

Similarly to in other contexts, the mixed borrowing of foreign law has caused incoherence between the relevant norms (*infra* at 51 et seqq.).

3. Relationship with the General Part of the Book on Contract

Art. 769 CCC sets out, “For matters not provided in this Chapter, the relevant provisions of Chapter Six (modification and assignment of contracts) of this Book on the assignment of claims shall be applied.” This provision is a natural consequence of the factoring contract being a mixed contract, which always contains the element of assignment of claims (*infra* at 11). In particular, nonrecourse factoring is actually a special form of the assignment of claim, while recourse factoring is rather close to a loan (*infra* at 19–21).

The question arising from art. 769 CCC is therefore two-fold. On the one hand, to what extent do the general rules on assignment of claims, such as art. 548 CCC, need modifications to be applied to factoring contracts (*infra* at 43, 44). A commentary holds that arts. 502 para. 3 and 545–550 CCC are applicable to factoring contracts.⁶

On the other hand, it is questionable whether the provisions in the chapter on factoring contracts can be equally applied to assignment of claims outside of factoring contracts.⁷ For example, the assignment of future receivables for factoring purpose is permissible. It is still undecided whether this rule can be extended to cover any claim for any purpose.⁸ Also, the provisions governing factoring contracts deviate from the general rules on assignment of claims, particularly regarding the effect of a notice of assignment and a person’s entitlement to notify the assignment (*infra* at 54, 41). Equally unclear is the question of whether these provisions are only relevant to factoring contracts.⁹ The above-mentioned commentary holds that arts. 761, 763–765 and 768 CCC apply *mutatis mutandis* to assignment of claims.¹⁰

Although not explicitly mentioned in the CCC, it is necessary to distinguish between a factoring contract and the assignment of a receivable,¹¹ since the former act serves to create a contractual obligation, which is to be performed by the latter act. Assignment of a receivable constitutes an act of disposition, the effectiveness of which is reliant on the disposal right of the assignor. This separation is particularly essential in determining the validity of multiple factoring contracts (*infra* at 51 et seqq.).

II. Definition, Types and Major Contents

For the sake of legal certainty, the factoring industry had expressed a wish that the legislator should clarify the legal nature of factoring contracts. However, due to the mixed nature of factoring contracts, the Chinese legislator has opted for a definition that is particularly open in order to accommodate various factoring forms.

1. Definition in Art. 761 CCC

a) Performance of Major Functions. Art. 761 CCC defines a factoring contract as “a contract under which a creditor of accounts receivable transfers the existing or future

⁶ Huang Wei (ed.), Contract II, 932.

⁷ Art. 764 CCC is deemed as a provision which can be applied to general assignment of claims *mutatis mutandis*, Huang Wei (ed.), Contract II, 921.

⁸ Li Yu, LS 2019/12, 37.

⁹ SPC, Contract III, 1777.

¹⁰ Huang Wei (ed.), Contract II, 933.

¹¹ Li Yu, LS 2019/12, 34; Zhan Shiyuan, GLR 2021/5, 87–88.

accounts receivable to a factor who provides services such as accommodation of funds, management or collection of the accounts receivable, guaranty for the payment of a debtor of the accounts receivable, and the like.” This definition follows the approach adopted by the Factoring Convention and enumerates the four major functions: finance for the supplier, maintenance of accounts relating to the receivables, collection of the receivables and protection against default in payment by debtors. In this chapter, the counterparty of the factor is referred to as the supplier.

- 11 Based on the definition of art. 761 CCC it is clear that the assignment of claims is a mandatory element of a factoring contract. However, other than for its international counterparts, art. 761 CCC does not specify how many functions a contracting party has to perform in order to qualify as a factor. This question is crucial as it constitutes the prerequisite to the application of the provisions governing factoring contracts. One possible solution is to require the performance of just one function, as this maximizes the scope of factoring contracts and may foster the growth of the factoring industry.¹² This construction is supported by previous relevant norms¹³ and is endorsed by some commentators.¹⁴
- 12 A minority view believes that if the factor provides merely one service, he can only choose one of the services: “finance for the supplier” or “protection against default in payment by debtors”. If someone chooses one of the following services: “maintenance of accounts relating to the receivables” and “collection of receivables” without providing one of the other two services, this cannot qualify as a factor. This is because the mere business of debt collection does not satisfy the requirements of a factoring contract, as it does not provide finance to the supplier.¹⁵
- 13 **b) Permissible Scope of the Receivables.** Art. 761 CCC is silent regarding the permissible scope of accounts receivable in a factoring contract. By definition, receivables only refer to pecuniary claims arising out of a contract, excluding non-pecuniary claims and non-contractual claims. From art. 3 para. 1 of the Uniform Methods of Registration¹⁶ and art. 8 of the Provisional Measures on Factoring, the conclusion can be drawn that China recognizes basically all kinds of monetary claims arising from contracts. This includes, in particular, those from sale of goods and provision of services, as well as monetary claims or proceeds arising from the lease of facilities as the object of a factoring contract. Moreover, the supplier can only be an enterprise and not a natural person.¹⁷
- 14 It used to be debated whether future receivables could be included in the scope of a factoring contract. On the one hand, previous provisions explicitly prohibited the assignment of future receivables for factoring purposes.¹⁸ However, on the other hand, such transactions were not uncommon in practice.¹⁹ Through art. 761 CCC, China has finally allowed future claims for factoring contracts to be transferable. This decision was made based on the developing trends of relevant international conventions and other

¹² Fang Xinjun, LaSD 2020/4, 108; SPC, Contract III, 1768.

¹³ Art. 4.2 of the Norms for the Factoring Business in the Banking Sector of China (中国银行业保理业务规范, issued on and effective from August 23, 2016; hereinafter: Factoring Business Norms) and art. 6 of the Provisional Measures on Administration of Factoring Business of Commercial Banks (商业银行保理业务管理暂行办法, issued on April 3, 2014; hereinafter: Provisional Measures on Factoring).

¹⁴ Huang Wei (ed.), Contract II, 906; Li Yu, LS 2019/12, 32; SPC, Contract III, 1768.

¹⁵ Fang Xinjun, LaSD 2020/4, 110.

¹⁶ Uniform Methods of Registration for Security in Movables and Rights (动产和权利担保统一登记办法), enacted on December 28, 2021, effective on February 1, 2022.

¹⁷ Fang Xinjun, LaSD 2020/4, 111.

¹⁸ I.e., art. 13 para. 1 of the Provisional Measures on Factoring.

¹⁹ Fang Xinjun, LaSD 2020/4, 115.

major civil law jurisdictions, such as Germany and Japan.²⁰ The assignability of future claims is an indispensable requirement for revolving factoring and pool factoring, where future receivables arising in a certain period of time are assigned through a lump sum agreement to the factor.

Yet, art. 761 CCC does not deal with the time at which the assignment of future 15 receivables takes effect. It is important to identify the priority of the creditors, particularly in the case of bankruptcy of the debtor and a court attachment on the accounts receivable. One suggestion is to grant the registration the effect of perfection, which means that, upon registration of the assignment, the factor can hold his right in the future receivables against a third party who has no registered right in the same receivables.²¹ However, with this solution, the issue of when the assignment takes effect is left unsettled. Another opinion believes that the assignment takes effect as soon as the future claim comes into existence and is automatically acquired by the supplier.²²

Another question that may be raised involves the separation of future claims and 16 fabricated claims. This may render the factoring contract invalid, as future claims may never come into existence in actuality. One scholar believes that the assignment of future receivables is valid as long as the future claim can be identified (特定化) when it comes into existence, even if the individualization is unavailable at the time of assignment.²³ Future claims can be divided into two types: those with a concrete underlying relationship, and those without a concrete underlying relationship. Although the latter is more speculative, it is not a fabricated claim as long as it is foreseeable and identifiable.²⁴ However, the determination of this still requires further concretization by the judiciary. A commentator suggests that assignable future receivables should include those receivables that lack a concrete underlying relationship, if, based on the counterparty, subject matter, nature of the contract, and transaction history, they are highly likely to arise in the future.²⁵

c) Market Access Limitation. Currently, factoring businesses are subject to super- 17 vision by the CBRC and can be conducted only by commercial banks and factoring companies (*supra* at 1). However, there are no uniform nationwide rules regarding market access. Some local regulations were issued by provincial governments in 2019 and later. In judicial practice, the effect of restricting access to the validity of factoring contracts has not yet become a prominent question, and corresponding judicial cases are still rare.

Art. 761 CCC does not touch upon the entry requirements of the factor and leaves 18 this to be governed by the general rules on validity of contract in violation of mandatory provisions (*supra* Chap. 5 at 25). One opinion suggests that a factoring contract should be valid even if the market access qualification has not been granted. Another opinion holds that a factoring contract should be valid despite the lack of market access if it is a single transaction. However, they hold that if the factor lacking market access consistently offers factoring services, then all factoring contracts concluded by him should be invalid.²⁶

²⁰ SPC, Contract III, 1764.

²¹ Li Yu, LS 2019/12, 39.

²² Zhang Jing, LS 2022/2, 125–126.

²³ Zhu Hu, LS 2020/5, 124.

²⁴ Li Zhigang, JLA 2020/15, 45.

²⁵ Zhan Shiyuan, GLR 2021/5, 92.

²⁶ Li Zhigang, JLA 2020/15, 45–46.

2. Types

- 19 **a) Recourse and nonrecourse factoring.** The distinction between recourse factoring and nonrecourse factoring is codified by art. 766 and 767 CCC respectively, which mainly restate existing provisions. The majority of factoring businesses in China carry out recourse factoring, which is different from other countries.²⁷ Recourse factoring is defined in art. 766 CCC as a type of factoring where the factor provides financial services, but lacks the obligation to provide a guaranty for bad debts. Art. 766 CCC stipulates that the factor of a recourse factoring may choose to request payment from either the supplier or the debtor. This is in line with the majority of court judgements that were previously decided on recourse factoring. These ruled that, unless otherwise agreed by the parties, the factor has the right to choose whom he first proceeds against, and he also has the right to claim from both the supplier and the debtor of the receivable, but cannot be paid repeatedly.²⁸ This means that art. 766 CCC has finally accepted the doctrine of security assignment (让与担保说) and rejected the doctrine of indirect payment (间接支付说) with regards to the relationship between the factor, the supplier and the debtor.²⁹
- 20 Under the doctrine of security assignment, a recourse factor has the right to, although is under no obligation to, first request that the debtor pays the receivable. This is the case even if it is agreed upon in the factoring contract that “the payment of accounts receivable is the first source of repayment of factored financing”, because such an agreement is simply a hackneyed phrase in factoring business.³⁰ In contrast to the general assignment of claims, a recourse factor does not have full interest in the receivable, and is obliged to return the remaining factored balance to the supplier after recovering the receivable and deducting its financing principal and interest and related expenses. This reflects the high-level of security it offers. The factor of recourse factoring is allowed to sue both the debtor and the supplier in one suit.³¹ A supplier that has returned the principle and interests to the factor, or has bought back the receivable, is entitled to request the debtor to pay the receivable.³²
- 21 In a nonrecourse factoring contract, the factor provides funds to the supplier and manages the account or collects the receivable from the debtor as a new creditor. Any profits or losses incurred by the factor in enforcing the claim is borne by itself. Since the supplier transfers most of the risk to the factor, the factor is bound to charge a higher factoring fee, and the part of the factor’s proceeds that exceeds the principal and interest of the financing funds and related fees need not be returned to the supplier.
- 22 It is worth noting that the guaranty of a nonrecourse factor for the debtor’s credit risk only includes credit failure, financial inability and non-willingness to pay. It does not cover the risk of dispute situation, creditor fraud, force majeure, changes in the underlying transaction contract, the debtor’s defense based on the underlying transaction contract, the right of set-off, and the right to termination.³³ Therefore, in the case of the materialization of these risks, the factor is entitled to request that the supplier repurchases the receivables or assumes liability for the breach of contract.

²⁷ SPC, Contract III, 1781.

²⁸ Li Yu, LS 2019/12, 44–45.

²⁹ Cai Rui, PSL 2021/10, 138; Li Yu, LS 2019/12, 45; SPC, Contract III, 1783.

³⁰ Li Yu, LS 2019/12, 45–46.

³¹ Art. 66 para. 2 of the Interpretation of Guaranty System.

³² Art. 66 para. 3 of the Interpretation of Guaranty System.

³³ Huang Wei (ed.), Contract II, 926; Li Yu, LS 2019/12, 48; Xie Hongfei/Zhu Guangxin (ed.), Typical Contracts II 561; Zhu Hu, Jurist 2020/4, 9.

b) Disclosed Factoring and Undisclosed Factoring. Disclosed factoring (公开型保理 ; 明保理) refers to factoring where the factor sends the debtor a notice of assignment, advises the debtor about the factoring relationship and notifies them to remit payments to the factor. Conversely, no notice of assignment is sent to the debtor in an undisclosed factoring agreement (隐蔽型保理 ; 暗保理). This is consequently favored by the supplier, who wants to retain a cooperative relationship with the debtor.

However, this advantage may be offset by the inability of the factor to “perfect” the acquired receivable to secure their priority right. Only the factor is eligible for registration, and this is, by nature, unavailable in undisclosed factoring. In the case of multiple assignments, the undisclosed factor may get a share of the receivable, but only if other factors neither registered the assignment nor sent a notice of assignment (*infra* at 51).

c) Other Types. The Glossary “Commercial Factoring Terminology: Basic Terminology”,³⁴ published by the Chinese Commercial Factoring Expertise Committee, compiles a number of other factoring types with brief explanations. This includes domestic and international factoring, import and export factoring, single-factor factoring and two-factors factoring, advanced factoring and maturity factoring and so on. However, this topic will not be discussed further in this chapter.

3. Written Requirement and Major Contents

Art. 762 para. 2 CCC sets out that a factoring contract must be in writing. Art. 762 para. 1 CCC further enumerates typical contents of a factoring contract, which include the business type, scope of service, term of service, information on the underlying transaction contract and the accounts receivable, financing funds through factoring, service remuneration and methods of payment thereof. This provision is clearly dispositive.

III. Bar on Assignment

1. Legal Effect

One issue that frequently arises, but has not been codified, is the situation where a contract clause prohibits the supplier from assigning a receivable. Is it still possible for the factor to recover from the debtor? The answer to this question can be found in art. 545 CCC, which provides “where the parties agree that a non-pecuniary claim may not be assigned, such an agreement may not be asserted against a *bona fide* third person. Where the parties agree that a pecuniary claim may not be assigned, such an agreement may not be asserted against a third person.” This provision distinguishes between pecuniary and non-pecuniary claims and stipulates different legal consequences for the anti-assignment clause on this basis. In the case of monetary claims, such an agreement is absolutely ineffective against third parties. This means the assignment of a receivable is valid even if the third party (i.e. the factor) knows of the existence of the anti-assignment clause.

It can be inferred from art. 545 CCC that an anti-assignment agreement is valid between the parties, meaning the supplier is liable to the debtor for damage, if the supplier assigns a receivable against an anti-assignment agreement. Such damage could take the form of additional fulfillment costs incurred by the debtor. In such a case, the debtor may off set these costs with the claim assigned to the factor.

³⁴ 商业保理术语: 基本术语, published on April 12, 2018, effective since May 1, 2018, <http://www.cfec.org.cn/ueditor/php/upload/file/20180423/1524468499102415.pdf>

2. Subsequent Assignments

- 29 Following this, we must consider whether the bar on assignment impacts the validity of a subsequent assignment of the same receivable, for example to another factor. One commentator suggests borrowing the solution found in art. 9 para. 1 of the Convention on the Assignment of Receivables in International Trade, which states that an anti-assignment agreement has no impact on a subsequent assignment made in breach of the terms of the factoring contract.³⁵ This opinion is backed by the wording of art. 545 CCC.

3. Conflict with Reservation of Title

- 30 It is possible that conflict may arise if the supplier's receivable, in order to secure payment for the product sold under reservation of title, has already been attached with a pledge in favor of a seller. In this case, both the factor and the seller have rights in the same receivable, so it is necessary to determine the priority of the two parties. So far, there have been no relevant disputes in mainland China, as reservation of title is rarely used in practice. However, conflict between factoring, pledge and assignment of the same receivable is also possible. This is governed by analogous application of art. 766 CCC, meaning that the time of registration determines the priority of the competing rights (*infra* at 51).³⁶

IV. Factoring Fraud

- 31 In China, factoring frauds are quite prevalent and amount to the greatest risk in the factoring sector. Particularly prevalent are "false underlying transactions", which pertains to the fabrication of non-existent receivables by the supplier and the debtor.³⁷ Art. 763 CCC was codified to address this, setting out that in such a case the debtor of the fabricated receivable may not assert a defense against the factor on the ground that the account receivable does not exist, unless the factor clearly knows of such a fabrication. In the literature, both the prerequisites for, and the necessity of, this provision are subject to intense debate. Apart from that, in order to invoke art. 763 CCC, the debtor has to prove that the underlying transaction does not exist and that the factor has actual or constructive knowledge of this.

1. Prerequisites

- 32 a) **Fabrication of an Account Receivable.** Fabrication of a receivable refers to the creation of an appearance of a receivable that does not actually exist.³⁸ Due to the broad wording of art. 763 CCC and its legislative history, it can be assumed that deliberate cooperation between the supplier and the debtor is not required.³⁹ In most cases fabrication of a receivable involves conspiracy between the supplier and the debtor, however, their separate acts without conspiracy may still constitute fabrication of a receivable in the sense of art. 763 CCC. A typical scenario is where the debtor makes a written confirmation of the receivable upon receipt of the transfer notice sent by the

³⁵ Fang Xinjun, LaSD 2020/4, 114.

³⁶ Art. 66 para. 1 of the Interpretation of Guaranty System.

³⁷ He Yinglai, ZSS 2020/7, 26.

³⁸ SPC, Contract III, 1774.

³⁹ Huang Wei (ed.), Contract II, 913.

supplier.⁴⁰ However, if the supplier fabricates the receivable unilaterally and the debtor remains silent upon receipt of the transfer notice sent by the factor, this cannot be considered a fabrication by the supplier and the debtor. The debtor does not have an obligation to inform the factor of his rejection of the claim. Thus, in this situation, the defense of nonexistence of the receivable remains available to the debtor.⁴¹ The signing of the receipt certifying that the notice of assignment is received is not considered confirmation of the content of the notice, i.e., of the receivable.⁴²

b) Actual or Constructive Knowledge. According to art. 763 CCC, only actual 33 knowledge of the factor may exclude him from asserting a defense against the fabrication of a non-existing receivable. Also, a consensus appears to have been reached among commentators that constructive knowledge of the factor should also fall within the scope of art. 763 CCC.⁴³ The reasoning is rather straightforward: if constructive knowledge were insufficient to trigger the application of art. 763 CCC, the factor would have no incentive to investigate the authenticity of the account receivable or to reduce the risks of factoring fraud. In this respect, a parallel can be drawn with art. 613 CCC, which bars the buyer from asserting warranty claims if he knew, or should have known, of the defect of title.

The scope of an investigation obligation, if such an obligation can be assumed, is 34 more controversial. Art. 7 of the Provisional Measures on Factoring explicitly stipulates that the factor has the obligation to review the authenticity of the underlying transaction and “ensure that initial ownership of the accounts receivable is clear and determined, the certificate(s) of previous transfer(s) are complete and there is no dispute over responsibilities”. The model factoring agreement drafted by the Commercial Factoring Expertise Committee also includes the obligation of the supplier to submit the original documents, such as the contract, invoice, and delivery certificate, to be reviewed by the factor. One commentator believes that this investigatory obligation is comprehensive, since in most cases factoring contracts involve ordinary debts that are not securitized.⁴⁴ For this reason, if a fabricated claim is reassigned to another factor, the assignee can be protected by art. 763 CCC only if he has discharged the obligation of investigation.⁴⁵ The scholarly opinion believes that, in the case of reassignment to another factor, the assignee deserves protection even if he has knowledge of the fabrication. This assumes that the flaw of the receivable has been purged by the first assignment⁴⁶ and fails to explain the reasoning for this conclusion, which deviates from the general rule that *bona fide* acquisition is unavailable for ordinary debts.

Another commentator believes that the standard of investigation imposed upon the 35 factor should not be too high. The investigation should be formal, but based on the standard of an ordinary person lacking relevant expertise. They also hold that only the original contract and the confirmation of the receivable should be subject to review.⁴⁷ However, this view is less differentiated and balanced, therefore failing to create incentives for the factors to prevent financial risks. It should thus be rejected.

⁴⁰ Huang Wei (ed.), Contract II, 913; He Yinglai, ZSS 2020/7, 28; Li Yu, LS 2019/12, 35.

⁴¹ He Yinglai, ZSS 2020/7, 32.

⁴² Shanghai Pudong Development Bank Co., Ltd. Changsha Branch v. Zoomlion Co., Ltd. (上海浦东发展银行股份有限公司长沙分行、中联重科股份有限公司合同纠纷案), Judgement of the SPC, (2017) Min Shen No. 132.

⁴³ Cui Jianyuan, JLA 2021/4, 66; Ding Junfeng, PJA 2021/4, 8; He Yinglai, ZSS 2020/7, 32–33; SPC, Contract III, 1776.

⁴⁴ Li Yu, LS 2019/12, 36–37.

⁴⁵ Li Yu, LS 2019/12, 36–37.

⁴⁶ Zhu Xiaozhe/Liu Jianfeng, PJA 2021/4, 44.

⁴⁷ Li Zhigang, JLA 2020/15, 48.

2. Legal Consequence

- 36 According to art. 146 para. 1 CCC, a receivable that is fabricated by the supplier and the debtor in conspiracy is void. In cases where the factor has no knowledge of the fabrication of the receivable, he may claim payment from the supplier, the debtor or both of them.⁴⁸ The claim against the debtor is based on art. 763 CCC and tort law, while the one against the supplier is based on tort law and contract law.⁴⁹
- 37 If the factor has knowledge of the fabrication of the receivable, the relationship between the factor and the supplier can be reinterpreted as a loan agreement, while the factoring contract – being a simulated act – is invalid.⁵⁰

Another form of factoring fraud is the creation of a collusive contract between the supplier and the factor to hide a real, but impermissible, loan agreement.⁵¹ In such a case, no real debtor is involved and art. 763 CCC is therefore inapplicable.

3. Necessity

- 38 Art. 763 CCC works to prevent the debtor from invoking the defense of nonexistence of the receivable. It consequently needs sufficient justification.⁵² Art. 405 BGB has often been cited for this purpose, stating: “If the obligor has issued a document relating to the debt then, if the claim is assigned and the document is presented at the same time, he may not, in relation to the new obligee, invoke the fact that the entering into or acknowledgement of the obligation is only occurring for the sake of appearance or that the assignment is excluded by agreement with the original obligee, unless the new obligee was aware of or ought to have known of the circumstances on assignment.”⁵³ However, the application of art. 405 BGB requires the issuance of a document relating to the debt by the obligor, which may give rise to the appearance of the existence of the debt. Under art. 763 CCC, such a certificate of debt is not required, which renders the threshold of application significantly lower. Thus, the justification of art. 763 CCC seems indeed questionable.

V. Notice by the Factor

- 39 Under art. 764 CCC the factor may notify the debtor of the assignment and, in doing this, has an obligation to disclose his identity and present the necessary certifying documents. Such documents include the factoring contract, notice letter of the assignment of claims, contract between the supplier and the debtor and trading documents.⁵⁴ Art. 764 CCC makes sense to a certain extent as it is hard for the debtor to verify the authenticity of the assignment. Also, the obligation of disclosure and provision of necessary documents can help the debtor to investigate the truthfulness of the assignment. Arguably, a flaw of art. 764 CCC is that it does not clearly stipulate the legal consequences following a breach of the obligation to disclose the factor’s identity and to present the necessary certifying documents.⁵⁵ However, we can assume that, in this case, the debtor may refuse to pay the receivable to the factor.

⁴⁸ Ding Junfeng, PJA 2021/4, 8.

⁴⁹ Ding Junfeng, PJA 2021/4, 8.

⁵⁰ Ding Junfeng, PJA 2021/4, 8.

⁵¹ Chinese Business Law.

⁵² He Yinglai, ZSS 2020/7, 29.

⁵³ Langenscheidt Translation Service.

⁵⁴ Ding Junfeng, PJA 2021/4, 8.

⁵⁵ Huang Hexin, 188.