European Commission proposal for a regulation on the law applicable to assignment to third parties – how will this impact your business?

Overview

On 12 March 2018, the European Commission (**EC**) published a proposal for a new Regulation on the law applicable to the third-party effects of assignments of claims (the **Regulation**), which involves issues of uttermost importance for businesses and banks engaged in cross-border financing in order to reduce existing legal uncertainty through the adoption of EU-wide, uniform conflict-of-laws rules. The proposal, setting out a high-level framework especially for those working in the fields of factoring, collateralization and securitization, is linked to the 2015 Action Plan on Capital Markets Union (**CMU**) and the EC's Mid-term Review of June 2017. The CMU is set to be enacted with the objective of removing barriers to cross-border investments and lowering costs of funding; the EC is committed to put in place all the building blocks by mid-2019. Completing the CMU is an urgent priority.

The Regulation, as part of the CMU and the Mid-Term Review, seeks to deal with one of the glaring omissions in the existing EU conflict-of-law rules relating to the contractual assignments found in the Rome I Regulation (593/2008). Currently, national securities laws are not harmonized at EU-level, this is why conflict-of-laws rules determine which national law applies in cross-border transactions. While the contractual element (i.e. the contractual relationship between the assignor and the assignee as well as the effects of the assignment on the relationship between the assignee and the debtor) of securities transactions is already regulated at EU level by the Rome I Regulation, the proprietary element which refers to the transfer of rights in property and affects third parties, is yet to be standardized. The Regulation therefore intends to fill the gap left by the Rome I Regulation by creating a parallel regulation on third-party effects of assignment of claims.

Certainly, the Regulation identifies differences in the national treatment of third-party effects of assignment of claims as one of the obstacles that stand in the way of cross-border investment in the Single Market and furthermore, envisages a targeted action in this area by rendering cross-border transactions less risky and boosting cross-border investment.

Scope of the new Regulation

With the increasing interconnectivity of national markets, a company can often assign a claim to an entity in another EU country which can lead to a conflict of applicable laws. For cross-border situations, a number of Member States do not have clear rules on third-party effects of assignment of claims. The current uncertainty as to the applicable law creates a higher legal risk in cross-border transactions compared to domestic transactions. The EC's solution is a general rule that in conflict situations the law of the assignor's habitual residence applies. The law of the assignor's habitual residence is easy to determine and most likely to be the place in which the main insolvency proceedings with respect to the assignor will be opened. The proposal is particularly suitable for bulk assignments (i.e. parties should enable to assign a portfolio of claims without being faced with many different laws) and assignments of receivables under future contracts (as a crucial source of finance for SMEs). However, special rules are needed to cater for sectors which may not be well served by the rules of the law of the assignor. This is why the two types of specific claims are exempted from the general rule: (a) cash on the account of a credit institution and (b) claims derived from financial instruments. In addition, for securitization transactions, the EC proposes a choice between the law of the assignor and the law of the assigned claim. Key parties benefitting from legal certainty are borrowers, financial institutions and financial intermediaries which transact in securities and claims as well as end investors.

Background

Substantively, there exists no harmonization in the fields of the assignment of a claim at EU level. The third party effects relate to who has ownership rights over a claim, especially in relation to: (i) which requirements must be fulfilled by the assignee to ensure that he acquires legal title over the claim as a consequence of the assignment; and (ii) how to resolve priority conflicts between the assignee and third parties.

These issues must be resolved by national conflict-of-law rules on third-party effects of assignment of claims at a Member State level. The Member States have conflict rules that diverge substantially: for example the law governing the assigned/pledged claim, the law governing the assignment/pledge contract or the law of the habitual residence of the assignor/pledger. Given the inconsistency in these rules, uncertainty as to which law applies leads to the need of formal requirements to recognize third-party effectiveness.

Currently, article 14 of the Rome I Regulation (entitled 'voluntary assignment and contractual subrogation') contains uniform conflict-of-laws rules determining the law applicable to the contractual relationships relating to a contract of assignment. However, the proprietary element or third-party effects of such an assignment of claims is not covered by the Rome I Regulation. Those elements include questions as to who has ownership rights over a claim and in particular to (i) what requirements must be fulfilled by the assignee in order to ensure legal title over the claim after an assignment (e.g. by providing written notice to the debtor or registration in a public register), and (ii) how priority between several competing claimants can be resolved, including those which arise in circumstances where there have been several assignments of the same claim or the question of priority over the rights of the assignor's creditors arises, as well as the rights of the assignee over the rights of the beneficiaries of a transfer of a contract in respect of the same claim, or the novation of contract against the debtor in respect of an equivalent claim.

An attempt concerning these issues during the negotiations for the Rome I Regulation to create an appropriate framework failed. Consequently, the new Regulation aims to cure this omission instead of simply being amended to Rome I.

Final thoughts

An – admittedly ambiguous – harmonization of conflict-of-laws rules at EU-level on the law applicable is very desirable to increase legal certainty. By introducing legal certainty in this area, the new rules will indeed promote cross-border investment, enhance access to credit and contribute to market integration. It will, in particular, enhance the quality of cross-border securitisation transactions by reducing their legal complexity.

Although the Rome I Regulation did not manage to address this issue, it still required the EC to prepare a report on the matter with a view to completing the gap. The new Regulation complements the existing rules in the Rome I Regulation.

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