



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



广东省商业保理协会  
GUANGDONG FACTORS ASSOCIATION



深圳市商业保理协会  
SHENZHEN FACTORING ASSOCIATION



亚洲保理  
ASIAFACTOR  
发|现|企|业|信|用|价|值



汇法网  
www.Lawxp.com



催天下  
www.CUITX.CN

# ISSUE 12

## Analysis Research Report on Factoring Judicial Precedents From March 2015 to February 2018

- Since March 2015, The Commercial Factoring Expertise Committee of China Association of Trade in Service, Guangdong Factors Association, Shenzhen Factoring Association, Asiafactor (Shenzhen), [www.lawxp.com](http://www.lawxp.com) and Cuitianxia has been jointly issued 12 issue of <Analysis Research Report on Factoring Judicial Precedents>, The Judicial Case Study Working Group conducted research and analysis of nearly 500 cases of factoring judicial precedents, explored the status quo and laws of factoring disputes, and found beneficial inspirations from them, which could be used as a reference to contribute to the development of the factoring industry.
- The working group will continue to share its research results with friends working in the factoring industry and those concerned about the industry and make our shares of contribution. All comments are appreciated.



If you have any advice or suggestion, please contact:

Li Mei: [mei.li@asiafactor.com](mailto:mei.li@asiafactor.com); Zhou Aiping: [aiping.zhou@asiafactor.com](mailto:aiping.zhou@asiafactor.com)

## 1. Data analysis on Factoring Precedents

- a) Background
- b) Risk structure
- c) Analysis on risk categories
- d) Analysis on special risk items
- e) Lawsuit analysis
- f) Analysis on the factor
- g) Analysis on the place where the dispute arises
- h) Industry Analysis

## 2. Data analysis on Legal precedents of commercial factoring

- a) Analysis on categories of risks
- b) Analysis on special risks
- c) Analysis on cases
- d) Analysis on places where disputes arise
- e) Analysis by industry

## 3. Special Topic: Credit Insurance

- a) Data analysis on credit insurance precedents
- b) Industry analysis of credit insurance precedents
- c) Should the debtor be sued first in the settlement of insurance claim?
- d) Is the Exemption Clause of the credit insurance reasonable?

## 4. Special Topic: Commercial Bill

- d) Analysis on bill holders' success rate
- e) Analysis on the non-causation principle of bills
- f) Analysis on the right of defense
- g) Implications of the analysis on commercial bill precedents to commercial factoring
- h)

## 5. Compulsory Execution Notarization

- d) Introduction to Compulsory Execution
- e) Procedure for Conducting Compulsory Execution
- f) Advantages of Factoring with Compulsory Execution
- g) Limitations of Factoring with Compulsory Execution
- h) Interpretation on Precedents of Compulsory Execution

## 6. E-contract

- d) Current situations of physical contracts
- e) Advantages of e-contract
- f) Legal basis
- g) Process
- h) Legal precedents

## 7. Implications of Legal Precedent Analysis

- d) Jurisdiction objection
- e) Defects in affirming rights
- f) Effect of delivery by EMS
- g) Means of fraud risk
- h) Indirect payment by the buyer

Major laws and regulations


## 8. Research on Recent Legal Developments

- a) Interpretation of the judgment summary (II) of the Tianjin High People's Court
- b) Interpretation on Articles in Trial Guidelines on Cases over Factoring Contract Disputes issued by Qianhai Court

## 9. Stress Testing Model for Factoring Risk Control

- a) Introduction of the model

## Appendix



# 1.Data analysis on Factoring Precedents (including bank factoring and commercial factoring)

up to **500**

factoring legal precedents (**including bank factoring and commercial factoring**)

## Collection of precedents

- Collected factoring precedents (including bank factoring and commercial factoring) nationwide through multiple channels since Jan 2014.
- Analyzed the precedents and summarized the imperative legal issues.

## Summarization of risk items

- Extracted 1 or 2 key risk items out of each precedent.
- By authentication, it is the factor's lack of effective identification and control over key risk items that cause the disputes.

## Output of the serial analytic results

- Summarized and categorized the risk items to form a complete framework.
- Generate the serial analytic results with positive significance to the risk control over factoring.



## Risk categories

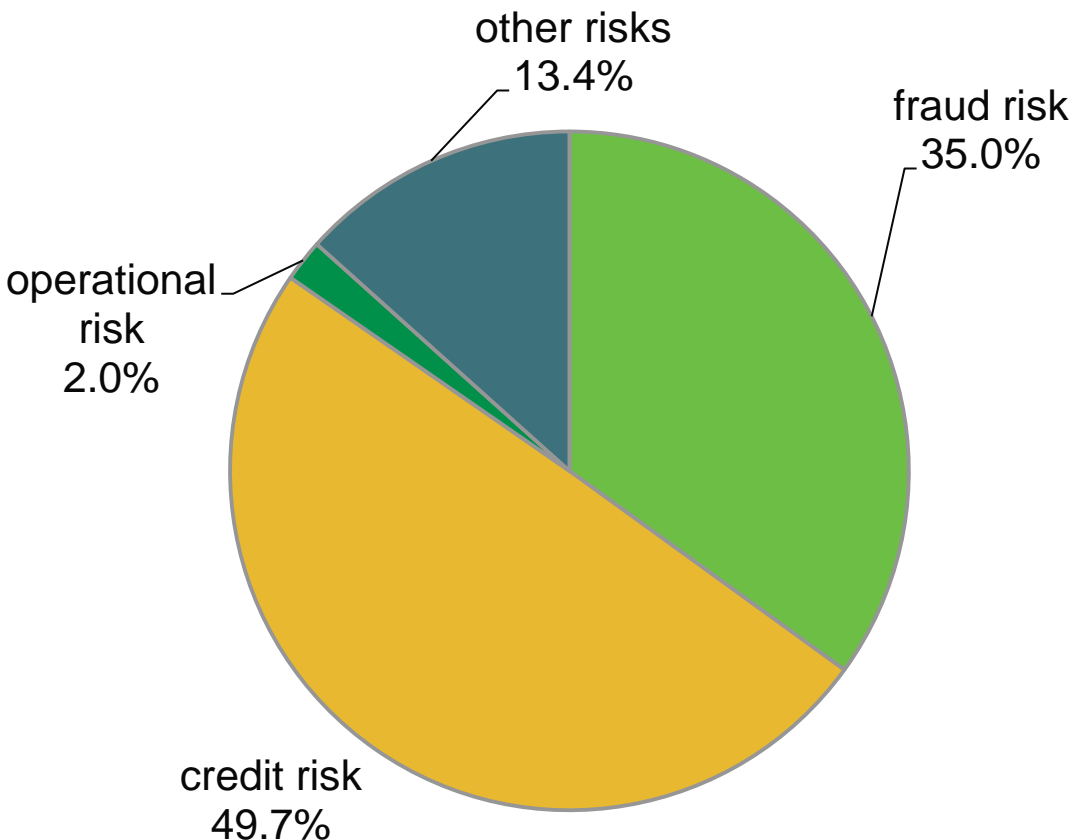
- Basing on each factoring precedent, define risk categories and summarize the statistics:



## Special risk items

- Special risk items are the most important risk factors for factoring. These risk items are summarized from the factoring precedents:
  - Fraudulent trade
  - Defects in AR assignments
  - Indirect payment
  - Counterfeited assignment of accounts receivable
  - Stop-payment order issued by the court to the overseas buyer
  - Distortion of the court
  - AR assignment prohibition clause
  - Jurisdiction objection
  - Disputes
  - Withholding interest in factoring financing
  - Absence of original copy of evidence

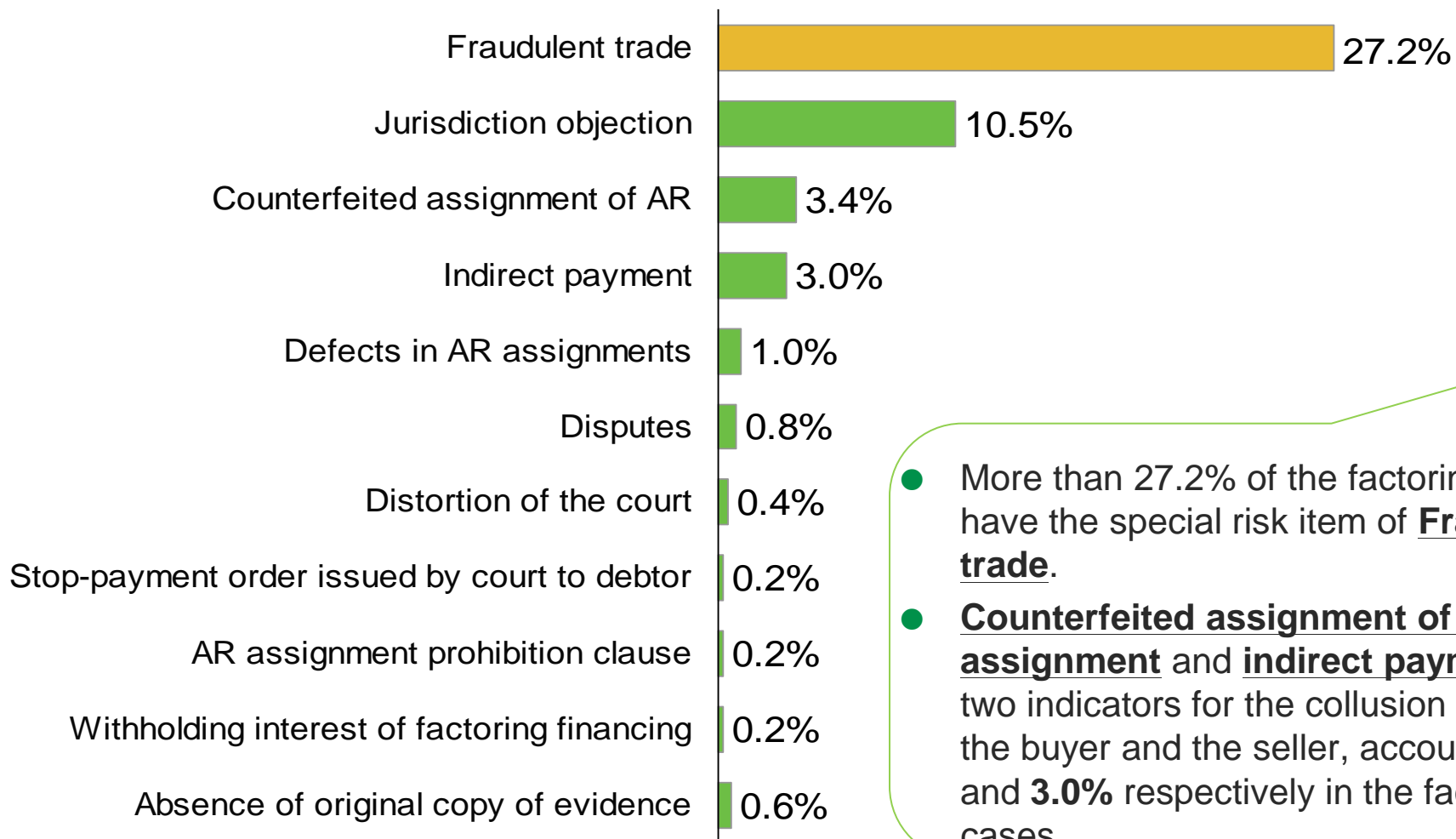
## Division of risk categories



- 35.0% of the factoring cases were caused by the **fraud risk**.
- The second largest risk category is the **credit risk**. Due to the limitation of data sources, nearly 20% of the precedents' written judgments have no explanation on the specific matters in issue. Given their intuitive nature, these cases are categorized into the credit-risk precedents. **In fact, supposed the statistics are sufficient, the proportion of credit-risk precedents should be far less than 49.7%, while the fraud-risk ones may far exceed 35%.**



## Analysis on special risk items



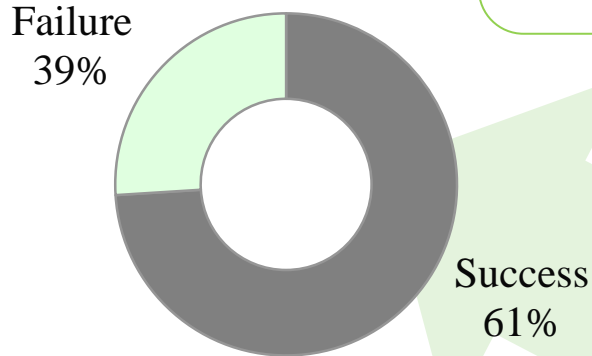
- More than 27.2% of the factoring cases have the special risk item of **Fraudulent trade**.
- **Counterfeited assignment of AR assignment** and **indirect payment**, the two indicators for the collusion between the buyer and the seller, account for **3.4%** and **3.0%** respectively in the factoring cases.



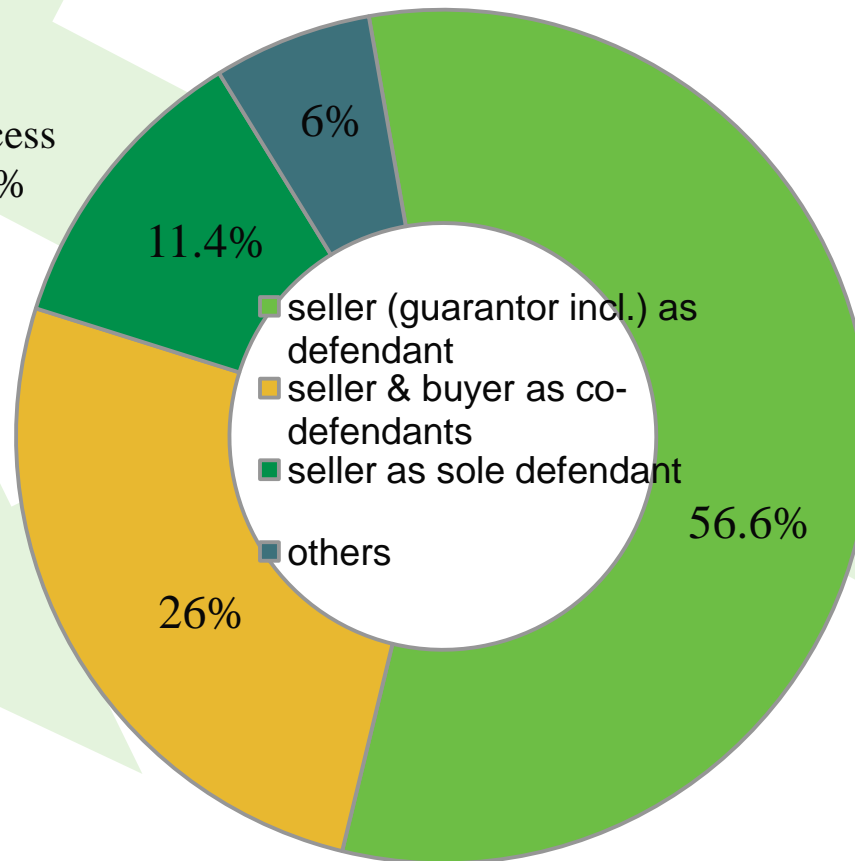
# Analysis on Lawsuits

- In 56.6% of the precedents, the factor choose to sue only the seller (including the guarantor) to be responsible for the repurchase, and the success rate was as high as 99.1%.
- The success rate of cases with the buyer as the sole defendant is 61%.

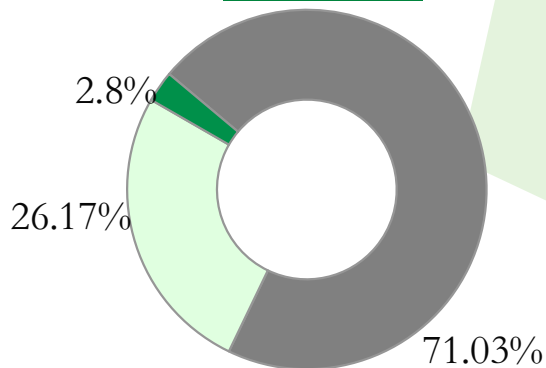
## The factor's success rate of cases with the buyer as the sole defendant



## Analysis on the Defendants



## The factor's success rate of cases with the buyer and the seller as co-defendants



## The factor's success rate of cases with the seller (including guarantor) as the defendant

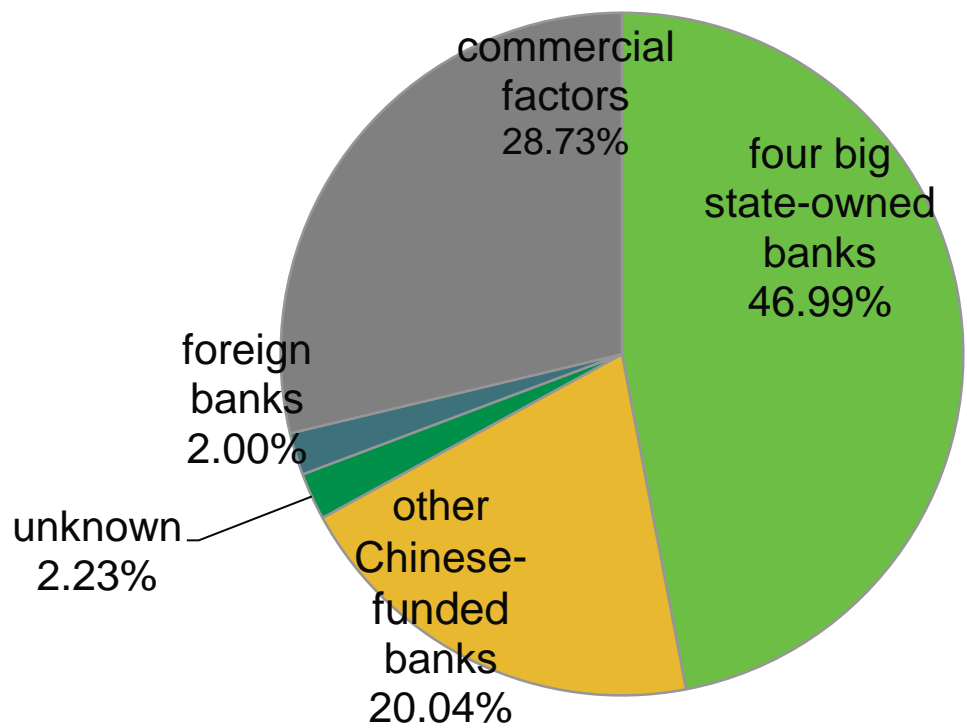


# Analysis on the affected Factors

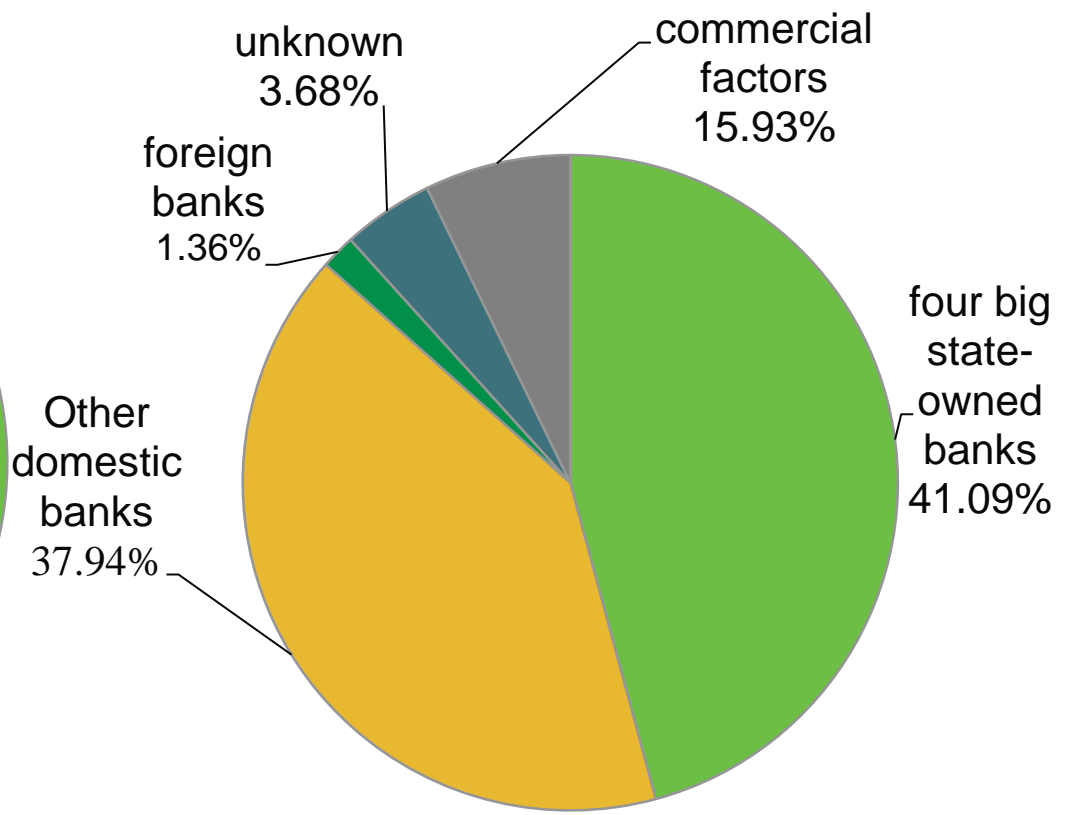


- In terms of the number of cases and the amount of money involved, the four big state-owned banks account for 46.99% and 41.09% respectively.
- In terms of the number of cases and the amount of money involved, the commercial factoring companies account for 28.73% and 15.93% respectively, both witnessing a substantial increase of the proportion. However, the data are collected from closed precedents. Considering the analysis on risk categories, supposed the statistics is sufficient, the two proportions may be even higher.

**number**



**amount**

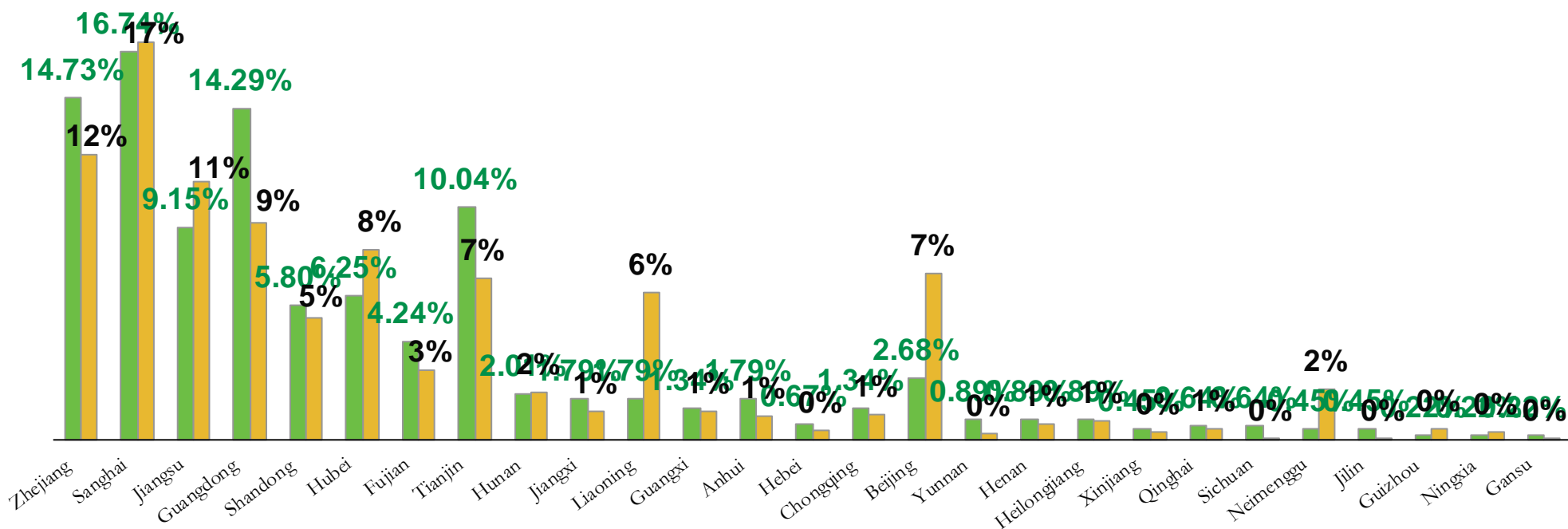


# Analysis on the Dispute Arising Place

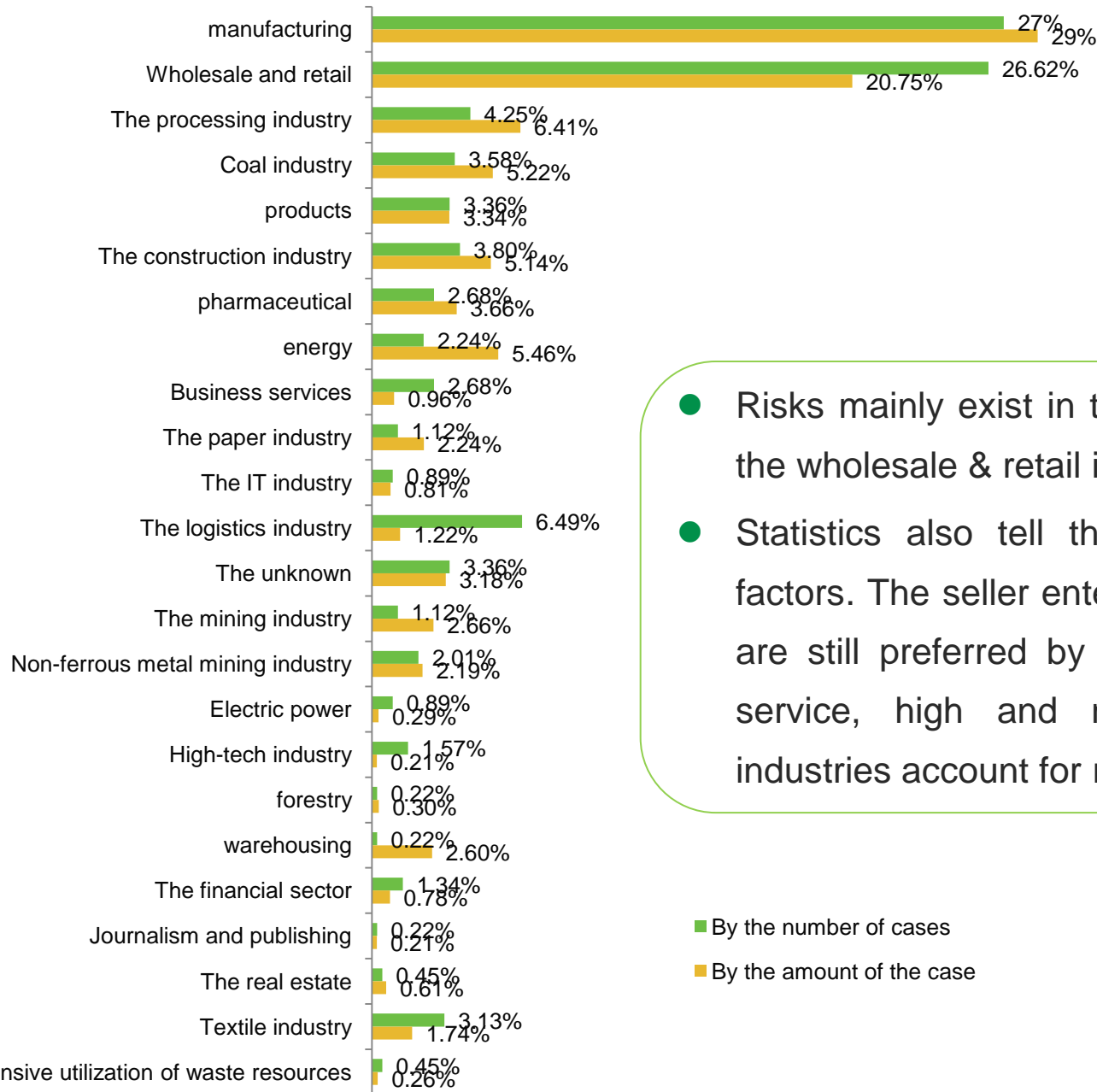


- Jiangsu, Zhejiang, Shanghai, and Guangdong encounter a higher frequency of risks in the factoring business than other regions, probably because these four regions are more active in conducting the factoring business.

■ number ■ amount



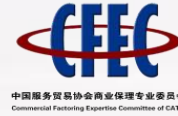
# Industry Analysis



- Risks mainly exist in the manufacturing industry and the wholesale & retail industry.
- Statistics also tell the major customer groups of factors. The seller enterprises of traditional industries are still preferred by factors, while the commercial service, high and new technology, and power industries account for rather small proportions.


■ By the number of cases  
■ By the amount of the case





## 2. Data analysis on Legal precedents of commercial factoring

up to **100** commercial factoring legal precedents



Collection of precedents



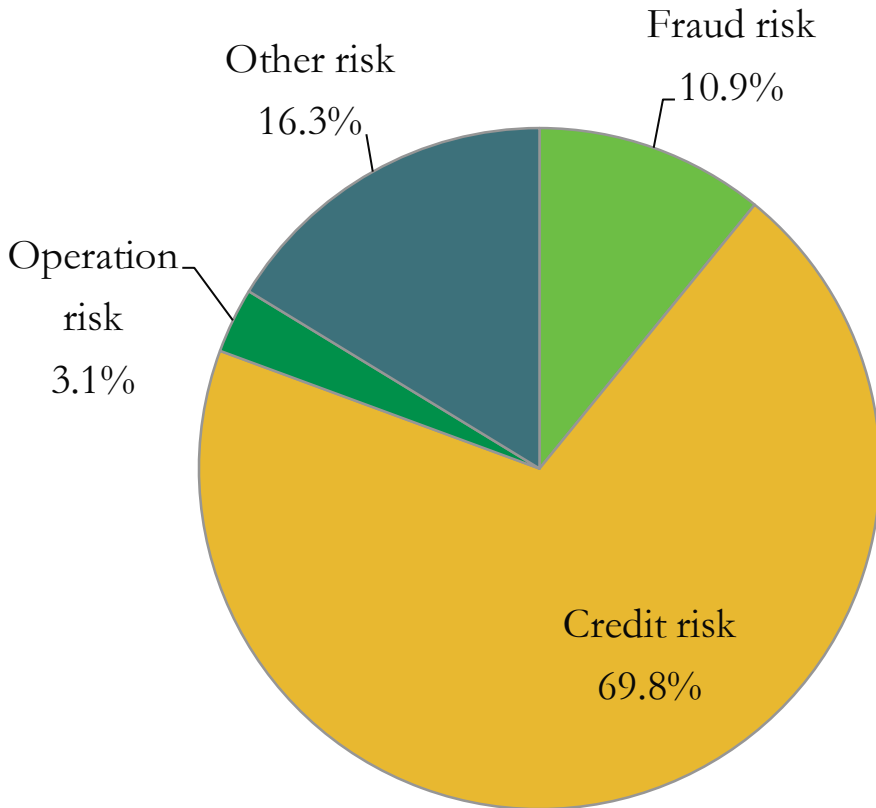
Summarization of risk items



Output of the serial analytic results



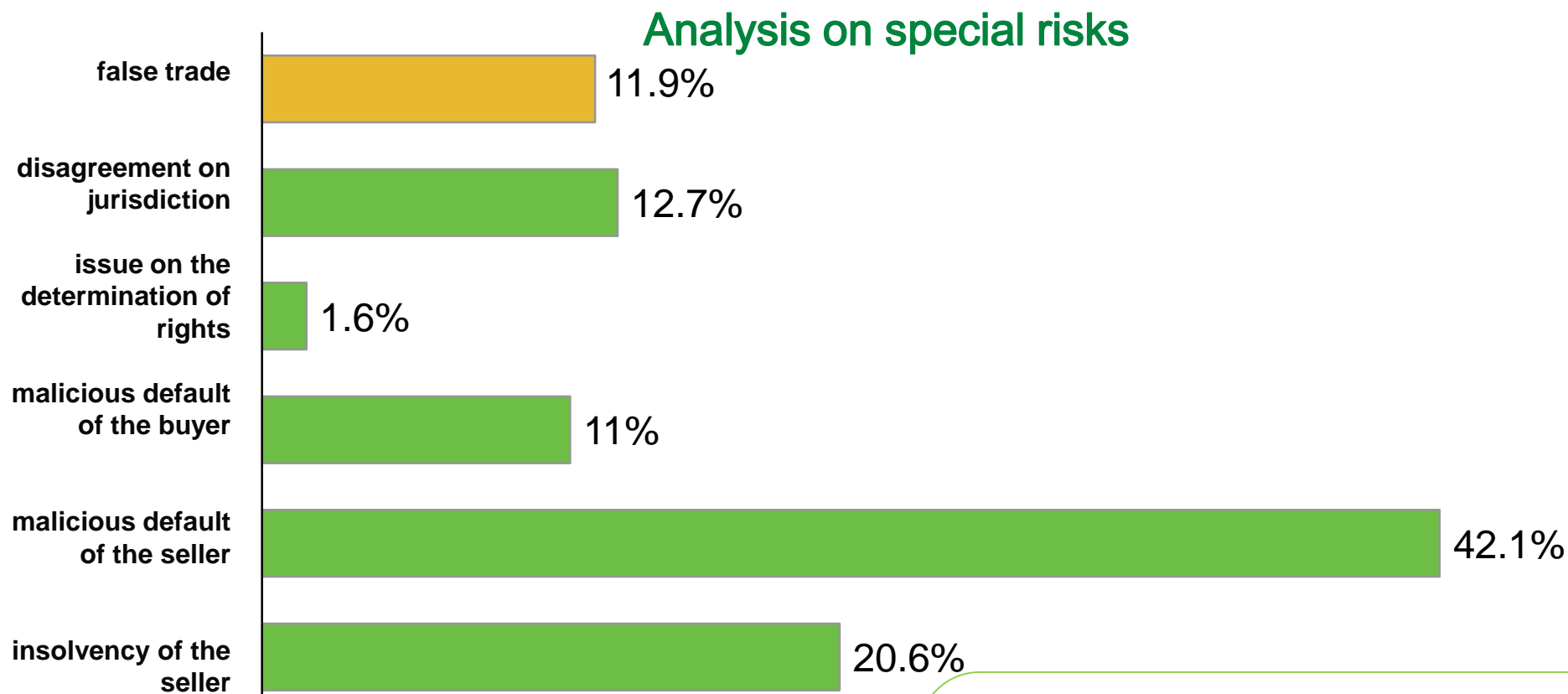
## Classification



- 10.9 % cases on commercial factoring are caused by **fraud risk**
- The proportion of cases on commercial factoring caused by fraud risks to all is higher than that of cases on factoring (bank factoring and commercial factoring) to all, which reflected that commercial factoring companies highly prioritize the prevention of false trade and other fraud risks and have higher capacities to prevent and control risks.



# Analysis on special risks



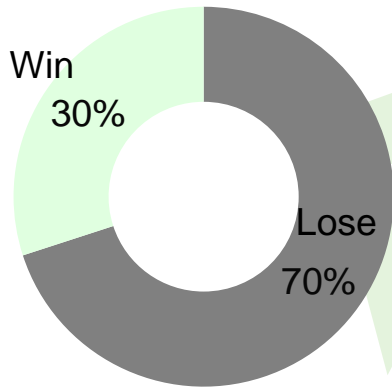
- 42.1% of cases on commercial factoring are caused by **malicious default of the seller**
- False trade contributes to 11.9% of all cases on commercial factoring, lower than that of cases on factoring (bank factoring and commercial factoring)



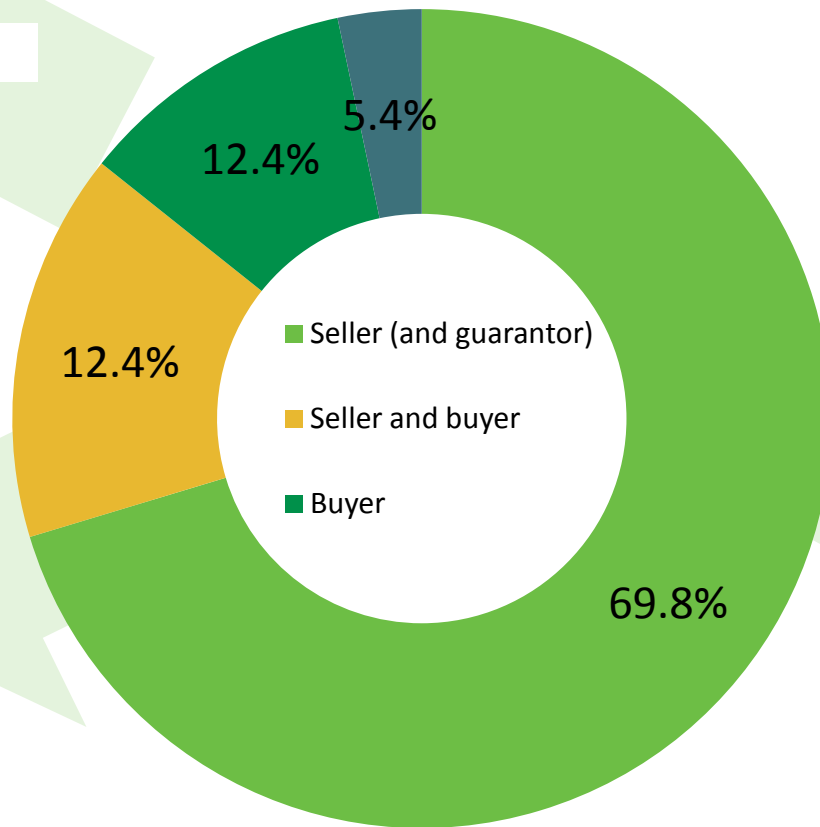
# Analysis on cases

- In 69.8 % of precedents, commercial factors choose to only require the seller (and guarantor) to perform the responsibility of repurchase, winning 98.57% of cases.
- While when the buyer is the only defendant, the chance of winning is only 30%, which is worth exploring

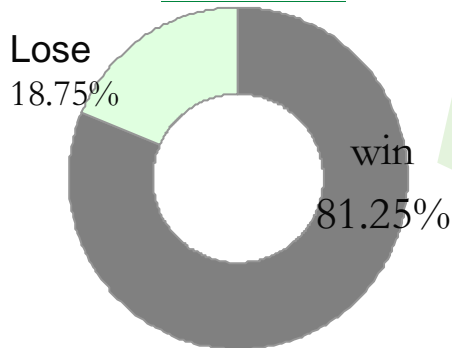
Factor's winning rate where the buyer is the only defendant



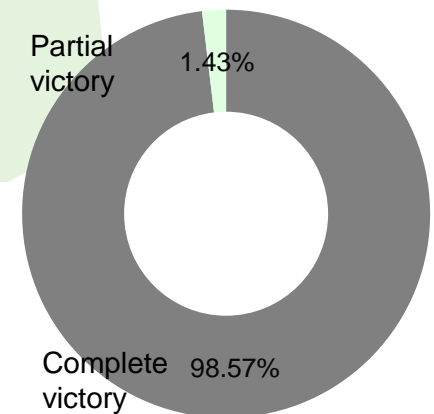
## Analysis of defendant



Factor's winning rate where the buyer and the seller are defendants



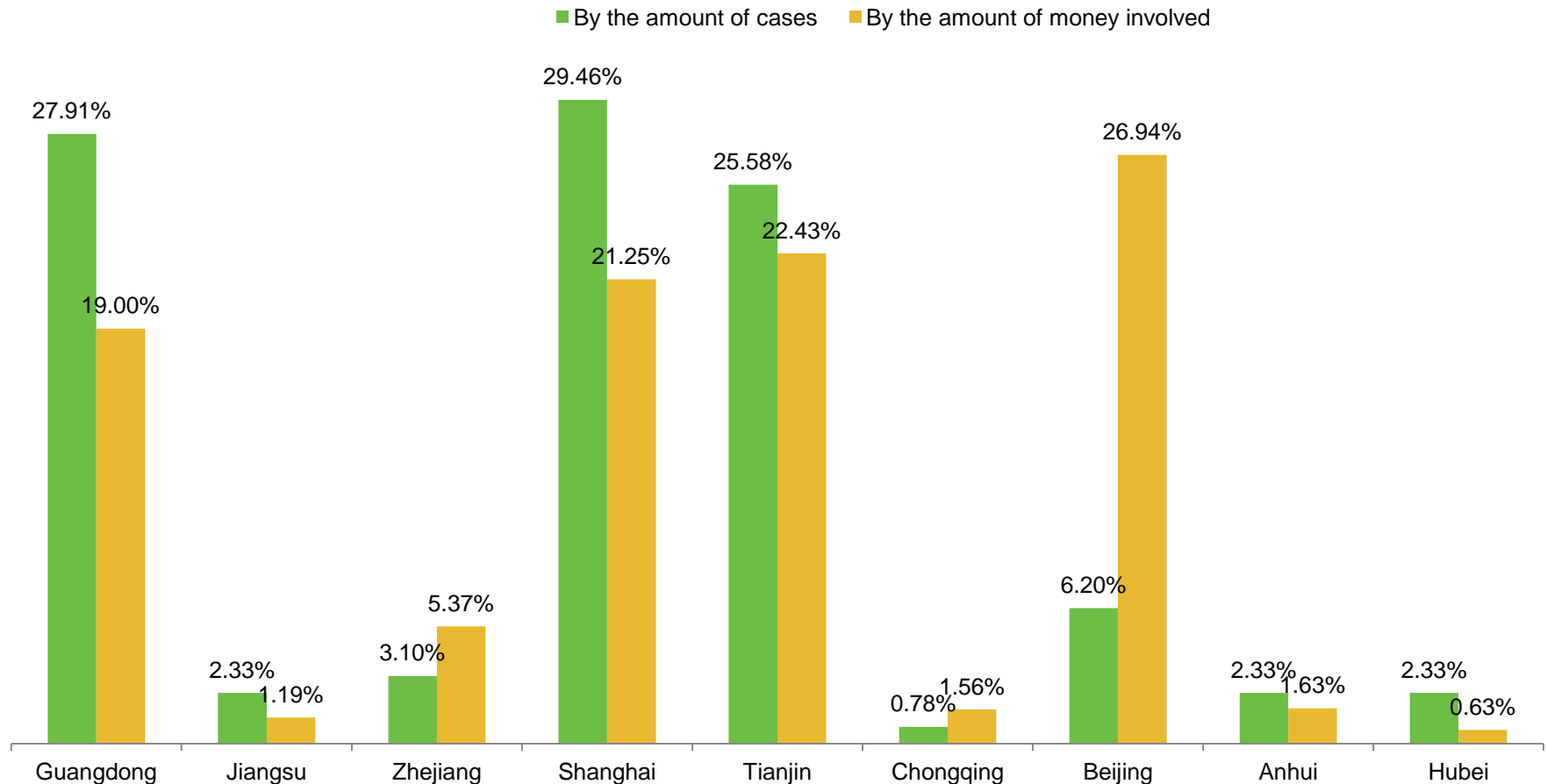
Factor's winning rate where the seller (and guarantor) are defendants



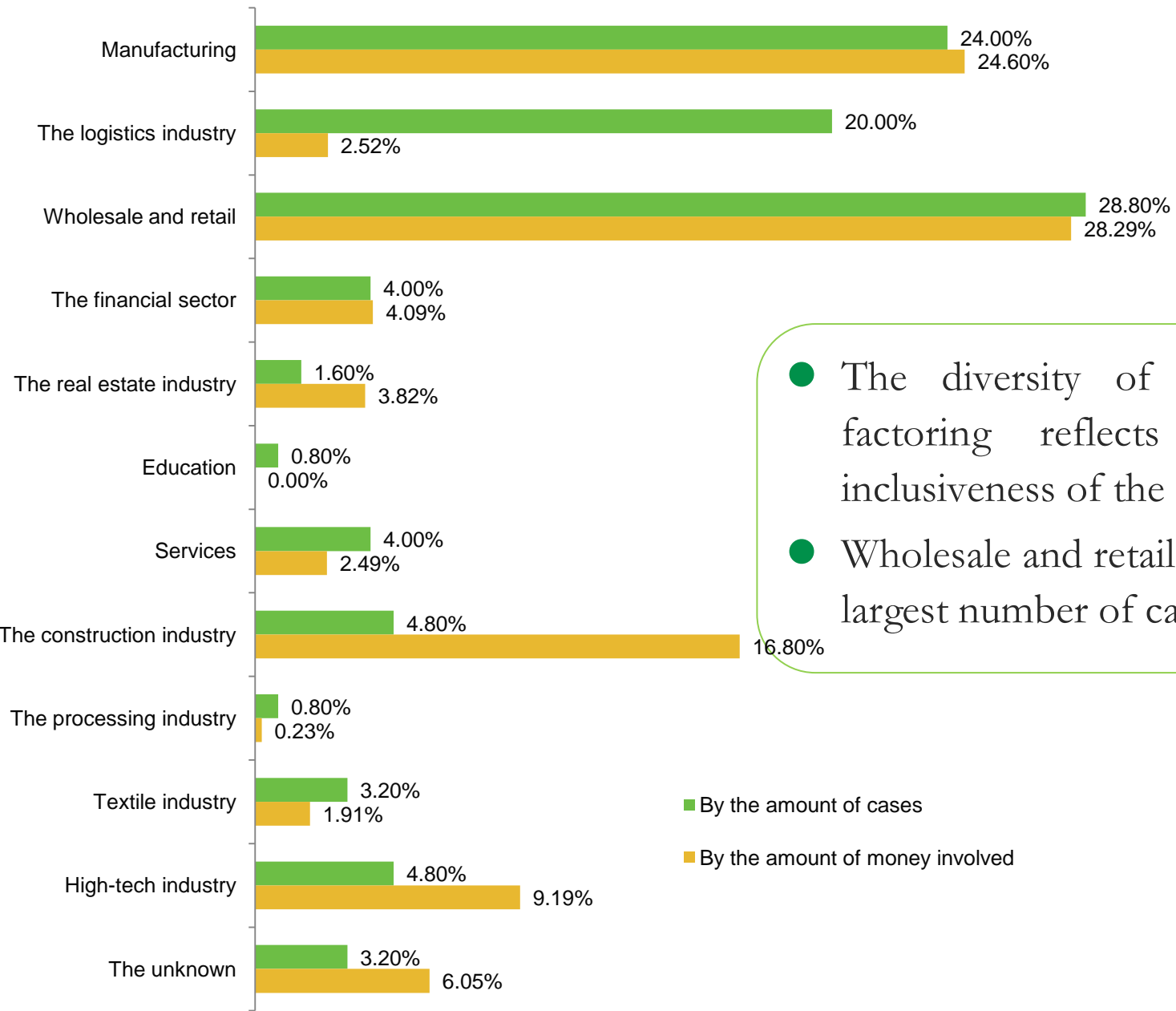
# Analysis on places where disputes arise



- Disputes on commercial factoring frequently occur in Guangdong, Beijing, Shanghai, Tianjin etc.
- Beijing has fewer cases, but has the largest amount of money involved.



# Analysis by industry



- The diversity of cases on commercial factoring reflects the flexibility and inclusiveness of the market.
- Wholesale and retail (trade) accounts for the largest number of cases.

■ By the amount of cases  
■ By the amount of money involved



(2015)  
Yue Yi  
Chang  
Zhong Zhi  
Yi Zi  
No.00056

Because of the default in the third party's debt, the seller was sued and subjected to compulsory execution. When the court judicially froze the seller's accounts receivable that had been assigned to the factor, the factor raised an objection to execution. Though the factor in this case conducted an undisclosed factoring, the court regard that the notice to the debtor was not the essential element for the validity of the agreement on the creditor's right assignment; and the court also regard that a failure to perform the obligation to notify would not invalidate the aforesaid agreement. Therefore, the factor had legally obtained the creditor's right. The court thus sentence to support the factor's objection to execution.

The factor claimed that the buyer should fulfill the accounts payable. The buyer defended that the seller did not actually deliver the goods and that the accounts receivable did not exist. The seller acknowledged the fact of non-delivery of the goods. Nevertheless, from the perspective of the court, both parties, in spite of their recognition of the authenticity of the *XXX Purchase and Sale Contract* and confirmation of the stamps' authenticity in the *Testimonial of Goods' Right Assignment*, *Testimonial of Goods' Receiving Acknowledgement*, and *Confirmation of the Notice on Accounts Receivable Assignment*, the seller and the buyer could neither give any reasonable explanation on the successive stampings, nor provide related evidence to overturn the written evidence above. Therefore, the court believes that the statements from the seller and the buyer were insufficient to overturn the fact that the accounts receivable were real as evidenced in the written form, and hence adjudicates that the buyer should be responsible for the payment.

(2015)  
Er Zhong  
Bao Min  
Chu Zi  
No. 29



# Commercial Factoring Case Study (2)



- In this case, the factor's individual liquidation was cancelled due to the bankruptcy process of the buyer. The factoring company was forced to participate in the bankruptcy liquidation and faced the risk of not being able to receive full compensation. From this case, it can be seen that it is particularly important for factoring company to promptly and efficiently collect and seize opportunities for risk disposal in the event of a credit risk on the buyer.

(2016)  
Su 02  
C.FR.  
No.37\*\*

- In this case, the factoring company entered into a factoring contract with the seller to establish a factoring legal relationship. On the basis of the factoring financing requested by the seller and the buyer's confirmation of the debt, the factoring firm has successively recovered the corresponding accounts from the buyer. Shortly afterwards, the buyer suffered a serious loss due to business and became insolvent. The buyer went into bankruptcy proceedings and the bankruptcy administrator took over the bankruptcy liquidation work.
- When reviewing the assets, the bankruptcy administrator considers that the buyer's repayment action on the factoring company occurred within six months prior to adjudicating the bankruptcy acceptance and submitted the bankruptcy revocation right to the court, requesting the factoring company to return the payment received.
- The court held that, according to Article 32 of the Bankruptcy Law, "If the debtor has such circumstance stipulated in the first paragraph of Article 2 of this Law as within six months before the people's court accepting an application for bankruptcy, the individual creditor has been paid. The administrator has the right to request the people's court to revoke it. The buyer's repayment to the factoring company within six months before the bankruptcy application is subject to individual repayment. This repayment shall be revoked according to law and the factoring company shall return the repayment to the buyer.

# Commercial Factoring Case Study (3)



- Although this case didn't involve factoring business, it is still significant to discuss some legal issues concerning the receivable accounts as a security object.

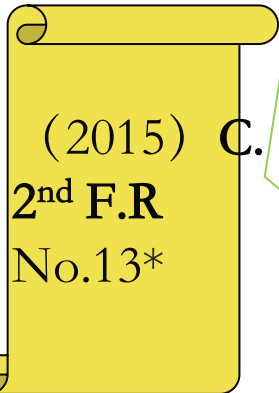
- In the case of disputes over financial loan contracts among Xuzhou Branch of China Minsheng Banking Co., Ltd., Anhui Coal Transportation and Marketing Co., Ltd. and Jiangsu Surun Energy Group Co., Ltd., Xuzhou Branch of China Minsheng Banking Co., Ltd. the Pledgee, Xuzhou Branch of China Minsheng Banking Co., Ltd., lodged a direct appeal for "Anhui Coal Transportation and Marketing Co., Ltd. to repay 30 million yuan of borrowings and corresponding interest within the scope of pledges receivable from Surun Company."
- The judgment of first instance was: "Xuzhou Branch of Minsheng Bank has the right to be given priority to repay from the Anhui Coal Company's receivable accounts of xxx Yuan pledged by Surun Company. Anhui Coal Company performs the above-mentioned payment obligations to Xuzhou Branch of Minsheng Bank within the scope of XX Yuan. Jiangsu High Court upheld the judgment in the second instance.
- In this case, the pledgee appealed to the sub-debtor to pay the pledged amount directly to the pledgee, which was supported by courts' first and second instance. This shows that some courts in the judicial practice have recognized that the pledgee can directly appeal to the subordinate debtor for payment.

(2013)  
Xu C. FT  
No.27\*

# Commercial Factoring Case Study (4)



- From this case, it can be seen that in the factoring business based on real trade, bills of exchange as one of the payment methods are more secure in specific situations than transfer (cash) payment methods for factoring firms.



- In this case, the seller applied for factoring financing to the factoring company based on the factoring legal relationship established with the factoring company and transferred the buyer's commercial draft for payables after endorsement to the factoring company. After the expiry of the bill of exchange, the buyer refused to redeem the goods due to disputes in the payment and the incorrect writing of the facet elements. Factoring company appealed to the court for payment.
- The court held that the buyer had no objection to the authenticity of the bill of exchange and that the error on the bill of exchange was not a necessary record specified in Article 9 of "Negotiable Instruments Law of the People's Republic of China", so the bill should be a valid bill. At the same time, the court held that instrument is circulating securities and it has the abstraction principle. Except a direct defense between the parties due to the invalid original reasons, the other through the endorsement of the goodwill of the parties to the bill circulation is the right holder of the bill, the rights on the bill can be exercised to the debtor. Its effectiveness in principle is not affected by the effectiveness of the cause relationship. And thus the court judged that the buyer should bear the responsibility of redemption.

# Commercial Factoring Case Study (5)



- Factoring company bears the burden of proving the authenticity and validity of debts when it claims payment from the buyer. This case reveals the importance of pledging the original trade documents when factoring the financing business.

- In this case, the factoring company provided corresponding financing to the seller based on the assignment of the seller's receivables, but the buyer did not pay the corresponding payment after the receivables were expired. The factoring company sued the buyer to the court without the support of the court at the first instance. The factoring company filed an appeal.
- The court of second instance held that in the lawsuit, the buyer objected to the authenticity of the creditor's right of the receivables, and held that the seller failed to fulfill the delivery obligation. After the invoice was issued, it was set invalid on its own. The payment terms have not yet been fulfilled. At the same time, the court held that the factor advocating the authenticity of the creditor's rights is the precondition for the buyer to fulfill its obligations, and the "*Product Purchase and Sales Contracts*", "*Outbound Warehouse Receipts*", and "*Material Receipts*" submitted by the factoring company to the court are all copies. There are also doubts that are not consistent with the common sense. The buyer also didn't not recognize this, thus it cannot achieve the degree of demonstrating the true existence of the creditor's right.
- The court of second instance held that the buyer is not responsible for the payment and decided to dismiss the appeal in accordance with the law and uphold the original judgment.

(2016)  
Lu 14  
C.FR.  
No.28\* \*



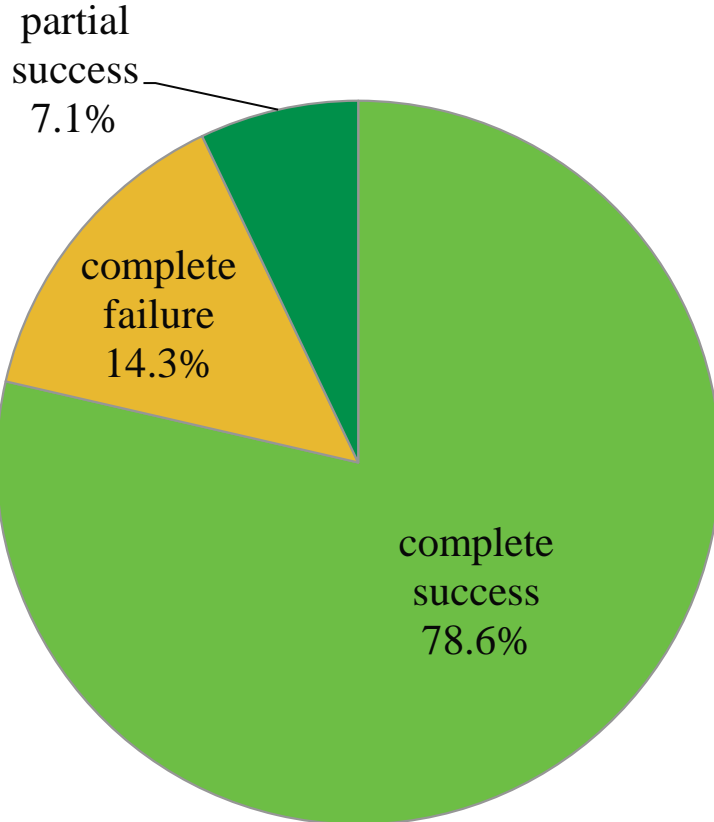
## 3. Analysis on Credit Insurance Precedents

# Data Analysis on Credit Insurance Precedents

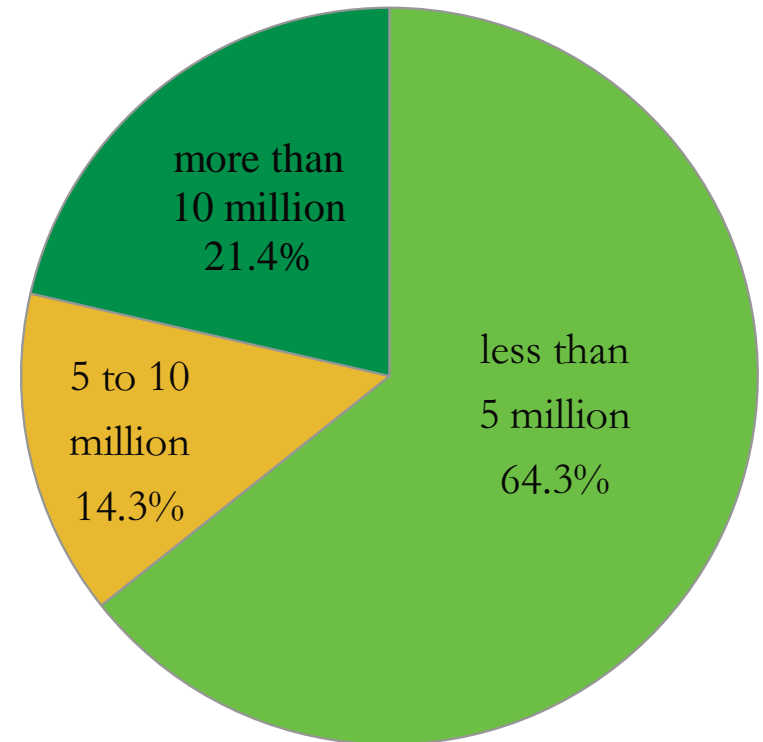


- In the credit insurance precedents, the rate of complete success of the insurant (usually the seller) reaches 78.6%.
- The proportion of cases involving less than RMB 5 million stood at 64.3%.

### By success rate of the insurant



### By amount (RMB)



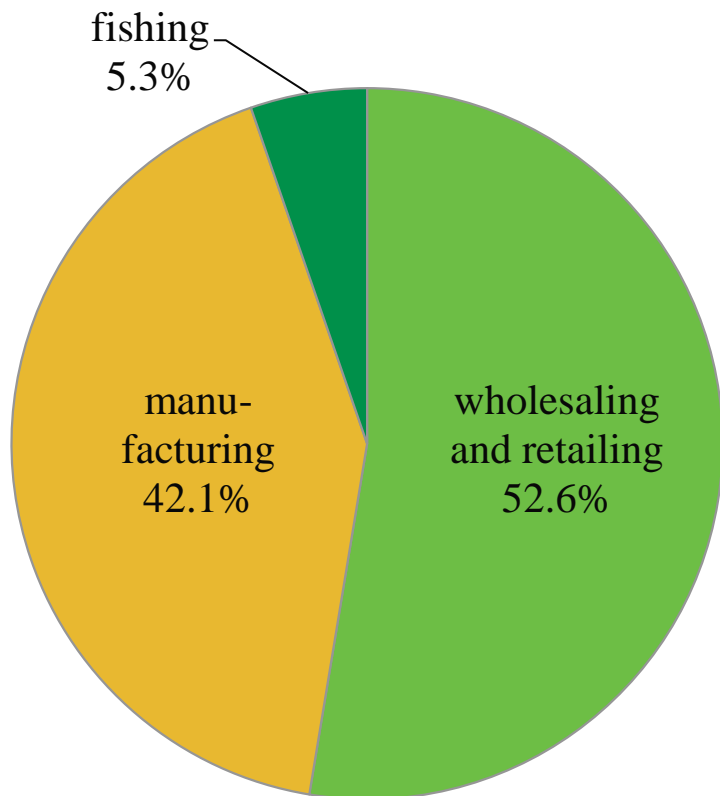


# Industrial Analysis on Credit Insurance Precedents

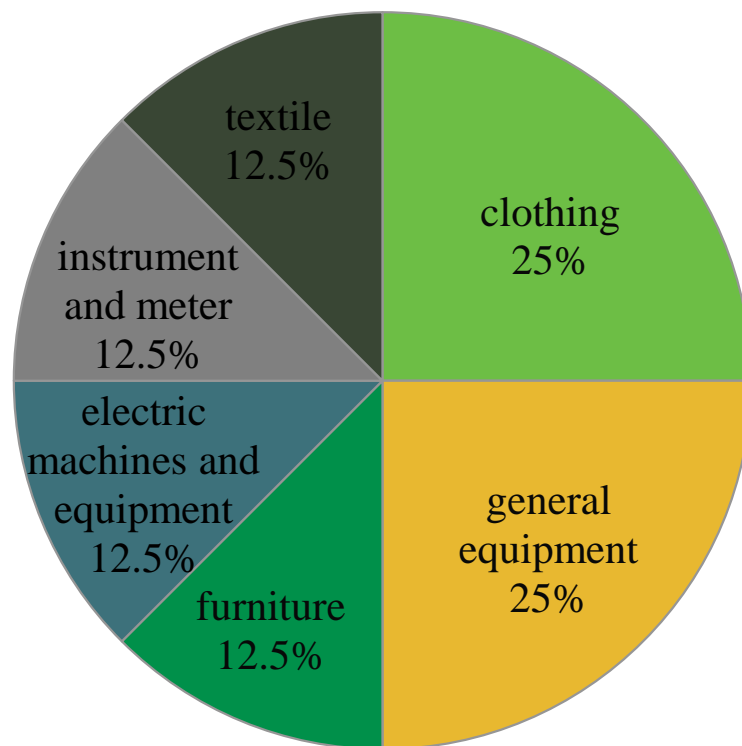



- In terms of the number of cases, credit insurance disputes mainly occur in the manufacturing and wholesale & retail industries with a proportion of 42.1% and 52.6% respectively.
- The clothing and the general equipment manufacturing industries have the largest proportion in the manufacturing industry.

### Industrial broad category



### specific industries of manufacturing



- 
- In credit insurance, when a transactional dispute arises, the general insurance clause requires that the seller (insurant) should first sue the buyer and then claim against the insurer.
  - However, in the precedents below, the court believes that unless the insurer can submit sufficient evidence to prove the existence of dispute, the seller (insurant) is entitled to directly claim against to the insurer.

**Guangdong**

**(2015) Yue Gao Fa Min Er Shen Zi No. 546**

**Fujian**

**(2015) Rong Min Zhong Zi No. 2053**

**Guangdong**

**(2014) Sui Zhong Fa Jin Min Zhong Zi No. 460**

# Are the Credit Insurance Exemption Clauses Widely Recognized?

Can the insurer claim a liability exemption at the excuse that the seller does not invoice and declare the transaction in time?

Can the insurer claim a liability exemption at the excuse that the seller does not submit the *Letter of Notice on Possible Damages* in time



Can the insurer claim a liability exemption at the excuse that the seller continues to supply goods while the buyer defaults in payment?

Can the insurer claim a liability exemption as the seller does not comply with the contract to claim its right against the guarantor first?

Can the insurer claim a liability exemption as the seller directly initiate the prosecution without first claiming against the insurer?

- The court's denial of the exemptions leads to a pro-insurant environment.
- While the insurer's disclaimer should be based on scientific data models, it should also rationally protect the right to claim of the insurant. In that case, the rationality of the disclaimer need further testing in judicial practices.



**(2015)  
Rong Min  
Zhong Zi  
No. 2053**

- The credit insurance contract has clear definitions on the scope of settlement of claims and the liability exemptions under specific circumstances.
- However, when a dispute occurs, usually both parties, especially the insurant, tend to challenge the exemptions. In this precedent, the court denied all the following exemptions commonly seen in an insurance contract.



## 4. Analysis on Commercial Bill

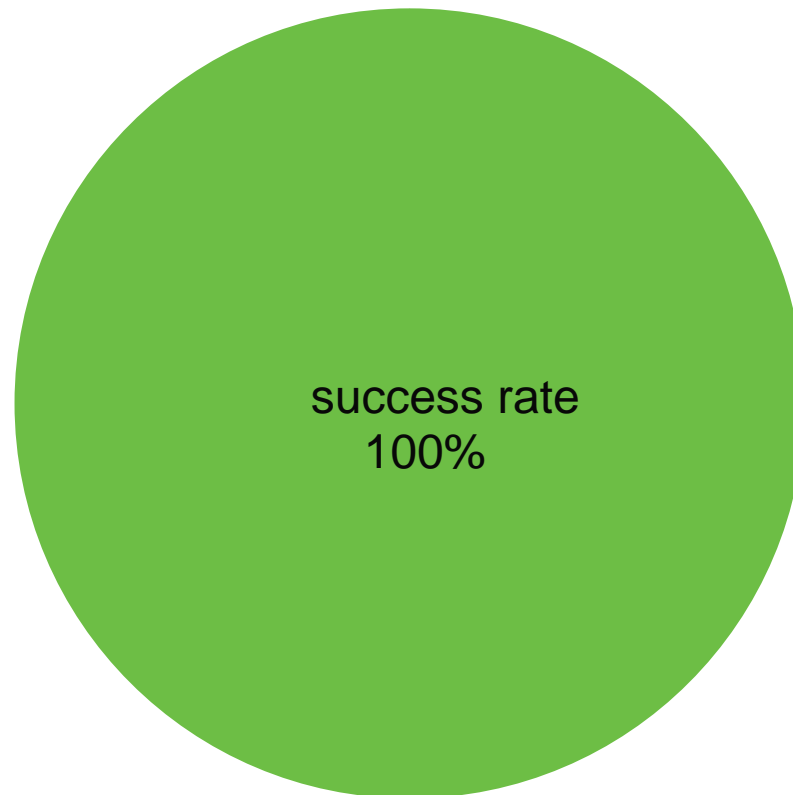


# Analysis on the Bill Holder's Success Rate



- In commercial acceptance precedents, the success rate of the bill holder reaches 100%.
- This statistical result indirectly reflects the non-causative legal characteristic of bills.

## Bill holder's success rate



# Analysis on the Non-causative Nature of Bills

Liaoning

(2015) Da Min San Zhong Zi  
No. 1027

Hubei

(2015) E Qing Shan Min Er Chu  
Zi No. 00475

Sichuan

(2015) Gao Xin Min Chu Zi No.  
6176

Shanghai

(2015) Jing Min Si (Shang) Chu  
Zi No. 2765

- In laws concerning the commercial bill, the non-causative nature is a vital feature. When a dispute over commercial bill arises, as the bill holder executes the right of recourse against the bill drawer / endorser / guarantor, the bill drawer / endorser / guarantor tends to raise all kinds of defenses.
- However, as long as the holder obtains the bill legally, and the bill is in the format required by the *Negotiable Instrument Law* and has complete recorded items and continuous endorsements, the bill holder is able to confront any defense raised by the bill drawer / endorser / guarantor.
- The precedents in the table reflect the non-causative legal characteristics of bills.





- When a bill dispute enters the litigation stage, usually the debtor will raise various defenses, including that the debtor thinks the drawing of the commercial bill does not have an authentic credit-debt relationship.
- According to the *Negotiable Instrument Law* and judicial interpretations, the debtor of the bill can only execute the right to defense against the bill holder with a direct credit-debt relationship with the debtor. The court does not support the defense against the bill holder of a transferred bill with endorsement.
- The following precedents properly represent the court's stance.

## Zhejiang Precedent

- (2014) Su Shang Zhong Zi No. 0087

## Shanghai Precedent

- (2015) Pu Min Liu Shang Chu Zi No. 737



# Analysis on the Right to Defense (2)



- According to the *Negotiable Instrument Law* and its interpretations, the non-causative nature of commercial bills is also a concept of relativity. When the bill holder obtains the bill by illegal means such as fraud, steal, and threat or obtains the bill with knowledge of the aforesaid circumstances yet with an ill intention; or when the bill holder obtains the bill with knowledge of the defenses between the debtor and the drawer or between the creditor and the remote holder, the non-causative nature of the bill will be overturned.
- However, in the following precedents, the court clearly requires the drawer or endorser of the bill should provide evidence to support the aforesaid defenses. Otherwise, the drawer or endorser will bear the adverse result of the litigation.

**Zhejiang**


(2015) Zhe Jia Shang Zhong Zi No. 582

**Zhejiang**

(2015) Zhe Hang Shang Zhong Zi No. 2308




- According to the previous analysis, we can draw experience to commercial factoring businesses with the commercial bill as means of payment:




When a dispute arises, the factoring company should learn to protect its rights and interests by taking advantage of the non-causative nature of commercial bills.

---



Meanwhile, factors should understand that the non-causative nature of bills has its limitations. They should objectively analyze and rationally treat the non-causative nature, and must not exaggerate it, only to ignore the necessary risk control such as the identification and prevention of the project risks.

---



The frequent occurrence of disputes over commercial bills demonstrates to some extent that in terms of the buyer's credit risk, the payment by commercial bill may have no difference from bank TT, cash, and other means of payment. Consequently, the evaluation on buyer's credit risk remains a key consideration for factors to determine the risks of the factoring business with the commercial bill as means of payment.



## 5. Compulsory Execution

# Introduction to Compulsory Execution



- Concept: the compulsory execution means that the notary public office notarizes the document evidencing creditor's rights and grants it with the compulsory execution effect. When the creditor's rights are overdue and not repaid in full, based on the compulsory execution notarization issued by the notary public office, the creditor (including mortgagee / pledgee) can directly apply for an execution of the people's court without filing an action.
- Legal basis:

## Laws & Regulations

- Article 238, *Civil Procedure Law of the People's Republic of China*
- Article 37, *Notarization Law of the People's Republic of China*

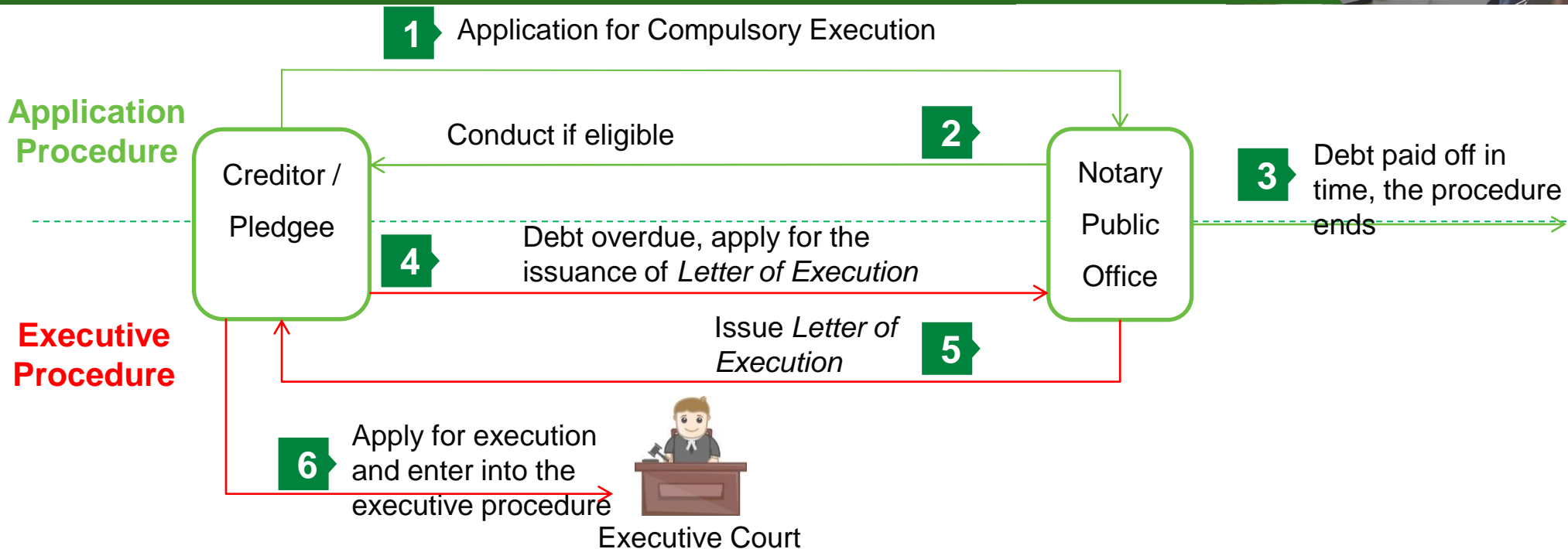
## Ministerial Rules

- Article 238, *Joint Notice on Issues of Executing Documents Evidencing Creditor's rights with Compulsory Execution Effect Granted by the Notary Public Office*, the Supreme People's Court and the Ministry of Justice
- Article 39 and Article 55, *Notarial Procedure Rules*

## Judicial Interpretation

- *The Supreme People's Court's Rules on Issues of the People's Court's Execution (Trial)* (Judicial Interpretation [1998] No. 15)
- *The Supreme People's Court's Reply on Whether the People's Court Should Accept a Party's Lawsuit on Dispute over the Content of Notarized Document Evidencing Creditor's Rights with Compulsory Execution Effect* (Judicial Interpretation[2008] No. 17)
- *The Supreme People's Court's Reply on the Request of the People's High Court of Shandong Province* 【(2014) Zhi Ta Zi No. 36】
- *The Supreme People's Court's Rules on Issues of the People's Court's Hearing Cases of Objection to Execution and Review on Execution* (December 29, 2014)

# Procedure for Conducting Compulsory Execution



## Requirements

- The document evidencing creditor's rights contains payment of money, goods, and negotiable securities.
- The credit-debt relationship is clear, and the creditor and the debtor have no doubt about the content of payment in the document evidencing creditor's rights.
- The document evidencing creditor's rights clearly states the debtor's promise that when he / she does not perform the obligation or performs the obligation incompletely, the debtor is willing to accept the compulsory execution in accordance with the law.
- The notarization should be applied for to the prescribed notary public office.
- The materials are complete.

*This procedural information is offered by  
Shenzhen Qianhai Notary Public Office.*

# Advantages of Factoring with Compulsory Execution



- Compared with common litigation procedures, the compulsory executive procedure can skip the first instance and the second instance trials and directly enter into the final executive procedure.

## efficient and convenient

Conducting the compulsory execution notarization means that the debtor gives up his / her right of action and defense. In that case, the compulsory executive procedure can skip the first and the second instance trials and directly enter into the executive procedure, which saves the time cost and makes the claim on the creditor's rights efficient and convenient.

## economical at litigation cost

The compulsory executive procedure saves the litigation cost of the first and the second instance trials and thus saves the cost in safeguarding the rights and interests to some extent.

## direct preservation of properties

A direct entrance into the executive procedure can directly preserve and execute the debtor's properties. While saving the cost in preserving the properties, the compulsory executive procedure exempts the factor from providing the equivalent guaranty of litigation / pre-litigation preservation as involved in common litigation procedures.



# Limitations of Factoring with Compulsory Execution



- As the factoring business is different from the traditional bank loan and private lending, there are also limitations on the factoring business with compulsory execution notarization.

## Limitations on the buyer's applicability

- The debtor's consent and cooperation throughout the process is the prerequisite for conducting the compulsory execution notarization.
- Given the contractual relationship directly established by the factor with the seller, the seller is also a borrower. It is not difficult to gain the seller's cooperation in conducting the notarization.
- However, as for the buyer who is not in a direct contractual relationship with the factor and has a comparatively advantageous position, more often than not, it is difficult to persuade the buyer to give up the right of action and cooperate in the notarization.

## Effects of the absence of the buyer's applicability

- For the factoring business, the primary repayment source is the buyer's repayment, and the second is the seller's repurchase. It is more important for factoring to ensure the buyer's repayment.
- The limitations on the buyer's applicability will definitely lead to the applicability of the project that relies on the buyer's repayment or that has a weak repurchase capability of the seller.
- The absence of the buyer's applicability leads to the dilemma where the recourse against the buyer can only follow the common litigation procedure. Consequently, the recourses against the buyer and the seller are not in the same judicial stage. The influence of such an imbalance on the factor claiming its right of recourse needs further testing in judicial practices.





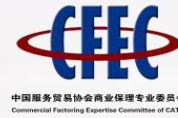
- In the following two precedents, the factor applied for the compulsory execution notarization to the notary public office. As the debtor failed to perform the repayment obligation when the debt was due, the factor requested the notary public office to issue the *Letter of Execution* by which it directly applied for the compulsory execution of the court. In accordance with the law, the court accepted the factor's application.
- Though the debtor in the precedents temporarily had no executable property and the executive procedure was not satisfying, the compulsory execution notarization completed the mission of ensuring that the factor was exempted from litigation and trial procedures and directly entered into the executive stage.

## Beijing Precedent

- (2015) Da Zhi Zi No. 2452

## Liaoning Precedent

- (2015) Fu Zhi Yi Zi No. 00086



## 6. E-contract



# Current situations of physical contracts

- High cost



Printing +



storage +



time +



labor +



logistics + ....

....



- Features of the factoring business will require frequent contracting for commercial factors, and physical contract will bring high cost, which is a burden for commercial factoring operators.
- Physical copies maybe lost or destroyed easily, bringing risks to record management



# Advantages of e-contract



- E-contract enables on-line and efficient signing of contracts
- E-contract lowers the operation cost for commercial factors, and is the trend for those companies to gain competitiveness with Internet plus.



The efficient and convenient methods lower costs



The contracts are easy to check and manage



It's easy to keep, making records safer



The signing process is simplified, making customers more satisfied



## ● Legal basis

### *Electronic Signature Law*

- **Article 13** If an electronic signature concurrently meets the following conditions, it shall be deemed as a reliable electronic signature:
  - (1) When the creation data of the electronic signature are used for electronic signature, it exclusively belongs to an electronic signatory;
  - (2) when the signature is entered, its creation data are controlled only by the electronic signatory;
  - (3) ...
- **Article 14:** A reliable electronic signature shall **have equal legal force** with handwritten signature or the seal.

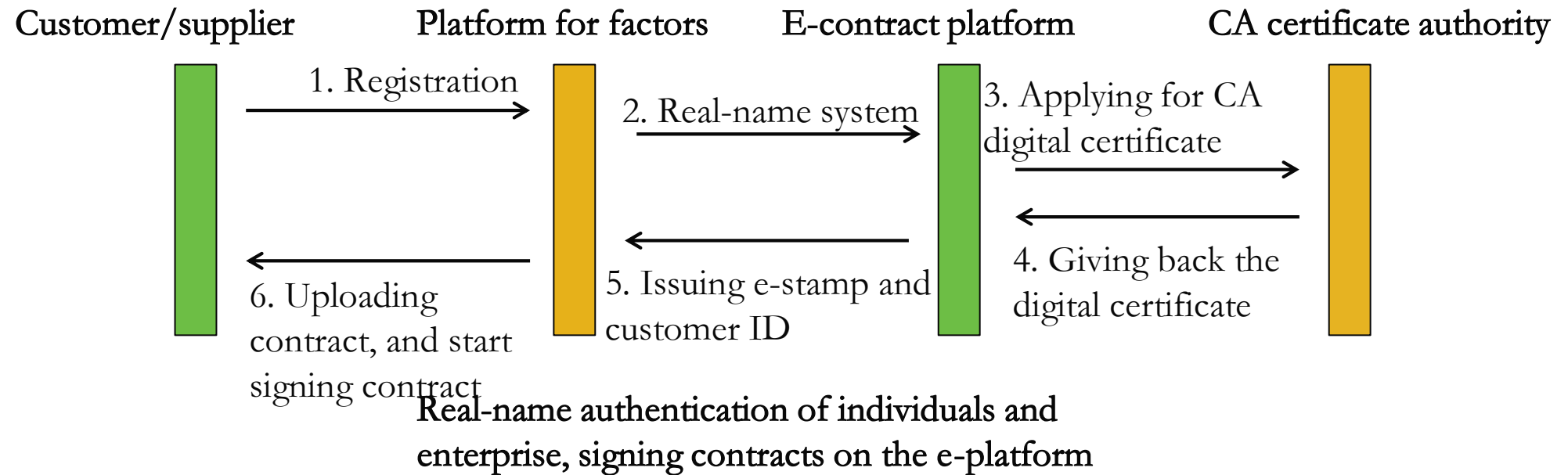
### *Contract Law*

- **Article 10** Forms of Contract; Writing Requirement A contract may be made in a writing, in an oral conversation, as well as in any other form.
- **Article 11** Definition of Writing A writing means a memorandum of contract, letter or **electronic message** (including telegram, telex, facsimile, electronic data exchange and electronic mail), etc. which is capable of expressing its contents in a tangible form.



- *Electronic Signature Law* and *Contract Law* provide legal basis for e-contract to have equal legal force with physical contracts.

## ● Processes



## Process

- After the real-name authentication, CA digital certificates are gained through the e-platform and the customer ID and e-stamp will be provided.
- Factors upload contracts to the e-platform, and the contract will be sent to the customer/supplier after it is signed by the factor.
- The customer/supplier signs the contract, which will be saved in a third-party platform.

*The data are provided by fadada.com*



- In the two precedents, the courts recognized the legal force of the e-contracts and ruled that the signatory shall perform its obligations under the contract. In the case in Jiangsu Province, the defendant questioned the legal force of the contract, but according to the Verification Report on National Standard E-contract presented by the platform and related laws and regulations, the legal force of the contract was recognized by the court.
- Though the legal precedents of e-contract are few now, according to legal basis like the *Electronic Signature Law*, the legal force will be recognized by the court to a large extent where the **real-name authentication is strictly controlled**, and requirements of “reliable electronic signature” in Article 14 of the *Electronic Signature Law* are met.

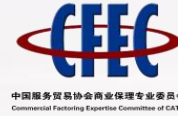
## Legal precedent in Zhejiang Province

- (2016) Zhe 0102 minchu No. 2027

## Legal precedent in Jiangsu Province

- (2015) Gushangchuzi No. 2605





## 7. Implications of Judicial Precedent Analysis

# 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.**

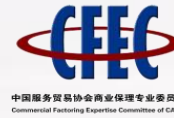
## Article 82 Contract Law

**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.**





## 8. Research on Latest Legal Developments

# 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.

## 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 debt 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



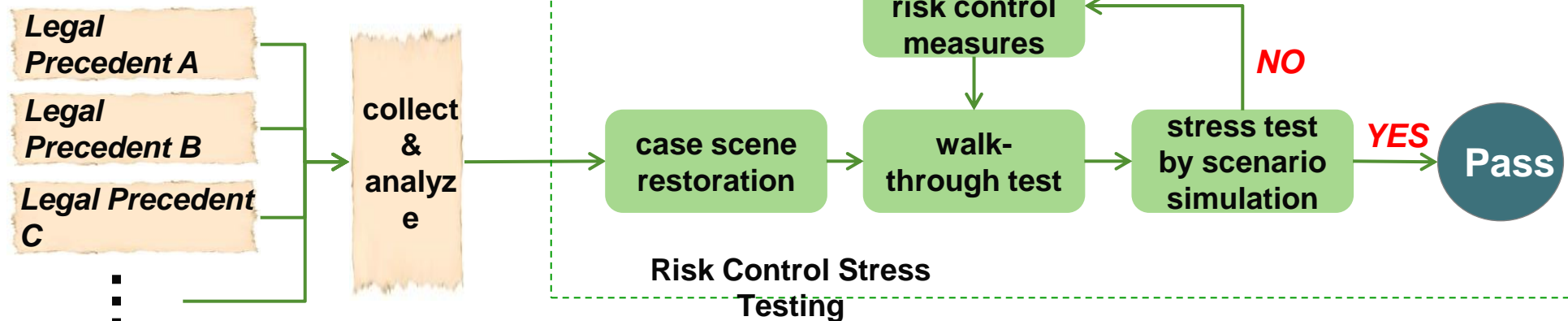
# Stress Testing Model for Factoring Risk Control



## 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

# 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.
- **Distortion of court:** in some backward regions where the economy is underdeveloped or the factoring industry lags behind, due to a general lack of the correct understanding of the factoring business in the judicial community, the court's judgment in some cases violates the fundamental legal principles of the factoring business.
- **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.





# Disclaimer

- This Powerpoint is produced by the Asiafactor (CN) Co., Ltd.. The content, whether in whole or in part, is prohibited from direct or indirect distribution, duplication, or redistribution, or transmission to any other person. Participating in this presentation or reading this Powerpoint means that you agree with the restraints above. Any nonobservance may violate related laws or rules.
- This Powerpoint is not verified by any independent third party. The impartiality, preciseness, completeness, and correctness of this Powerpoint is not guaranteed and should not be relied upon. The content of this Powerpoint should be understood in the environment where it was made. There is not and will not be any update to reflect material changes after the presentation. This company, together with the members of the Board of Directors, management, employees, agents, and advisors, is responsible for neither the content of this Powerpoint at any time, nor any loss caused by using the content of this Powerpoint.

