UNCITRAL and HCCH
Virtual Colloquium on Applicable Law in Insolvency Proceedings

Applicable Law in Securities and Other Financial Instruments

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Question 1:
Where should be the limit of lex fori concursus?
Why do reasonable people disagree on this question?

Question 2:
Why do traditional PIL rules focus on connecting factors?
In the digital age, is focusing on the location of a thing as the relevant connecting factor outdated?

Question 3:
Which is more difficult, harmonization of substantive law rules or harmonization of PIL rules?

Areas:
I will take up financial transactions, such as intermediated securities, collateralization of account receivables and closeout netting provisions in financial derivatives.

My theme: Think functionally

What is the goal and functions of insolvency law rules?
Does this tell us an answer to the question of what should be the applicable law in insolvency proceedings?
If the applicable law in insolvency is different from that outside insolvency, such applicable law in insolvency may be difficult to know ex ante, because where an insolvency proceeding takes place is unknown at the time when parties agree on a collateral transaction involving intermediated securities, for instance. Partial optimization does not necessarily lead to overall optimization.

Location of digital data is often difficult to find. Also, where the role of humans diminishes and smart contracts or computer programs dominate, focus has to change from location to something else.

Perhaps contrary to our intuition, harmonization of PIL rules may be more difficult than harmonization of substantive law rules. Macro-level disputes are more difficult to be judged or evaluated by empirical studies than micro-level disputes.

Two basic questions in insolvency law in a cross-border context are what law applies and how far it should be.
Traditionally, lex fori concursus is recognized, but how far it should be is subject to debate.

[Note: lex fori concursus is the law of the State in which the insolvency proceedings are commenced and includes both procedural and substantive legal rules (UNCITRAL).]

Similar questions exist in other areas.
For example, lex monetae is recognized but how far is not clear.
A state must have power to define its fiat money, so for State X's fiat money, lex monetae should apply to legal issues even outside State X. Is this correct?

What if in State Y, A sells goods to B and B agrees to pay A by means of State X's fiat money in exchange for the delivery of the goods. What law should be the applicable law that governs A or B's rights and obligations?
Usually, lex monetae does not apply and lex contractus applies.
What if in State Y, C and D dispute over the ownership of X's fiat money?
Again, usually, lex monetae does not apply and (probably) lex rei sitae applies.

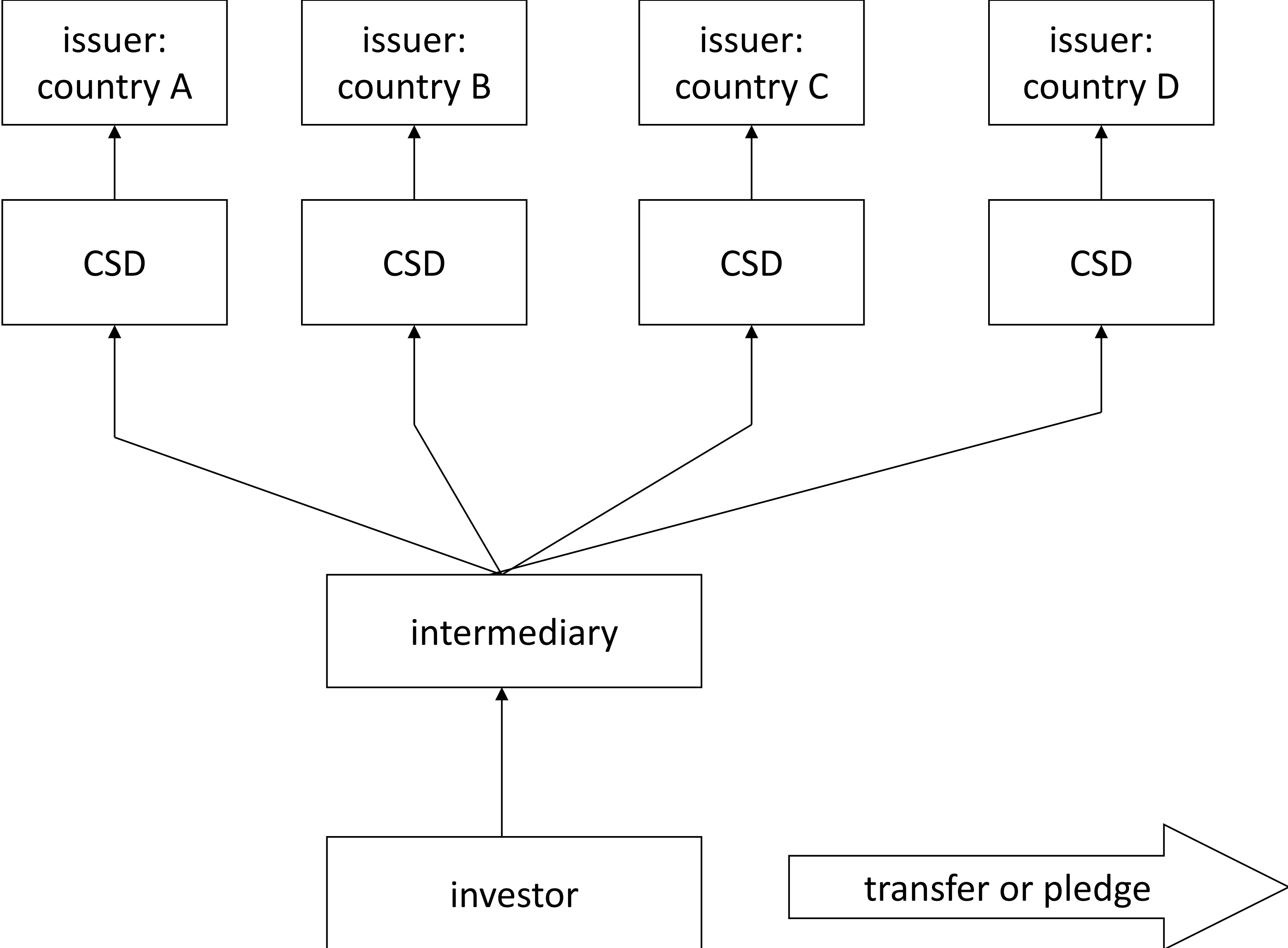
The point is that the applicable law is the same as where virtual currency rather than fiat money is used as a means of payment. I think reasonable people agree on this.

Is it bad if the applicable law in insolvency is different from that outside insolvency? Is it not so bad if ex ante, people know the applicable law? Is it correct to say that what is important is not whether the applicable law in insolvency is the same as -- or different from -- the applicable law outside insolvency, but rather whether the applicable law is known to the parties at the time of the contract and not changed ex post?

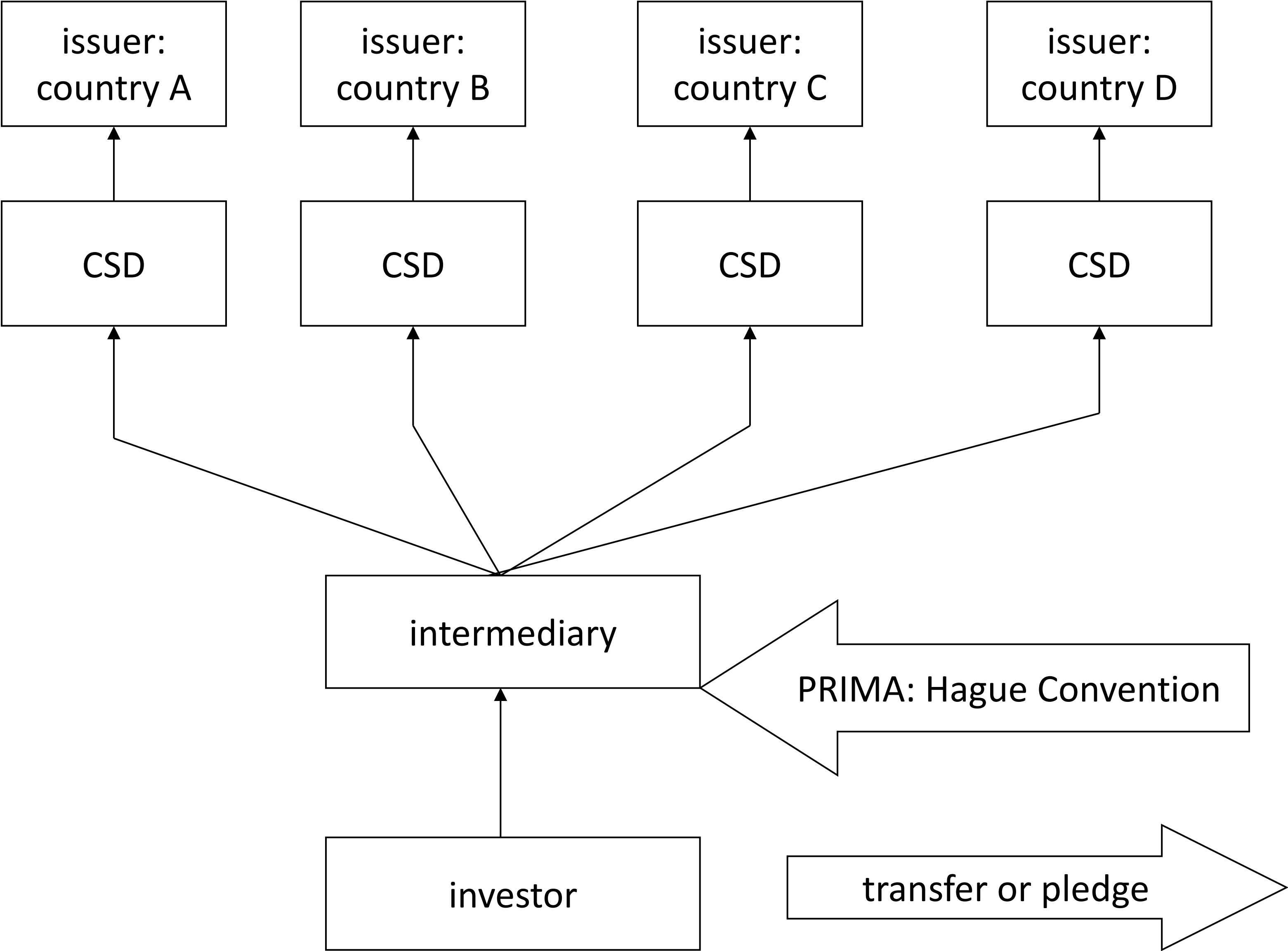
I think this is not correct at least in certain fields, in particular in financial transactions. First, if the applicable law in insolvency is different from that outside insolvency, such applicable law in insolvency may be difficult to know because where an insolvency proceeding takes place is unknown at the time when parties agree on a collateral transaction involving intermediated securities, for instance. Second, parties might misbehave by using insolvency proceedings in order to change initial entitlements ex post, and this would bring in disruptions and raise social costs with financial transactions.

So, a typical modern law says: while lex fori concursus should be recognized and applied within insolvency regarding both procedural and substantive issues, exceptions should be recognized for, for example, the effectiveness against third parties of collateral transactions and basic priorities involved there, that is, the applicable law outside insolvency is and should be the applicable law in insolvency for those legal issues.

Intermediated Securities



Intermediated Securities



If everything is in one state and insolvency substantive law rules change the rules outside insolvency, there must be a reason, and it is the reason why insolvency law exists in that state.

From a functional perspective, the role of insolvency law rules is to minimize debtor misbehavior (in the debtor-creditor problem) and creditor misbehavior (both in the debtor-creditor problem and creditor-creditor problem).
In other words, a hypothetical bargain is one useful way of thinking in understanding and justifying the situations where insolvency substantive law rules depart from the rules outside insolvency.

From this perspective, as far as legal issues such as the effectiveness against third parties of collateral transactions and basic priorities are concerned, there is no reason why people might agree, in a hypothetical bargain, to many different laws being applied, because where an insolvency proceeding takes place is unknown at the time when parties agree on a particular financial contract.