

NEW REGULATIONS ON RECEIVABLES FINANCING IN THE CONTEXT OF SUPPLY CHAIN FINANCE

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Abstract

In the past, due to the lack of specialized legislation for the supply chain finance industry and the fact that receivables financing is a new type of financing model, there may be a lack of clear and reasonable solutions for receivables financing disputes. The Civil Code, which takes note of this situation and focuses on responding to the relevant issues, is the latest development in the civil legal regulation of supply chain finance. The Supreme People's Court issued the Interpretation of the Relevant Guarantee System and the Interpretation of the General Provisions of Book Contracts. On the basis of summarizing the trial practice experience in recent years, the Supreme People's Court issued the Conference Minutes (draft) of the National Courts' Financial Trial Work. These legal updates, as the basis for trials in judicial practice, set new norms for receivables financing transactions and refined the relevant rules. These legal updates have responded well to the problems of multiple assignments of accounts receivable and fictitious accounts receivable in receivables financing, which is conducive to the settlement of disputes and the promotion of the healthy development of supply chain finance.

I. INTRODUCTION

Supply chain finance, leveraging the advantages of core enterprises, can assist small and medium-sized enterprises (SMEs) in obtaining bank credit, preventing non-core enterprises (SMEs) with weak risk resistance on the supply chain from falling into the dilemma of fund flow disruption. This helps address the problem of “difficult and expensive financing”, broadening the financing channels for SMEs. In recent years, national policies have consistently guided and supported the development of supply chain finance.

Legal support is particularly crucial for promoting the healthy and rapid development of supply chain finance. At the legal level, the former *Property Law*, *Contract Law*, *Guarantee Law*, *Law on Commercial Banks*, and *General Provisions of Civil Law* legal systems and other basic legal systems have consistently served as the legal basis for the operation of supply chain finance business. However, due to the lack of specialized legislation for the supply chain finance industry, and because receivables financing, as a new type of financing model, has a constantly changing and developing industry form, transaction mode, and gradually exposed risks, disputes related to supply chain finance once entered into litigation, will present complex legal application and risk prevention issues in the trial of the case, which urgently need to be analyzed in-depth and researched for a solution.

Among these, the most common are disputes involving fictitious accounts receivable and multiple assignments. Due to legal ambiguity, courts in different

localities have not formed a unified judgment on the complex civil legal relationships in such disputes. This has also led to unpredictable debt recovery in receivables, hindering the development of factoring financing to some extent and making it challenging to resolve disputes. Fraudulent transactions and duplicate financing pose greater challenges to financial stability. For example, in July 2019, Noah's Wealth Management was defrauded of \$3.4 billion in supply chain financing by Chengxing International Group causing a bad impact. Existing regulations for traditional financial models cannot address the complex legal relationships and specific issues in supply chain finance. Responding to and regulating such issues requires civil legal norms.

The *Civil Code*, which came into effect in 2021, acknowledges this situation and actively addresses related issues, representing the latest development in the civil legal regulation of supply chain finance.¹ The *Civil Code* incorporates the rules on pledge of receivables into the section on pledge of rights. Considering that factoring business, as a means of enterprise financing, is typical in terms of setting up rights and obligations, external effects, etc., and that provisions on factoring contracts are conducive to promoting the healthy development of factoring business, the *Civil Code* has stipulated factoring contracts as a special chapter as a nominated contract in the Contracts Section.

In the era of the “**Civil Code**”, the Supreme People’s Court introduced the “*Interpretation of the Supreme People’s Court of the Application of the Relevant Guarantee System of the Civil Code of the People’s Republic of China*”² and “*Interpretation by the Supreme People’s Court of Several Issues Concerning the Application of Title One General Provisions of Book Three Contracts of the Civil Code of the People’s Republic of China*”³. The Supreme People’s Court summarized the trial practice in recent years and formed the “*Conference Minutes (draft) of the National Courts’ Financial Trial Work*”⁴, providing a judicial basis for receivables financing transactions and establishing new standards. Thus, these legal updates consolidate rules regarding the assignment, pledging, and factoring of accounts receivable, scattered across the general provisions, section of right to pledge, contract section, and relevant

¹ Minfadian (民法典) [Civil Code] (promulgated by the Nat’l People’s Cong., May 28, 2020, effective Jan. 1, 2021) .(Chinalawinfo)

² Zuigao Renmin Fayuan Guanyu Shiyong Zhonghua Renmin Gongheguo Minfadian Youguan Danbao Zhidu de Jieshi (最高人民法院关于适用《中华人民共和国民法典》有关担保制度的解释) [Interpretation of the Supreme People’s Court of the Application of the Relevant Guarantee System of the Civil Code of the People’s Republic of China] (promulgated by Sup. People’s Ct. Dec. 25, 2020, effective Jan. 1, 2021) (Chinalawinfo). [hereinafter *Interpretation of the Relevant Guarantee System*].

³ Zuigao Renmin Fayuan Guanyu Shiyong Zhonghua Renmin Gongheguo Minfadian Hetongbian Tongze Ruogan Wenti de Jieshi (最高人民法院关于适用《中华人民共和国民法典》合同编通则若干问题的解释) [Interpretation by the Supreme People’s Court of Several Issues Concerning the Application of Title One General Provisions of Book Three Contracts of the Civil Code of the People’s Republic of China] (promulgated by Sup. People’s Ct. May. 23, 2023, effective Dec. 5, 2023) (Chinalawinfo). [hereinafter *Interpretation of the General Provisions of Book Contracts*].

⁴ Quanguo Fayuan Jinrong Shenpan Gongzuo Huiyi Jiyao (Zhengqiu Yijian Gao) (全国法院金融审判工作会议纪要(征求意见稿)) [Conference Minutes (draft) of the National Courts’ Financial Trial Work] (promulgated by Sup. People’s Ct. Apr. 13, 2023), <http://www.baotoulawyer.com/info/6080.jspx> [hereinafter *Conference Minutes(draft)*].

rules in judicial interpretations, forming a comprehensive civil legal framework for receivables financing. Additionally, the People's Bank of China released the “*Measures for the Unified Registration of Security Interests Over Movable Properties and Rights*”⁵ to assist in the registration and priority ranking rules for accounts receivable financing transactions.

Accounts receivable financing mainly has two modes: one is factoring, where the creditor of accounts receivable assigns existing or future accounts receivable to the factor. The factor provides services such as fund financing, accounts receivable management, or collection, and payment guarantee for the accounts receivable debtor. The primary obligation in the factoring contract is the assignment of the receivable. The second mode is accounts receivable pledging, where the lender and borrower sign a loan contract with accounts receivable pledged as collateral. In essence, it is a pledge of right, which guarantees the realization of the claim in the main contract by assigning the receivables. This article contends that legal updates mainly provide definitive answers to issues related to multiple factoring or pledging of accounts receivable and fictitious accounts receivable.

This article primarily summarizes, organizes, and analyzes the new rules established in China's civil law for receivables financing in the context of the development of supply chain finance. These rules significantly impact receivables financing transactions. The second section of this article focuses on the new rules for multiple assignments of accounts receivable. The third section analyzes the new rules concerning fictitious accounts receivable. The article concludes with a brief summary.

II. RULES GOVERNING MULTIPLE ASSIGNMENTS OF ACCOUNTS RECEIVABLE (FACTORING OR PLEDGING)

A. *Rules for Multiple Assignments of Accounts Receivable in the Civil Code and Judicial Interpretations*

In practice, conflicts over the priority of multiple factoring (or pledging) transactions frequently arise. These conflicts not only involve conflicting rights among multiple assignees but also extend to the debtor. Specifically, determining which assignee of the debt can obtain priority repayment from the debtor and which assignee the debtor can validly settle payments with poses challenges. In the former *Contract Law*, Chapter V on contract modification and assignment does not explicitly address the priority issue after the multiple assignments of the same debt. In principle, the assignment of a debt takes effect and has external effects upon agreement. Thus, in cases of multiple debt assignments, the assignee who first reaches an agreement gains the debt.

In practice, various viewpoints exist, such as prioritizing based on the order of signing the assignment contract, the sequence of notifying the debtor, the

⁵ Dongchan he Quanli Danbao Tongyi Dengji Banfa (动产和权利担保统一登记办法) [Measures for the Unified Registration of Security Interests Over Movable Properties and Rights], (promulgated by St. Council, Nov. 18, 2021, effective Jan. 1, 2022) (Chinalawinfo) [hereinafter *Measures for Registration*].

order of processing accounts receivable transfer registrations, and proportional simultaneous settlement among multiple assignees. Disputes arising from these conflicting rights are abundant in the operation of supply chain finance, and the ambiguity in laws and regulations has led to frequent disorder in reality, posing significant legal risks for all parties involved in transactions.

The *Civil Code* acknowledges this issue and provides highly innovative rules. Article 768 specifies the competitive priority in multiple factoring of accounts receivable, addressing the priority rules among multiple assignees when multiple factoring contracts involve the same accounts receivable claim.⁶ Firstly, this provision introduces the standard of prioritizing accounts receivable claim transfers based on registration as the primary criterion, followed by notification as a secondary criterion. In other words, for all legally registered assignees, the assignee who registers first acquires the accounts receivable. In cases where there is no registration, the assignee who first notifies the debtor obtains the accounts receivable. Secondly, this provision stipulates that unregistered or unnotified assignees of the debt claim are on equal footing and should be compensated proportionally, known as the “debt claim separation rule”.

Based on the principle of treating similar legal relationships similarly, Article 66, Section 1 of the *Interpretation of the Relevant Guarantee System* specifies that when there are simultaneous factoring, accounts receivable pledging, and debt claim transfers on the same accounts receivable, the priority order is determined with reference to Article 768 of the *Civil Code*.⁷ In the interpretation, it naturally applies to cases where only two legal relationships exist on the same accounts receivable. Examples include factoring and accounts receivable pledging, factoring and debt claim transfers, and accounts receivable pledging and debt claim transfers. This interpretation also encompasses situations involving multiple pledgings of accounts receivable and multiple complete assignments of accounts receivable.⁸ Subsequently, Article 50, Section 1 of the *Interpretation of the General Provisions of Book Contracts* clarified the rules for general multiple transfers of debt claims, in harmony with

⁶ Minfadian(民法典)[Civil Code](promulgated by the Nat'l People's Cong., May 28, 2020, effective Jan. 1, 2021), Art. 768 : Where a creditor of an account receivable concludes multiple factoring contracts with different factors so that the factors claim their rights against the same account receivable, the account receivable shall be obtained by the factor of a registered factoring contract in priority over the factors of unregistered factoring contracts, or, where all factoring contracts are registered, by the factors in an order according to the time of registration, or, where none of the factoring contracts have been registered, by the factor stated in the transfer notice which has reached the debtor of the account receivable first in time. Where none of the factoring contracts have been registered and no transfer notice has been sent, the account receivable shall be obtained by the factors on a pro-rata basis on the amount of financing funds each has provided, or the service remuneration each is entitled to. (Chinalawinfo)

⁷ *Interpretation of the Relevant Guarantee System*, Art. 66 section 1.

⁸ See Fan Jiahui(范佳慧), *Shihang Xin Yingshang Huanjing Pinggu Shiye Xia Woguo Dongchan Danbao Zhidu Shensi* (世行新营商环境评估视野下我国动产担保制度审思), [A Study on China's Secured Transactions Law from the Perspective of the New Business Ready Project of the World Bank], 5 BIJIAOFA YANJIU (比较法研究)[JOURNAL OF COMPARATIVE LAW], 149, 153 (2023).

the rules outlined in Article 768 of the *Civil Code*.⁹ Articles 13, 15, 20, and 29 of the *Conference Minutes(draft)* all adhere to this rule.¹⁰

In line with the rules described above, the newly revised *Measures for the Unified Registration of Security Interests Over Movable Properties and Rights* of the People's Bank of China has deleted the relevant portion of the former *Measures for the Registration of the Pledge of Accounts Receivable* relating to the statement that "Where multiple rights are created on the same account receivable, the pledgees shall exercise their rights according to the chronological sequence of registration."¹¹

The priority registration rule alters the prerequisites for the external effectiveness of accounts receivable transfers since the former *Contract Law*. Due to the absolute priority effect of registration, it encourages the assignee of debt claims to promptly complete the registration to mitigate transaction risks.

The legitimate value basis for the claim separation rule when the elements of resistance are unclear lies in the principle of equal rights among creditors. In cases where the debt payment is divisible, a pro-rata relationship forms among the assignees. In cases where the debt payment is indivisible, a quasi-joint

⁹ *Interpretation of the General Provisions of Book Contracts*, Art. 50 section 1.

¹⁰ *Conference Minutes(draft)*, Art. 13(extract): If, after the factor has been assigned the receivables to be available and the assignment has been registered, the creditor of the receivables repeatedly assigns or pledges to a third party the receivables claim actually arising, the order of priority between the factor and the other assignees and pledgees is determined in accordance with Article 66, paragraph 1, of the Interpretation of the Relevant Guarantee System.

Art 15(extract): If, after a creditor of a receivable has entered into multiple factoring contracts in respect of the same receivable, the debtor of the receivable performs all or part of its obligation in accordance with the agreed terms of payment to the factor indicated in the first valid notification of the assignment to arrive, the extinction of a corresponding part of the obligation occurs with respect to the other factors. If the factor assigns the receivable to another factor for reconsolidation and the debtor of the receivable, upon receipt of notification, performs its obligation under the agreed terms of payment to the factor indicated in the last arriving valid notification of the assignment, this has the effect of extinguishing the obligation for the creditor of the receivable, the factor and the reconsolidator.

Art 20: The people's court does not support the claim that the other registered factors should not enjoy priority on the ground if they know that the receivables have been assigned by the factor who does not register the assignment of the receivables. If multiple factors repeatedly assign the same receivables to carry out recourse factoring business, and the factors neither register nor notify the debtor of the receivables before initiating or participating in the litigation, each factor obtains the receivables in proportion to the amount of the factored financing or remuneration for the services rendered.

Where a factor conducting non-recourse factoring business requests to participate in the distribution of the amount of the receivables assigned to it, the people's court shall support the request.

Art 29(extract): If a creditor of an accounts receivable pledges and then assigns the same accounts receivable to another person for factoring or creates a repeated pledge of the same accounts receivable and registers it, the priority between the pledgor and the factor shall be determined in accordance with the provisions of Article 66, paragraph 1, of the Interpretation of the Relevant Guarantee System.

¹¹ See *Dongchan he Quanli Danbao Tongyi Dengji Banfa (Xiuding Zhengqiu Yijian Gao) Xuding Shuoming* (《动产和权利担保统一登记办法(修订征求意见稿)》修订说明) [Note on revisions to the "Measures for the Unified Registration of Security Interests Over Movable Properties and Rights (Revised Exposure Draft)"] (Chinalawinfo) <https://www.pkulaw.com/protocol/a46eb815a2ab943d93391c49ef466f60bdfb.html?tao=1&keyword=%E3%80%8A%E5%8A%A8%E4%BA%A7%E5%92%8C%E6%9D%83%E5%88%A9%E6%8B%85%E4%BF%9D%E7%BB%9F%E4%B8%80%E7%99%BB%E8%AE%B0%E5%8A%9E%E6%B3%95%EF%BC%88%E4%BF%AE%E8%AE%A2%E5%BE%81%E6%B1%82%E6%84%8F%E8%A7%81%E7%A8%BF%EF%BC%89%E3%80%8B%E4%BF%AE%E8%AE%A2%E8%AF%B4%E6%98%8E>.

ownership of claims forms among the assignees, establishing joint and several debt relationships externally. The legal consequences balance the clearance risk of creditors, the protection of debtors, and the convenience of exercising debt rights.¹²

After the enactment of the *Civil Code*, in practice, the first-registered assignee may not notify the debtor first, and after the debtor of the receivable has performed its obligation to the factor in accordance with the notice of assignment of the claim, can the first-registered creditor claim its rights against the debtor? The *Civil Code* does not appear to provide for such a situation. But as a general rule, the debtor performs its obligation in accordance with the factor indicated in the first arriving valid notice, the effect of extinguishment of the obligation occurs, and it has a refusal-of-performance defense against the other factors. In addition, the first factor to register is entitled to request the factor that has accepted the performance of the debt to return the proceeds to itself.¹³ This rule is established in jurisprudence, Article 50 of the *Interpretation of the General Provisions of Book Contracts* and Article 15 of the *Conference Minutes(draft)* clarifies the rule that the debtor shall perform to the assignee who notifies first, and the priority of receivables is still determined by the order of registration.¹⁴

B. The effectiveness of accounts receivable Assignment registration

According to the principle of publicity of property rights, in the case of pledging accounts receivable, the pledge right does not automatically establish itself after the pledge contract is concluded; instead, the pledge right is established upon the registration of the pledge. Accounts receivable pledges should adhere to the principle of publicity of property rights, aiming to make it effective against third parties, thus reasonably balancing the interests of the pledgee, pledger, and third parties. In the publicity of accounts receivable pledging, Article 445 of the *Civil Code* adopts the method of a written contract plus registration. This is primarily considered because the publicity effect of registration is strongest, facilitating third parties in understanding the encumbrances on accounts receivable conveniently. It also better protects the interests of the pledgee and third parties, thereby promoting transaction efficiency and security. In this regard, Article 27 of the *Conference*

¹² See Zhu Xiaozhe (朱晓喆) & Feng Jieyu (冯洁语), *Baoli Hetong Zhong Yingshouzhangkuan Duochong Zhuanrang De Youxian Shunxu—Yi Minfadian Di 768 Tiao Wei Zhongxin* (保理合同中应收账款多重转让的优先顺序——以《民法典》第 768 条为中心) [*Priority of Multiple Assignments of Accounts Receivable in Factoring Contracts*], 1 FAXUE PINGLUN (法学评论) [LAW REVIEW] 172, 177-182 (2022). [hereinafter ZHU & FENG]

¹³ See Liu Guixiang (刘贵祥) *Guanyu Jinrong Minshangshi Shenpan Gongzuo Zhong De Linian Jizhi He Falv Shiyong Wenti* (关于金融民商事审判工作中的理念、机制和法律适用问题) [*On the Idea, Mechanism and Law Application for the Trial of Financial Civil and Commercial Cases*] 1, FALV SHIYONG (法律适用) [JOURNAL OF LAW APPLICATION], 10, 17 (2023).

¹⁴ See supra note 9, 10.

Minutes(draft) reaffirms this principle.¹⁵ However, for factoring transactions, registration is not a prerequisite for the effectiveness of debt-assignment.

Article 768 of the *Civil Code* changes the original antagonistic elements of the assignment of receivables and makes "registration" and "notification" antagonistic elements, providing that registration has absolute priority, i.e. in the case of multiple factoring or assignments, the first registered assignee acquires the receivables. Moreover, the antagonistic element of Article 768 does not take into account the subjective state of the assignee's good or bad faith, so that even if the registered assignee (the factor) is aware of the prior notice, it still has priority over the notifying assignee. Thus, the factor will necessarily choose to view the registration first, rather than inquire of the debtor.¹⁶

Since the *Civil Code* accords a certain degree of credibility to the registration of assignments of receivables as an antagonistic element under certain circumstances, it is questionable whether the debtor is obliged to consult the registration of receivables. Theoretically, the main function of registration as an element against third parties or other assignees is to deal with questions of priority among multiple assignees and to make it available for inspection by the assignee, without involving the debtor's rights and obligations. The debtor is in good faith as long as it performs its obligation to the first assignee to give notice. In other words, the debtor performs the receivable to the assignee by virtue of the notification and not by virtue of the registration, and he is not obliged to consult the registration of the receivable. In response to this dispute, the *Conference Minutes(draft)* clarifies two rules: first, registration and notification are two completely independent things, and the registration of the assignment of the receivable by the factor or the assignee in the Uniform Platform for Registration of Security Interests Over Movable Properties and Rights does not have the effect of notification to the debtor of the receivable.¹⁷ Second, the debtor performs the obligation to the factor specified in the first arriving valid notification, and the effect of extinguishment of the obligation occurs, and to the other factor has the defense of refusal of performance without regard to the registration status of the receivable.¹⁸ This makes it clear that the debtor is not obliged to consult the registration of the assignment of the receivable.

¹⁵ *Conference Minutes (draft)*, Art. 27 : If the pledgee fails to register the pledge, resulting in the pledge not being established in accordance with the law, and the pledgee requests the pledgee and the debtor of the receivable to assume responsibility, the people's court shall not support the request because the debtor of the receivable is not one of the parties to the pledge contract, and did not participate in the conclusion of the contract.

¹⁶ See Zhu &Feng, *supra* note 12, at 172.

¹⁷ *Conference Minutes (draft)*, Art. 15 (extract): Registration of an assignment of a receivable by a factor in the Uniform Security Registration Platform for Movable Assets and Rights does not have the effect of notifying the debtor of the receivable.

¹⁸ See *supra* note 13, also 10.

C. Effectiveness of Accounts Receivable Assignment Notification

Whether notification is given determines whether the transfer of accounts receivable becomes effective against the debtor, aligning with the general rule of assignment of claims in Article 546 of the Civil Code. In the pledging and factoring of accounts receivable, the Civil Code follows a similar approach. Regarding effectiveness against the debtor, Article 768 does not alter the rule that transfer notification is effective against the debtor. Although Article 768 grants opposing effectiveness to the registration of the assignment and the prior notification, this effectiveness occurs between the registrant, the first sender of the notification, and other assignees or other rights holders (such as pledgees), without involving the debtor. Even if the registration of the assignment may make the debtor aware, registration is not a prerequisite for effectiveness against the debtor; notification in accordance with Article 546 is still required to be effective against the debtor.

Article 50 of the *Interpretation of the General Provisions of Book Contracts*¹⁹ refers to Article 768 of the *Civil Code* regarding the priority of rights of the factor in the case of multiple assignments of accounts receivable, confirming that the effectiveness of “notification” is limited to the assignee and the debtor. The debtor is obligated to perform only to the assignee who first notified, except when the debtor knows that the assignee who accepts the performance is not the first. The second section specifically defines the first notification and outlines how the judicial system examines and determines the assignee who first notifies.²⁰ Articles 15 and 28 of the *Conference Minutes(draft)* also reiterate that the assignment of accounts receivable becomes effective against the debtor only after notification.²¹

Article 768 of the *Civil Code* also considers “notification” as a type of element of antagonism. If the assignment of the claim is not registered, then notification serves both as a requirement for asserting rights against the debtor and as an antagonism factor. That is, in the case of multiple assignments or factoring where the assignee is not registered, the assignee specified in the first assignment notice received by the debtor obtains the accounts receivable. An area of concern is whether the debtor has an obligation to clarify the assignment of the accounts receivable to the assignee at the time of notification. According to the principle that the assignment of the claim should not worsen the debtor’s position, the debtor is not obligated to respond at this time, as it would otherwise increase the debtor’s burden.²²

¹⁹ See supra note 12.

²⁰ *Interpretation of the General Provisions of Book Contracts*, Art. 50 section 2.

²¹ *Conference Minutes(draft)*, Art. 15(extract): If a factor that has not notified the debtor of the receivable of the assignment of the receivable requests the debtor of the receivable to perform the obligation on the ground that the debtor of the receivable has actual knowledge that the factor has been assigned the receivable, the people’s court shall not support such a request.

Art. 28 (extract) The creation of a pledge over a receivable is not effective against the debtor of the receivable if the pledgee does not notify the debtor of the receivable of the fact of the creation of the pledge.

²² See Zhu & Feng, supra note 15, at 177.

III. RULES REGARDING FICTITIOUS ACCOUNTS RECEIVABLE

In the past, concerning disputes related to fictitious accounts receivable, courts could only solve problems through the deduction of civil law principles or analogical application of relevant civil law norms. There were no clear answers to issues such as whether the debtor should bear responsibility to the factor, whether the factor could request the debtor to fulfill obligations, and the standards of the factor's due diligence obligations and liability allocation in the context of fictitious accounts receivable. How the law regulates the persistent issue of fictitious accounts receivable in factoring business, and how civil law measures the interests between factors and debtors in cases of fictitious accounts receivable, ensuring the protection of factors without exacerbating debtor obligations, are issues that neither pre-existing legal provisions nor judicial practices have addressed before the enactment of the *Civil Code*.

A. Basic Rules Regarding Fictitious Accounts Receivable

Article 763 of the *Civil Code* provides a unified solution to this issue, clarifying that in cases where a creditor and debtor enter into a factoring contract involving fictitious accounts receivable, the debtor shall bear the responsibility of *rechtsschein* towards the factor. In principle, a lower standard of due diligence obligation is imposed on the factor, enhancing protection for *bona fide* factors, thereby controlling operational risks for factoring enterprises and maintaining financial security.

Article 763 is based on the principle of positive reliance interest protection and the resulting *rechtsschein* theory. The *rechtsschein* refers to the representation of the phony right which is incompatible with the real right, and the civil law takes the *rechtsschein* as the true and leads the *bona fide* third party to get what it wants, this results in that the real obligee bears the adverse consequence.²³ In the special case of fictitious account receivable, the constituent elements of the debtor's responsibility of *rechtsschein* can be interpreted from Article 763 as including the *rechtsschein* of the receivable, the factor's reliance, and the debtor's imputability.²⁴

The intent of the *rechtsschein* theory is not to pursue the person responsible for the attribution of the result but rather to preserve the smooth running of the transaction, with legal consequences for the person relying and the person with a real right, according to the *rechtsschein* and the extent of the reliance.²⁵

In the case of a fictitious account receivable, "shall not assert a defense against the factor on the ground that the account receivable does not exist" in essence means that the factor obtains the account receivable and may request the debtor to honour it. The factor may also seek remedies through tort law, where the debtor bears the liability for damages, and the scope of liability

²³ See Yang Zhiqiong (杨志琼), *Quanli Waiguanzeren yu Zhapianfanzi* (权利外观责任与诈骗犯罪) [*The Rechtsschein and Crime of Fraud*], 6 ZHENGFA LUNTAN (政法论坛) [TRIBUNE OF POLITICAL SCIENCE AND LAW] 32,45 (2017).

²⁴ See CLAUDIUS WILHELM CANARIS, *GERMAN COMMERCIAL LAW* 147-148 (Yang Ji ed., 1st ed. 2006).

²⁵ See LARENZ, *supra* note 7, at 886. See also CANARIS, *supra* note 4, at 151.

protects positive reliance interests, but there is a rule of contributory negligence in the calculation of the amount of damages,²⁶ and the factor will be liable according to the degree of negligence if the factor fails to find out the untruthfulness of the account receivable due to poor auditing. However, the responsibility of *rechtsschein* is applied without regard to the factor's negligence, and the debtor fulfills the debt in accordance with the entirety of the account receivable.

Similarly, Article 61, section 1 of the *Interpretation of the Relevant Guarantee System*,²⁷ and Article 26 of the *Conference Minutes(draft)*²⁸, based on reducing transaction costs, increasing transaction efficiency, controlling the possibility of risk, and verifying the authenticity of accounts receivable, explicitly state that a debtor who falsely confirms the non-existence or extinguishment of accounts receivable cannot claim non-liability, providing definitive guidance for judicial judgments.

B. Criteria for Good Faith of the Assignee

In judicial practice, the rules of Article 763 of the *Civil Code* have started to be applied. However, there is still considerable controversy in academia and practice regarding the “knowing” exception and the examination standards for the factor. The criterion of good faith is “not knowing”. In principle, it is considered that the actor who is not knowing due to general negligence is still regarded as good faith, and the actor who is grossly negligent is not regarded as good faith, but this is only a general criterion. It can be seen that negligence is precisely the equilibrium factor of value judgment in the interest measurement in the application of responsibility of *rechtsschein*, and the standard of good faith relies on the different requirements of the degree of negligence to differentiate, so as to reflect the law's measurement of interests between the reliance person and the person who is responsible for the *rechtsschein*.²⁹

In the special case of fictitious account receivable, article 763 explicitly excludes from good faith those cases in which “the factor clearly knows such fabrication”, and does not stipulate in general terms that “it shall not be used

²⁶ Minfadian(民法典) [Civil Code](promulgated by the Nat'l People's Cong., May 28, 2020, effective Jan. 1, 2021), Art. 173: Where an infringed person is also at fault for the occurrence or aggravation of the same damage to himself, the liability of the tortfeasor may be mitigated.

See Zhuqi (朱奇) & Shihao (施浩) & Huangdi (黄颀), *Baoli Yewu Zhong Yingshouzhangkuan Buzhenshi de Zeren Chengdan* (保理业务中应收账款不真实的责任承担)[Liability for untrue accounts receivable in factoring business] 32 RENMIN SIFA (人民司法) [PEOPLE'S JUDICATURE] 14, 14-17. See also Sunchao(孙超) *Baoli Suoshe Jiufen zhong de Liyi Hengliang yu Caipan guize* (保理所涉纠纷中的利益衡量与裁判规则)[Weighing of interests and adjudication rules in disputes involving factoring] 32 RENMIN SIFA (人民司法) [PEOPLE'S JUDICATURE] 25, 25-29.

²⁷ *Interpretation of the Relevant Guarantee System*, Art. 61 section 1.

²⁸ *Conference Minutes(draft)*, Art. 26(extract): If the debtor of the receivable pleads that the receivable does not exist or has been extinguished, it is dealt with in accordance with Article 61, paragraphs 1 and 2, of the Interpretation of the Relevant Guarantee System.

²⁹ See Shi Yifeng (石一峰) *Sifa Zhong Shanyi Rending de Guize Tixi* (私法中善意认定的规则体系), [Systematic Rules on Good Faith Identification in Private Law] 4 FAXUE YANJIU(法学研究)CHINESE JOURNAL OF LAW 131, 136 (2020).

against *bona fide* third parties”,³⁰ nor does it specify that the criteria for good faith is “not knowing due to other than gross negligence”.³¹ In other words, this article, although it does not follow the general standard of good faith, is not a legal loophole, but reflects the legislator’s special legal policy considerations for the comprehensive protection of the factor.

Whether it is legislative materials,³² the understanding and application of the *Civil Code* compiled by the Supreme People’s Court,³³ or judicial practice, in most cases, it recognizes this approach.³⁴ In this regard, the *Conference Minutes(draft)* once again clarified the rules of Article 763 of the *Civil Code*. Article 19 of the minutes stipulates that if the factor is not knowingly aware of the fictitious nature of the receivables, whether or not the factor is careful to review the authenticity of the receivables, and the receivables creditor or debtor fabricates the receivables, the factor has a series of claims.³⁵ This proves that the *Civil Code* has indeed adopted a legal policy that specially protects factors, which also conforms to the constitutive elements and legal effects of *rechtsschein* theorie, aiming to safeguard the security of dynamic transactions and prevent higher examination obligations imposed on factors.

C. New Rules for Unilaterally Fictitious Receivables by Creditors

While the *Factoring Contract* chapter in the *Civil Code* specifies the legal responsibilities regarding the conspiratorial fictitious by the accounts receivable

³⁰ Minfadian(民法典) [Civil Code](promulgated by the Nat’l People’s Cong., May 28, 2020, effective Jan. 1, 2021) · Art. 61, 65, 94, 145, 170, 171, 225 (Chinalawinfo).

³¹ Minfadian(民法典) [Civil Code](promulgated by the Nat’l People’s Cong., May 28, 2020, effective Jan. 1, 2021) · Art. 613. (Chinalawinfo); Zuigao Renmin Fayuan Guanyu Shiyong Zhonghua Renmin Gongheguo Minfadian Wuquanbian de Jieshi Yi (最高人民法院关于适用《中华人民共和国民法典》物权编的解释(一)) [Interpretation of the Supreme People’s Court on the Application of Real Rights Book of Civil Code One] (promulgated by Sup. People’s Ct. Dec. 25, 2020, effective Jan. 1, 2021) Art. 14 (Chinalawinfo).

³² See Shi Hong (石宏), *Zhonghua Renmin Gongheguo Minfadian Shijie Yu Shiyong Hetongbian Xiace* (《中华人民共和国民法典》释解与适用·合同编(下册)) [“Civil Code of the People’s Republic of China” Interpretation and Application- Book Contracts (2)], 545(2020).

³³ See Zuigao Renmin Fayuan Minfadian Guanche Shishi Gongzuo Lingdao Xiaozu (最高人民法院民法典贯彻实施工作领导小组, *Zhonghua Renmin Gongheguo Minfadian Hetongbian Lijie Yu Shiyong San* (中华人民共和国民法典合同编理解与适用(三)) [Understanding and Application of the Contracts Section of the Civil Code of the People’s Republic of China (III)], 1776 (2020).

³⁴ See Huoerguosi Xinjun Shangye Baoli Youxian Gongsu Su Suning Yigou Jituan Gufen Youxian Gongsu Deng Baoli Hetong Jiufen An (霍尔果斯新骏商业保理有限公司诉苏宁易购集团股份有限公司等保理合同纠纷案) [Horgos Xinjun Commercial Factoring Co. Ltd. v. Suning Tesco Group Co. Ltd.] · (2020) 沪民终364号(Shanghai High People’s Ct. 2020); Jiangtong Guoji Shangye Baoli Youxian Zeren Gongsu Su Shanghai Dunzhan Shiye Youxian Gongsu Deng Jiekuan Hetong Jiufen An(江铜国际商业保理有限责任公司诉上海顿展实业有限公司等借款合同纠纷案) [Jiangtong International Commercial Factoring Co. Ltd. v. Shanghai Dunzhan Industrial Co. Ltd.], (2019) 沪74民初553号(Shanghai Financial Ct. 2019). See also Wu Junxue (吴峻雪)& Zhai Shuang(翟爽), *Gongyinglian Jinrong Zhong Xugou Yingshouzhangkuan Baoli Hetong De Shencha Guize* (供应链金融中虚构应收账款保理合同的审查规则) [Rules for reviewing fictitious accounts receivable factoring contracts in supply chain finance], 3, RENMIN FAYUAN ANLI XUAN(人民法院案例选) [CHINA LAW REPORT], 131, 131-143 (2023); Zhou Hengyu(周恒宇), *Baoli Jiaoyi Zhong Xugou Yingshouzhangkuan De Xiaoli Rending Yu Falv Houguo*(保理交易中虚构应收账款的效力认定与法律后果) [Effect Affirmation and Legal Consequence of Cooking up Receivables in Factoring Transaction], 29, RENMIN SIFA(人民司法) [PEOPLE’S JUDICATURE] 21, 21-25, (2022).

³⁵ *Conference Minutes(draft)*, Art 19 section 1.

creditor and the debtor, it does not elaborate on the legal consequences of a unilateral fictitious act by the creditor. Article 49, Section 2 of the *Interpretation of the General Provisions of Book Contracts* provides certain protection for the assignee from the perspective of prohibiting assertion, explicitly stating that after the debtor acknowledges the authenticity of the debt, they may not claim that the debt does not exist.³⁶

Regarding factoring business, Article 18 of the *Conference Minutes(draft)* clearly enumerates four situations of fictitious accounts receivable, with the third one being “the debtor confirms to the factor the authenticity of the accounts receivable”, which clearly indicates that situations, where the creditor unilaterally fictitiously acts but the debtor confirms, are also governed by Article 763 of the *Civil Code*, meeting the requirements of *rechtsschein* theorie.³⁷

In addition, in the practical “undisclosed factoring” business, there are indeed cases of unilateral fictitious acts by only the creditor because factors do not need to confirm or notify the debtor when signing factoring contracts. Faced with this situation, Article 19, Section 2 of the *Conference Minutes(draft)* stipulates that in such cases, the factor may not demand the debtor to fulfill the accounts receivable obligation.³⁸ Therefore, it can be further inferred that if the debtor has not confirmed the authenticity of the accounts receivable, there is, in principle, no attributability, and they do not bear the obligation for the accounts receivable. These rules fill the gaps left by the *Civil Code*.

IV. CONCLUSION

In response to various disputes arising from the frequent transfer of accounts receivable in the development of supply chain finance, the *Civil Code* incorporates good experiences from judicial practices and adopts rules from comparative law. It also innovates many rules tailored to China’s national conditions, forming a legal system for accounts receivable financing. With the rapid development of financing activities in the supply chain and industrial chain of Chinese enterprises, new situations have emerged in the judicial

³⁶ *Interpretation of the General Provisions of Book Contracts*, Art. 49 section 2.

³⁷ *Conference Minutes(draft)*, Art. 18: Any of the following circumstances constitutes “fictitious accounts receivable as the subject of assignment” under Article 763 of the *Civil Code*:

(1) Falsification of the underlying transaction information such as contracts and performance documents, or fictionalization of the background of the underlying transaction with real contracts and performance documents;

(2) Deliberately concealing the fact that accounts receivable have been extinguished, or falsely increasing the amount of accounts receivable;

(3) The debtor of the receivable confirms to the factor that “the receivable is genuine”;

(4) Other acts in which the creditor and debtor of the receivable jointly create a false appearance of entitlement to the receivable.

³⁸ *Conference Minutes(draft)*, Art. 19 section 2: In a dark factoring business, where the debtor of the receivable is not involved in the fictitious receivable, the people’s court does not support the factor’s claim against the debtor of the receivable in accordance with Article 763 of the *Civil Code*. This is unless the debtor of the receivable is notified of the assignment and does not object to the factor within a reasonable period of time.

practice under the application of the *Civil Code*. It is necessary to promptly unify the standards of judgment, promote the healthy and stable development of the supply chain and industrial chain of Chinese enterprises, and optimize and upgrade them.

In this context, complementary judicial interpretations of the *Civil Code*, such as the *Interpretation of the Relevant Guarantee System* and *Interpretation of the General Provisions of Book Contracts*, have been introduced. The National Court Financial Trial Work Conference held in 2023 also focused on discussing the trial of disputes related to supply chain finance, leading to the formulation of the *Conference Minutes (draft) of the National Courts' Financial Trial Work*. Within the established framework of the *Civil Code*, it further refines relevant rules, contributing to the clarity and uniformity of the law. Overall, these legal updates effectively address issues in accounts receivable financing, such as multiple assignments and fictitious accounts receivable, facilitating dispute resolution and promoting the healthy development of supply chain finance.

The Supreme People's Court of China has continuously issued judicial policies in recent years, requiring that the role of judicial functions be given full play in the trial to help broaden the financing channels of private enterprises to reduce the cost of financing and to help the development of small, medium and micro-enterprises, which mentions that it is necessary to promote the healthy development of supply chain finance in accordance with the law and that innovative forms of supply chain finance should be recognized in accordance with the law.³⁹

The legal updates provide a comprehensive system of rules for accounts receivable financing, which is of great significance. However, the application and interpretation of these rules still need to be further refined in judicial practice. As highlighted by the Supreme People's Court's requirements, how to handle disputes related to supply chain finance in accordance with the law, prevent and resolve financial risks, while not undermining the vitality of the development of supply chain finance, may be a matter that legislators, courts, and scholars need to further consider in the coming period.

³⁹ See Zuigao Renming Fayuan Guanyu Chongfen Fahui Sifa Zhineng Zuoyong Zhuli Zhongxiaowei Qiye Fazhan De Zhidao Yijian (最高人民法院关于充分发挥司法职能作用 助力中小微企业发展的指导意见) [Guiding Opinions for Fully Maximizing the Role of Judicial Functions to Boost the Development of Micro, Small and Medium-Sized Enterprises], (promulgated by Sup. People's Ct. Jan 13, 2022, 法发〔2022〕2号), Art. 10; Zuigao Renming Fayuan Guanyu Youhua Fazhi Huanjing Cujin Minying Jingji Fazhan Zhuangda De Zhidao Yijian(最高人民法院关于优化法治环境 促进民营经济发展壮大的指导意见) [Guiding Opinions of the Supreme People's Court on Optimizing the Legal Environment to Promote the Development and Growth of the Private Economy], (promulgated by Sup. People's Ct. Sept 13, 2023, 法发〔2023〕15号的通知), Art. 16.