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From:	Commission Services
To:	Delegations
Subject:	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 - Non-paper from the Commission Services

Delegations will find attached for their information the Commission Services non-paper which was sent on 19 December 2023 to the EP and to the Council.

ANNEX

19 December 2023

Proposal for a Regulation
on the law applicable to the third-party effects of assignments of claims

Non-paper
from the Commission services

LEGAL NOTICE
The objective of this non-paper is to inform the trilogue discussions. It has been prepared by the Commission services and does not necessarily reflect the position of the European Commission.

This non-paper briefly recaps the state of play in the file and explains some of the possible effects of the measures proposed by the European Parliament to the Council on 25 September 2023.

I. Scene setter

- The Commission proposal designates the national law that should apply to determine who has acquired title over a claim assigned on a cross-border basis: the 'law of the assignor's habitual residence' would apply as a rule to the third-party effects of assignments of claims and the 'law of the assigned claim' would apply as an exception to the third-party effects of assignments of cash, to the assignment of claims arising from financial instruments and to the assignment of claims in the context of securitisation if that law is chosen by the assignor and the assignee.

- Each of these applicable laws has its own advantages and disadvantages:

  - the assignor's law is in principle more transparent and can thus provide a greater degree of predictability to third parties. However, it changes with each successive assignment and requires the assignee to comply with two laws: the assignor's law to acquire title over the assigned claim and the assigned claim law for its relationship with the debtor;

  - the assigned claim law is generally less transparent and thus generally provides a lesser degree of predictability to third parties. However, it remains the same throughout successive assignments and makes it possible for the assignee to comply with only one law as regards both the acquisition of title over the assigned claim and its relationship with the debtor. For these reasons, the assigned claim law is the law typically applied by market participants to the third-party effects of assignments of claims in financial markets.

- The European Parliament adopted its first reading position in February 2019.

  The Council adopted a General Approach text in June 2021.

  Trilogues were launched in December 2021 but no progress has been achieved to date as the Council and the Parliament did not agree in technical discussions on the interpretation of the concept of 'the law of the assigned claim':

  - according to the Council's text, the law of the assigned claim means, in accordance with the Rome I Regulation, either (i) the law chosen by the parties to the original contract where the parties have made that choice (Article 3 of the Rome I Regulation), or (ii) in the absence of a choice of law by the parties, the law designated by the Rome I Regulation;

  - according to the Parliament, the law of the assigned claim should be taken to mean only the law designated by the Rome I Regulation in the absence of a choice of law even where such a choice has been made by the parties to the original contract.

  The last trilateral technical meeting was held in March 2022.

- On 25 September 2023, the Chair of the European Parliament's Committee on Legal Affairs (JURI) sent a letter to the Spanish Minister of Justice putting forward proposals on the application of the law of the assigned claim and the protection of third parties.

II. The Parliament's proposals

The Parliament's proposals consist of three measures, one main measure and two additional measures.

1. <u>First measure</u>

- The Parliament maintains the principle that, where the draft legislative text provides for the application of the law of the assigned claim, this law should be the law designated by the Rome I Regulation or the Rome II Regulation without taking into account the law chosen by the parties to the original contract. However, the Parliament proposes a limited exception to this principle.

  Specifically, the Parliament proposes that, where the parties to the original contract have chosen the law applicable to it, that law can apply as the assigned claim law to the third-party effects of the assignment of claims in the exceptions from the assignor's law provided for in Article 4(2) of the Council's text (cash, assignments in financial markets, credit claims) and Article 4(3) (if the assigned claim law is chosen by the parties to the assignment in the context of securitisation) if the law chosen by the parties to the original contract is (that is, coincides with) one of the following laws:

  (a) the law of the habitual residence of the assignor at the time of the conclusion of the assignment contract;

(b) the law of the habitual residence of the debtor at the time of the conclusion of the original contract (or, where the debtor is substituted, the habitual residence of the debtor at the time the substitution is accepted by the creditor); or

(c) the law of the habitual residence of the assignee at the time of the conclusion of the assignment contract.

Otherwise, the law chosen by the parties to the original contract would not apply and, instead, the law designated by the Rome I Regulation in the absence of a choice of law or the law designated by the Rome II Regulation would apply.

- The above proposal would have important consequences.

i) Hypothetical laws

Where the parties to the original contract choose the law applicable to it, they typically do so at the time of the conclusion of the contract. At that time, the parties do not know whether any claim arising from the contract will be assigned. Therefore, while the parties to the original contract could choose a law based on the habitual residence of the creditor, a law based on the habitual residence of the debtor or any other law convenient to them, they could not choose a law based on the habitual residence of the assignor or a law based on the habitual residence of the assignee as, at that time, the parties do not know whether the creditor will become an assignor or who an eventual assignee might be.

Given that, at the time of the conclusion of the original contract, the laws of the habitual residence of the assignor and of the assignee are hypothetical, the coincidence of the law chosen by the parties to the original contract with either of these two laws is unlikely. This would significantly reduce the chances that the law chosen by the parties to the original contract can apply as the assigned claim law to the third-party effects of the assignment of claims, as the only guarantee that this will happen is that the parties choose the law of the habitual residence of the debtor.

ii) Reduced transparency and predictability and imposition of additional hurdles on third parties

As indicated, the assigned claim law is in principle less transparent and cannot thus be easily predicted by third parties.

The Parliament considers that applying to the third-party effects of the assignment of claims a law chosen by the parties to the original contract only where that law coincides with one of the three accepted laws would strengthen the transparency for third parties for assignments subject to the assigned claim law.

Yet, the Parliament's proposal would not result in increased transparency or predictability for the following reasons.

If it is accepted that the law applicable to the third-party effects of the assignment of claims can be the law chosen by the parties to the original contract, which specific law applies to the third-party effects of the assignment of the claims - whether the law of the habitual residence of the debtor, of the assignor or of the assignee or any other law, does not have any impact on transparency.

This is because any law chosen by the parties to the original contract, even if that law coincides with one of the three laws accepted by the Parliament, or a choice by the parties to the assignment of the assigned claim law in the context of securitisation, would continue to be stipulated in the original contract or in a separate document on choice of law, neither of which would be immediately available to third parties[1].

In fact, the Parliament's proposal would reduce predictability by imposing additional hurdles on third parties.

This is because, in order for third parties to know the law applicable to the third-party effects of the assignment of claims, third parties would need to take the following steps:

- first, in addition to ascertaining the law chosen by the parties to the original contract, third parties would need to check whether that law coincides with one of the three laws accepted by the Parliament. This would require third parties to find the habitual residence of the debtor, and/or the habitual residence of the assignor and/or the habitual residence of the assignee, which can be a complicated fact-finding and legal qualification task;

- second, if the law chosen by the parties to the original contract does not coincide with any of the three laws accepted by the Parliament, third parties would need to ascertain which law the Rome I Regulation would designate as the law applicable to the original contract in the absence of a choice of law. This would require a qualification of the contract (as, for example, sale of goods, provision of services, franchise, distribution), which may in turn require specific legal advice.

The additional steps, fact-finding tasks and legal qualifications required under the Parliament's proposal even where the parties to the original contract have chosen the applicable law would reduce transparency, predictability and, thereby, legal certainty as to the law applicable to the third-party effects of the assignment of claims.

[1] It should be noted that the Securitisation Regulation provides for a comprehensive transparency framework for the EU securitisation market. Its provisions ensure that there is full disclosure and no uncertainty as regards which law applies to the assignment of the claims (Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012, OJ L 347, 28.12.2017, p. 35).

The complexity of the various steps required under the Parliament's proposal would also significantly increase the legal costs incurred by the parties for cross-border assignments of claims, although the decrease of the parties' legal costs for such assignments is one of the objectives of the Commission proposal.

iii) Interference with the smooth functioning of financial markets

In cross-border contracts the parties typically choose the law applicable to their contract. As provided for by Article 14(2) of the Rome I Regulation, the law applicable to the original contract (whether or not chosen by the parties to the original contract) will govern the relationship between the assignee and the debtor.

As indicated earlier, an advantage of applying the law of the assigned claim to the third-party effects of the assignment of claims is that it makes it possible for the assignee to comply with only one law as regards both the acquisition of title over the assigned claim (that is, the third-party effects of the assignment) and its relationship with the debtor (that is, the contractual obligations as regards the debtor under the original contract). This advantage has led market participants to apply the assigned claim law to the third-party effects of assignments of claims in financial markets.

Under the Parliament's proposal, the law chosen by the parties to the original contract would only apply to the third-party effects of the assignment as the assigned claim law if the chosen law coincides with either the law of the habitual residence of the assignor, of the debtor or of the assignee. The drawback is that the law chosen by the parties to the original contract may often not coincide with any of the three accepted laws because the habitual residence of the debtor, of the assignor or of the assignee may be located in countries whose law is not considered appropriate or customary for the transaction in question. As a result, the law chosen by the parties to the original contract would not apply as the assigned claim law to the third-party effects of the assignment and, instead, the law designated by the Rome I Regulation in the absence of a choice of law would apply.

The application of the law designated by the Rome I Regulation even where the parties chose the law applicable to their contract means that, in many cases:

- the additional steps, fact-finding tasks, legal qualifications and connected costs explained in point (ii) above would be required and, furthermore,

- the assignee would need to comply with two different laws: (i) the law chosen by the parties to the original contract as regards the debtor, and (ii) the law designated by the Rome I Regulation in the absence of a choice of law as regards the acquisition of title over the assigned claim.

The level of complexity involved in the Parliament's proposal and the fact that assignees would need to comply with two different laws instead of only one law as regards the debtor and the acquisition of title over the assigned claim would render the Parliament's proposal impracticable in financial markets, hampering cross-border assignments and thus seriously affecting the development of the Capital Markets Union. The application of the Parliament's proposal would thus seriously adversely affect the smooth functioning of financial markets and interfere with the market participants' practice of applying the assigned claim law, including when chosen by the parties to the original contract, to the third-party effects of assignments of claims.

iv) Impossibility to resolve priority conflicts where the same claim has been assigned twice to different assignees

Sometimes an assignor assigns the same claim twice to different assignees (typically by mistake). The assignees can have their habitual residence in the same country or in different countries.

Under the Commission proposal and the Council's text, where the law applicable to the third-party effects of the assignment of claims is the assigned claim law, one same law will apply to the third-party effects of both assignments, typically the law chosen by the parties to the original contract or, otherwise, the law designated by the Rome I Regulation in the absence of a choice of law. Therefore, the acquisition of title over the assigned claim and the resolution of priority conflicts between the assignees will be governed by the same law in both assignments.

Under the Parliament's proposal, where the same claim has been assigned twice to different assignees, it can occur that the law chosen by the parties to the original contract does not coincide with either the law of the habitual residence of the assignor or the law of the habitual residence of the debtor but that:

- in the first assignment of the claim to assignee A, the law chosen by the parties to the original contract coincides with the law of the habitual residence of assignee A. In that case, the law applicable to the third-party effects of the assignment of the claim would be the law chosen by the parties to the original contract as the assigned claim law as the law chosen by the parties to the original contract would coincide with one of the accepted laws;

- in the second assignment of the same claim to assignee B, the law chosen by the parties to the original contract does not coincide with the law of the habitual residence of assignee B. In that case, as the law chosen by the parties to the original contract would not coincide with the law of the habitual residence of either the assignor, the debtor or the assignee, the law applicable to the third-party effects of the assignment of the claim would be the law designated by the Rome I Regulation in the absence of a choice of law.

As the third-party effects of each assignment of the same claim would be governed by different laws, namely (i) the law chosen by the parties to the original contract, which coincides with the law of the assignee's habitual residence, in the first assignment, and (ii) the law designated by the Rome I Regulation in the absence of a choice of law in the second assignment, an insoluble question would arise: which law should apply to resolve the priority conflict between competing assignees A and B?

The absence of an answer to this question would render the Parliament's proposal concerning the assigned claim law not viable.

2. <u>Second measure</u>

As a second measure, the Parliament proposes a prohibition to change the law applicable to the contract.

This measure would be intended to protect third parties (for example, a competing assignee or the assignor's creditors) from a change by the parties to the original contract of the law governing their contract for fraudulent purposes. This could occur if, for example, the parties to the original contract change the initial applicable law to choose another law that includes no specific requirements for the acquisition of title over the assigned claim so as to facilitate the acquisition of title over the assigned claim by a second assignee or to remove claims from the insolvency estate to the prejudice of the assignor's creditors.

The difficulty with this measure is that a prohibition on the parties to a contract to change the law applicable to their contract would impinge on party autonomy and on national substantive contract law. An alternative measure could be the inclusion in the draft legislative text of a reference to Article 3(2) of the Rome I Regulation.

Article 3(2) of the Rome I Regulation includes a specific safeguard to protect the interests of third parties where the parties to a contract change the law applicable to their contract:

> "Any change in the law to be applied that is made after the conclusion of the contract shall not (…) adversely affect the rights of third parties".

An assignee or a creditor adversely affected by a change of the law governing the original contract could thus invoke Article 3(2) of the Rome I Regulation before the court resolving a priority conflict with a competing assignee.

In insolvency cases, the safeguards laid down in the law applicable to the assignor's insolvency would apply in addition so that fraudulent transactions, including assignments of claims in the vicinity of insolvency, can be declared void or unenforceable.

3. <u>Third measure</u>

As a third measure, the Parliament proposes the inclusion in the draft legislative text of a provision, inspired by recital 26 of the EU Succession Regulation, stating that nothing should prevent a court from applying mechanisms designed to tackle the evasion of the law, such as *fraude à la loi.* This is not an unknown safeguard in instruments of private international law.

III. Additional points

In addition to the three above-mentioned measures, the Parliament mentions the following issues in its letter.

1. Brexit

The Commission proposal and the Impact Assessment were drafted prior to Brexit. The Parliament expresses concern about the fact that the prevalent choice of law (by the parties to the original contract) points to English law and that the impact of Brexit on the file was not examined in the Impact Assessment.

It is important to recall that an instrument of private international law that provides for a connecting factor to determine the law applicable to the third-party effects of the assignment of a claim has no influence on the substantive law that the parties choose to apply to the claim created by their original contract at a moment when it is not even known whether the claim will be assigned.

When choosing the law applicable to their contract, the parties are guided by considerations such as the contents of a given substantive law, the markets where the parties operate, the countries where customers are located, the jurisdiction chosen by the parties for their disputes, the parties' familiarity with a given substantive law or trade usages. If any, Brexit could have the effect of leading market participants to increasingly choose the law of a Member State as the law governing their contracts in order to continue to benefit from the advantages of being subject to the Union common financial regulatory rules as well as to the Union common rules on jurisdiction, applicable law and recognition of judgments, all of which should facilitate cross-border assignments of claims.

2. The Rome II Regulation

The Rome I Regulation governs the law applicable to contractual obligations and thus designates the law applicable to claims of a contractual nature (for example, a claim for payment for the sale of goods). The Rome II Regulation governs the law applicable to non-contractual obligations and thus designates the law applicable to claims of a non-contractual nature, that is, claims arising from tort, delict, unjust enrichment, *negotiorum gestio* and *culpa in contrahendo* (for example, a claim for payment for damage caused to personal property).

It is common ground between the Parliament, the Council and the Commission that the Commission proposal applies to the third-party effects of the assignment of claims, whether the claims are of a contractual or a non-contractual nature. Therefore, whether a claim is created by a contractual obligation or arises as a result of a non-contractual obligation, the claim can be assigned to an assignee. Irrespective of the nature of the assigned claim, the law applicable to the relationship between the assignor and the assignee is designated by Article 14(1) of the Rome I Regulation, and the law applicable to the relationship between the assignee and the debtor is designated by Article 14(2) of the Rome I Regulation.

Where, in the Commission proposal and the Council's text, the law of the assigned claim applies to the third-party effects of the assignment of claims, this law can be: (i) in the case of contractual claims, either the law chosen by the parties to the original contract or the law designated by the Rome I Regulation in the absence of a choice of law, or (ii) in the case of non-contractual claims, either the law designated by the Rome II Regulation or the law chosen by the parties by an agreement concluded after the event giving rise to the damage occurred or, where all the parties pursue a commercial activity, by an agreement before the event giving rise to the damage occurred.

The Parliament indicates that the law of the assigned claim shall be that designated by the Rome I and II Regulations not taking into account a law chosen by the parties to the original contract.

Therefore, as in the case of the application of the assigned claim law to the third-party effects of the assignment of contractual claims, the Parliament proposes that, where the assigned claim law applies to the third-party effects of the assignment of non-contractual claims, the law chosen by the parties should not apply unless that law coincides with the law of the habitual residence of the assignor, of the debtor or of the assignee.

The considerations mentioned in this non-paper as regards the consequences of limiting the application of the law chosen by the parties as the assigned claim law to the third-party effects of the assignment of contractual claims would also apply in connection with the assignment of non-contractual claims.

3. The 2006 Hague Securities Convention

The 2006 Hague Securities Convention aims to provide legal certainty by designating the law applicable to the holding and transfer of securities held with an intermediary (including matters such as perfection and priority).

When explaining the application of the assigned claim law, the Parliament refers to the 2006 Hague Securities Convention to support its proposal that the assigned claim law should mean the law chosen by the parties to the original contract only where it is a law that has a connection with the parties or the situation at hand. The Parliament considers that this would provide better predictability and, to some extent, transparency for third parties, as there is only a limited number of laws that might be applicable to their situation.

As regards the expected transparency and predictability resulting from a limitation of the application of the law chosen by the parties to the original contract as the assigned claim law to the third-party effects of assignments of claims, we would refer to the comments in point II.1(ii) above on the reduced transparency and predictability and the additional hurdles that the Parliament's proposal would impose on third parties.

As regards the applicable law, in essence the 2006 Hague Securities Convention provides that the parties to the securities account agreement (that is, the holder of the securities account and the relevant intermediary) can choose the applicable law governing the issues falling within the scope of the Convention but that this choice will apply only if the chosen law is the law of a country where the relevant intermediary has an office involved in the maintenance of securities accounts.

It may be noted that discrepancies among delegations about the applicable law laid down in the Convention led to the Convention being signed and ratified by only three countries. The Convention as an example of a legislative text imposing limits on the applicability of the law chosen by the parties to the original contract would not thus seem the most viable.