PRINCIPLE AND UTILITY IN THE STRUCTURE
OF SECURITIES OWNERSHIP

A COMMENT ON SCHWARCZ & BENJAMIN

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In Intermediary Risk in the Indirect Holding System for Securities,¹ Professors Schwarcz and Benjamin take as their central motivating principle the time-honored idea that nemo dat quod non habet, or no one gives more than he or she has. This principle, also known as the “derivation principle” of property ownership because it maintains that the rights of each property owner should be derived from the rights of the property’s previous owner,² provides a window onto some of the most central and intractable questions in the commercial law field.

The nemo dat principle seemingly makes abundant and conclusive common sense: how, a non-lawyer would truculently ask, could anyone possibly give more than he or she has? But common sense turns out to be under-determinative in this area,³ and the answer to the truculent question is easy: by legal fiat. That is, the commercial law system can enable X to give more to Y than X has, not by con-

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3. Consonant with this under-determinativeness, Schwarcz’s and Benjamin’s support for the nemo dat principle in the context of indirect securities ownership is based on considerations, beyond the scope of this brief commentary, that are considerably more detailed than a simple invocation of common sense. See Schwarcz, Global Economy, supra note 1, at 1573–77, 1580–86.
juring additional rights out of thin air, but by expropriating some of
Z’s rights in order to include them in the package that Y gets from X.
And as I explore in detail in a forthcoming article, the American
commercial law system does so over and over again, in widely varying
contexts. (One example, salient here because Schwarcz and Benja-
min explicitly focus on it, is the U.C.C. provision that gives priority to
the secured creditor (Y) who takes as collateral from a securities in-
termediary (X) the securities entitlements held by an entitlement
holder (Z), even if the entitlement holder does not consent.) The
commercial law system’s reason for taking these steps is to foster
commerce between X and Y, by freeing Y from concerns that third
parties, such as Z, will have claims to the property that defeat Y’s.
These violations of the nemo dat principle have a common sense of
their own, one which duels with the common sense of the nemo dat
principle itself, and hence, the validity or invalidity of the principle
cannot be resolved simply by applying common sense.

Moral philosophy can hardly lay claim to being a readier prob-
lem-solver than is common sense. The moral philosophical approach
does, however, frame the issues more sharply and, more important,
reveals the depths of what is at stake in a way that ordinary com-
mercial law scholarship often does not. The nemo dat principle is of a
piece with the classical liberal tradition, which of course prizes indi-
vidual autonomy for its own sake, including, notably, freedom of al-
ienation. Thus, if the only way for Y to get more than X had is for
the law to conscript Z’s property, then protection of Z’s freedom
from non-consensual alienation calls for denying Y anything more
than X had. (This classical liberal outlook is enshrined in the
U.C.C.’s own self-declared purposes and policies, which include ex-
panding commercial practices through “custom, usage and agree-
ment of the parties.”) By contrast, departures from the nemo dat principle

4. Carl S. Bjerre, Commerce and Community: The Redistributionist Streak in American
Commercial Law (on file with the author).
5. In addition to the priority issues discussed in the text below, examples include the void-
able title and entrusting rules for goods, the holder in due course rules for negotiable instru-
ments, the protected purchaser rules for securities in the direct holding system, the true con-
signment rules in secured transactions, and, in the indirect holding system for securities, the rule
imposing pro rata treatment on entitlement holders.
7. U.C.C. § 8-511(b) (2000) (secured creditor of a securities intermediary has priority over
entitlement holder when secured creditor has control of the financial asset).
8. The authorities here range from Locke and Kant to Robert Nozick, and are more fully
explored in Bjerre, supra note 4.
in the interest of fostering commerce are of a piece with the utilitarian and pragmatic philosophical traditions, which of course reject the idea of inviolable natural-law rights and, instead, evaluate rules or actions in light of their practical results.\(^\text{10}\)

In the continuing conflict between these two philosophical traditions, Schwarcz and Benjamin have focused on an area that has been a true stronghold for the utilitarian tradition, simply because the indirect holding system for securities has an even more potentially enormous practical impact than do most commercial law rules. The richly interlocking, complexly tiered and cross-wired nature of the indirect holding system presents the specter of “systemic risk,” in which problems with one intermediary can readily cause problems with other intermediaries, and so on, potentially destabilizing the entire system.\(^\text{11}\) For these reasons it is refreshing and laudable that Schwarcz and Benjamin remind us of the individualistic, classical-liberally rooted *nemo dat* approach even in this context, while remaining non-doctrinaire enough to entertain utilitarian countercurrents, such as the secured creditor priority mentioned above.

It is unclear whether Schwarcz and Benjamin would, if pressed as a philosophical matter, align themselves generally with the classical liberals or the utilitarians. On one hand, they clearly see the secured creditor priority rule as a limited departure from their starting principle of *nemo dat*.\(^\text{12}\) On the other hand, however, they imply a utilitarian bent more generally by, among other things, expressing reservations about a conflict-of-laws approach to the intermediary risk problem (such as that currently proceeding under the auspices of the Hague Conference on Private International Law\(^\text{13}\)) on the grounds that such an approach might sometimes point to a jurisdiction that does not award priority to secured creditors.\(^\text{14}\) To notice this ambivalence is not to criticize it, for as I note above and elsewhere,\(^\text{15}\) the

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\(^\text{10}\) The authorities here, too, are wide-ranging, from the Skeptics through Hume and the Chicago-school law and economics analysts. This tradition is, usually tacitly, the predominant viewpoint in commercial law scholarship today.


\(^\text{14}\) Schwarcz & Benjamin, *supra* note 1, at 329–30; see also *id.* at 320–21 (discussing the indirect holding system itself in terms of a utilitarian framework).

\(^\text{15}\) *See supra* notes 4–5 and accompanying text.
same ambivalence pervades much of the body of American commercial law.