Feature

KEY POINTS

- Article 14 of Rome I will govern most contractual assignments dealt with by European courts.
- What is considered a "voluntary assignment" or a "contractual subrogation" within the ambit of Art 14 is an autonomous European concept, and will not necessarily mirror precisely each legal system's definition of assigned rights.
- The ECJ has recently confirmed that Art 14 does not, in general, govern the law applicable to third party rights arising out of, or in relation to, assignments.
- The EU is in the advanced stages of considering a draft regulation which will govern third party effects of assigned rights. The draft regulation is controversial, but it will in any event not form part of English law.

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Article 14 of Rome I and choice of law rules in cross border assignments

The assignment of contractual rights and causes of action plays a pivotal role in many finance transactions. Issues may occur, however, where such transactions are international in nature, and there is ambiguity over the proper law governing the assignment, or aspects thereof. Understanding such issues is fundamental, given they can go to the very validity and enforceability of such transactions. This article looks at and outlines the basic concepts a contracting party should understand before entering into a cross-border assignment; it identifies common issues which might affect enforceability and highlights areas of uncertainty in the current rules.

INTRODUCTION

The assignment of contractual rights and causes of action is an essential aspect of international business. Assignment plays a pivotal role in financing arrangements by for example allowing companies to obtain secured loans or enter into factoring agreements. Assignments are also becoming increasingly important in the field of litigation finance, with more-and-more companies taking assignments of accrued causes of action, judgments or arbitral awards in order to pursue or enforce them.

Difficult issues arise, however, in relation to cross-border assignments, particularly where there is ambiguity over the proper law governing the assignment. For the purposes of choice of law rules, do, for example, voluntary assignments of contractual rights properly give rise to proprietary questions or questions of third-party effect, which need to be considered separately? Such issues can be absolutely fundamental and may impact upon the very validity and enforceability of certain transactions. The area is further complicated by the wide array of circumstances in which assignments can arise and the fact that rules that may be seen as suitable for certain types of assignment, may be less so for others.

This article is intended to provide an introduction to some of the issues that arise in relation to cross-border assignments of contractual rights. This article addresses two main issues:

- first, the scope of Art 14 of Regulation (EC) No 593/2008 (Rome I); and
- second, and more briefly, the March 2018 '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' (the Draft Regulation); and the alternative approaches which might be taken to the question of the third-party effect of assignments.

THE ROME I REGULATION

The EU-wide choice of law rules governing "voluntary assignment" and "contractual subrogation" are contained within Art 14 of Rome I. These rules apply to such arrangements made on or after 17 December 2009. Assignments made prior to this date, but after 1 April 1991 are governed by the similarly, but not identically, worded Art 12 of the Rome Convention.

Under the current proposals for a UK exit from the European Union, the Rome I Regulation will continue to apply during the transition period until the end of 2020, and will then be incorporated into domestic law and will continue to be applied by UK courts.[1] Accordingly, the scope of Art 14 of Rome I will likely remain central to questions of choice of law pertaining to assignments of rights in cases before the English courts.

Article 14 of Rome I provides that:

> "Article 14 – Voluntary assignment and contractual subrogation
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> 1. The relationship between assignor and assignee under a voluntary assignment or contractual subrogation of a claim against another person (the debtor) shall be governed by the law that applies to the contract between the assignor and assignee under this Regulation.
> 2. The law governing the assigned or subrogated claim shall determine its 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 been discharged.
> 3. The concept of assignment in this Article includes outright transfers of claims, transfers of claims by way of security and pledges or other security rights over claims."

There are (at least) four important things to consider concerning the effect and scope of Art 14:

- first, the meaning of the concept of "voluntary assignment" and "contractual subrogation";
- second, the ambit of the rules which apply to determining the governing law

of the relationship between the assignor and assignee;

- third, how to determine the law applicable to the question of whether a right is capable of assignment; and
- fourth, what rules apply to determine third party effects of assignments.

Although the focus in this article is on the choice of law rules set out in Rome I, it is important to note that in cases before the English courts, the choice of law rules at common law for voluntary assignments are likely to mirror those under Rome I.[2]

The Scope of "Voluntary Assignment" and "Contractual Subrogation"

The very nature of Rome I – being a regulation which aims to harmonise choice of law rules across different European legal systems – means that it aims to apply concepts consistently across legal systems which may otherwise approach and define such obligations in disparate ways. This means that, axiomatically, the meaning of "voluntary assignment" and "contractual subrogation" in Rome I are not to be given the meaning provided for such phrases in any particular, individual legal system, but are instead to be interpreted as independent, autonomous concepts for the purposes of Rome I.[3]

Article 14(3) itself gives some guidance on the scope of the Article, providing that it "*includes* outright transfers of claims, transfers of claims by way of security and pledges or other security rights over claims" (emphasis added).

The wording of Art 14(3) makes clear that the examples provided are non-exhaustive, and this suggests that Art 14 may in future be interpreted to govern situations broader than those specifically identified. In this regard it is noted that the wording of the final part of Art 14(3) "other security rights over claims" is already, in itself, very broad. The reach of Art 14 may, therefore, be wide indeed.

With regard to the question of "contractual subrogation" it has been suggested that the use of the phrase in Art 14 (such wording not appearing in Art 12 of the Rome Convention) was intended to clarify that the Article specifically governs situations where a third party satisfies a debt owed to a creditor and thereby subrogates to the rights of the creditor. This is a situation common in many European legal systems[4] and is one which is viewed by many such systems as a form of assignment. In the commentary to the Commission's original proposal of what is now Art 14 it was there explained that "[v]oluntary assignment and contractual subrogation perform a similar economic function".

The scope of the concepts covered by the Article is not, however, entirely unlimited. One obvious fetter on its ambit is that the assignment in question must – to some degree at least – be "voluntary". An immediate question raised is who must "volunteer" the assignment; the assignor, the assignee, and/or the debtor whose debt is being assigned?

It is suggested in this regard that the "voluntary" nature of the assignment is assessed with reference to the assent between the assignor and the assignee, and not to that of any debtor, or non-parties who might be affected by it. As discussed further below, the ECJ has recently held that Art 14 does not extend to determining the governing law of the rights of third parties to assignments. Such an approach is highly supportive of a conclusion that the "voluntary" aspect of an assignment required to bring it within the scope of Art 14 is that of the primary parties to the assignment, and not any third parties who may be affected by it.

It is suggested that "contractual subrogation" will likely be similarly interpreted as requiring assent or agreement between the assignor and the assignee (as the "contractual" nature of such subrogation suggests).

A further question is what is it that will be considered sufficient to constitute "voluntariness"? At the one end of the scale, explicit contractual agreement between the "right-holder" and the "right-acquirer" will clearly fulfil this condition, but there may be uncertainty where – for instance – a right of subrogation or assignment is held to operate as a rule of national law in a particular situation, even in the absence of explicit agreement (such as, perhaps, where the discharge of a liability under an insurance policy provides an assignment-type right to an insurer even absent an express contractual right of subrogation). These are questions on the penumbra of Art 14, the answers to which are likely to be case-dependent.

One can see an argument whereby, taking the insurance example just given, it may be suggested that where a rule of national law operates *in lieu* of a contractual promise (or, perhaps, by way of an implied term that might be excluded if so desired) that may be sufficient to constitute a "voluntary assignment", whereas a rule which operates entirely independent of agreement might not.

A further limitation on the scope of Art 14 is provided by Art 1(2)(d) of Rome I which states that "obligations arising under bills of exchange, cheques and promissory notes and other negotiable instruments to the extent that the obligations under such other negotiable instruments arise out of their negotiable character" are excluded from the scope of the regulation. However, as explained above, even where an assignment falls outside the scope of Rome I, an English court is likely to apply substantially similar choice of law rules at common law, insofar as the question at issue is properly characterised as one of assignment.

The rules determining the governing law of the assignor and assignee relationship

As noted above, Art 14(1) provides that:

> "[t]he relationship between assignor and assignee under a voluntary assignment or contractual subrogation of a claim against another person (the debtor) shall be governed by the law that applies to the contract between the assignor and assignee under this Regulation."

The term "relationship" was not used in the Rome Convention (which referred to "mutual obligations"). What is meant by

"relationship" is clarified in recital 38 of Rome I, which states:

> "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, as between assignor and assignee, in legal orders where such aspects are treated separately from the aspects under the law of obligations. However, the term 'relationship' should not be understood as relating to any relationship that may exist between assignor and assignee. In particular, it should not cover preliminary questions as regards a voluntary assignment or a contractual subrogation. The term should be strictly limited to the aspects which are directly relevant to the voluntary assignment or contractual subrogation in question."

This makes clear that, even in legal systems which might view the assignment of a right as a question of property and not contract or private law obligation, the governing law should nevertheless be determined by an application of Rome I by assessing the transaction *as though it were* a contract.

The rule, therefore, is that pursuant to Art 14(1), the law governing the "relationship" between the assignor and the assignee is that which would be determined by application of the other Articles of Rome I. Where, for instance, an assignment agreement contains a valid choice of law clause, it would be the law nominated by that clause which applies by virtue of Art 3 of Rome I. Where there is no choice of law clause, the Art 4 default provisions may be referred to.

Where Art 4(2) is in play, it has been held in England (in the case for the purposes of the similarly worded Rome Convention, not Rome I) that the "habitual residence" of the "party required to effect the characteristic performance of the contract" is determined by the habitual residence of the assignor[5] (albeit it seems the point was not the subject of argument).

The law applicable to questions of assignability

Article 14(2) provides, in terms, that whether a right is capable of assignment is determined by the law which governs that right,[6] again in the context of Art 12 of the Rome Convention.

This approach (as observed by Mann J in *Waldwiese* itself) may result in more than one law being considered, as it may well be the case that the law of the right being assigned and the law of the assignment itself differ.

The rules determining the governing law applicable to third parties

In *Raiffeisen Zentralbank Österreich AG v Five Star Trading LLC* [2001] EWCA Civ 68 (*Five Star*), the Court of Appeal had cause to consider whether it was the law governing the assignment, the law governing the right assigned, or some other law, which dictated the formalities which had to be complied with in order for an assignment to be valid. In *Five Star*, the right in question was a right to an indemnity under an insurance policy governed by English law which had been assigned by way of a deed of assignment also (stated to be) governed by English law. In contesting the validity of the assignment, it was argued that French law requirements of notice had to be satisfied in order for the assignment to be valid as against third parties, and that such French law requirements applied because the assignment was proprietary in nature and therefore it was the law of France as the *lex situs* (being the domicile of the insurers) which needed to be complied with – in other words it was said that the relevant issue fell outside the scope of the Rome Convention.

In holding that it was in fact only necessary for English law requirements of notice to be met Mance LJ (as he then was), giving the judgment of the court, considered that a proprietary analysis of such issues was unlikely to be correct, and that the question of the validity of the assignment as against third parties was a matter within the ambit of Art 12 of the Rome Convention, and was (by Art 12(2)) to be determined with reference to the law of the right assigned.

In coming to such a conclusion, Mance LJ pointed out that a proprietary analysis of questions of validity of assignments as against third parties was (in the insurance context at least) unlikely to be practical, requiring as it would, numerous different notification requirements to be complied with and considered by a court where, as is common, multiple insurers each with different domiciles had underwritten certain percentages of any given risk.

Mance LJ also further pointed out that such an approach would, in essence, provide a party taking an assignment with a "double hurdle", in that a debtor would always enjoy the protection, not only of the proper law of the obligation assigned, but also of the law governing any proprietary aspects of such a transaction.

A wide reading of Art 12(2) of the Rome Convention, so as to encompass questions of priority and third-party effect, was also adopted by the German Supreme Court in two decisions on 20 June 1990 (VIII ZR 158/89) (1990) RIW 670 and 26 November 1990 (II ZR 92/90) (1991) RIW 158.

The expansive reading of Art 12 of the Rome Convention, and the attractive simplicity of its approach has, however, been undermined by the recent decision of the ECJ in *BGL BNP Paribas SA v TeamBank AG Nürnberg* (Case C-548/18).

In *TeamBank* the Higher Regional Court of Saarland (the *Saarländisches Oberlandesgericht*) referred to the ECJ a number of questions concerning whether Art 14 of Rome I governed, either directly or by analogy, the applicable law concerning the third-party effects of the assignment of a claim in the event of multiple assignments of the claim by the same creditor to successive assignees.

In holding that it did not govern such questions, the ECJ referred to the original proposal for the Rome I regulation and noted that it was expressly provided for therein that the third-party effects of an assignment were to be governed by the law of the place where the assignor had its habitual residence. This proposal was not, however, taken up when the final Regulation was published, and instead by Art 27(2) it was stated that the issue

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should be dealt with by way of a proposed amended regulation.

Given this, the ECJ concluded that the issue was intentionally not addressed by Rome I. A clear distinction was therefore drawn between the position of the debtor (a third party to the assignor/assignee relationship) and the position of other third parties. It must, therefore, be the case that the proper law governing such issues is left to the national choice of law rules of whichever court is seised of the issue.

THE DRAFT REGULATION

As noted above, by Art 27(2) of Rome I (Review Clause) it was provided that a proposed amended regulation would be produced to address the issue of the choice of law rules applicable when considering the third-party effects of voluntary assignments. The Draft Regulation is the result of this.

Subject to certain limited exceptions, Art 4 of the Draft Regulation makes the law of the assignor's habitual residence the law applicable to determining the third-party effects of an assignment. This proposal has proved controversial and has drawn criticism from a number of market bodies, including the European Central Bank, ISDA, and the LMA.

Whilst further clarity as to third party effects would be welcome, especially in circumstances where these are now said to fall outside the scope of Rome I, the present Draft Regulation appears unsatisfactory. Full analysis of the Draft Regulation is outside the scope of this article, but suffice it to note that (reflecting some of the discussion of the Court of Appeal in *Five Star*, considered above) much of the problem centres on the fact that a requirement to look at the requirements of the law of the habitual residence of the assignor will likely add complexity, uncertainty and cost to many international transactions involving assignments, especially where there is already a need under Rome I to consider the applicable law of the assignment (Art 14(1)) and the applicable law of the underlying right to be assigned (Art 14(2)). As a matter of principle, it is difficult to see why the position of the debtor (a third party in relation to the assignor/assignee relationship), which is governed by Art 14(2), should be different from that of other third parties. There would appear to be much to commend a general rule in relation to third party effects based on the underlying law of the right to be assigned.

The UK indicated on 9 July 2018 that it will not opt into the Draft Regulation (irrespective of Brexit), and so it will not form part of English law. That leaves open what the English choice of law rule is in relation to the third-party effect of assignments if it is not to be found in Art 14(2) of Rome I. One possibility is that the approach in *Five Star* (albeit premised on an analysis of the Rome Convention) is nevertheless taken to be the English domestic choice of law rule as to third party effects. Another is that English courts use their freedom after Brexit (and the transition period) to depart from ECJ case law, and *TeamBank* in particular, and hold that third party effects do fall within the scope of Art 14(2), whether directly or by analogy.

CONCLUSIONS

- As noted above, the potential impact of different governing laws on certain aspects of international agreements involving assignments is significant. An understanding of the relevant choice of law rules is therefore essential for those dealing with such transactions.
- Article 14 of Rome I is likely to identify the choice of law rules relevant to such transactions, and its ambit is potentially rather broad. That said, however, it does appear that the Article will *not* cover the choice of law rules for:
  - involuntary assignments;
  - transactions which are properly construed as arising out of the transfer of negotiable instruments; and
  - the applicable law concerning the third-party effects of the assignment of a claim in the event of multiple assignments of the claim by the same creditor to successive assignees. ■

1 See Art 66 of the Agreement on the Withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, 19 October 2019 and The Law Applicable to Contractual Obligations and Non-Contractual Obligations (Amendment etc.) (EU Exit) Regulations 2019.

2 See Dicey, Morris & Collins, *The Conflict of Laws* (15th ed) at 24-055.

3 See eg *Raiffeisen Zentralbank Österreich AG v Five Star Trading LLC* [2001] EWCA Civ 68.

4 See eg sub-s 4 of Chapter IV 'Extinction of Obligations' of the French Civil Code – especially Art 1346.

5 See *Gorjat v Gorjat* [2010] EWHC 1537 (Ch) at [12].

6 See *Waldwiese Stiftung v Lewis* [2004] EWHC 2589 (Ch) at [18].

Further Reading:

- The assignment of debts: which law applies to the question who has the better proprietary right to an assigned debt? (2011) 9 JIBFL 544.
- Should the EU address conflict of laws questions thrown up by cross-border capital markets? (2017) 8 JIBFL 470.
- LexisPSL: Banking & Finance: Proprietary issues arising from the assignment of debts: a new rule?