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# Development of Rules for Determining Applicable Law for the Third-party Effects of Assignment of Claims

*Michaela Garajová\**

## Abstract

Due to the lack of legal certainty in determining the law applicable to third-party effects of the assignment of claims and, consequently, determining the law applicable to the owner of the claim after a cross-border transaction, the European Commission proposed a new regulation aimed at increasing cross-border transactions investment and market integration. The aim of the new regulation is clear and the reasons for its proposal are understandable. Nevertheless, we wonder what impact the new regulation will have on cross-border transactions if it is adopted as it is right now. Will these uniform rules reduce legal risks and bring significant added value to financial markets?

## Keywords

Assignment of Claims; Cross-border Transactions; Third-party.

## 1 Introduction

Cross-border transactions, the mobility of companies within the European Union (“EU”) and the exercise of freedom of establishment are among the most debated topics in the European Commission in the 21<sup>st</sup> century. The reason is that a well-established legal framework for cross-border operations, that are already needed, is a driving force for economic growth, the proper functioning of the EU economy and the strengthening of the single internal market. For some time, the EU has been adopting instruments to achieve the proper functioning of the single market by removing various

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\* Masaryk University, Faculty of Law, Department of International and European Law, Veveří 70, Brno, Czech Republic, Michaela.Garajova@mail.muni.cz, ORCID: 0000-0001-5908-7700

legal barriers. These barriers hinder the development of trade, contractual relations and reduce legal certainty between entities from different member states, thus slowing down business development within the EU.

The area of assignment of claims contributes to global economic growth by strengthening cross-border investment and thus facilitating access to business finance. Claims are assets of economic value that are easy to transfer and good short-term source of finance for the assignor. Given the existence of an international element in these contractual relations, legal certainty and predictability between them are being undermined. The uncertainty stems from unclear rules governing the effects of the assignment of a claim to a third-party. In this respect, the EU has proposed a separate uniform rule on conflict of laws rules in the Proposal for a regulation of the European Parliament and of the Council on the law applicable to the third-party effects of the assignments of claims on 12 March 2018 (“Draft Regulation, alternatively Proposal for the regulation on the law applicable to the third-party effects”). From that date on the EU as well as the National Legislative Councils discuss the contribution of the new proposal that should ensure predictability and legal certainty in determining the ownership of a receivable that has been transferred to a third foreign party.

The conflict of laws rules governing the proprietary aspects of the assignment of a claim are currently regulated at member state level and are therefore based on different connecting factors. The current legislation is therefore inconsistent.<sup>1</sup> Which law determines the conditions that must be fulfilled to transfer a claim from ownership of an assignor to ownership of an assignee so it would have third-party effects? This question should be answered by the proposal for new regulation of the European Commission that was introduced in March 2018 and provides a two-tiered system of connecting factors for the determination of applicable law to third-party effects.

<sup>1</sup> The inconsistency in the determination of the law applicable to the effects of the assignment of claims results from the explanatory memorandum of the European Commission on the proposal for a Regulation of the European Parliament and of the Council on the law applicable to the effects of assignment to third parties on 12 March 2018. E.g. Poland is based on the law of the assigned claim, Belgium and France are based on the law of the assignor’s habitual residence, and the conflict of laws rules of the Netherlands are based on the law of the assignment.

How does the adoption of the proposal for a regulation change the overall legal regulation of assignment? The Draft Regulation deals solely with the conflict of laws on the effects of the assignment of a claim. On the other hand, the Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations (“Rome I Regulation”) contains a conflict of laws rule for determining the law applicable to the relationship between the assignor and the assignee, which will remain in force even after the adoption of the Draft Regulation. The question, therefore, arises as to whether the legal certainty of the parties to the relationship arising from the assignment of a claim will be enhanced by introducing a uniform conflict of laws rules at Union level but thereby creating a duplicate legal regime for the assignment of a claim.

Against this background, this article is divided into 5 chapters starting with the analyzation of the legal development in the area of third-party effects of the assignment of claims that has an impact on the member states and the EU. Then the revision of the current Art. 14 of the Rome I Regulation that plays a significant role in the determination of applicable law on the assignment as a whole will be made. Continuing with the analysis of the European Commission Report on the question of the effectiveness of an assignment and Proposal for the regulation on the law applicable to the third-party effects and finally, a conclusion will be drawn.

## **2 The legal development**

The transactions in claims are considered to be the backbone of financial markets since it allows many financial transactions and is therefore important for funding business all over the globe. Even though the assignment of claims is an important mechanism used by companies and financial institutions across borders, it is still not easy for credit providers, investors or other entities involved to identify which national law applies to the determination of the ownership of the claim concerned.

Because the assignment of claims is not restricted by a particular territory, the cross-border assignments are a common practice in the area of financial operations. There are no physical but legal obstacles that must be resolved. Companies and credit institutions involved in such process require legal

certainty to finance its business activities by using claims and provide for such services. Nonetheless, the concept of the assignment of claims differs between jurisdictions of members states.<sup>2</sup>

Consequently, the different national rules regulating the third-party effects of such assignments bring the legal uncertainty about who is the owner of the claim among the parties of the assignment transaction itself as well as the market participants who are not the party to such transactions but somehow interact with the parties and therefore need to have the certainty who has the right to the claim in question.<sup>3</sup> Yet, the unification of the substantive law among all members states cannot be achieved, because of the unique approach of each state. The most appropriate solution is a common conflict of laws rules in all member states that would determine the applicable law regardless of which court has to decide.

The topic of the determination of the applicable law on third-party effects of assignment of claims has been discussed on different national forums. The United Nations Convention on the Assignment of Receivables in International Trade, adopted in 2001 (“UN Convention”), sets an objective to “*establish principles and to adopt rules relating to the assignment of receivables that would create certainty and transparency and promote the modernization of the law relating to assignments of receivables, while protecting existing assignment practices and facilitating the development of new practices.*”<sup>4</sup> However, it has not entered into force so far. One of the most important parts of the UN Convention deals with the impact of assignment on third parties. The UN Convention addresses the issue in Art. 22–24 through the conflict of laws rules: “*the law of the State in which the assignor is located governs the priority of the right of an assignee*

<sup>2</sup> See the country reports of the British Institute of International and Comparative Law. Study on the question of the effectiveness of an assignment or subrogation of a claim against third parties and the priority of the assigned or subrogated claim over a right of another person – final report [online]. *edz.bib.uni*. Published in 2018 [cit. 20. 1. 2020]. [http://edz.bib.uni-mannheim.de/daten/edz-k/gdj/12/report\\_assignment\\_en.pdf](http://edz.bib.uni-mannheim.de/daten/edz-k/gdj/12/report_assignment_en.pdf)

<sup>3</sup> See the Commission Directorate General for Justice and Consumers and Directorate General for Financial Stability, Financial Services and Capital Markets Union. Inception Impact Assessment [online]. *European Commission*. Published on 28 February 2017 [cit. 20. 1. 2020]. [https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-1073039\\_en](https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-1073039_en)

<sup>4</sup> See Preamble of UN Convention.

*in the assigned receivable over the right of a competing claimant.*<sup>5</sup> The rule specifies that the assignor's location shall determine the applicable law since the "location" means the place of central administration and therefore it will always refer to one easily determinable jurisdiction.

The same conflict of laws rule specified in the UN Convention was proposed by the European Commission in 2005 as a part of the Proposal for a Regulation of the European Parliament and of the Council on the law applicable to contractual obligation<sup>6</sup> ("Proposal for Rome I Regulation") in Art. 13 para. 3.<sup>7</sup> Unfortunately, the views of the co-legislators of the Rome I Regulation was different. They requested further studies to determine the applicable law and therefore the question of third-party effects of claims itself was not addressed in the Rome I Regulation. Despite that the Art. 27 para. 2 of the Rome I Regulation expressly required the European Commission to submit a report on the question of the effectiveness of an assignment or subrogation of a claim against third parties and the priority of the assigned or subrogated claim over a right of another person by 2010.<sup>8</sup>

### 3 What the assignment of claims means

An assignment of claim entails three parties' relationship between an original creditor, an assignor, who has a claim against a debtor and who is in need of cash, therefore, assigns the claim to a new creditor, an assignee. Moreover, the effectiveness of the assignment is relevant for creditors of the assignor, other assignees or other third parties.

As mentioned above, the assignment of claims allows both simple transactions, transfers of a single claim from assignor to the assignee, as well as complex financial transactions such as financial collateral arrangements

<sup>5</sup> Ibid., Art. 22.

<sup>6</sup> Commission of the European Communities. Proposal for a Regulation of the European Parliament and of the Council on the Law Applicable to Contractual Obligations (Rome I) [online]. *EUR-Lex*. Published on 15 December 2005 [cit. 12. 1. 2020]. [http://www.europarl.europa.eu/meetdocs/2004\\_2009/documents/com/com\\_com\(2005\)0650\\_/com\\_com\(2005\)0650\\_en.pdf](http://www.europarl.europa.eu/meetdocs/2004_2009/documents/com/com_com(2005)0650_/com_com(2005)0650_en.pdf)

<sup>7</sup> See Art. 13 para. 3 Proposal for Rome I Regulation.

<sup>8</sup> Ibid., Art. 27 para. 2.

and factoring, that are used by companies to obtain liquidity and have access to credit, and securitization as a tool used to optimize the use of capital. The whole procedure of the assignment is based on the transfer by the assignor, who is in the position of a creditor, its claim against a debtor to an assignee.<sup>9</sup> However, taking into account the cross-border element that typically occurs in international trade, the situation may get more complicated.

In the case of factoring, company A has claims in the form of invoices past due against different clients from the several member states in the amount of EUR 5 000. Company A finds a factoring company F to which company A assigns all invoices for discount price in the amount of EUR 4 700. However, company A needs to know:

1. whether under the applicable law on the aspects of the assignment are all the invoices assignable, or
2. whether the assignment will be effective against a third-party in case of company A's insolvency.

The answers on this question may however differ. Applying different national conflict of laws rules and consequently different national substantive rule **on one same assignment of bulk of claims**, may result into the following: some of the claims included in the assigned bulk of claims may be assignable without any special requirements, other national regulations may require conditions to be met, such as the duty to inform the debtors, or some, in the end, may totally prohibit the assignment of claims in question. There is a high legal uncertainty that results in a legal risk when it comes to the outcomes of disputes depending on the law applied by national courts of member states.

To avoid the legal risk, one of the main topics for discussion in the European Commission since 2005 was to secure the legal certainty through

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<sup>9</sup> European Commission. Report on the question of the effectiveness of an assignment or subrogation of a claim against third parties and the priority of the assigned or subrogated claim over the right of another person [online]. *EUR-Lex*. Published in 2016 [cit. 20.1.2020]. <https://eur-lex.europa.eu/legal-content/EN/TEXT/?uri=CELEX%3A52016DC0626> (“Report on the question of the effectiveness of an assignment”).

the adoption of harmonized rules at the EU level on the law applicable to the third-party effects of assignments of claims.

### 3.1 What are the third-party effects of the assignment?

The third-party effects are understood as aspects of the assignment that are excluded from the application of Art. 14 of the Rome I Regulation. Generally, and in the meaning of the subject of this article, the third-party effects of the assignment of claims are (i) the effectiveness of an assignment of claims against third parties and (ii) the determination of priority of claims in case of competing assignments.<sup>10</sup> Both categories are connected to the aspects regarding the passing of the right or the title to the claim on another third person. Therefore, the related question that must be answered is who the third-party concerning the assignment of claims is. As *Labonté* analyzed in his article, the third-party are (i) creditors of the assignor, (ii) competing assignees, if there are any, and (iii) creditors of the assignee.<sup>11</sup>

## 4 The Rome I Regulation and its Article 14

The Art. 14 para. 1 of the Rome I Regulation currently determines the applicable law to the contractual obligation between the parties of the assignment – assignor and assignee.<sup>12</sup> The law between the assignor and the assignee that is of a contractual claim is determined either according to the Art. 3 para. 1 of the Rome I Regulation by the parties' choice of law or according to Art. 4–8 by objective connecting factors, or if the claim is non-contractual it is determined by Regulation (EC) No 864/2007 of the European Parliament and of the Council of 11 July 2007 on the law applicable to non-contractual obligations.

Para. 2 of the Art. 14 determines the applicable law regarding “*assignability, the relationship between the assignee and the debtor, the conditions under which the assignment or subrogation can be invoked against the debtor and whether the debtor's obligations have*

<sup>10</sup> See Art. 27 para. 2 Rome I Regulation that requires the European Commission to submit a Report on the question of the effectiveness of an assignment.

<sup>11</sup> See Labonté, H. Third-Party effects of the assignment of claims: new momentum from the Commission's Capital Markets Union Action Plan and the Commission's 2018 Proposal. *Journal of Private International Law*. 2018, Vol. 14, No. 2, p. 328.

<sup>12</sup> Art. 14 Rome I Regulation.

*been discharged.*”<sup>13</sup>, that is the debtor protection rules. The law of the assigned claim governs (i) the conditions of the notification of the debtor about the assignment, (ii) obligations of the debtor after receipt of notification of the assignment, (iii) the conditions of set-off or pay-off of the claim, or (iv) the regime of other defenses of the debtor.<sup>14</sup> According to the wording, the law of the underlying assigned claim applies on above-mentioned issues that cannot be subject to the disposition of the parties because it could compromise the protection and legal certainty of the debtor.

The Rome I Regulation, therefore, covers the area of assignment of claims between the parties interested in such relationship and should not apply to any aspects outside the circle. The member states aimed to exclude the third-party effects of assignment from the scope of the Art. 14 and it was caused by a disagreement among the member states. The disagreement resulted from different approaches that were taken by the member states in this matter. Consequently, the Rome I Regulation was adopted without determination of applicable on the matter in question since its exclusion was the only way how to save the whole legal instrument.<sup>15</sup>

As a result, Art. 27 para. 2 of the Rome I Regulation specifies the obligation to submit a Report on the question of the effectiveness of an assignment or subrogation of a claim against third parties and the priority of the assigned or subrogated claim over a right of another person.

It must be noted that confusion regarding the scope of application of the Art. 14 still exists because of wrong clarification of the issue that is further analyzed in Recital 38 of the Rome I Regulation: “*In the context of voluntary assignment, the term ‘relationship’ should make it clear that Article 14 (1) also applies to the property aspects of an assignment (...).*”<sup>16</sup> Some scholars argue that

<sup>13</sup> Ibid., Art. 14 para. 2.

<sup>14</sup> Garcimartín Alférez, F.J. Assignment of claims in the Rome I Regulation: Article 14. In: Ferrari, F., Leible, S. (eds.). *Rome I Regulation: The Law Applicable to Contractual Obligations in Europe*. Munich: European Law Publishers, 2009, pp. 231–232.

<sup>15</sup> Mankowski, P. The race is on: Germ reference to the CJEU on the interpretation of Art. 14 Rome I Regulation concerning third-party effects of assignments [online]. *Conflict of laws.net*. Published in September 2018 [cit. 10. 10. 2019]. <http://conflictoflaws.net/2018/the-race-is-on-german-reference-to-the-cjeu-on-the-interpretation-of-art-14-rome-i-regulation-with-regard-to-third-party-effects-of-assignments/?print=pdf>

<sup>16</sup> See Recital 38 Rome I Regulation.



such wording suggests that the Art. 14 covers even the passing of title that has third-party effects.<sup>17</sup> However, such a conclusion is not correct and as *Labonté* mentioned in his article, the main argument against such meaning of the Art. 14 and Recital 38 is, that this Recital had been included in the Rome I Regulation already in Proposal of the Rome I Regulation that counted with an explicit provision for the determination of the applicable law for the third-party effects of the assignment before it was rejected by the member states. This implies that Art. 14 of the Rome I Regulation applies solely to the relationships between the assignor and assignee and the debtor. The Recital 38 cannot be invoked against this conclusion.

## 5 The first steps taken by the European Commission

The European Commission delivered its Report on the question of the effectiveness of an assignment or subrogation of a claim against third parties and the priority of the assigned or subrogated claim over the right of another person<sup>18</sup> (“Report on the question of the effectiveness of an assignment”) 6 years later than expected. The Report included a deeper examination of the current problems and the proposal of possible solutions.

First problems that occur concerning the determination of the applicable law to the third-party aspects of the assignment are (1) **the current divergence of substantive rules** in the member states of the EU as well as (2) **different conflict of laws rules that were adopted by the member states** on this matter. The conflict of laws rules of each member states are inconsistent because they are based on different connecting factors that determine the applicable law.<sup>19</sup>

The European Commission examined the laws of member states and brought to a light different conflict rules from each member state. E.g. in the Netherlands the law of the contract between assignor and assignee governs all aspects of the assignment. On the other the hand, in Belgium the law

<sup>17</sup> Labonté, H. Third-Party effects of the assignment of claims: new momentum from the Commission’s Capital Markets Union Action Plan and the Commission’s 2018 Proposal. *Journal of Private International Law*. 2018, Vol. 14, No. 2, pp. 329–330.

<sup>18</sup> Rome I Regulation.

<sup>19</sup> See Report on the question of the effectiveness of an assignment, p. 4.

of the assignor's habitual residence shall apply. Different approach was taken by Sweden where the *lex rei sitae* shall apply.<sup>20</sup>

The divergence in the conflict rules is more than obvious and it causes the second current problem, **the legal uncertainty that results from complexity**. Firstly, the relationship between assignor, assignee and the debtor and different understanding of the concept of the assignment among jurisdictions is already a complex and only on the substantive national law level. Such complexity transferred on the conflict of laws level results in even more confusion and adds to the growth of uncertainty. Moreover, the legal uncertainty is supported by overlapping rules of regulations adopted in the EU that may be applied at the same time. Such conflict may, for example, occur in case of an insolvency of an assignor. Firstly, Art. 14 of the Rome I Regulation clarifies the applicable law between the assignor and the assignee, however, in the event of insolvency of the assignor, the Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings ("Insolvency Regulation Recast") may cause a bigger uncertainty. In such case, the law of the state where the insolvency proceedings are commenced against the assignor determines even aspects related to the assignment of claims to third-party.<sup>21</sup>

Taking into account the current problems examined in the Report on the question of the effectiveness of an assignment, the European Commission came forward with three possible approaches: (i) the law applicable to the assigned claim, (ii) the law of the contract between assignor and assignee, or (iii) the law of the assignor habitual residence. However, considering the existing conflict of laws rules in Art. 14 of the Rome I Regulation, some of the options that were proposed by the European Commission in the Report on the question of the effectiveness of an assignment will not help to lower the complexity but on the contrary.

Let's imagine that assignor A, with his habitual residence in Slovakia, assigns a claim against the debtor B to the assignee C. The law governing the claim itself is the Czech Law and the law governing the assignment between A and C is the Austrian Law. Currently, the assignee must deal with

<sup>20</sup> Ibid., pp. 6–7.

<sup>21</sup> Ibid., p. 8.

2 laws – the Austrian Law and the Czech Law. The law applicable to the third-party effects would be:

1. in case of the first approach, the Czech Law;
2. in case of the second approach, the Austrian Law; or
3. in case of the third approach, the Slovakian Law.

## 5.1 The law applicable to the assigned claim

The law of the assigned claim is already applicable according to the Art. 14 para. 1 of the Rome I Regulation to the debtor protection rules. What if the law of the assigned claim would apply even on the third-party effects? The assignor and the assignee must consider the law of the assigned claim if they choose to transfer such claim for example in question of assignability of the claim. The claim may become non-assignable because of the protection rules of the debtor that come into the game.<sup>22</sup> There are more prerequisites for transfer of claim that are regulated by the law of the assigned claim and should, therefore, regulate also third-party effects of the assignment.<sup>23</sup> Another issue that supports this approach is the debtor position in case of a set-off. The original creditor, the assignor, rightfully assigned the claim to an assignee who chose as the applicable law to the assignment German law. However, the debtor wants to determine whether it can still exercise the set-off against the assignor. In such case, he will have to refer to the law other than the one under which his obligation arose to determine whether it is still possible to set off its debt with the original creditor, the assignor.<sup>24</sup> To avoid the complexity of applicable laws that apply to the whole process of the assignment, the law of the assigned claim should apply even to third-party effects.

The European Commission in its Report on the question of the effectiveness of an assignment suggests that the law applicable between the assignor and the debtor against whom the assignor has its debt would also apply

<sup>22</sup> Such case can occur for example when a debtor assigned his salary to pay off his debt but then he becomes penniless. Some of the national laws forbid the assignment of salary as a protection for the employee.

<sup>23</sup> Labonté, H. Third-Party effects of the assignment of claims: new momentum from the Commission's Capital Markets Union Action Plan and the Commission's 2018 Proposal. *Journal of Private International Law*. 2018, Vol. 14, No. 2, p. 335.

<sup>24</sup> *Ibid.*, p. 336.

on the aspects of the assignment in respect of the third-party. In case the law applicable to the assigned claim could not be determined, the “supportive” rule pointing to the law of the state of the assignor’s habitual residence would have to apply.<sup>25</sup> The law of the assignor’s habitual residence will be further analyzed in chapter 5.3.

## 5.2 The law of the contract between assignor and assignee

The law of the contract between the assignor and the assignee which is the law of the assignment may represent a better option in case of bulk assignments of claims. The assignor may decide to transfer more than one claim to a single assignee. However, not all the transferred claims could be created under the same law. If we would apply the approach specified in previous chapter 5.1 on third-party effects, it would lead to a mess that would not strengthen the legal certainty.

On the other hand, applying the law of the assignment, which means the law that was chosen by the assignor and the assignee or otherwise determined, would lead to a single applicable law regulating the transfer of claims on third parties. But we still cannot forget to the possibility of applying the law of the assigned claim under the Art. 14 para. 2 of the Rome I Regulation in case of protection of the debtor even in case of the assignment.<sup>26</sup>

Quite good deterrent example of this approach was further analyzed in the BIICL report.<sup>27</sup> There may arise a situation when the assignor assigns the claim to more than one assignee in quite short time lapse. If the law of the assignment would also apply to third-party effects than the priority problem occurs because both of the assignees legally and in a good faith obtained the claim and are entitled to it. And since the law of assignment would apply

<sup>25</sup> See Report on the question of the effectiveness of an assignment, p. 11.

<sup>26</sup> Labonté, H. Third-Party effects of the assignment of claims: new momentum from the Commission’s Capital Markets Union Action Plan and the Commission’s 2018 Proposal. *Journal of Private International Law*. 2018, Vol. 14, No. 2, p. 337.

<sup>27</sup> See the country reports of the British Institute of International and Comparative Law. Study on the question of the effectiveness of an assignment or subrogation of a claim against third parties and the priority of the assigned or subrogated claim over a right of another person – final report [online]. *edz.bib.uni*. Published in 2018, p. 401 [cit. 20. 1. 2020]. [http://edz.bib.uni-mannheim.de/daten/edz-k/gdj/12/report\\_assignment\\_en.pdf](http://edz.bib.uni-mannheim.de/daten/edz-k/gdj/12/report_assignment_en.pdf)

also to third-party effects, which in this case means laws of two states, the meta conflict of laws would be necessary to decide which of the transfers has the priority.<sup>28</sup>

### 5.3 The law of the assignor’s habitual residence

The third option that was considered in the Report on the question of the effectiveness of an assignment as the law applicable to third-party effects was the law of the assignor’s habitual residence. Considering that the assignment of claim is a package of legal acts and transactions by adding a third connecting factor to determine the law applicable to some aspects of the whole process does not simplify the assignment. However, this approach has some advantages. Besides the ones mentioned in chapter 5.2 regarding the law of the assignment, there are more.

It is based on an objective connecting factor that provides the creditors and other third parties with certainty since it would regulate the information obligations of the assignor and would function as “information center” for the creditors.<sup>29</sup>

Another argument in favor of this solution is its harmonization with the Insolvency Regulation Recast. According to the Report on the question of the effectiveness of an assignment, such a solution would solve the above-mentioned problems occurring concerning insolvency proceedings. The law of the assignor’s habitual residence is easier to determine and it is most likely to be the place in which the main insolvency proceedings concerning the assignor will be commenced.<sup>30</sup> This may be the most supportive argument to apply this approach because the main concern of an assignee is the recognition of his rights over the claim in the event of insolvency of the assignor.<sup>31</sup>

<sup>28</sup> Labonté, H. Third-Party effects of the assignment of claims: new momentum from the Commission’s Capital Markets Union Action Plan and the Commission’s 2018 Proposal. *Journal of Private International Law*. 2018, Vol. 14, No. 2, p. 338.

<sup>29</sup> Garcimartín Alférez, F. J. Assignment of claims in the Rome I Regulation: Article 14. In: Ferrari, F., Leible, S. (eds.). *Rome I Regulation: The Law Applicable to Contractual Obligations in Europe*. Munich: European Law Publishers, 2009, p. 239.

<sup>30</sup> See Report on the question of the effectiveness of an assignment, p. 11.

<sup>31</sup> Garcimartín Alférez, F. J. Assignment of claims in the Rome I Regulation: Article 14. In: Ferrari, F., Leible, S. (eds.). *Rome I Regulation: The Law Applicable to Contractual Obligations in Europe*. Munich: European Law Publishers, 2009, p. 240.

Furthermore, the third parties that will be affected by the transaction, the creditors of either the assignor or the assignee, usually do not have an option to determine the applicable law to the claim or the assignment. This option should act as protection for third parties when analyzing whether the transfer of claims was effective against them.<sup>32</sup>

Even though there are supportive arguments for such an approach, its applicability would bring complications into some business transactions, since there would be three different laws that would have to be considered by the assignee.

## **6 The proposal for the regulation on the law applicable to the third-party effects of the European Commission**

The expected result of the Report on the question of the effectiveness of an assignment, delivered by the Commission was a single general rule that would apply to all aspects of an assignment in all sectors and for all types of assignments without any exception. Did the European Commission fulfil its obligation and brought a light into the determination of the applicable law of the third-party effects of assignment of claims?

Removing barriers to cross-border transactions in claims and investment is the main objective set by the EU to be achieved by the new Proposal for the regulation on the law applicable to the third-party effects of assignments of claims (“Proposal for the regulation on the law applicable to the third-party effects”).<sup>33</sup> Nevertheless, there are still doubts whether the Proposal actually eliminates the legal uncertainty or just adds more of it.<sup>34</sup>

<sup>32</sup> Labonté, H. Third-Party effects of the assignment of claims: new momentum from the Commission’s Capital Markets Union Action Plan and the Commission’s 2018 Proposal. *Journal of Private International Law*. 2018, Vol. 14, No. 2, pp. 339–340.

<sup>33</sup> See European Commission. Proposal for a Regulation of the European Parliament and of the Council on the law applicable to the third-party effects of assignments of claims [online]. *EUR-Lex*. Published in March 2018, p. 1 [cit. 20. 1. 2020]. <https://eur-lex.europa.eu/legal-content/EN/TEXT/HTML/?uri=CELEX:52018PC0096&from=EN>

<sup>34</sup> Labonté, H. Third-Party effects of the assignment of claims: new momentum from the Commission’s Capital Markets Union Action Plan and the Commission’s 2018 Proposal. *Journal of Private International Law*. 2018, Vol. 14, No. 2, p. 323.

As mentioned in chapter 1, the different set of national conflict rules that regulates the issue in question causes the legal uncertainty about who has the legal title to the assigned claim, what happens if third parties claim legal title over the same claim, or which member state's authority is entitled to resolve dispute related to such transaction. Consequently, this lack of certainty creates a legal risk in cross-border assignments of claims resulting in loss of legal title, higher transaction costs or complete waive of the business opportunity.<sup>35</sup>

## **6.1 The structure of the Proposal for the regulation on the law applicable to the third-party effects**

The Proposal for the regulation on the law applicable to the third-party effects is parallel to the Rome I Regulation regarding the basic provision on the scope of the regulation that is taking into account all existing regulations of the EU including the Rome I Regulation. The Proposal for the regulation on the law applicable to the third-party effects consists of the provision on universal application resulting in the possible application of a law of a third state, overriding mandatory provisions and public policy of the forum e.g. in case of mandatory obligation to register the assignment of claim in public register, the exclusion of *renvoi* and finally the relationship with other provisions of the EU and existing international conventions. The Proposal for the regulation on the law applicable to the third-party effects includes special new provisions regarding the applicable law and its scope.

## **6.2 The applicable law on third-party effects of the assignment of claims**

The Proposal for the regulation on the law applicable to the third-party effects came with uniform conflict of laws rules in respect of the third-party effects of the assignment of claims defined in Art. 4. According to its Recital 15, the conflict of laws rules shall govern proprietary effects of assignments of claims between all parties involved as well as in respect of third parties.<sup>36</sup> The scope of the Art. 4 of the Proposal for the regulation

<sup>35</sup> See Proposal for the regulation on the law applicable to the third-party effects, pp. 4–5.

<sup>36</sup> See Recital 15 Proposal for the regulation on the law applicable to the third-party effects.

on the law applicable to the third-party effects includes the proprietary rights not only of the third parties e.g. creditors. This provision shall apply also between the assignor and the assignee and the assignee and the debtor. However, some scholars<sup>37</sup> consider the wording of recital 15 in connection with Art. 4 of the Proposal for the regulation on the law applicable to the third-party effects inconsistent with current legal rules provided by the Art. 14 of the Rome I Regulation. According to their opinion, Art. 14 of the Rome I Regulation implicitly covers even the proprietary rights between assignor the assignee as this conclusion results from the Recital 38 of the Rome I Regulation. Reasons, why such an opinion must be rejected, are further analyzed in chapter 4.

The Proposal for the regulation on the law applicable to the third-party effects laid down a general rule for the determination of the applicable law based on the assignor's habitual residence. In the meaning of the Proposal for the regulation on the law applicable to the third-party effects, the "*habitual residence*" "*means, for companies and other bodies, corporate or unincorporated, the place of central administration; for a natural person acting in the course of his business activity, his principal place of business.*"<sup>38</sup> The definition is partially transposed from the Rome I Regulation, specifically its Art. 19.<sup>39</sup> The European Commission decided to exclude from the scope of the definition of the "habitual residence" the branches, because of a possible uncertainty if the same claim would be assigned by the branch as well as by the central administration.<sup>40</sup>

However, there is a problem linked to the habitual residence of assignor that the Proposal for the regulation on the law applicable to the third-party effects envisaged – the potential change of assignor's central administration between individual assignments of a single claim. The rule on the conflict mobile establishes as the applicable law the law of the assignor's habitual residence that was applicable at the time when one of the assignments became effective against third parties.<sup>41</sup>

<sup>37</sup> See for example Kronke, H. Assignment of Claims and Proprietary Effects: Overview of Doctrinal Debate and the EU Commission's Proposal. *Oslo Law Review*. 2019, Vol. 6, No. 1, p. 12.

<sup>38</sup> Art. 2 letter f) Proposal for the regulation on the law applicable to the third-party effects.

<sup>39</sup> Art. 19 Rome I Regulation.

<sup>40</sup> See Proposal for the regulation on the law applicable to the third-party effects, p. 18.

<sup>41</sup> Art. 4 Rome I Regulation.



For fulfilment of needs of the market participants, there are two exceptions from the general rule specified in the Art. 4 para. 2 that provides the applicability of the law of the assigned claims between the assignor, the original creditor, and the debtor.

Firstly, the law of the assigned claim is applicable in case of the assignment of cash by the creditor credited to an account in the credit institution such as a bank.<sup>42</sup> The first contract that assigns claim is concluded between the assignor and the debtor, the bank. Such regulation strengthens the legal certainty since in many cases, the applicable law of the assigned claim will be the law of the state where the bank is located. If there are further assignments of the same claim, the applicable law on the third-party effects of such assignment will be determined according to the law of the contract between the assignor, and the first debtor, the bank.

The second exception is the assignment of claims arising from financial instruments.<sup>43</sup> The Proposal for the regulation on the law applicable to the third-party effects uses the derivative contract that is used mostly by investors as risk protection, as an example of the financial instruments in question. Again, the legal certainty is quite high in this case, because the law applicable to the assignment of claim is either chosen by the parties or determined in accordance with non-discretionary rules applicable to the relevant financial market.<sup>44</sup>

Moreover, the Proposal for the regulation on the law applicable to the third-party effects allows an alternative for the parties given the applicable law on the third-party effects of the assignment of the claim in respect of the securitization. The parties, meaning the assignor and the assignee, may choose for the third-party effects the law applicable to the assigned claim or remain subject to the general rule, the law of the assignor's habitual residence.<sup>45</sup> The Proposal for the regulation on the law applicable to the third-party effects itself provides with an explanation of why the alternative in respect of securitization and no other financial transactions exist. The current practice of some credit institutions is the application of the law

<sup>42</sup> Ibid., Art. 4 para. 2 letter a).

<sup>43</sup> Ibid., Art. 4 para. 2 letter b).

<sup>44</sup> See Proposal for the regulation on the law applicable to the third-party effects, p. 19.

<sup>45</sup> Art. 4 para. 3 Rome I Regulation.

of the assigned claim because then all claims in question are regardless of their assignors' habitual residence subjected to the same law.<sup>46</sup>

It is common that one single claim was assigned more than once and that the parties of each assignment chose a different applicable law to the third-party effects. In case of such conflict of different legal systems, the Proposal for the regulation on the law applicable to the third-party effects determines the clear rule. Based on an objective factor that is the time aspect of the efficiency of the claim against a third-party.<sup>47</sup> This rule copies the rule used for the conflict mobile. And as well as in case of conflict mobile, the rule is responding to the purpose of the Proposal that concerns the third-party effects.

### 6.3 What it means in practice

The regime for the applicable law to third-party effects of the assignment of claims chosen by the European Commission reflects the previous negotiations between the member states that were linked to the preparation of the Rome I Regulation. In that time there were two approaches supported by the member states: the application of (i) the law of the habitual residence of the assignor and (ii) the law of the assigned claim. Since both approaches had some drawbacks, a combination of both of them was examined as well. The member states came to the following: the general rule would be the law of the assignor's habitual residence and exceptions for certain types of claims would be introduced.<sup>48</sup> However, the main problem in that time was to draft the exceptions that led to the rejection of including these rules into the Rome I Regulation.

The law of the habitual residence of the assignor as governing law of the third-party effects is considered by many well-known scholars<sup>49</sup>

<sup>46</sup> See Proposal for the regulation on the law applicable to the third-party effects, p. 20.

<sup>47</sup> Art. 4 para. 4 Rome I Regulation.

<sup>48</sup> Garcimartín Alférez, F.J. Assignment of claims in the Rome I Regulation: Article 14. In: Ferrari, F., Leible, S. (eds.). *Rome I Regulation: The Law Applicable to Contractual Obligations in Europe*. Munich: European Law Publishers, 2009, p. 246.

<sup>49</sup> See Walsh, C. Receivables Financing and the Conflict of Laws: The UNCITRAL Draft Convention on the Assignment of Receivables in International Trade. *Dickinson Law Review*. 2001, Vol. 106, p. 174. Or Goode, R. The Assignment of Pure Intangibles in the Conflict of Laws. In: Gullifer, L., Vogenauer, S. (eds.). *English and European Perspectives on Contract and Commercial Law. Essays in Honour of Hugh Beale*. Oxford: Hart Publishing Ltd, 2014, pp. 353, 375.

to be the best and logical option. It is said that this approach is a practical solution for many forms of assignment, especially in case of assignment of future or bulk claims, the most predictable and easily ascertained by any third-party and also consistent with the Insolvency Regulation Recast and the UN Convention.<sup>50</sup>

Taking into account that there are 2 main industries covered by the Proposal for the regulation on the law applicable to the third-party effects – factoring and securitization, the European Commission had to even, in this case, introduce exceptions.

In case of factoring when a company assigns a bulk of claims, usually future receivables, to an assignee it is the most convenient to apply the general rule – the law of the assignor’s habitual residence. The bulk of receivables consists of more than one future claim that may be governed by different laws. If we would apply the law of the assigned claim on the third-party effects that would mean that for each claim the assignee would have to consider different national rules.

On the other hand, the Proposal for the regulation on the law applicable to the third-party effects offers the assignor and the assignee flexibility in relation to a securitization. When an assignor, such as a bank, does not want to be exposed to the risk that the loans it has provided will not be repaid, it assigns the claims to the assignee, that is called the “special purpose vehicle”, that then issues the securities and sells it to investors. In the case of large securitization transactions, the assignors are located in different states. This means that the assignee (the special purpose vehicle) will need to comply with the requirements laid down in the law that governs the assigned claims (that is, the contract between the assignor and the debtor) to ensure that it acquires legal title over the assigned claims. The law of the assigned claim corresponds to the current market practice involving large banks by applying the law of the assigned claim to the third-party effects where the assigned claims are all subject to the same law but the assignors are located in various states.

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<sup>50</sup> Kronke, H. Assignment of Claims and Proprietary Effects: Overview of Doctrinal Debate and the EU Commission’s Proposal. *Oslo Law Review*. 2019, Vol. 6, No. 1, p. 15.

## 7 Conclusion

The very existence of general rules governing the law applicable to the effects of the assignment of claims to third parties entails a certain shift in certainty in the context of financial operations in the EU. Thus, the parties affected by these transactions can predict the rules that will regulate the proprietary aspects of the transfer of claims to third parties.

The fact that the European Commission has taken into account the overall development of the rules in this area in the Proposal for the regulation on the law applicable to the third-party effects and, at the same time, the previous positions of the member states which were manifested in the Proposal for Rome I Regulation is positive. Furthermore, the European Commission has taken into account the practice that is typical for the different types of financial transactions covered by the Proposal for the regulation on the law applicable to the third-party effects, which promotes continuity and does not imply any interference with the operation to date.

In addition, the Proposal for the regulation on the law applicable to the third-party effects clarifies the scope of Art. 14 para. 1 of the Rome I Regulation in relation to Recital 38 regarding the proprietary aspects of the assignment of claims to third parties. In that regard, it must be said that the Rome I Regulation and the Proposal are complementary since the Rome I Regulation applies exclusively to the relationship between the assignor, the assignee and the debtor. On the other hand, the conflict of laws rules in the Draft Regulation will regulate exclusively the effects of the assignment of claims on third parties. The adoption of the general rule of applicable law, which is the law of the assignor's habitual residence, reflects current Union law, thus avoiding any conflict at this level. The Proposal for the regulation on the law applicable to the third-party effects thus complements and concludes the legal framework for the regulation of issues relating to the assignment of claims, reinforces the legal certainty of actors in this area and thus fulfils the objectives set by the European Commission in its Report on the question of the effectiveness of an assignment.

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