansas Medical Center, LLC and used them as collateral for a \$315,000 bank loan. The documentation

28. See *Smith*, 492 F. App'x at 982 ("The issue presented in this appeal is whether a creditor . . . [has control when the intermediary requires an additional signature] before transferring the accounts to the creditor's designee." (emphasis added)).

29. *Smith v. Powder Mountain, LLC*, Nos. 08-80820, 08-81185, 2011 WL 2457906, at \*8 (S.D. Fla. June 16, 2011), *rev'd*, 492 F. App'x 981 (11th Cir. 2012).

30. *Smith*, 492 F. App'x at 982–85. A witness for PIP testified that the intermediary had "continue[d] to raise . . . what we felt was this irrelevant issue with the Foundation and the [a]uthority [of the co-trustees]." *Smith*, 2011 WL 2457906, at \*10. Similarly, the intermediary's witness testified that there was continued communication "about additional information that needed to be included in the letter of instruction." *Id.* at \*5.

31. *In re Brown*, 479 B.R. 112 (Bankr. D. Kan. 2012).

32. *Id.* at 114.

33. *Id.* at 117.

34. *Id.* at 121.

included a note, an “Assignment of Investment Property/Securities,” and an “Uncertificated Securities Control Agreement.”

The opinion began by characterizing the collateral—the logical approach because Article 9’s treatment depends on this characterization—and correctly concluded that the LLC units were general intangibles rather than securities.<sup>35</sup> The definition of “security” under U.C.C. section 8-102(a)(15) is supplemented by section 8-103(c), which provides that an interest in an LLC is generally not a security, unless one of three exceptions apply,<sup>36</sup> and none applied in *Brown*. First, the LLC interests were not actually “dealt in or traded on securities exchanges or in securities markets.”<sup>37</sup> Second, the terms of the LLC interests did not “expressly provide” that they were securities governed by Article 8.<sup>38</sup> And third, the LLC interests were not investment company securities.<sup>39</sup>

Nonetheless the loan documentation referred to the units as “investment property,” “uncertificated securities,” or “margin stock.” All of these designations were incorrect (assuming that the first two terms were used in their U.C.C. sense, as is commonly provided in loan documents).<sup>40</sup> The units could not be uncertificated securities without being securities.<sup>41</sup> They could not be investment property without being securities or other types of collateral, as to which no contention was or could reasonably have been made.<sup>42</sup> And they could not be margin stock because LLCs do not issue stock.<sup>43</sup> Accordingly the court concluded that the units fell into Article 9’s residual categorization, general intangibles.<sup>44</sup>

The remaining issues were whether the security interest in the LLC units, as so categorized, was attached and perfected. The court held that there was attachment because the loan documents taken together constituted an authenticated security agreement that adequately described the collateral “[b]y an admittedly thin margin”<sup>45</sup> under U.C.C. sections 9-203(b)(3)(A) and 9-108.<sup>46</sup> The court

35. *Id.* at 116–17.

36. U.C.C. §§ 8-102(a)(15), 8-103(c) (2011).

37. *Id.* § 8-103(c); see *Brown*, 479 B.R. at 117. Compare U.C.C. § 8-102(a)(15)(iii) (2011) (more broadly encompassing interests “of a type” so dealt in or traded on).

38. U.C.C. § 8-103(c); see *Brown*, 479 B.R. at 117.

39. U.C.C. § 8-103(c); see *Brown*, 479 B.R. at 117.

40. *Brown*, 479 B.R. at 116.

41. U.C.C. § 8-102(a)(18) (2011); see *Brown*, 479 B.R. at 116–17.

42. U.C.C. § 9-102(a)(49) (2009); see *Brown*, 479 B.R. at 116–17.

43. See *Brown*, 479 B.R. at 119.

44. *Id.* at 117.

45. *Id.* at 120.

46. *Id.* at 120–21. Without detailing all of the court’s Article 9 reasoning in this Article 8 portion of the survey, the court reluctantly concluded that it was “objectively determinable,” U.C.C. § 9-108(b)(6) (2009), that the LLC units were the collateral, because the documentation despite its misnomers did describe the number of units and identify the issuing entity (correctly named) as a limited liability company. *Brown*, 479 B.R. at 121. “As LLCs typically do not issue ‘stock,’ a reader could reasonably conclude that the ‘preferred stock’ was, in fact, a membership interest. . . . And, there is no doubt that these units are what Dr. Brown offered and what the Bank received as security for the repayment of its note.” *Id.* at 120. If the description had simply covered “all of debtor’s interest in Kansas Medical Center, LLC,” this would be a much simpler case.” *Id.* at 120 n.39.

also held that the security interest was perfected by the filing of a financing statement, notwithstanding further instances of poor drafting.<sup>47</sup>

The opinion's attachment analysis was also interesting in a variety of ways for Article 8½ purposes. The court rejected arguments that either section 9-203(b)(3)(C)—providing for attachment by delivery of a certificated security in registered form—or section 9-203(b)(3)(D)—providing for attachment by control of investment property could apply.<sup>48</sup> As noted above, the transaction documents did include a self-styled Uncertificated Securities Control Agreement. This agreement was executed by each of the debtor, the secured party, and the issuer and it set forth the issuer's agreement "to comply with the instructions originated by the Secured Party without further consent by the Debtor."<sup>49</sup> If the LLC interests had been uncertificated securities, this document would probably have sufficed to give the bank control of them under section 8-106(c)(2), thereby conferring not only attachment but also perfection.<sup>50</sup>

Separately, the opinion recited but did not evaluate the bank's argument that it should prevail under section 9-203(b)(3)(B)—providing for attachment by possession of collateral other than certificated securities—by virtue of the Uncertificated Securities Control Agreement.<sup>51</sup> Such an argument should be squarely rejected. There are certain analogies and structural similarities between control under section 8-106 and possession under section 9-203(b)(3)(B), but possession under the latter provision is a physical inquiry to be made of tangible collateral, or at least semi-tangible collateral such as certificated securities. By contrast, as the Official Comments remind us, the concept of control

is not to be interpreted by reference to similar concepts in other bodies of law. In particular, the requirements for "possession" derived from the common law of pledge are not to be used as a basis for interpreting subsection (c)(2) or (d)(2). Those provisions are designed to supplant the concepts of "constructive possession" and the like. A principal purpose of the "control" concept is to eliminate the uncertainty and confusion that results from attempting to apply common law possession concepts to modern securities holding practices.<sup>52</sup>

Technically speaking, the comment warns against possession being bootstrapped into control, while the bank's argument in *Brown* sought to do the opposite, namely bootstrap control into possession.<sup>53</sup> Nonetheless courts should keep a clear picture of Article 8's carefully drawn statutory distinctions and not be bamboozled by the idea that possession could somehow be conferred by the mere execution of a control agreement.

47. *Brown*, 479 B.R. at 121. The collateral description referred to "margin stock/securities (uncertificated)" and "shares of preferred stock," but did correctly identify the issuer and its address and the number of shares of interest, and the court held section 9-108 to be satisfied, "if only by a hair." *Id.*

48. *Id.* at 117–18.

49. *Id.*

50. See U.C.C. § 9-314(a) (2009) (providing that security interest in investment property may be perfected by control).

51. *Brown*, 479 B.R. at 118 (referencing, but not analyzing, U.C.C. § 9-203(b)(3)(B)).

52. U.C.C. § 8-106 cmt. 7 (2011).

53. *Brown*, 479 B.R. at 118.

Despite missing the opportunity for dictum that would have clarified this last point, the case is well decided. The bank's fate here is a good object lesson that it is not enough for a lender to have good forms; those forms must also be carefully tailored to the transaction at hand.

## EXCLUSION OF SECURITIES FROM U.C.C. ARTICLE 2

Two cases involved the exclusion of securities from U.C.C. Article 2. In *Lehman Brothers Holdings, Inc. v National Bank of Arkansas*,<sup>54</sup> the court mistakenly held that a mortgage was a security, with cursory reasoning that successfully but clumsily freed the buyer's assignee from U.C.C. Article 2's statute of limitations. The mortgage originator had sold several mortgages to Lehman Brothers Bank, accompanied by contractual promises to repurchase the mortgages if certain representations and warranties were breached. Representations and warranties regarding the properties' appraised value and the correctness of the loan underwriting documents were in fact breached, and Lehman Brothers Holdings, Inc. (assignee of the buyer) sought to recover from the originator. The originator raised Article 2's four-year statute of limitations as a defense, and the court correctly rejected that defense.<sup>55</sup>

In the process, however, the court for some reason embraced Lehman's argument that the mortgages were investment securities (as well as "things in action," a more defensible classification)<sup>56</sup> and thus expressly excluded from Article 2's definition of goods.<sup>57</sup> The court recited U.C.C. section 8-102(a)(15)'s definition of "security," but failed to apply it, and apparently neither party called the court's attention to the notorious New York Court of Appeals decision in *Highland Capital Management LP v. Schneider*.<sup>58</sup> Of course the baseline rule that securities are excluded from Article 2 is correct, but the court would have much more ably avoided Article 2's statute of limitations either by addressing itself to "things in action" or by simply holding that the mortgages were not "things . . . which are movable at the time of identification to the contract for sale."<sup>59</sup>

In the second case, *Belmont Partners, LLC v. China YiBai United Guarantee International Holding, Inc.*,<sup>60</sup> the court ably adapted an Article 2 remedy to the

---

54. 875 F. Supp. 2d 911 (E.D. Ark. 2012).

55. *Id.* at 916-17.

56. *Id.* at 916.

57. "'Goods' means all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than the money in which the price is to be paid, investment securities (Article 8) and things in action." U.C.C. § 2-105(1) (2011).

58. 866 N.E.2d 692 (2007) (holding over a strong dissent that certain promissory notes were securities for purposes of a statute of frauds dispute). The case is expressly disapproved in a conforming amendment to U.C.C. Article 8 adopted as part of the 2010 revisions to U.C.C. Article 9. See U.C.C. § 8-102(a) cmt. 13 (2011).

59. U.C.C. § 2-105(1) (2011).

60. No. 3:10-CV-00020, 2011 WL 678063 (W.D. Va. Feb. 16, 2011). The case escaped discussion in last year's survey because of the indirectness of its relationship to Article 8.



breach of a contract to sell securities. Comment 1 to section 2-105 invites courts to apply Article 2 by analogy in just this way.

It is not intended by [the] exclusion [of investment securities from this Article] . . . to prevent the application of a particular section of this Article by analogy to securities . . . when the reason of that section makes such application sensible and the situation involved is not covered by the Article of this Act dealing specifically with such securities (Article 8).<sup>61</sup>

And remedies for breach of a contract to sell securities are in fact not covered by Article 8. The Prefatory Note to the 1994 revisions to Article 8 tells us:

Article 8 is in no sense a comprehensive codification of the law governing securities or transactions in securities. . . . Although Article 8 deals with some aspects of the rights and duties of parties who transfer securities, it is not a codification of the law of contracts for the purchase or sale of securities. (The prior version of Article 8 did include a few miscellaneous rules on contracts for the sale of securities, but these have not been included in Revised Article 8.)<sup>62</sup>

In *Belmont Partners*, the subject of the contract was 6.6 million shares of restricted stock representing a 5 percent stake in the defendant, China YiBai United Guarantee International Holding, Inc. (“China YiBai”).<sup>63</sup> The buyer, Belmont Partners, LLC (“Belmont”), had performed its end of the bargain by delivering a controlling interest in a company called SpectraSource, Inc. to a corporation that merged into China YiBai. Upon the closing of the merger, China YiBai had been required to issue to Belmont the 5 percent stake, but China YiBai did not perform for almost eighteen months. Belmont sued for damages resulting from the delay and the court acted as finder of fact.

The court’s written opinion carefully applied section 2-713, “Buyer’s Damages for Non-Delivery or Repudiation,” to the securities context.<sup>64</sup> Generally the statute measures damages using a “cover”-type measure, which is to say the market value at the time the buyer learned of the breach minus the contract price.<sup>65</sup>

61. U.C.C. § 2-105 cmt. 1 (2011).

62. U.C.C. art. 8, Prefatory Note § III.B, 2C U.L.A. 429, 439 (2005). The Prefatory Note later elaborates:

Article 8 has never been, and should not be, a comprehensive codification of the law of contracts for the purchase and sale of securities. The prior version of Article 8 did contain, however, a number of provisions dealing with miscellaneous aspects of the law of contracts as applied to contracts for the sale of securities. Section 8-107 dealt with one remedy for breach, and Section 8-314 dealt with certain aspects of performance. Revised Article 8 deletes these on the theory that inclusion of a few sections on issues of contract law is likely to cause more harm than good since inferences might be drawn from the failure to cover related issues. The deletion of these sections is not, however, intended as a rejection of the rules of contract law and interpretation that they expressed.

*Id.* § IV.B.8, 2C U.L.A. at 458.

63. *Belmont Partners*, 2011 WL 678063, at \*1.

64. *Id.* at \*4–9.

65. U.C.C. § 2-713 (2011). In this case, the contract price did not need to be subtracted because Belmont had already performed. See *Belmont Partners*, 2011 WL 678063, at \*1, \*4. However, the value of the stock at the time of the defendant’s late performance would have been subtracted, if the court’s analysis had needed to proceed that far. See *id.* at \*5.

Unfortunately for Belmont, the stock of China YiBai was not traded on any exchange; moreover the Pink Sheets trades in the stock were infrequent, and of unrestricted rather than restricted securities, and much smaller in volume than the 5 percent of China YiBai called for by the contract. Belmont failed to offer expert testimony about the effect of these facts on the market value called for by the statute. The court accordingly concluded that Belmont had failed to prove damages to the requisite degree of certainty, and it awarded only nominal damages of \$1.<sup>66</sup>

## PROGRESS TOWARD EFFECTIVENESS OF THE HAGUE SECURITIES CONVENTION

In a development of interest to all who practice in the field of the commercial law of securities, President Obama transmitted the Hague Securities Convention to the Senate for its advice and consent to ratification,<sup>67</sup>—a critical step toward the Convention becoming effective as a matter of United States law. The time frame for any Senate action cannot, however, be predicted at this time.

As described in previous surveys,<sup>68</sup> the Convention establishes choice of law rules that determine which jurisdiction's substantive law applies to a broad range of commercial law issues affecting transactions in indirectly held securities. From the perspective of United States lawyers, the Convention's choice of law rules mesh very well with those currently applicable under U.C.C. Articles 8 and 9.<sup>69</sup> However there could be occasional differences in outcome between the two bodies of law.<sup>70</sup>

The Convention has already been ratified by Switzerland and Mauritius,<sup>71</sup> and it takes effect among nations party to it three months after a third nation's

66. *Id.* at \*8–9.

67. Message from the President of the United States Transmitting the Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary, *convention concluded July 5, 2006*, S. Treaty Doc. No. 112-6 (2012) [hereinafter Message from the President], available at <http://www.gpo.gov/fdsys/pkg/CDOC-112tdoc6/pdf/CDOC-112tdoc6.pdf>.

68. See Sandra M. Rocks & Kate A. Sawyer, *Survey of International Commercial Law Developments During 2003*, 59 *BUS. LAW.* 1663, 1671–72 (2004); Sandra M. Rocks & Kate A. Sawyer, *Survey of International Commercial Law Developments During 2002*, 58 *BUS. LAW.* 1657, 1664–65 (2003).

69. See Carl S. Bjerre & Sandra M. Rocks, *A Transactional Approach to the Hague Securities Convention*, 3 *CAP. Mkts. L.J.* 109, 123 (2008).

70. See *id.* at 116. The Permanent Editorial Board of the Uniform Commercial Code may issue a Commentary on the interactions between the Convention and the Code. For detailed discussions of aspects of the Convention, see Bjerre & Rocks, *supra* note 69; James S. Rogers, *Conflict of Laws for Transactions in Securities Held Through Intermediaries*, 39 *CORNELL INT'L L.J.* 285 (2006); Christophe Bernasconi & Harry C. Sigman, *The Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (Hague Securities Convention)*, 10 *UNIFORM L. REV.* (n.s.) 117 (2005). For a thorough and authoritative analysis, see ROY GOODE ET AL., *EXPLANATORY REPORT ON THE HAGUE CONVENTION ON THE LAW APPLICABLE TO CERTAIN RIGHTS IN RESPECT OF SECURITIES HELD WITH AN INTERMEDIARY (HAGUE SECURITIES CONVENTION)* (2005), available at <http://www.hcch.net/upload/exp36en.pdf>.

71. CHRISTOPHE BERNASCONI, *THE HAGUE SECURITIES CONVENTION: A MODERN AND GLOBAL CONFLICT OF LAWS REGIME FOR TRANSACTIONS INVOLVING SECURITIES HELD WITH AN INTERMEDIARY 2* (2012), available at [www.hcch.net/upload/outline36e.pdf](http://www.hcch.net/upload/outline36e.pdf).

ratification.<sup>72</sup> As noted in the Secretary of State's Letter of Submittal to the President, ratification by the United States is supported by the relevant regulatory agencies, by securities clearing and settlement entities, and by commercial market interests and securities industry associations.<sup>73</sup> The American Bar Association has also adopted a formal resolution recommending U.S. ratification.<sup>74</sup>

---

72. Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary art. 19(1), July 5, 2006, 46 I.L.M. 649, available at <http://www.hcch.net/upload/conventions/txt36en.pdf> ("the first day of the month following the expiration of three months after the deposit of the third instrument of ratification, acceptance, approval or accession referred to in Article 17").

73. Message from the President, *supra* note 67, at v-vi.

74. *See id.* at vi.