International Factoring In China Part II: assignment of receivables

Description

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Assignment of receivables is the core of factoring business. An accurate and clear understanding of Chinese laws in respect of assignment of receivable is vital and paramount for engaging in factoring business in China.

As you may have noticed in the Part I post "overview of legal regimes for factoring industry", the legal framework governing assignment of receivables is mainly laid out in China Contract Law.

I. Receivables That Can be Assigned

Article 79 (Assignment of Rights; Exceptions) of China Contract Law reads:

> The creditor may assign its rights under a contract in whole or in part to a third person, except where such assignment is prohibited:
>
> (i) in light of the nature of the contract;
>
> (ii) by agreement between the parties;
>
> (iii) by law.

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It shall be noted (1) the creditor rights under contracts as prescribed in the quoted article encompass not only financial or monetary account receivables in factoring business but also claim rights of non-pecuniary nature; (2) as a general rule, account receivables in factoring business falling within the three prohibition circumstances shall not be assigned by the creditors. There is an exception under Chinese laws with respect to the account receivables that are prohibited from assignment in the original/underlying contract, and this point will be dealt with later in this post.

Future Receivables

What has caused controversy is the question whether the "creditor's rights" as prescribed in that Article 79 include "future receivables".

From a conservative point view, the rights assignable under Article 79 do not cover future receivables for the reason that one cannot assign a right he or she does not have at the time of assignment or transfer. As you can see from rules on commercial factoring promulgated by local governments in China, only the rules in Shanghai Free Trade Zone explicitly cover future receivables. However we notice that judicial practice may be more liberal towards future receivables perceiving and apprehending that future receivables factoring accounts for a big portion of whole industry, for

example, in Tianjin High People's Court's first opinions on factoring, it explicitly mentioned future receivables in one of its provisions indicating validity of assignment of future receivables, an clear echo of the international attitude towards valid factoring of future receivables.

II. Assignment of Receivables and Notice of Assignment

While people talk about assignment of receivables, it seems that there is different understanding of "assignment of receivables" as to whether it is a true sale or not. I stumbled onto an article titled "The Difference Between Assignment of Receivables & Factoring of Receivables" which explained that in Texas of USA, assignment of receivables means to collateralize the receivables instead of selling them.

Assignment of Receivables is a True Sale

But in China both legislation and judicial practice have made it clear that assignment of receivables is true sale. There is not much argument on whether factoring of receivables is a true sale or not, regardless of whether financing is provided or not. Latest judicial interpretation from China Supreme Court on application of laws in sale and purchase contract disputes includes the assignment of creditor's rights within its ambit (but without clear reference to "factoring" in that interpretation), and therefore relevant rules regarding sale and purchase contract can apply to assignment of receivables.

So it is certain under Chinese laws that once assignment of receivables is effected, then the title in the receivables passes to the assignee or the buyer.

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Notice of Assignment

Article 80 of China Contract Law reads:

> Article 80 Where the obligee assigns its rights, it shall notify the obligor. Such assignment is not binding upon the obligor if notice is not given.
>
> A notice of assignment of rights given by the obligee may not be revoked, except with the consent of the assignee.

So according to this article 80, to assign a receivable, the creditor shall notify the debtor of the assignment. Otherwise, this assignment is not binding on the debtor. In other words, failing a property notice to debtor, the assignee cannot request the debtor to pay money to him or her. Notice is a must and shall have to be dealt with seriously.

(1) pursuant to this article 80, only the creditor shall have the right to notify the debtor of the assignment. While this may seem weird to factors, it is real and clear. However in order to accommodate factoring practice, Tianjin High People's Court has been bold enough to provide in its guidelines that factoring companies may serve notice of assignment on the debtor if it is so stipulated in the factoring contract with the client/supplier, whereby the factoring companies shall prove the fact of assignment of receivables and its identity of being a factoring company. It shall be born in mind that Tianjin High People's Court's guidelines may only be upheld by lower courts in Tianjin, and won't be followed by courts outside Tianjin area.

(2) what should be written in the notice? First of all, it shall be made crystal clear that the notice is to inform the debtor of the assignment of certain receivables to the assignee. A mistake that factors may make is to simply tell the debtor to pay the money into a different bank account without disclosing the fact that the receivables are being assigned. Secondly, since the assignment of receivables is considered as a sale under Chinese laws, the receivable being sold shall be identified clearly in the notice of assignment such as reference to parties, amounts, contract number and etc. A challenge in this regard is related to identifying future receivables given the reluctance of Chinese courts to recognize assignment of future receivables. The notice shall try to be specific about parameters for identifying future receivables.

(3) how should the notice be served on the debtor? In order to make the assignment effective, the notice served shall have to be actually received by the debtor and the burden of proof on actual receipt shall rest on the shoulder of the assignor and the factor. The best bet is to have the debtor acknowledge in writing the receipt of the notice of assignment as in the case of three-party (client, factor and customer) factoring agreement.

Assignment of Receivables without Notice

In factoring world, there are basically two cases in which assignment of receivables is not notified to the debtor.

(1) the so-called “non-notification factoring” where, as per request of its client, notice of assignment of receivables is not served on the debtor except in circumstances stipulated in the factoring contract. In undisclosed factoring, the debtor shall still pay off the receivables directly to the assignor of the receivables or the client of the factoring company.

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(2) in international two-factor factoring, it is often the case that the assignment of receivables from the exporter to the export factor is not notified to the foreign debtor/buyer, and then the export factor in turn assigns the same receivables to the import factor which assignment is duly notified to the debtor, so to the debtor, the receivables are assigned to the import factor only without knowledge of the assignment from the supplier/exporter to the export factor.

One has to wonder what difference it makes when the assignment is not duly notified? What is exactly assigned when notice of assignment is not made to debtor?

In civil law system, a creditor right is understood as a right to request the counterpart to perform or refrain from performing certain acts. Logically and naturally, if one assigns his creditor right against his debtor, the assignment shall entitle the assignee to make the same request to the counterpart. Otherwise, it does not seem to be an assignment of complete creditor right. In the case of assignment of receivables without notice, the assignee has no right to request the debtor to pay the money to him, so one can validly hold that the assignee has not acquired the full title of the creditor right at all. In turn, when the assignee (say export factor) has not acquired the creditor right, it certainly cannot sub-assign the same creditor right (receivables) to sub-assignee (the import factor).

Nonetheless, we noticed that a recent case judgement (the dispute is about L/C) entered by China Supreme Court, when addressing the legal effect of transferring bill of lading from shipper to a bank, expounded on its understanding of Article 80 of China Contract Law that the handover of bill of lading

(representing a creditor's right to request delivery of goods) without notice to carrier is still a valid assignment of creditor's right only that the assignee cannot prevail against third party in actual possession of the goods.

It is my opinion that an effective assignment of any creditor right must be accompanied with a proper notice of assignment to the debtor in the absence of a registration system. In the case of non-notification factoring, the factoring contract for the assignment of receivables is still valid as between the assignor and assignee but what is actually assigned or transferred is the future money proceeds of the receivables but not the receivables/creditor right itself. So at present under Chinese laws, each assignment and sub-assignment shall be made with proper notice of assignment to the debtor, and otherwise challenge may be raised against assignee as to its title in the acquired receivables.

III. Right of Priority in case of Multiple Assignments of Same Receivables

Proper notice of assignment can give rise to effective assignment of receivables under Chinese laws. What if there are more than one notice of assignment (to different assignees) sent to the debtor? Among the completing claimants, who will have the priority over others? This fraudulent multiple assignments of the same receivables are always happening in factoring business in the world, it must be addressed.

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There is no clear provision on this in any statutory laws in China. While China has set up a registration for pledging of receivables, has been in operation for years, China has not set up a registration system for assignment of receivables. In fact, back in 2012, a Shanghai intermediary court made it clear that the registration of assignment of receivables on the central bank's online system does not mean anything in the absence of clear laws conferring the intended effects thereon. In the said case, the bank thought that the registration of the assignment of receivable on the online system could substitute notification of assignment to debtor, but apparently the court didn't agree.

Again, Tianjin High People's Court in its local guidelines conferred on the online registration system the legal effect that the assignee who doesn't check out the receivable's status by logging into the online system would not be considered as bona fide assignee and therefore cannot claim priority over prior assignee that has done the registration of its assignment. As noted above, the guidelines are only effective with local courts in Tianjin City.

Without a law-prescribed registration system, the other options are to base priority on either the order of conclusion of assignment contracts or the order of notices of assignment. However either way, it is not conscionable to leave the other party in grievance.

Given the provision of Article 80 of China Contract Law, it is very likely that Chinese courts will give priority to the assignee who has informed the debtor of the assignment of receivables in the first place. In case none of the assignees having made the notification, then the assignee that signs the assignment contract in the first place will be given priority.

It is suggested by Model Factoring Law and I concur, that an online registration system with proper statutory endorsement as to its effect shall be employed to tackle the priority issue in multiple assignment of the same receivables.

It is worth a note that some lawyers in factoring industry have proposed that the priority shall be based

on whoever receives the invoices evidencing the receivables, arguing that (1) receivables assigned are like personal properties capable of being delivered to the assignee and thus ownership or title in the such receivables passes thereby, (2) then the invoices represents receivables, (3) so the delivery of invoices shall mean the passing of ownership, (4) accordingly the assignee that acquires the invoices in the first place shall have the priority over other assignees who don't have.

However, I disagree with the arguments. Account receivables are no personal properties being capable to physical delivery, and commercial invoices cannot be considered as representing receivables and such invoices can be made in as many copies as possible, and if the invoices mentioned refers to China's tax fapiaos, then the fapiao is an evidence of receipt of payments under Chinese laws, contrary to the alleged function of representing a valid receivables.

That is why none of those international laws have ever referred to such a way to decide on priority in relation to assignment of receivables.

IV. Contractual Restriction on Assignment of Receivables

Another major concern in factoring business is the validity of assignment of receivable under a contract which prohibits the assignment of contractual right in its own clauses.

Unfortunately, China Contract Law makes it clear in Article 79 that a creditor's right cannot be assigned if so prohibited in the contract from which the right arises. This provision of the Contract Law has been considered as compulsory breach of which can lead to voidness of the assignment.

However to alleviate the rigidity of the restriction to accommodate the development of factoring industry in China, courts may be ready to find the assignment of such restricted receivables valid and effective so long as the factor is bona fide at the time of conclusion of the assignment contract.

Again, Tianjin High People's Court has made this explicit in its guidelines to the same effect as described in the preceding paragraph. The guidelines have gone further to also provide that the factor may claim damages for losses incurred due to the assignor violating the contractual restriction on the assignment.

In the meantime, it shall be noted that the assignor in breach of the contractual restriction may also be sued by the debtor.

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