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The Governing Law of Assignments (including Charges) under the Rome I Regulation and the Insolvency Regulation

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When does the governing law of a contract matter?

- When there is a dispute

What is the commonest reason for a dispute?

- Failure to pay what is prima facie due under a contract

Why does this happen?

- When a solvent debtor disputes the amount due and when the debtor or creditor becomes insolvent. When there is one or more assignments of a debt and it is unclear whether the debtor should pay the assignor or an assignee and or where one or more third parties asserts a claim against the debt on the basis of its rights against the assets of a party in the chain of ownership of the debt.
- The differing approaches of the Rome I Regulation and the Insolvency Regulation allow plenty of room for confusion where one or more of the parties situate in the EU becomes insolvent.
- This may vary according to whether the relevant rule of insolvency law is characterised as mandatory in character, or a rule of public policy applicable regardless of governing law.

Article 14 - Rome I Regulation - Voluntary assignment and contractual subrogation

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.

Source: 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)

Article 19 – Rome I Regulation - Habitual Residence

1. For the purposes of this Regulation, the habitual residence of companies and other bodies, corporate or unincorporated, shall be the place of central administration.

   The habitual residence of a natural person acting in the course of his business activity shall be his principal place of business.

2. Where the contract is concluded in the course of the operations of a branch, agency or any other establishment, or if, under the contract, performance is the responsibility of such a branch, agency or establishment, the place where the branch, agency or any other establishment is located shall be treated as the place of habitual residence.

3. For the purposes of determining the habitual residence, the relevant point in time shall be the time of the conclusion of the contract.

Comment on Article 14

- It is thought there is a lacuna in that Article 14 does not deal with the rights of third parties (e.g. competing assignees for holders of security over their assets) inter se.
- Nevertheless recital 38 applies Article 14(1) to the property aspects of an assignment as between assignor and assignee where the relevant system of law would consider this separately from the law of obligations. This is a narrow provision, but potentially capable of applying through a chain of assignments to produce an "owner" of the debt entitled to claim the amount of the debt, regardless of whom the debtor actually pays. In any event, it seems that the governing laws of the various assignments must be applied sequentially.
- English law has answered the question of applicable law by treating the question as one of contract and equivalent to the question whom the debtor should pay, so applying the law of the underlying debt to questions of competing rights (*Raffeisen v Five Star* [2001] 3 All ER 257 applying Article 12 Rome Convention).
- Dutch law has chosen the law in Article 14(1) (Article 10(2), Conflicts Property Act).
- Many commentators favour the mandatory application of the law of the place of habitual residence of the assignor to resolve this question.
- While work is on-going on a possible clarification of Article 14, this will not address any mis-match with the Insolvency Regulation when the issues arise in the context of the insolvency of the original debtor, an assignor or an assignee.

Insolvency Regulation - Article 4 - Law applicable

1. Save as otherwise provided in this Regulation, the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened, hereafter referred to as the "State of the opening of proceedings". (Jurisdiction to open proceedings is given to the Member State "within the territory of which the centre of a debtor's main interests is situated". This, in the absence of proof to the contrary, is the place of the registered office: Article 3(1)).

2. The law of the State of the opening of proceedings shall determine the conditions for the opening of those proceedings, their conduct and their closure. It shall determine in particular:

   a) against which debtors insolvency proceedings may be brought on account of their capacity;
   b) the assets which form part of the estate and the treatment of assets acquired by or devolving on the debtor after the opening of the insolvency proceedings;
   c) the respective powers of the debtor and the liquidator;
   d) the conditions under which set-offs may be invoked;
   e) the effects of insolvency proceedings on current contracts to which the debtor is party;
   f) the effects of the insolvency proceedings on proceedings brought by individual creditors, with the exception of lawsuits pending;
   g) the claims which are to be lodged against the debtor's estate and the treatment of claims arising after the opening of insolvency proceedings;
   h) the rules governing the lodging, verification and admission of claims;
   i) the rules governing the distribution of proceeds from the realisation of assets, the ranking of claims and the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right in rem or through a set-off;
   j) the conditions for and the effects of closure of insolvency proceedings, in particular by composition;
   k) creditors' rights after the closure of insolvency proceedings;
   l) who is to bear the costs and expenses incurred in the insolvency proceedings;
   m) the rules relating to the voidness, voidability or unenforceability of legal acts detrimental to all the creditors.

Source: Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings

Article 5 - Insolvency Regulation - Third parties' rights in rem

1. The opening of insolvency proceedings shall not affect the rights in rem of creditors or third parties in respect of tangible or intangible, moveable or immoveable assets - both specific assets and collections of indefinite assets as a whole which change from time to time - belonging to the debtor which are situated within the territory of another Member State at the time of the opening of proceedings.

2. The rights referred to in paragraph 1 shall in particular mean:

   a) the right to dispose of assets or have them disposed of and to obtain satisfaction from the proceeds of or income from those assets, in particular by virtue of a lien or a mortgage;
   b) the exclusive right to have a claim met, in particular a right guaranteed by a lien in respect of the claim or by assignment of the claim by way of a guarantee;
   c) the right to demand the assets from, and/or to require restitution by, anyone having possession or use of them contrary to the wishes of the party so entitled;
   d) a right in rem to the beneficial use of assets.

3. The right, recorded in a public register and enforceable against third parties, under which a right in rem within the meaning of paragraph 1 may be obtained, shall be considered a right in rem.

4. Paragraph 1 shall not preclude actions for voidness, voidability or unenforceability as referred to in Article 4(2)(m).

Article 2(g) "the Member State in which assets are situated" shall mean, in the case of:

- tangible property, the Member State within the territory of which the property is situated,
- property and rights ownership of or entitlement to which must be entered in a public register, the Member State under the authority of which the register is kept,
- claims, **the Member State within the territory of which the third party required to meet them has the centre of his main interests**, as determined in Article 3(1).

Insolvency of Original Debtor - All relevant jurisdictions in EU

Article 14(2) Rome I provides for the application of the governing law of the original claim (which will be a chosen law or that determined under the Regulation in the absence of choice - in the case of a supply contract, for example, the law of the habitual residence of the supplier) to 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

Article 4 Insolvency Regulation provides for the law of the insolvency (which will be the law of the Member State in which the centre of a debtor's main interests is situated) to determine, inter alia:

- the effects of insolvency proceedings on current contracts to which the debtor is party;
- the claims which are to be lodged against the debtor's estate..;
- the rules governing the distribution of proceeds from the realisation of assets, the ranking of claims and the rights of creditors who have obtained partial satisfaction after the opening of insolvency proceedings by virtue of a right in rem or through a set-off;
- the conditions under which set-offs may be invoked.

It is not clear if, for this purpose the private international law of the State of the insolvency form part of the law to be applied, or just the domestic law, and this may depend upon the approach of the law of the insolvency itself. but there is clearly an overlap between the above and Article 14(2).

So if the law of the original claim were French law, but the law of the insolvency were English law, the conditions under which an assignment may be invoked against the debtor would be governed by French law under Rome 1 and whether the claim under that assignment can be lodged against the debtor's estate by English law.

Would English law look to French law to decide whether the claim may be invoked by the assignee and thus to determine whether the assignee or the assignor may claim in the insolvency of the debtor, or would it simply apply the English domestic rule on this point?

Insolvency of the Assignor - I

- In that event the assignor will be subject to insolvency proceedings in its centre of main interests.
- Article 14(1) Rome I provides that the rights of the assignor and assignee inter se are governed by the law of the assignment.
- Article 4 Insolvency Regulation provides that the law of the insolvency determines which assets which form part of the estate.
- If the law of the assignment is Spanish law and the law of the insolvency is English law and Spanish law says that the assignee has the right to claim the underlying debt directly/ or has a proprietorial interest in the underlying debt as against the assignor and English law says that the underlying debt forms part of the estate of the insolvent assignor with the assignee having only a contractual claim against the estate, which prevails in the dispute between the assignor and the assignee?
- If the law of the assignment is the law of the habitual residence of the assignor, conflict will only be avoided if that turns out also to be the law of the insolvency - which would depend on where the assignor had its centre of main interests – in particular the law of the assignment will not be that of the insolvency if the assignor has its registered office in e.g. England, but the assignment was made by its Spanish branch or its place of "central administration" for Rome I purposes, was not England, even though England was its centre of main interests for insolvency purposes (perhaps because the assessment is made as at different dates or for more subtle reasons).

Insolvency of the Assignor - 2

- Further complications arise according to the governing law of the original debt and the location of the debt.
- If the governing law of the underlying debt is Spanish law, under Rome I Article 14(2), that law will decide whether the assignee or the assignor can claim against the debtor without regard to the location of the debtor, but under Article 2 of the Insolvency Regulation a monetary claim is situate where the party required to meet the claim has its centre of main interests.
    - If that were Denmark and the assignment is by way of charge, then it is possible Article 5 of the Insolvency Regulation will direct application of the law of Denmark to determine whether the debtor should pay the assignor or the assignee. This displaces the law of the insolvency and only brings in Spanish law if Danish law would look to Spanish law. This would be binding on the assignor in the insolvency and also determine whether the rights of the assignee are superior in ranking to those of other creditors of the insolvent assignor. Does the law of the assignment come into play at all?
    - If the governing law of the underlying debt were the same law as the law of the insolvency, Article 5 would not apply.

Insolvency of the Assignee

In this case the insolvent estate is a claimant only (assuming the law of the insolvency regards the claim as part of the estate). Otherwise, the governing law of the assignment determined under Rome I does not appear to be displaced, unless there is a question of set-off. If there are questions whether:

- The assignor having collected the debt from the original debtor can exercise a right of set-off and at what date when accounting to the assignee for the proceeds; or
- The original debtor can set off and as at what date against the insolvent estate, amounts owed to it either by the insolvent estate or by the assignor, when meeting the claim of the insolvent estate as assignee;

these would under the Insolvency Regulation Article 4 be determined by the law of the insolvency. If the governing law of the assignment or of the underlying debt is different and would reach a different conclusion, then would that law be displaced? Will this be affected by the location of the underlying debt and whether or not the assignment is by way of charge?

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