

Analysis Report on China's Factoring Legal Precedents

Annual Report of 2016



亚洲保理
ASIAFACTOR
应|收|账|款|可|以|融|资



汇法网
www.Lawxp.com



催天下
WWW.CUITX.CN

Contents

1. 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. Overview of Commercial Factoring Precedents

- a) Overview of disputes
- b) Analysis on the seller
- c) Analysis on the commercial factoring company
- d) Analysis on closed commercial factoring cases
- e) Study on closed commercial factoring cases

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

- a) Analysis on bill holders' success rate
- b) Analysis on the non-causation principle of bills
- c) Analysis on the right of defense
- ₁ d) Implications of the analysis on commercial bill precedents to commercial factoring

5. Compulsory Execution Notarization

- a) Introduction to Compulsory Execution
- b) Procedure for Conducting Compulsory Execution
- c) Advantages of Factoring with Compulsory Execution
- d) Limitations of Factoring with Compulsory Execution
- e) Interpretation on Precedents of Compulsory Execution

6. Implications of Legal Precedent Analysis

- a) Jurisdiction objection
- b) Defects in affirming rights
- c) Effect of delivery by EMS
- d) Means of fraud risk
- e) Indirect payment by the buyer
- f) Major laws and regulations

7. 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

8. Stress Testing Model for Factoring Risk Control

- a) Introduction of the model

Appendix

- a) Definition of risk categories
- b) Definition of special risk items

Summary

- **The Commercial Factoring Expertise Committee of China Association of Trade in Service, Guangdong Factors Association, Shenzhen Factoring Association, Asiafactor (Shenzhen), www.lawxp.com and Cuitianxia** jointly released the *Analysis Research Report on Factoring Judicial Precedents* for the 3rd quarter of 2016 in November, 2016. Since then, the working group on judicial precedents continued research on 30 more cases and updated the database on precedents. Meanwhile, the working group focuses on the interpretation of *Guidelines on the Judgment of Cases over Factoring Contract Disputes in Qianhai Shekou Free Trade Area (on Trial)* in this report to provide latest progress on factoring legislation and jurisdiction, enabling the law to better play its role as a sword.
- 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; **Zhou Aiping:** aiping.zhou@asiafactor.com



亚洲保理
ASIAFACTOR
应|收|账|款|可|以|融|资



汇法网
www.Lawxp.com

1. Analysis on Factoring Precedents

400+ Related legal precedents for analysis

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 Structure

Risk categories

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

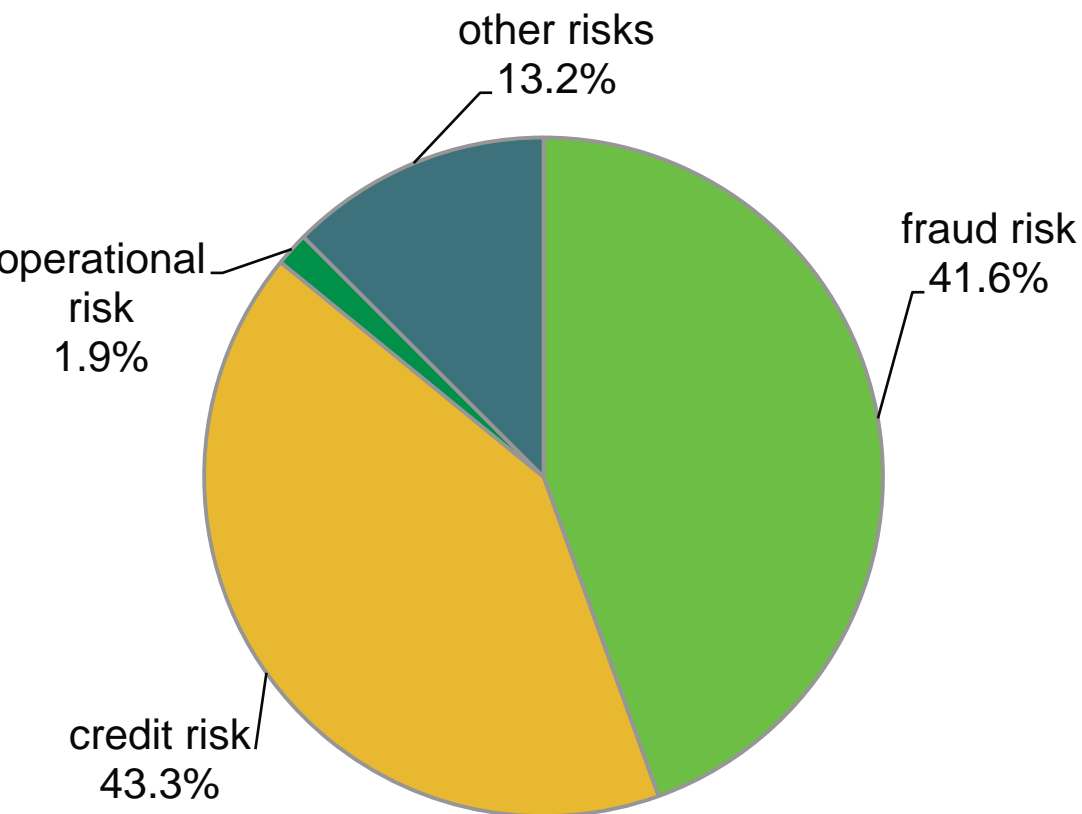


Special risk items

- 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

Analysis on Risk Categories

Division of risk categories

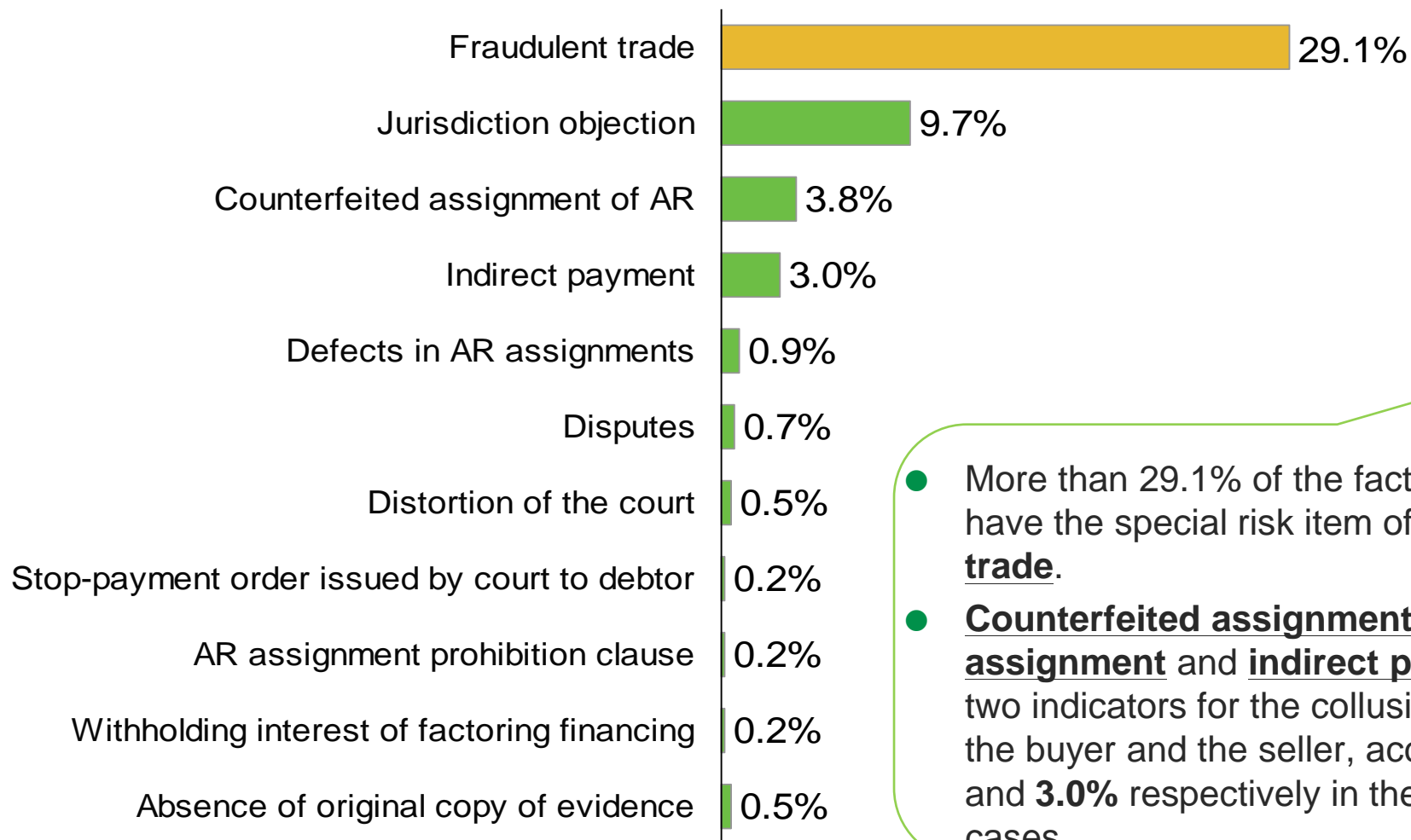


- 41.6% of the factoring cases were caused by the **fraud risk**.
- The second largest risk category is the **credit risk**. Due to the limitation of data sources, nearly 20% of the precedents' written judgments have no explanation on the specific matters in issue. Given their intuitive nature, these 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 43.3%, while the fraud-risk ones may far exceed 41.6%.**



Analysis on Special Risk Items

Analysis on special risk items

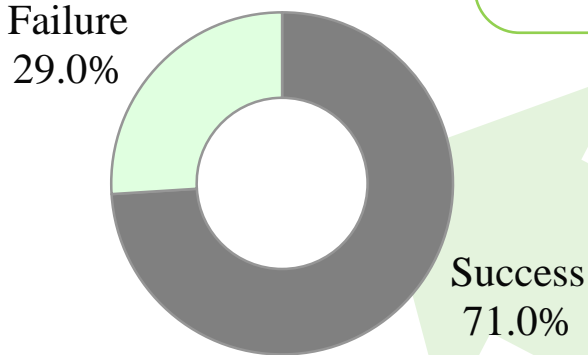


- More than 29.1% of the factoring cases have the special risk item of **Fraudulent trade**.
- **Counterfeited assignment of AR assignment** and **indirect payment**, the two indicators for the collusion between the buyer and the seller, account for **3.8%** and **3.0%** respectively in the factoring cases.

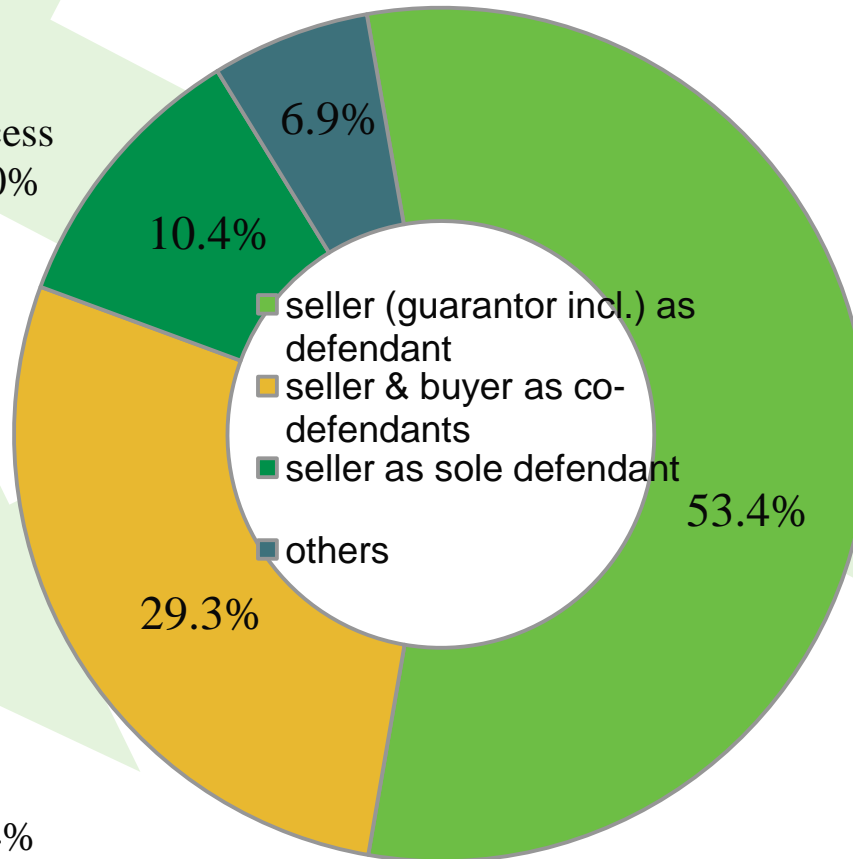
Analysis on Lawsuits

- In 53.4% 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 99.5%.
- The success rate of cases with the buyer as the sole defendant is 71.0%.

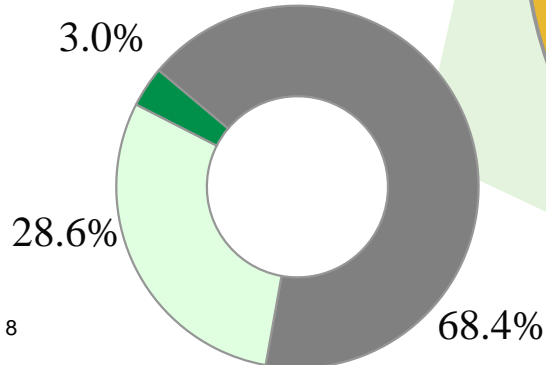
The factor's success rate of cases with the buyer as the sole defendant



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

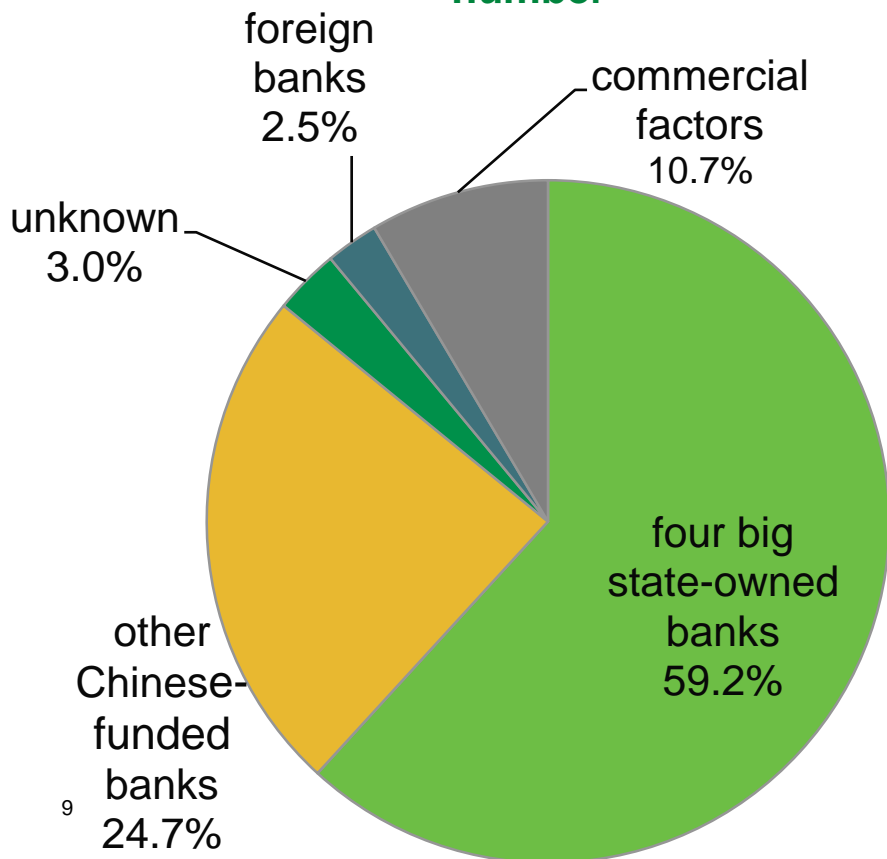


Analysis on the affected Factors

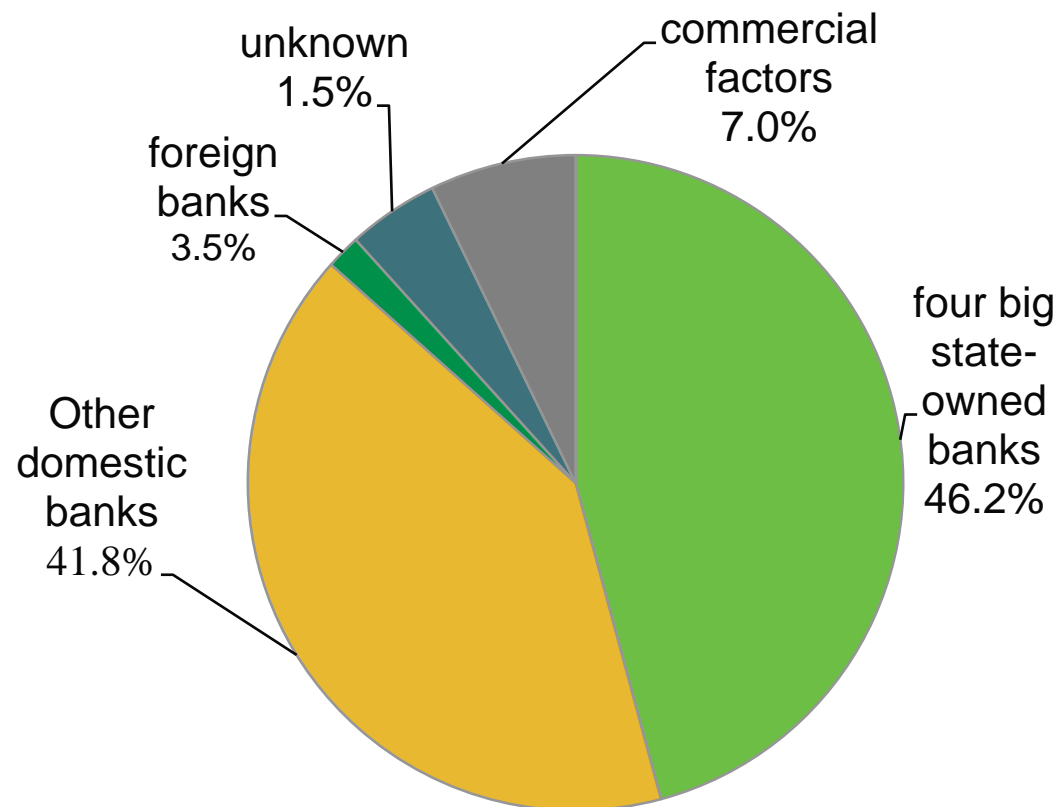


- In terms of the number of cases and the amount of money involved, the four big state-owned banks account for 59.2% and 46.2% respectively.
- In terms of the number of cases and the amount of money involved, the commercial factoring companies account for 10.7% and 7.0% respectively, both witnessing 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

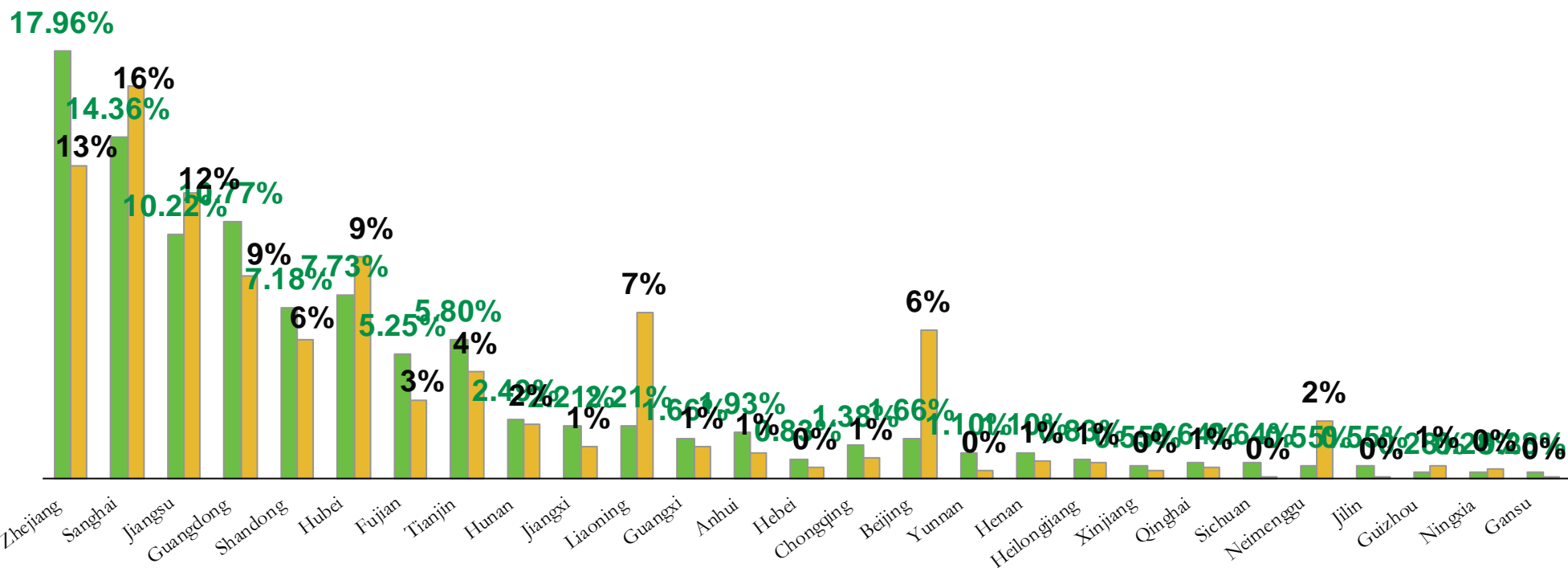


Analysis on the Dispute Arising Place

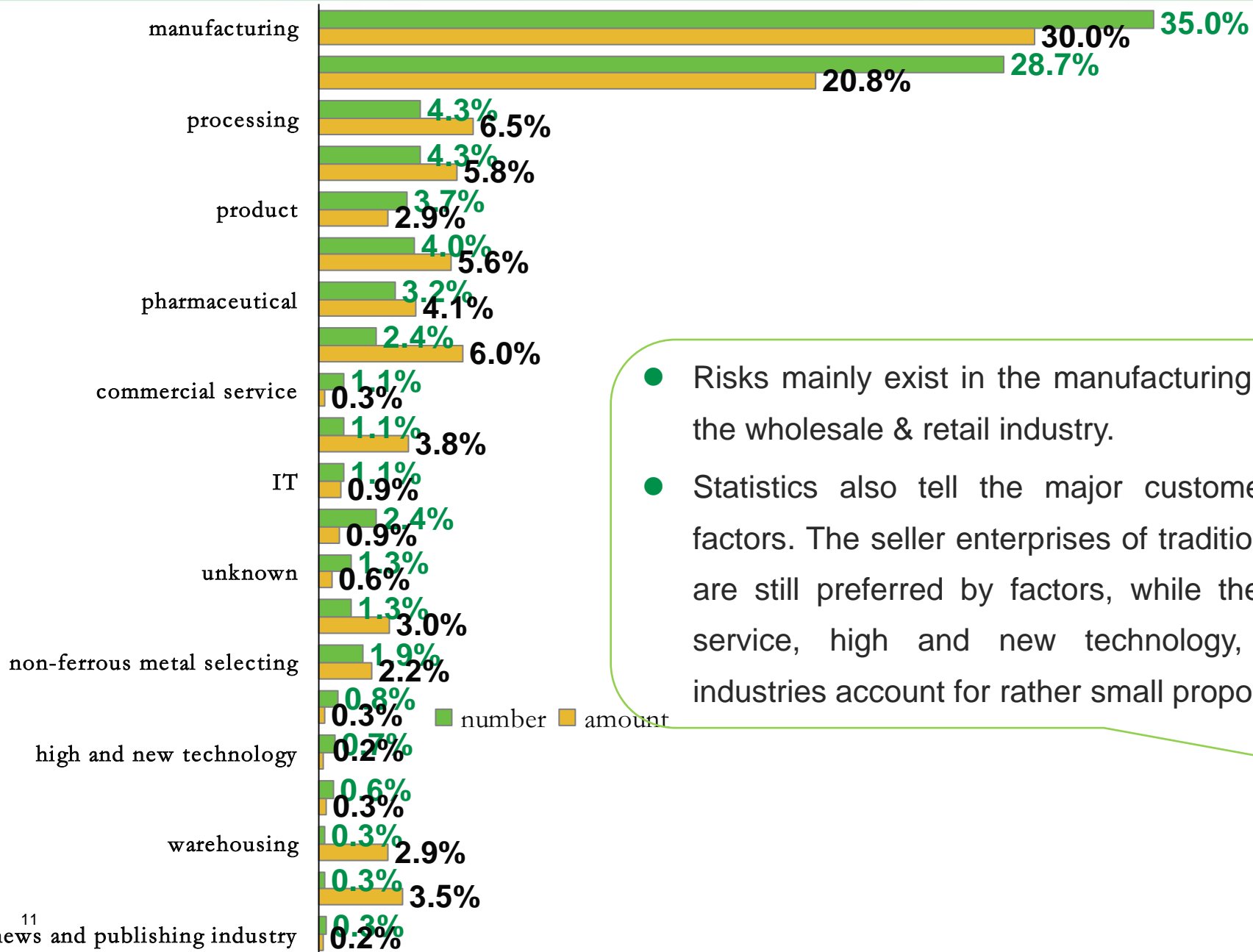


- Jiangsu, Zhejiang, Shanghai, and Guangdong encounter a higher frequency of risks in the factoring business than other regions, probably because these four regions are more active in conducting the factoring business.

■ 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.





亚洲保理
ASIAFACTOR
应|收|账|款|可|以|融|资



汇法网
www.Lawxp.com

2. Overview of Commercial Factoring Disputes

Overview of Commercial Factoring Disputes



- The commercial factoring disputes accounted for 10.7% of all disputes in this report. However, according to the public statistics, more and more commercial factoring cases have entered the trial process but have not been closed yet.

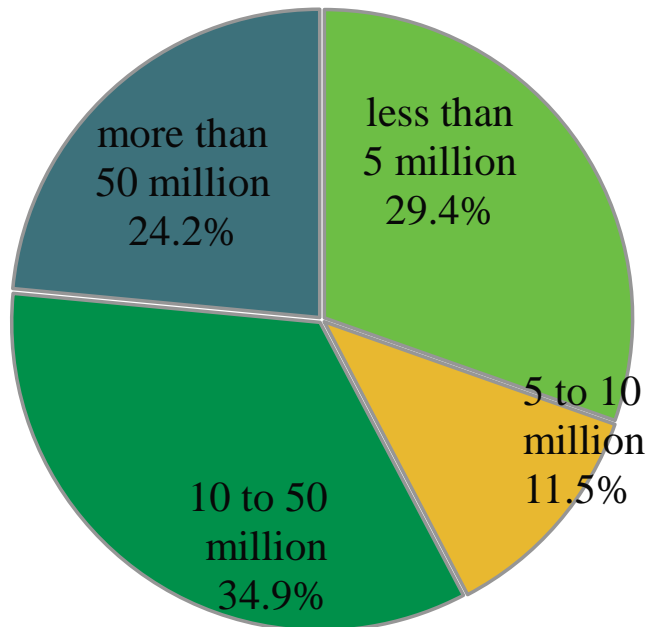
Region	Number of Cases	Number of Factors Involved	Industries Involved
Shanghai	194	31	wholesale & retail, energy, manufacturing (metal products), food manufacturing (organic food), catering, and fishing
Tianjin	96	10	logistics, manufacturing (auto components & spare parts), energy, wholesale & retail, and textile & clothing
Shenzhen	41	15	manufacturing (machine components & spare parts), food manufacturing (grain & oil), printing, high and new technology, and pharmaceutical manufacturing
Beijing	8	3	manufacturing (wood & baboon products), and manufacturing (auto components & spare parts)
Guangzhou	5	1	printing, and high and new technology
Chongqing	5	5	manufacturing (auto components & spare parts)
Zhejiang	3	2	high and new technology (smart card)
Zhuhai	1	1	wholesale & retail

Analysis on the Defendant (the Seller)

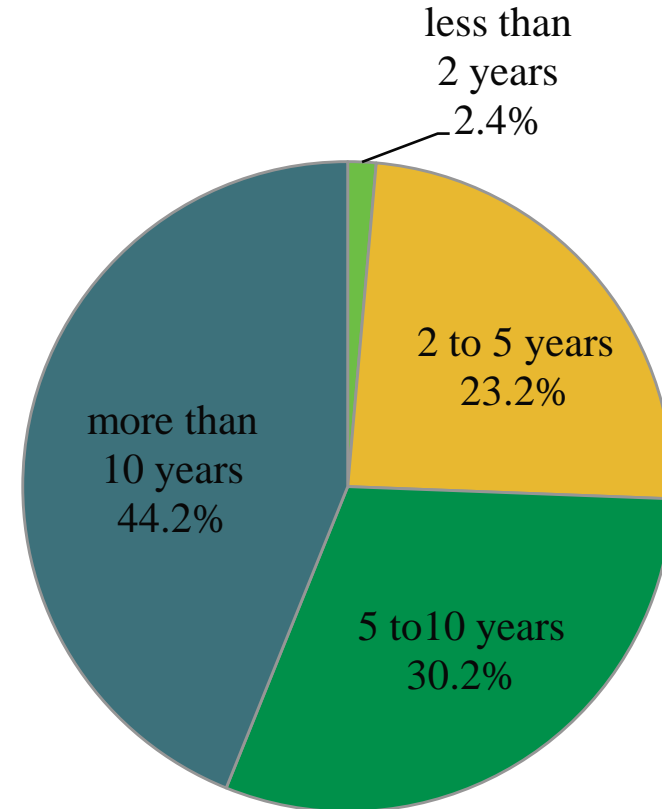


- In the commercial factoring disputes, 34.9% of the defendants (mainly sellers) are SMEs with registered capital between RMB 10 million and 50 million.
- The proportion of the enterprises established for no more than 2 years as the defendant (the seller) is 2.4%.

Registered capital (RMB)



Duration

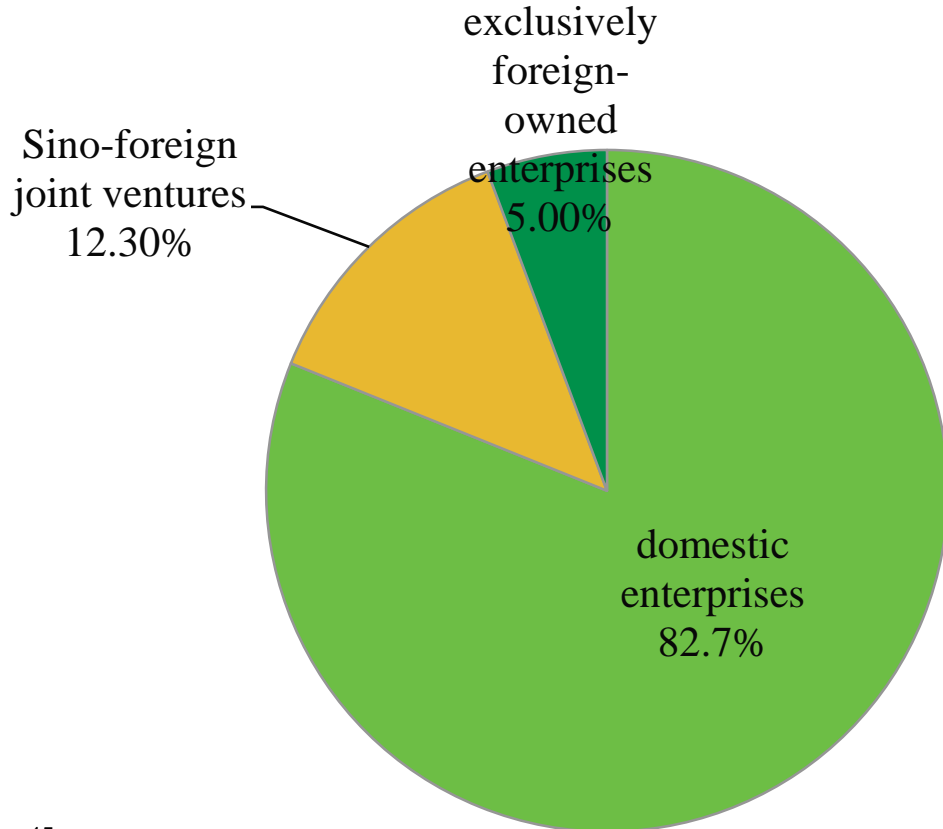


Analysis on the Accuser (Commercial Factoring Company)

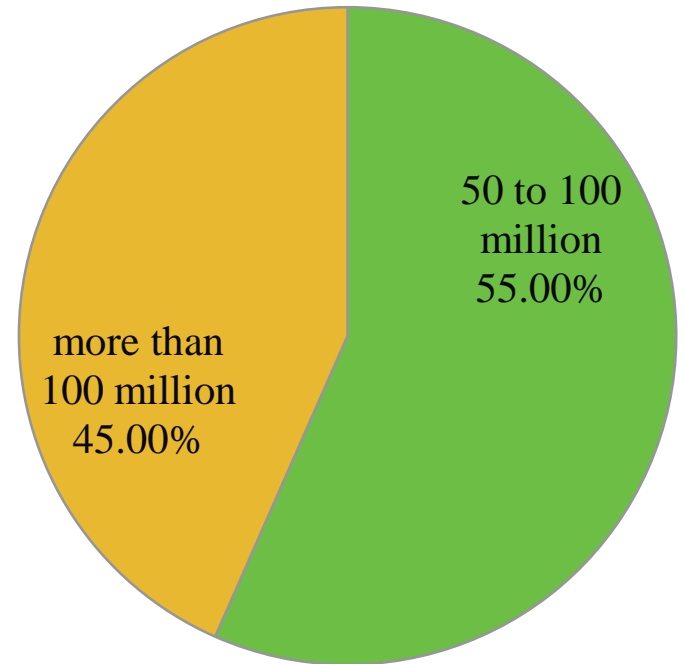


- The commercial factoring companies involved in disputes are mainly domestic companies, which account for 82.7%.
- Of the commercial factoring companies involved in disputes, the enterprise with their registered capital of more than RMB 100 million account for 45.0%.

By nature of enterprise



By registered capital (RMB)

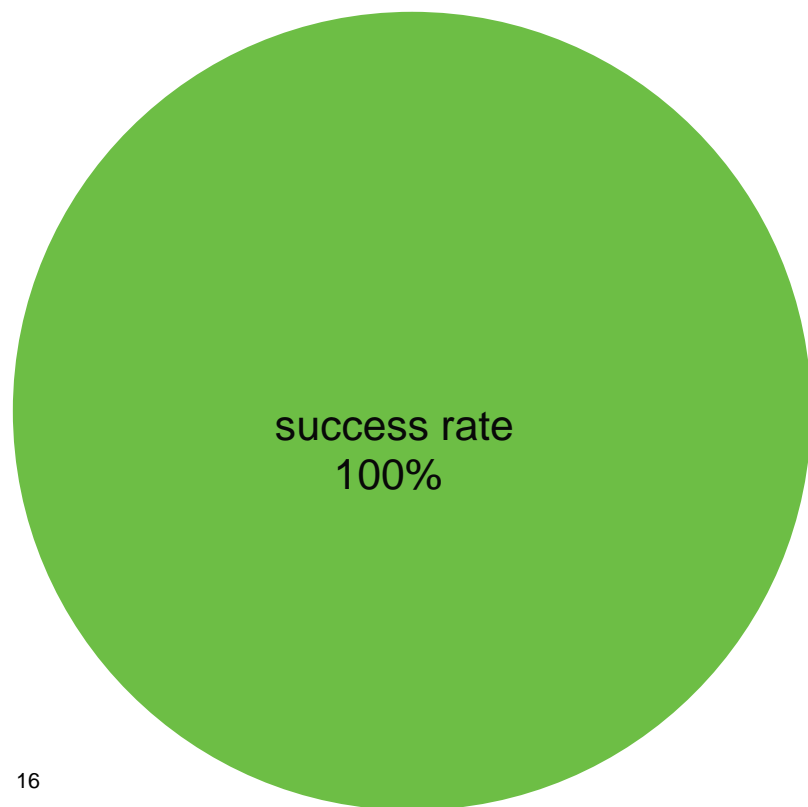


Analysis on Closed Commercial Factoring Precedents

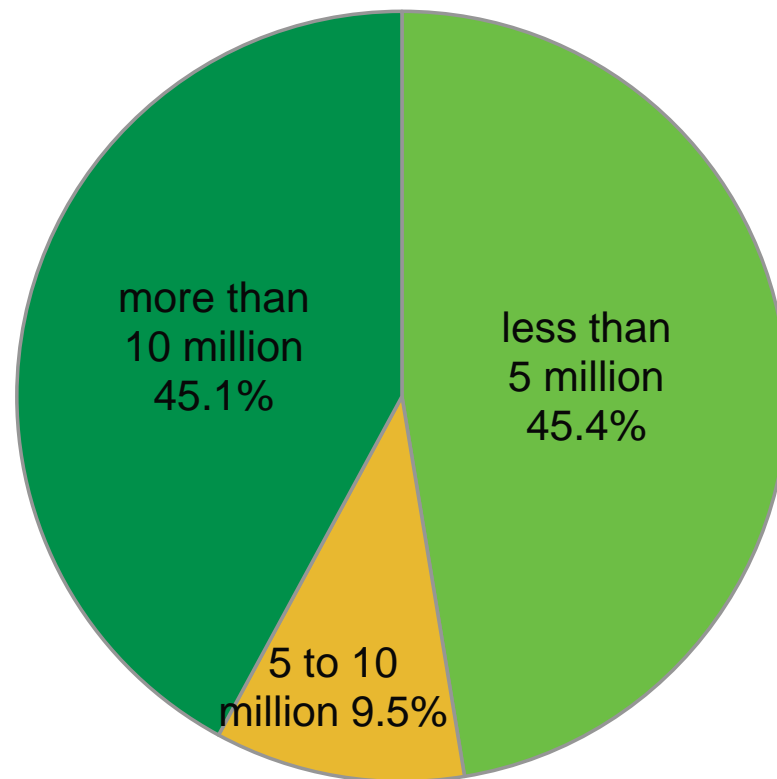


- In the closed commercial factoring precedents, the factor's success rate reaches 100%.
- In the closed commercial factoring precedents, the proportion of precedents with a value of the subject matter under RMB 5 million decreased to 45.4%, while those with a value of subject matter over RMB 10 million increased to 45.1%.

By success rate



By subject matter's value (RMB)



Study on Closed Commercial Factoring Precedents

(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 regarded 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 regarded 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 sentenced 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



亚洲保理
ASIAFACTOR
应|收|账|款|可|以|融|资



汇法网
www.Lawxp.com

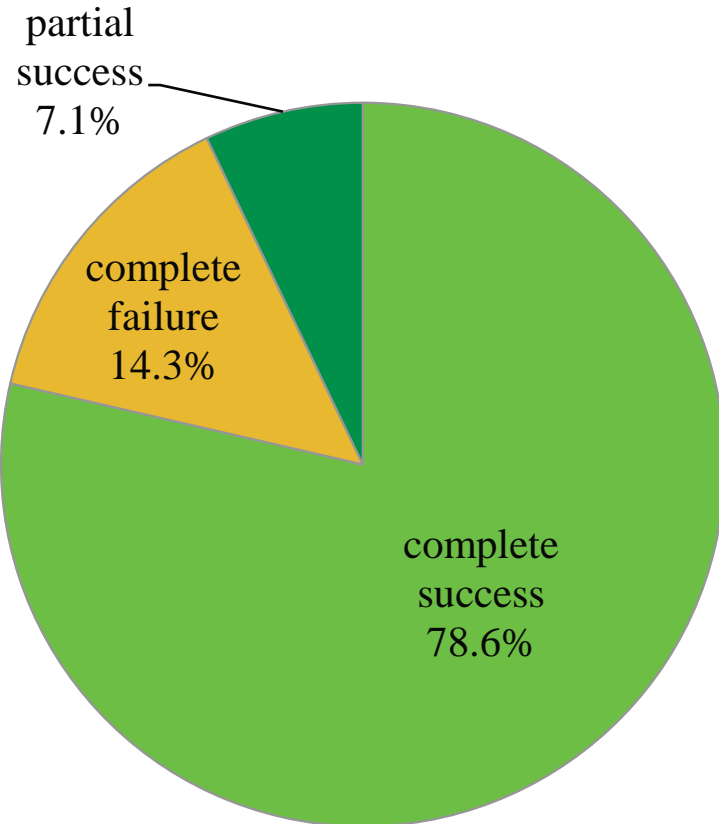
3. Analysis on Credit Insurance Precedents

Data Analysis on Credit Insurance Precedents

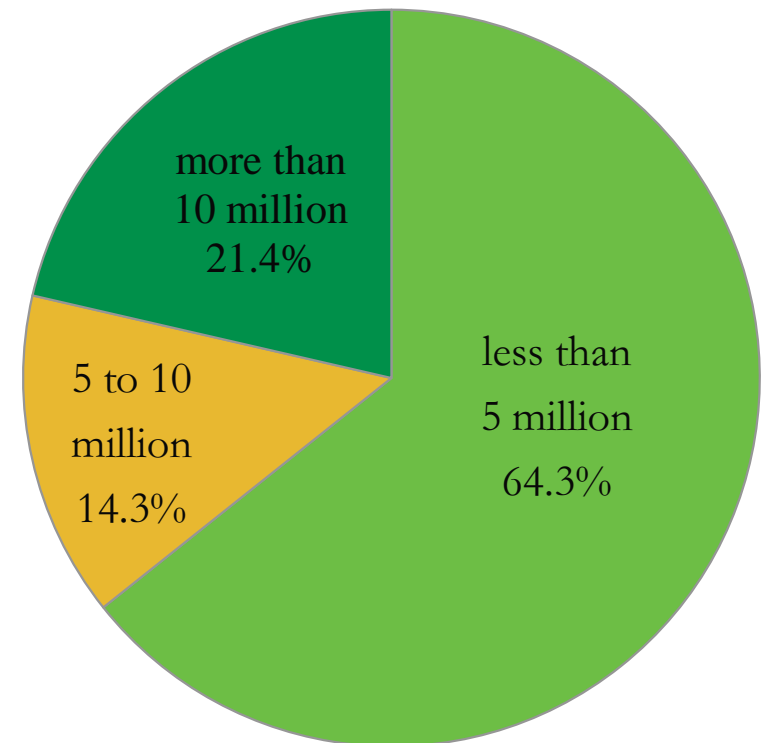


- In the credit insurance precedents, the rate of complete success of the insurant (usually the seller) reaches 78.6%.
- The proportion of cases involving less than RMB 5 million stood at 64.3%.

By success rate of the insurant



By amount (RMB)

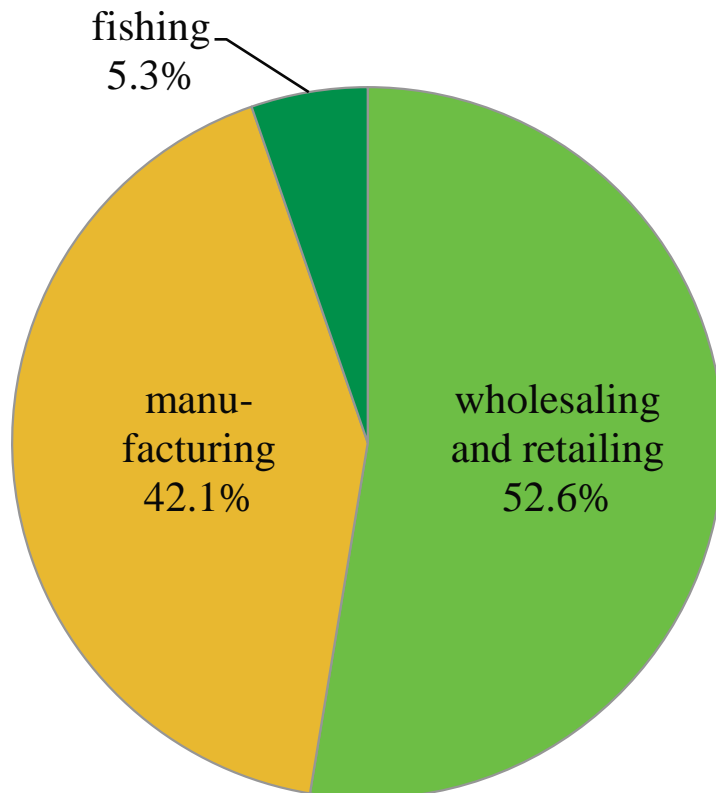


Industrial Analysis on Credit Insurance Precedents

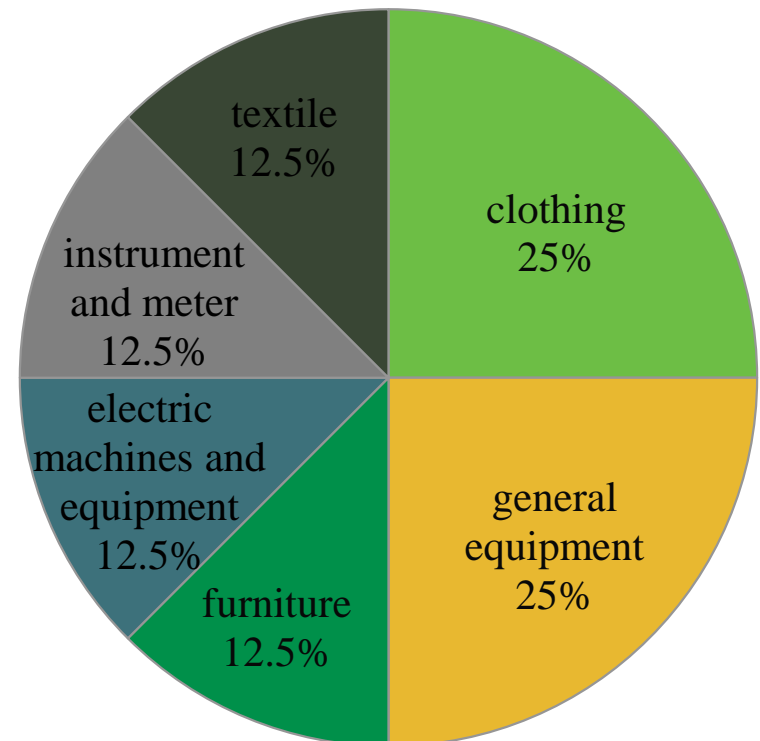


- In terms of the number of cases, credit insurance disputes mainly occur in the manufacturing and wholesale & retail industries with a proportion of 42.1% and 52.6% respectively.
- The clothing and the general equipment manufacturing industries have the largest proportion in the manufacturing industry.

Industrial broad category



specific industries of manufacturing



Should the Debtor Be Sued First in the Settlement of Insurance Claim?



- 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.



亚洲保理
ASIAFACTOR
应|收|账|款|可|以|融|资



汇法网
www.Lawxp.com

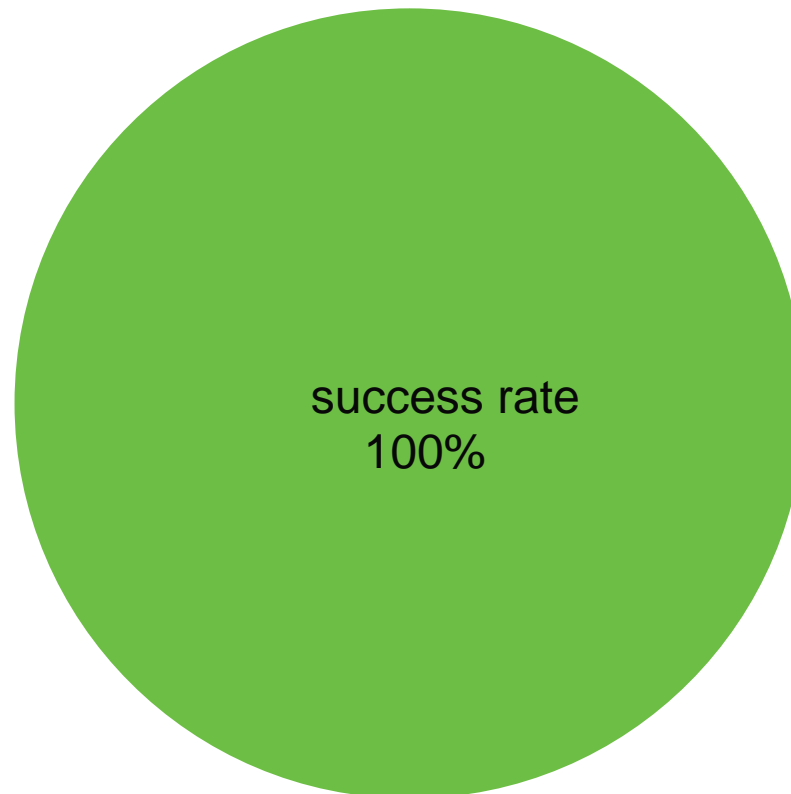
4. Analysis on Commercial Bill

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.



Analysis on the Right to Defense (1)



- 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


Significance of the Commercial Bill Precedents to Commercial Factoring




- 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.



亚洲保理
ASIAFACTOR
应|收|账|款|可|以|融|资



汇法网
www.Lawxp.com

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*

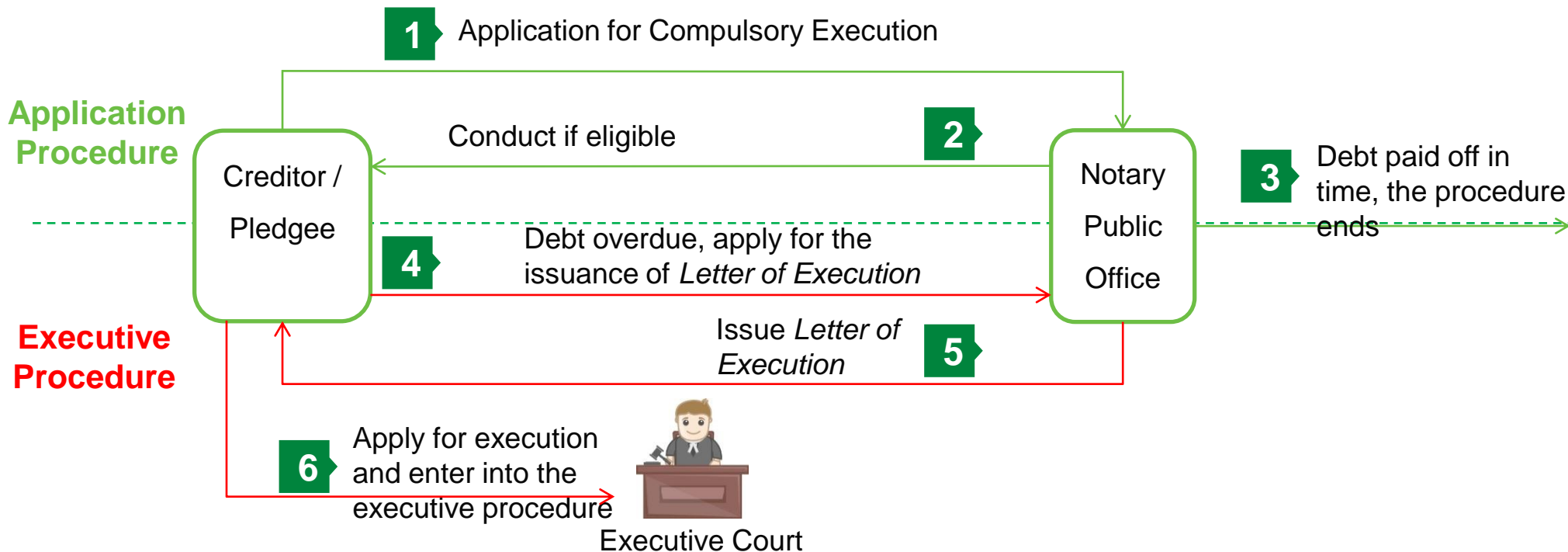
Ministerial Rules

- 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



- 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.

Requirements

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.

Interpretation on Precedents of Compulsory Execution



- 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



亚洲保理
ASIAFACTOR
应|收|账|款|可|以|融|资



汇法网
www.Lawxp.com

6. 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.



亚洲保理
ASIAFACTOR
应|收|账|款|可|以|融|资



汇法网
www.Lawxp.com

7. 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.

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

Articles

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

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

Interpretation

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

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

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



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

Articles

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

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

interpretation

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

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

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..

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.

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.



亚洲保理
ASIAFACTOR
应|收|账|款|可|以|融|资



汇法网
www.Lawxp.com

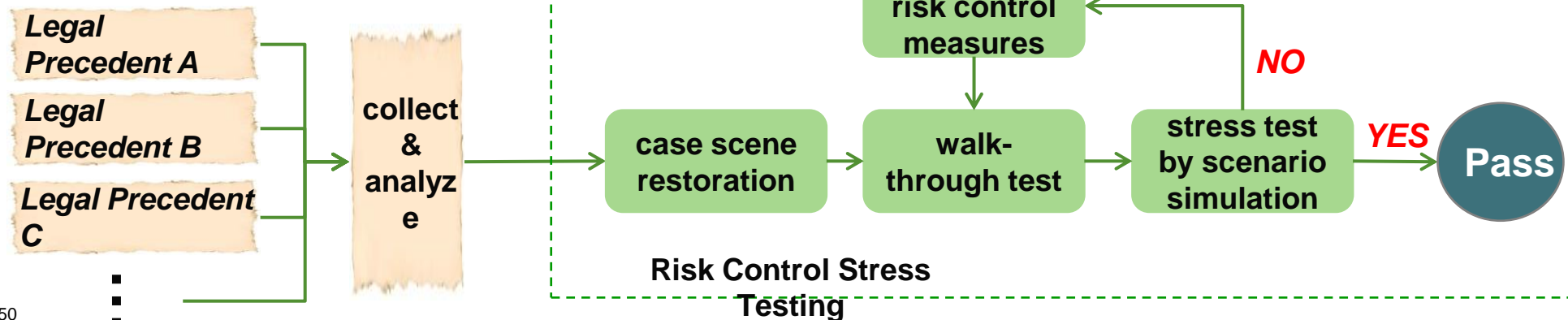
8. Stress Testing Model for Factoring's Risk Control

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!



亚洲保理
ASIAFACTOR
应|收|账|款|可|以|融|资



汇法网
www.Lawxp.com

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.