

6. Implications of Legal Precedent Analysis



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Dispute over Jurisdiction: Lawsuits Against the Buyer & the Seller Can Be Tried As a Joinder of Actions!



- A factoring dispute entering the litigation stage often triggers the objection to jurisdiction, especially when the buyer is the defendant. The buyer usually contends that: ① it is not a signatory of the factoring contract and requires that the lawsuit against the buyer should be tried as a separate case; ② it is not bound by the jurisdiction clause agreed on in the factoring contract and requires that the case should be transferred to the court of the buyer's location.
- The following precedents defeat the points above and unanimously argue that: ① the lawsuit against the buyer should be tried as a joinder of actions with the one against the seller; ② the case should be tried by the court in jurisdiction (usually of the factor's location) as agreed in the factoring contract.

Shandong

- (2014) Lu Min Xia Zhong Zi No. 290

Shanghai

- (2013) Hu Yi Zhong Min Liu (Shang) Zhong Zi No. 270

Beijing

- (2014) Gao Min Zhong Zi No. 00045

Hunan

- (2014) Xiang Gao Fa Li Min Zhong Zi No. 77

AR Assignment Is Not Simply About “Stamp and Affirm”!

- At the stage of notifying the accounts receivable assignment, most factors regard the buyer’s official seal as the basis to affirm the creditor’s rights. However, such a method ignores the legal risk brought up by the failure to authenticate the buyer’s official seal.
- The precedents below demonstrate that because the buyer denies the authenticity of the official seal on the assignment receipt and the factor fails to further prove the seal’s authenticity, the court rejects the factor’s claims.
- Factors should draw lessons from these cases to reinforce the authentication of the buyer’s official seal and use the EMS to deliver the notice as a supplement.



Guangdong (2013) Yang Cheng Fa Min Er Chu No. 235

Fujian (2014) Xia Min Zhong Zi No. 2768

Shandong (2014) Zi Shang Chu Zi No. 193

Tian jin (2014) Er Zhong Min Er Chu Zi No. 164

Tianjin (2014) Er Zhong Min Er Chu Zi No. 165

EMS Notice Delivery: Supportive and Reliable!



- In the precedent below, the factor delivers the *Notice on Accounts Receivable Assignment* by EMS, and the buyer tries to overturn the effect of delivery with the defenses: ① this case involves a huge value in the creditor's rights assignment, but the factor only delivers the notice by EMS to the business agent without verifications from the legal person and the financial officer; ② the express delivery slip can only prove that the document is sent out, but can not evidence the content of the document sent out.
- However, the court believes that the factor has already provided the EMS business slip and the delivery inquiry slip, both of which are sufficient to prove that the factor has performed the obligation to notify the creditor's rights assignment. Therefore, the court adjudicates that the assignment is valid and the buyer should bear the legal responsibility to pay the goods price to the factor.
- This precedent gives strong support to the legal effectiveness of using EMS to deliver the assignment notice and is inspirational to affirming rights in factoring.

Affirming Rights by EMS

(2014) Zhe Yong Shang Wai Chu Zi No. 57

Fraud Risk: Varieties

- The precedents below show the fraudulent means frequently used by the seller. Once tricked, the factor may fail to obtain any compensation from the buyer and lose the chance to claim against the credit insurance company.
- How to identify and prevent frauds is a big challenge to the factor's risk control.



counterfeiting the buyer's official seal on the delivery receipt of the notice

(2012) Dong Er Fa Min Si Chu Zi No. 224, (2013) Yang Cheng Fa Min Si Chu Zi No. 235, (2013) Nan Shang Chu Zi No. 663, (2013) Tong Xing Er Chu Zi No. 0191, (2013) Zhu Min San Chu Zi No. 19, (2014) Xia Min Zhong Zi No. 2768, (2014) Er Zhong Min Er Chu Zi No. 164, (2014) Er Zhong Min Er Chu Zi No. 165, (2014) Er Zhong Min Er Chu Zi No. 166, (2014) Er Zhong Min Er Chu Zi No. 167, (2014) Er Zhong Min Er Chu Zi No. 200, (2014) Zi Shang Chu Zi No. 193, (2014) Yi Xing Zhong Zi No. 00182

counterfeiting transaction contract

(2012) Dong Er Fa Min Si Chu Zi No. 224, (2012) Huang Pu Min Wu (Shang) Chu Zi No. 8352, (2012) Pu Min Er (Shang) Chu Zi No. 2247, (2014) Yi Xing Zhong Zi No. 00182, (2014) Pu Min Liu (Shang) Chu Zi No. 8200

counterfeiting the invoice of value-added tax

(2012) Pu Min Er (Shang) Chu Zi No. 2247, (2012) Huang Pu Min Wu (Shang) Chu Zi No. 8352, (2013) Tong Xing Er Chu Zi No. 0191, (2014) Pu Min Liu (Shang) Chu Zi No. 8200, (2014) Liao Xing Er Zhong Zi No. 00050, (2014) Shao Sheng Shang Chu Zi No. 142-1, (2014) Yi Xing Zhong Zi No. 00182

counterfeiting the delivery slip, warehouse warrant, and statement of account

(2012) Yi Xing Zhong Zi No. 00182, (2013) Fu Min Er Chu Zi No. 21, (2014) Yi Xing Zhong Zi No. 00182

colluding with the buyer to fraud

(2013) Fu Min Er Chu Zi No. 21, (2013) Tong Xing Er Chu Zi No. 0191号, (2015) Er Zhong Bao Min Chu Zi No. 29

Indirect Payment: AR Assignment Is Valid, But Indirect Payment Is Not!

(2013) Pu
Min Er
(Shang)
Chu Zi No.
2712

The buyer knew that the seller had assigned the accounts receivable to the factor yet still paid the goods price to the seller. The factor claimed that the buyer should pay the price to the factor, and the claim gained the court's support. The buyer that paid twice for the same creditor's rights had no choice but to request the seller to refund the previous payment.

After signing and issuing the *Receipt* for accounts receivable assignment, the buyer continued to pay part of the goods price to the seller. Later, the factor claimed that the buyer should be responsible for the payment, while the buyer contended that the amount of goods price already paid to the seller should be set off. The court adjudicated that the buyer should bear the obligation to pay the full price to the factor.

(2010) Zhe
Hang
Shang
Zhong Zi
No. 1086



- According to the precedents above, after the buyer's indirect payment to the seller, the creditor's rights are not destroyed or lost, the buyer will probably have to bear the cost of double payments for the same creditor's rights.
- The protection for the legal assignee can effectively deter the buyer from indirect payment.

Major Laws & Regulations on Which the Court Judge Factoring Cases



- When judging factoring disputes, the courts nationwide mainly invoke the following laws and regulations. To prevent factoring's legal risk, it is very useful to correctly interpret and to deeply understand these laws and regulations.

Article 80 Contract Law

A creditor may assign all or part of the rights under a contract to a third party, except for the following circumstances:

- (I) the rights are unassignable according to the nature of the contract;**
- (II) the rights are unassignable according to the parties' agreement;**
- (III) the rights are unassignable according to relevant laws.**

Article 81 Contract Law

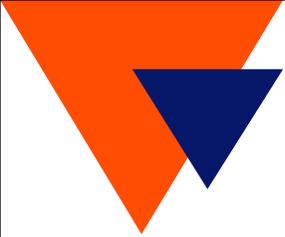
When assigning the rights, the creditor should notify the debtor of the assignment. Otherwise, the assignment is not effective to the debtor. The notice on creditor's rights assignment must not be cancelled except with the assignee's consent.

Article 82 Contract Law

When the creditor assigns the rights, the assignee shall obtain any incidental right associated with the creditor's rights except that such incidental right is exclusively personal to the creditor.

Article 25 Civil Procedural Law

The two parties of the contract can negotiate on and select in the written contract the jurisdiction of the court of the place where the defender is domiciled, where the contract is performed, where the contract is signed, where the plaintiff is domiciled, or where the subject matter is located, but must not contradict to the rules about tiered jurisdiction and exclusive jurisdiction in this law.



7. Study of the Latest Classic Factoring Case



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Study of Factoring Case (1)

Redress for factors as the transferred receivable were applied for seizure/freezing by other creditors of the supplier

- Due to supplier's disputes with others, legally transferred buyer's receivable of the factor is applied for seizure/freezing by other creditors of the supplier. The factor first filed an outsider objection to the enforcement court, but was rejected;
- The factor then filed a lawsuit for enforcement objection and was supported by the court. This case forms an important reference for factors.



Case study (1)

Enforcement Objection

(2016)
Jing
0108 Zhi
Yi No.
021

- **[Proposing an enforcement objection]** A bank, as a creditor of a supplier, applied to the court for sealing up and freezing the supplier's accounts receivable of RMB 7 million at the buyer's. The factor, as an outsider of the case, filed an **enforcement objection** to the court and asked the court to suspend the execution of supplier's receivable at the buyer's.
- **[Court's Opinion]**
- First, the factor advocates that the receivable claims based on the transfer of creditor's rights is a **claim right** in the nature of the right, which can be realized by the performance of the opposite party, and is not directly equivalent to the absolute domination of ownership or preferential compensation of real rights granted by way of security. Therefore, the factor **does not have the right to impede the enforcement** of the subject from the perspective of the right of property.
- Secondly, the establishment of the creditor's right claimed by the factor depends on factors such as the effectiveness of the transfer of creditor's right, and the substantive dispute concerning such effectiveness is not within the scope of the enforcement procedure. Since the Bank, the petitioner for execution, does not recognize the creditor's right claimed by the factor, and the buyer does not object to the supplier's creditor relationship, **the facts and related effectiveness of the transfer of the creditor's rights** claimed by the factor **are not confirmed by legal instrument in force**, and the only evidence such as the contract cannot be directly used as a sufficient basis for determining the facts of the case during execution procedure.
- Therefore, the Court believes that the evidence provided by the factor is insufficient to prove that it has legally enjoyed the transferred claims and **rejects** the objection request.

Case study (1)

*lawsuit for
enforcement
objection*

(2016)
Jing 0108
Min Chu
No. 16438
/ (2018)
Jing 01
Min
Zhong
No.7222

- [Prosecution]
- After its execution objection is rejected, the factor filed a **suit for enforcement object** against co-defendants of the bank, the supplier and the buyer, requesting legal recognition of the factor as the sole owner of the disputed RMB 7 million accounts receivable and that the court lift the freezing and deduction of RMB 7 million accounts receivable in accordance with the law.
- [First-instance court opinion]
- The factor and the supplier **jointly signed** the notice on the transfer of creditor's rights. Although the mail is sent by the factor to the buyer, **the content** of the mail **clearly indicates** the supplier's intention to transfer the creditor's right to the factor, and the buyer has signed and received the mail, so the creditor's rights involved have been transferred; meanwhile, the factor has registered at credit reference center and **announced to unspecified person, which has the effect against the third party**.
- The court thus supported the claim of the factor, and ruled lifting the freezing of receivable according to the law.
- [Second Court of Appeal] After the judgment of the court of first instance, the bank refused to accept and filed an appeal. The court of second instance also rejected the appeal and upheld the original judgment.

Study of Factoring Case (2)

The Initial Day for Statute of Limitations for Factoring Disputes



Case study (2)



- The factor shall pay attention to the statute of limitations when claiming rights to the buyer. The factor shall strictly review the settlement terms in the basic trade contract, use the buyer's payment date as the initial day for statute of limitations, and exercise the right in time during the statute of limitations to avoid losing the right to win because the statute of limitations expires.

- [Basic case] When the factor sued the buyer and the seller, the buyer argued that the factor notified the creditor to send the Introduction Letter and the Invoice Signing Letter to the buyer on February 11, 2014, so the statute of limitations expires on February 11, 2016. The factor sued on October 9, 2016 when the statute of limitations has expired and the court is requested to reject the claim of the factor.
- [Court's point of view] The factor is entitled to claim creditor's rights against the buyer as a result of transfer of the rights, so such creditor's rights originate in the basic transaction contract between the buyer and the seller. The statute of limitations for claims under the basic transaction contract shall be calculated **in accordance with the agreement of the corresponding contractual debt performance period**. The Invoice Signing Letter on February 11, 2014 transferred the creditor's rights under the Commissioned Production Contract involved in the case. According to the contract, the payment period is 9 months after invoicing, and the Invoice Signing Letter specifies that the invoice date is February 10, 2014, therefore, the statute of limitations should be counted from November 20, 2014.

(2018)
E Min
Zhong
No.478

Study of Factoring Case (3)

Buyer's Responsibility in Factoring Cases Involving Recourse①



Case Study (3)



- In this case, the court holds that the nature of **recourse factoring contract** is a **loan contract secured by the pledge of the debt (accounts receivable)**, and determines that the buyer fulfills its responsibility by paying the principal and interests of factoring financing to the extent of the amount of the accounts receivable. This view differs from the mainstream determination of factoring legal relationship, but represents the views of some courts.

- **[Basic case]** The amount of accounts receivable transferred is RMB 125005844.25, and the factoring bank provides factoring financing principal according to 80% of the receivable, which is RMB 99930000. In case of overdue, the factoring bank appeals: 1. The buyer is required to pay the principal of the accounts receivable RMB 125005844.25 and the interest of overdue payment; 2. The creditor is required to pay the part of financing funds unfulfilled by the buyer to the plaintiff after the expiration of the performance period determined by the ruling of the above-mentioned buyer's debts to the extent of no more than the financing principal of RMB 99930000, and the interest of overdue payment; and so on.
- **[Court's point of view]** The court of first instance (Zhongshan Intermediate People's Court) held that the main purpose of the factoring bank's contract is to obtain interest income by issuing factoring financing loans **instead of obtaining accounts receivable**, so a recourse factoring contract is **a loan contract** secured by the pledge of the debt (accounts receivable) in essence, and when the borrower fails to perform the debt obligation according to the contract, the lender has the right to receive priority compensation within the scope of the pledged credit amount. According to this, the court rules that the buyer should be responsible for the payment of the principal and interest of the factoring financing up to the amount of the accounts receivable. The court of second instance (Guangdong Higher People's Court) also upheld the original judgment.

(2017)
Yue Min
Zhong
No.2789

Study of Factoring Case (4)

Buyer's Responsibility in Factoring Cases Involving Recourse②



Case Study (4)



- In practice, there are additional views on buyer's responsibility in recourse factoring cases. The buyer and the seller usually defend against the improper benefits of the factor. In this case, based on the principle of equality, the Supreme Court considered the responsibility of the buyer is limited to the principal and interest of the factoring funds. We can see different views among courts comparing this case with the previous one.

(2018)
Supreme
People's
Court Min
Shen
No.1513

- **[Basic case]** The amount of accounts receivable transferred is **RMB 50 million** and the factoring financing provided by the factor to the creditor is **RMB 40 million**. The two parties agreed on recourse factoring. Later, the buyer did not pay on time, the factor requested the buyer to fulfill the payment obligation of RMB 50 million. **The second instance court (Shanghai Higher People's Court) considered that the transaction model of the case belongs to atypical guarantee** and did not support the claim for **RMB 10 million** spread by the factor. The factor was not satisfied and applied for retrial.
- **[Supreme Court's point of view]** The legal nature of the credit transfer contract involved in the **factoring business with recourse is not pure credit transfer**. In the case that the factor **exerts right of recourse**, it shall not enjoy the creditor's **right more than the factoring funds**. After the factor exercises the right of recourse, the scope of the rights that the factor can claim from the buyer shall be limited to the RMB 40 million **factoring funds** that it paid to the creditor **and corresponding interest**.

Study of Factoring Case (5)

Validity of Factoring Contract When Accounts Receivable Claims are False



Case study (5)



- When accounts receivable claims are false, the validity of factoring contract depends on whether the factor is in good faith when signing the contract. If the factor knows or should have known that the accounts receivable are false and still handles the factoring business, the factoring contract shall be deemed invalid due to the conspiracy and hypocrisy intention of the party.

(2018)
E01
Min
Zhong
No.526

- **[Basic case]** Before launching factoring business, the factor reviewed the *Supply and Demand Contract*, *Buyer's Confirmation Letter for Accounts Receivable*, *Reconciliation Letter* and other documents. In the lawsuit, the buyer proposed that the accounts receivable is **fictitious**, which is **loan in the name of factoring**, that the factor and the seller maliciously collude to defraud its signature on relevant documents without actual transaction, and that the factor knows that the accounts receivable are false and maliciously approved and constructed fictitious accounts receivable.
- **[Court's point of view]** When the buyer makes a defense against the factor with transferred creditor's rights on the grounds that the accounts receivable are fictitious, the validity of factoring contract depends on whether the factor has reason to believe that the accounts receivable is true, legal and effective when signing the factoring contract, that is, whether the factor knows or should have known that the claims that the buyer claims are not true. The existing evidence in this case does not prove that the factor participated in the contracting process of the sales contract between the parties of the case, nor can it prove that the factor should know that the basic contract of the creditor's rights involved in the case is a false meaning between the buyer and the seller. The relevant documents submitted by the buyer to the factor are **sufficient for the factor to have reasonable trust and have the reason to believe** that the creditor's rights of the accounts receivable are true, legal and valid. Therefore, even if the contract between the buyer and the seller is a false meaning expression, the parties **must not use such contract to defend against the kind third party of the factor.**

Study of Factoring Case (6)

The Date When the Responding Materials are Received Serve as the Arrival Date of the Notice of Creditor's Rights Transfer



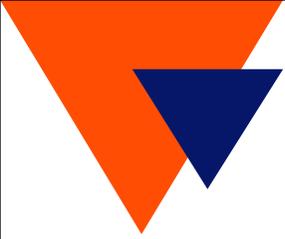
Case study (6)



- The case is a dispute over the transfer of ordinary claims. The transferee was unable to provide the original delivery certificate of the notice on the creditor's rights transfer and claimed that the date when the debtor received the responding materials should serve as the proof for the arrival of the notice, and the court also adopted it. The case has certain reference significance to the factor.

- **[Basic case]** After the transferee (the plaintiff) has transferred the creditor's claim to the debtor, he filed a lawsuit against the debtor. The debtor argued that it had no debt or creditor relationship with the transferee and that it did not receive a notice of creditor's rights transfer, so it requested the court to reject the plaintiff's claim. The plaintiff stated in court that he had already given notice but the original delivery certificate was no longer available. However, according to the plaintiff, the defendant should be aware of the transfer of creditor's rights when receiving the responding materials, so this node should be used as the arrival of the notice on the creditor's rights transfer.
- **[Court's point of view]** Although the plaintiff did not provide evidence to prove that the creditor notified the debtor of the creditor's rights transfer, the plaintiff claimed that the arrival date of the responding materials should serve as the arrival date of the notice on creditor's rights transfer. For the plaintiff's claim, the court held that **the way to fulfill the obligation to notify creditor's rights transfer by filing a suit is not prohibited by law** and is conducive to saving judicial resources and **does not harm the debtor's interests in essence**. The case gives the defendant sufficient litigation rights to ensure that it has sufficient time to provide evidence to refute the original request, so the plaintiff's claim that the arrival date of responding materials serving as the arrival date of the notice on creditor's rights transfer.

(2016)
Chuan
0603 Min
Chu
No.3532



8. Research on Latest Legal Developments



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Interpretation of the Judgment Summary (II) of the Tianjin High People's Court



- In July 2015, the Tianjin People's High Court reissued the judgment summary, the first of which was issued in October 2014. The judgment summary (II) presented more detailed provisions on the tough issues in trials on factoring contract disputes, unified the judgment criteria and judicial dimensions, and marked a large step forward of Tianjin in the factoring judicature.
- The legislative and judicial support to the factoring industry of Tianjin sets up an example for other regions and the whole country.

Articles

Otherwise provided, when assigning the accounts receivable to the factor, the creditor should notify the debtor of the assignment. Otherwise, the assignment is not effective to the debtor. Whether the debtor receives the notice or not does not affect the validity of the factoring contract.

If the creditor and the factor agreed in the contract to let the factor notify the debtor, the factor should evidence the fact of the creditor's rights assignment over the accounts receivable and identify itself when delivering the notice on the creditor's rights assignment to the debtor.

Interpretation

The provision makes clear the validity of “undisclosed factoring”: though it can be inferred from Article 80 of the *Contract Law* and the legal precedents, an explicitly provided recognition of the validity of “undisclosed factoring” still has a positive significance.

The conditional recognition of the validity of factor's delivery of the notice: according to Article 81 of the *Contract Law* and the legal precedents, usually the assignment notice should be delivered to the debtor by the original creditor. This summary corresponds with the factoring practice and recognizes the factor's delivery of the notice for the first time. However, it does not elaborate on “should evidence the fact of the creditor's rights assignment on the accounts receivable” and may thus cause ambiguity.

Interpretation of the Judgment Summary (II) of the Tianjin High People's Court

Articles

If the creditor and the debtor agree that the creditor's rights are unassignable, the creditor must not assign all or part of the accounts receivable to the factor except the creditor's right over the accounts receivable of a factor with *bona fide* obtainment.

If (the factor or the creditor and the debtor) agree to use the electronic signature and data message or agree to use the electronic signature and data message on any kind of electronic transaction platform to deliver the notice on the creditor's rights assignment, and if the debtor uses the electronic signature and data message or uses the electronic signature and data message on any kind of electronic transaction platform to promise or confirm the fact of the creditor's rights assignment, as long as all the acts above conform to the *Law of Electronic Signature of the People's Republic of China*, the court can adjudicate that the assignment of the creditor's rights is effective to the debtor.

Interpretation

***Bona fide* obtainment of the unassignable creditor's right:** with the *bona fide* obtainment, even if the underlying transaction contract has the clause of unassignable creditor's rights, the factor can still be legally assigned with the creditor's rights over accounts receivable. However, for the factor, the proof-providing for *bona fide* obtainment may be difficult in practice.

The assignment of the creditor's rights can have diverse forms: though the summary confirms the diversity of the forms of the creditor's rights assignment including electronic signature and data message, the prerequisite is that either the factor or the creditor must have an agreement with the debtor in advance, which may make it hard to confirm the diverse forms in practice. But it is still an acknowledgeable breakthrough that the notice is no longer confined to written forms.

Interpretation on Articles in *Trial Guidelines on Cases over Factoring Contract Disputes* issued by Qianhai Court



- Shenzhen Qianhai Cooperation Zone People's Court issued *Guidelines on the Judgment of Cases over Factoring Contract Disputes in Qianhai Shekou Free Trade Area (on Trial)* in January, 2017.
- The issuance of the document means that the settlement of such disputes in Qianhai Shekou FTA should abide by the guidelines, which is a landmark.

Articles

[Causes of action] Cases on factoring contract disputes are new ones and involve legal relations of underlying contracts and factoring legal relations. Thus, their causes of action could be determined as disputes on factoring contracts.

[Jurisdiction is determined when both the creditor and the debtor are charged] When the factor files a lawsuit against the creditor and the debtor as co-defendants to a people's court with jurisdiction, the objection raised by the debtor on the jurisdiction shall not be sustained.

interpretation

Causes of action for cases on factoring contract disputes are clarified: Previously, disputes on factoring were categorized as disputes on loan contracts or on other contract. Qianhai Court clearly regulates causes of action for cases on factoring disputes and clarifies that factoring disputes are complex disputes involving legal relations of underlying contracts and factoring legal relations, which helps understand the essence of factoring disputes.

Jurisdiction could be determined based on the factoring contract when both the creditor and the debtor are charged: When the factor filed a lawsuit against the creditor and the debtor, whether the jurisdiction should be determined based on the underlying contract or the factoring contract has long been controversial. The guidelines regulate that the jurisdiction is determined according to the factoring contract, representing the protection on factors' legal actions.

Interpretation on Articles in *Trial Guidelines on Cases over Factoring Contract Disputes* issued by Qianhai Court

Articles

[Fictitious underlying contract] Where the assignor of the creditor's rights and a third party fabricate underlying contract relations and signs an agreement of transfer on the account receivable with a factor taking the account receivable creditor's rights without real transaction as the transfer subject matter, the people's court shall sustain the factor's requirements in good faith, including canceling the agreement and the assignor bearing legal liabilities like returning the property and compensating for losses.

[Procedures taken when the debtor determines the authenticity of the debt] When a third party or the debtor checks the authenticity of the debt in the underlying contract with the factor, the people's court shall sustain the factor when the factor in good faith claims that the contract is valid and requires the debtor or the third party bear the liability for satisfaction for the factoring applicant as in the scope determined by the debtor or the third party.

Interpretation

Protection on factors in good faith under fictitious trades : It's almost impossible to prevent false trades in factoring. The guidelines regulate the responsibilities the seller shall bear for the factor in articles, which could contribute to ending/ reducing cases involving false trading.

The factor could require the debtor bear the liability for satisfaction when the debtor is involved in the fraud: Based on the article, the debtor's involving in fraud under false trades is seen as admitting that the false debt is real, the factor can require the debtor to bear the liability for satisfaction as in the scope determined by the debtor, which could contribute to ending/ reducing cases involving false trading. The factor shall gain the written evidence affirmed by the debtor..

Interpretation on Articles in *Trial Guidelines on Cases over Factoring Contract Disputes* issued by Qianhai Court

Articles

[Scope of transfer] The account receivable creditor's rights that are not prohibited to assign in laws and administrative regulations could be assigned by law.

[Effect of the prohibition of assignment on the factor] Where the creditor and the debtor agree that the creditor's rights are prohibited to assign, the factoring contract regulates that the creditor shall assign all or part of the account receivable to the factor, there is no legal effect on the creditor to assign the account receivable, except where the factor gains the account receivable creditor's rights in good faith.

Interpretation

Operations not prohibited in laws could be conducted: There was no specific legal basis to determine whether the account receivable creditor's rights in special trades could continue to serve as the factoring. According to Qianhai court, creditor's rights that are not prohibited to assign in laws and regulations could be the legal account receivable creditor's rights in factoring. "Operations not prohibited in laws could be conducted", which helps extend the factoring business.

Factor's gains in good faith under prohibition of assignment: The article is consistent with the requirements in the minutes of the Tianjian Higher People's Court. According to the requirement, breakthrough of the factoring business under the prohibition of assignment is not realized. Due to regulations in the *Contract Law*, the road for the factoring business to break through the limits in the prohibition of assignment is a long one.

Interpretation on Articles in *Trial Guidelines on Cases over Factoring Contract Disputes* issued by Qianhai Court

Articles

[Conditions where the notification obligation is deemed as performed] Where the underlying contract or factoring contract does not cover how the notice of assignment of account receivable shall be sent, the notification obligation shall be seen as performed under one of the following conditions:

- A. The creditor has clearly listed items related to the subject and content of the assignment of account receivable on the invoice for the account receivable, and the debtor has received the invoice;
- B. The factor signs an agreement on the assignment of creditor's rights with the creditor and the debtor;
- C. The notice on the assignment of account receivable has been sent by post to the registered address of the debtor or the address agreed on by both parties and the notice has been delivered;
- D. The notice on the assignment of account receivable has been sent by post to the contact designated by the debtor in the underlying contract, and the notice has been delivered;
- E. The notice on the assignment of account receivable has been sent to the e-mail address designated by the debtor in the underlying contract and the debtor has confirmed by reply;
- F. Other conditions where the notification obligation could be seen as performed.

Interpretation

Ways to confirm rights have been clarified: As the *Contract Law* does not clearly stipulate, there was no agreement on where the notification obligation of credit assignment as required in the *Contract Law* could be seen as performed. Thus there was a limited understanding that the creditor shall confirm with the stamp, hindering the performance of the factoring business to a certain extent and causing controversies of all parties when disputes emerge. In particular, the buyer would shirk the responsibility of payment by using the legal loopholes that may exist in the conformation of rights.

Qianhai Court clearly regulates five conditions where the notice could be seen as sent. Such act helps the factor extend its business and provide basis for ending disputes.

Interpretation on Articles in *Guidelines on Cases over Factoring Contract Disputes* issued by Qianhai Court

Article

[Handling requirements of setting off the obligation of repurchasing with assigned receivables] Where the right of recourse is involved in disputes, the people's court will not support the creditor's claim of setting off his or her repurchasing obligations to factors with assigned receivables.

[Determination of right of recourse] Where the factoring contract does not cover the right of recourse, and both parties agree that the factor can perform the right of recourse when the debt cannot be paid as the debtor raises a defense or performs the right of set-off, the right of recourse is deemed as applicable. The parties involved can transform the contract without the right of recourse to one with such right with the unilateral promises of the creditor, supplementary agreement or other means.

Interpretation

Guarantee of factors' rights of recourse: Qianhai Court clarifies that the creditor cannot set off repurchasing obligations with assigned receivables. The rule guarantees the factor's rights of recourse where such rights are involved.

Determination of the right of recourse: under specific conditions, based on the substantial rules or agreement of both parties in the factoring contract, Qianhai Court can determine that a contract without the right of recourse is one with such right. The rule also reflects the guarantee of factors' rights of recourse.

Interpretation on Articles in *Guidelines on Cases over Factoring Contract Disputes* issued by Qianhai Court

Article

[Relief measures for factors] Where the debtor fails to pay all the receivables before the deadline as required and the following claims made by the factor shall be supported:

- (1) [availing against the debtor according to the underlying contract] where the debtor receives the notification of the assignment of debt and fails to pay as required by the notification, the factor requires the debtor to pay;
- (2) [availing against the creditor according to the factoring contract] where the debtor does not perform obligations, the factor requires the debtor to return the financing fund or repurchase the account receivable creditor's rights according to the factoring contract;
- (3) [availing against the debtor and the creditor according to the factoring contract] where the debtor of the contract cannot pay off debts, the factor has the right of recourse or the appraisal rights to the creditor to repurchase receivables, the factor sues the debtor and creditor, requiring the debtor to perform the liability for satisfaction and the creditor performing the obligations beyond the debtor's liabilities;
- (4) [agreed joint liability] where the factor agrees with the debtor and creditor that the creditor and the debtor share joint liabilities for receivables, the factor sues the debtor and creditor and requires them to perform joint liabilities.

Interpretation

Identifying factors' relief measures: in the past disputes on factoring, courts apply various standards to determine whether the factoring contract and underlying contract shall be put in a trial and how the factor avail itself against the debtor and creditor after the trial.

Qianhai Court clarifies that the factor can make claims to both the debtor and the creditor, and gives clear rules on the right of claim or appeal when the factor makes claims to the debtor and/or the creditor.

It provides clear rules on relief measures involving multiple subjects and rights and interests of several parties. Some legislative gaps are filled to a certain extent and the relief rights of factors are effectively guaranteed.

Interpretation on Articles in *Guidelines on Cases over Factoring Contract Disputes* issued by Qianhai Court

Article

[The underlying contract shall not be altered without the factor's permission] where the debtor receives the notification of the assignment of receivables, the debtor and creditor alter the underlying contract without the permission of the factor, such alter shall not be legally binding to the factor.

[Assigned Rights Subject to Accrued Defenses of debtor] Upon receipt of the notice of assignment of the creditor's right, the debtor may, in respect of the factor, avail itself of any defense it has against the underlying contract.

[Availability of Set-off to debtor] Upon receipt of the notice of assignment of the creditor's right, if the debtor has any right to performance by the assignor which is due before or at the same time as the assigned creditor's right, the debtor may avail itself of any set-off against the factor.

Interpretation

Protection of the factor when the underlying contract is altered without the factor's permission: where the creditor and debtor alter the underlying contract after the assignment of receivables without the factor's permission, such alter may cause substantial influences on the possibility or the amount of compensation received by the factor, which is not a party of the underlying contract. Qianhai Court makes it clear that the alter made on the underlying contract without the factor's permission is not legally binding to the factor.

The rule protects the factor and contributes to safeguarding the legal rights and interests of factors and cracking down on non-credible behaviors of creditors and debtors.

Assigned Rights Subject to Accrued Defenses of debtor and Availability of Set-off to debtor:

according to the *Contract Law*, Qianhai Court makes no material breakthroughs on the debtor's such rights, requiring the factor to comprehensively understand the underlying contract and other business of the creditor and debtor in practice to prevent risk.

Interpretation on Articles in *Guidelines on Cases over Factoring Contract Disputes* issued by Qianhai Court

Article

[Legal force of registration and identification of goodwill] The factor shall sign in the Registration Platform of Chattel Financing of the Credit Reference Center of the People's Bank of China to check the ownership of receivables. If not, goodwill shall not apply.

[Repeated transfer of receivables] Where the creditor repeatedly transfers the same receivables and multiple factors claim rights, the person with the power shall be determined based on the following rules:

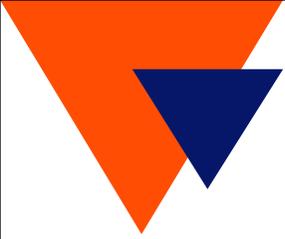
- (1) where the assignment of receivables is registered, the registered shall be protected in priority. Where the debtor has received the notification of the assignment of the creditor's right before registration, and has paid part of or all receivables, the factor completing the registration can claim rights to the original creditor;
- (2) where the assignment of receivables is not registered, the determination shall be made based on the time when the debtor receives the notification of the assignment of receivables. The rule does not apply when the debtor colludes with others;
- (3) where the assignment of receivables is not registered and the notification of assignment is not sent to debtors, the determination shall be made based on the time when the factoring financing fund is released.

Interpretation

Strict performance of inquiry and registration process: according to the article, the factor shall complete inquiry and registration processes in practice to ensure its priority in the assigning of receivables against a third party

Determination of rights under repeated assignment of receivables: Qianhai Court clearly specify how to determine the person with power when the account receivable creditor's rights is repeatedly assigned. It's notable that the rule prioritizes registration, and the determination is based on the receipt of the notification when no registration is made.

The rule clarifies that the registration in the Registration Platform of Chattel Financing comes first, which helps protect legal rights and interests of good-will factors and regulates the factoring market.



9. Stress Testing Model for Factoring's Risk Control



中国服务贸易协会商业保理专业委员会
Commercial Factoring Expertise Committee of CATIS



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GUANGDONG FACTORS ASSOCIATION



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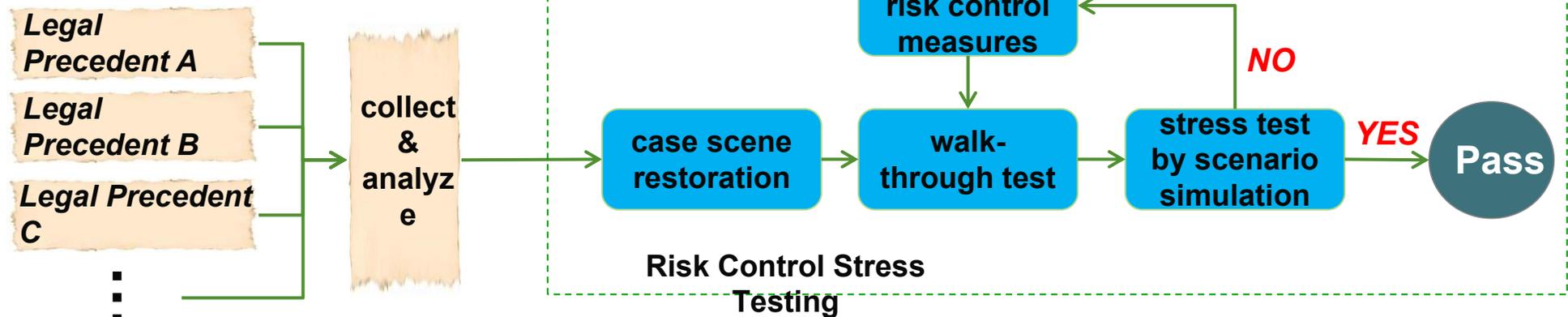
亚洲保理
ASIAFACTOR

Stress Testing Model for Factoring Risk Control

Introduction

- The precedents collected not only structure and quantify the risks involved in the factoring business, but also provide sound guidance on the risk control in practice.
- Based on the precedents, to evaluate the risk control capability and implement the PDCA risk control capability cycle improvement system, the Asiafactor developed the **stress testing model for risk control** which came into use in January 2014.
- The risk control stress test uses the constant analytic results of factoring precedents as the data input, makes cycle tests on the Asiafactor's risk control, operation, legal affairs operation, and e-business system, and uses the "passing rate" as the test result output.
- It is our hope that by trying the stress testing model for factoring risk control, we can find more risk control methods that fit into China's national conditions and business environment.

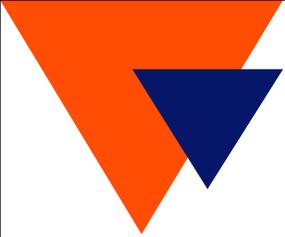
Overview of the Risk Control Stress Testing Model



To be continued...



- If you have any advice or wish to see the achievements of our follow-up research, please leave your message on our **Wechat official account**. Your advice is of high value to us!
- Follow our official account on Wechat for more fantastic ideas!



Appendix. Definitions



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Definitions of Risk Categories

- **Fraud risk:** refers to the risk of the factor's loss caused by the seller enterprise at any stage of the factoring business by fraudulent means, including defrauding funds by false trade, counterfeiting the assignment notice in affirming rights, privately notifying the buyer to change the account number after financing, requiring the buyer to pay the goods price to another account of the seller, etc.
- **Credit risk:** refers to the risk of the factor's loss because the buyer or seller enterprise is unwilling or unable to perform the obligation of payment or repurchase out of ill intention, bad business operation, bankruptcy, or other reasons.
- **Operative risk:** refers to the risk of the factor's loss because of the irregular operation or the moral hazard in operation in business processes such as due diligence, examination and approval of funding, granting loans, and management after loan.
- **Other risks:** includes distortion of court, stop-payment order issued by the court to the overseas buyer, etc.

Definitions for Special Risk Items

- **Fraudulent trade:** the seller defrauds the factor of the funds, falsifying commercial transactions by counterfeiting the transaction contract, transaction voucher, statement of account, invoice, etc, including deceiving the factor by the seller alone, collusively deceiving the factor by both the seller and the buyer, and collusively deceiving the factor by the seller and the insider of the factor.
- **Fake notice on accounts receivable assignment:** when the buyer is affirming its rights, the seller, to meet the factor's need of affirming rights, counterfeits the files about the buyer's knowledge of or consent with the fact of the creditor's rights assignment by carving the buyer's official seal without authorization or by other means.
- **Indirect payment:** after the seller assigns the creditor's rights to the factor, the buyer pays the money that should have been paid to the factor to the seller, including the intentional indirect payment of the buyer and the indirect payment of the buyer as demanded by the seller.
- **Defects in AR assignments:** assigned with the creditor's rights, the factor fails to require or supervise the seller to deliver the assignment notice, or the notice has defects that prevents it from taking effect or causes the dispute over the notice's validity.
- **Stop-payment order issued by the court to the overseas buyer:** in the international factoring dispute, given the historical disputes between the overseas buyer and the seller, the court at the place where the overseas buyer is located gives the overseas buyer a mandatory document to stop the payment under the letter of credit.

Definitions for Special Risk Items (Continued)

- **Dispute over the clause on unassignable creditor's rights:** the factor accepts the seller's assignment of the creditor's rights irrespective of the clause on unassignable creditor's rights in the transaction contract. Consequently, when claiming the creditor's rights against the buyer, the factor can not obtain the court's support because the assignment of the creditor's rights is invalid.
- **Dispute over jurisdiction:** when the factor sues the buyer / seller / insurer in a factoring dispute, the parties involved raise objection to the court's jurisdiction, hence the dispute over jurisdiction.
- **Dispute over transaction:** when the factor claims its right to be paid against the buyer, the buyer rejects at the excuse of transaction disputes such as disagreement on quality between the buyer and the seller.
- **Withholding interest in funding:** when granting the loans, the factor withholds some interest. When the factor seeks legal remedies, the court does not support the factor and determines that the interest and penalty should be calculated on the principal that has deducted the withholding interest.
- **Absence of original evidence:** in conducting the factoring business, the factor fails to collect or retain the original copy of the transaction contract, transaction voucher, statement of account, invoice, etc. When a dispute occurs, the absence of original evidence leads to the failure or difficulty in gaining the court's support for claiming the creditor's rights.



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