

Flexibility in Assignment of Contractual Rights: Assignment of Account Receivables

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One significant aspect of contract flexibility is the ability of contracting parties to transfer their rights and duties, through the doctrines of assignment and delegation, which reduces risks and advances efficiency. The assignment of account receivables may be the most commonplace, and most important, example of this type of contract flexibility. As transactions become more global, however, both the laws and the practices surrounding assignment of account receivables become more complex and national laws differ concerning the assignment of these intangible rights and the regulations of financial intermediaries who carry out the transaction. More and more, businesses must understand the challenges and opportunities surrounding assignments of accounts receivables. Accordingly, this chapter examines and compares the law and practice of account receivables in China, the United States of America, and the United Kingdom. The analysis is based on the assignment of account receivables ranging from traditional factoring, forfeiting, to modern cross-border securitization transactions. Through comparison, this chapter concludes by identifying the various legal issues about Chinese law and proposing corresponding solutions.

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1. Introduction

1.1. Evolution of assignment of contractual rights

Contracts are regarded as private law between the business parties to the transaction because they are based on the agreement of the contracting parties. A contract gives rise to obligations which are enforced or recognized by law. The stability of this “private law” is important because both parties need to perform their obligations according to the contract. If the contract terms or the parties to the contract could be freely changed, the parties as well as any third party creditors may not be able to predict what their rights and obligations would be. Contract law thus provides such a protection by recognizing duly formed contracts and imposing liabilities on the party who fails to perform their contractual obligations.

However, with economic development, contract law has recognized that the business needs of both parties may change, along with the circumstances under which the parties made the contract. In such cases, adherence to the original contract terms may hinder the business transactions. While stability of the contract is still important, flexibility has thus become more and more significant, especially to meet the needs for globalization, in the context of which the business parties come from different countries and it is more likely that their business needs may change over time.

Generally, a contract only binds its two parties. However, after the contract has been made, one of the parties may want to liquidate immediately its future rights under the contract, or find some third party willing to perform its future duties under the contract. To accomplish these ends, contract law has developed the devices of assignment of contractual rights and delegation of contractual duties. This chapter focuses on the assignment of contractual rights, under which the benefits of a contract will be transferred to a third party.² More precisely, an assignment of contractual right is a voluntary manifestation of intention by the holder of an existing right to make an immediate transfer of that right to another person.³ The assignment

² G.H. Treitel, *The Law of Contract* 590 (Sweet & Maxwell 1995).

³ Brian Blum, *Contracts* 673 (Aspen Law & Business 1998).

of contractual rights is an ideal illustration of the process, and the importance, of maintaining flexibility in contracting.

1.2. Account receivables as contractual rights

One of the most significant uses of assignments in modern law occurs in the context of commercial financing. Where a business sells goods to a purchaser, more often than not the sale is on credit, which means that the purchaser promises to pay the price plus interest at some time in the future. This promise may be converted into money by the seller through assigning of the right to payment to a commercial lender, such as a bank or other financing institution. This is known as accounts receivable financing.⁴ The transfer (assignment) of accounts is a mainstay of commercial financing.

The assignment of accounts happens not only within a country, but also worldwide. With the development of the global economy, competition in international trade has become more and more intense. The international market has gradually become purchaser-oriented, and the competition of various industries is fierce. As in domestic businesses, the enterprises of various countries have adopted credit sales in order to expand their participation in the international market. As a result, the sales volume of international trade has been enlarged and the scale of businesses has been expanded. Meanwhile, many enterprises have accumulated more and more account receivables with different due periods, occupying much of the enterprises' capital. On the one hand, the enterprises are facing huge pressure of financing and the risks that large amount of account receivables may not be successfully collected; on the other hand, competition requires that the enterprises continue to offer credit sales, so that new account receivables are accrued continuously. In order to resolve the problem, businesses liquidate their account receivables by assigning them to financial intermediaries.

The assignment of account receivables as an important way of financing has developed quickly in recent years, challenging the laws in different countries. Although account

⁴ John Edward Murray, Jr., *Contracts: Cases and Materials* (5th Ed.) 932-33 (Lexis Publishing 2000).

receivables are assigned in both international and domestic contexts, often domestic laws determine whether and to what extent the contractual rights can be freely assigned.

2. Assignment of account receivables

2.1. Definition

The Uniform Commercial Code of the United States defines “account” as:

a right to payment of a monetary obligation, whether or not earned by performance, (i) for property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of; (ii) for services rendered or to be rendered; (iii) for a policy of insurance issued or to be issued; (iv) for a secondary obligation incurred or to be incurred; (v) for energy provided or to be provided; (vi) for the use or hire of a vessel under a charter or other contract; (vii) arising out of the use of a credit or charge card or information contained on or for use with the card; or (viii) as winnings in a lottery or other game of chance operated or sponsored by a State, governmental unit of a State, or person licensed or authorized to operate the game by a State or governmental unit of a State.

The term does not include

(i) rights to payment evidenced by chattel paper or an instrument; (ii) commercial tort claims; (iii) deposit accounts; or (iv) rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.⁵

Chinese law defines “account receivables” as the rights to payment that the obligee has against the obligor arising out of providing certain goods, services, or facilities, including the

⁵ UCC § 9-102(2).

rights to present and future monetary payment and the proceeds thereof, but excluding the right to payment arising out of negotiable instruments or other securities.⁶

In December 2001, the United Nations issued the Convention on the Assignment of Receivables in the International Trade, in which “assignment” is defined as “the transfer by agreement from one person (“assignor”) to another person (“assignee”) of all or part of or an undivided interest in the assignor’s contractual right to payment of a monetary sum (“receivable”) from a third person (“the debtor”).⁷

The various definitions reflect the different focus of each legal document, but it is generally agreed that account receivables are the right to payment of a monetary obligation. As discussed above, one important purpose of assignment of account receivables is to obtain financing since account receivables are creditors’ rights with significant economic value. In practice, account receivables may be transferred directly or be used as collateral. This chapter focuses on the direct transfer.

2.2. General forms of assignment of account receivables

There are various ways to get financing based on account receivables. The most popular ways include factoring, forfaiting, and securitization of the receivables.

2.2.1. Factoring

“Factoring” is a contract, pursuant to which a supplier may or will assign account receivables to a third party (known as a “factor”) for ledgering receivables, collecting proceeds and protecting against bad debts. Factoring is a full financial package that combines services of credit protection, account receivables’ bookkeeping, and collection of proceeds. Under a factoring contract, the factor agrees to purchase the seller’s account receivables, normally without recourse, and assumes responsibility for the debtor’s financial inability to pay. If the

⁶ Measures on Registration of Pledged Account Receivables, art. 4 (issued by People’s Bank of China in 2007).

⁷ See article 2(a) of the Convention.

debtor goes bankrupt or is unable to pay its debts for credit reasons, the factor will pay the seller.⁸ People use factoring mainly for consistent cash flow, lower administration costs, reduced credit risks, and more time to concentrate on their core business activity.

Factoring may be traced back to the period of industrial revolution. In order to export its goods, the textile mills in the northern part of England appointed agencies in North America to sell their products and then remit the proceeds back to England. Those agencies were the embryos of factors today.⁹

When the seller and buyer of the account receivables are in different countries, the service is called international factoring. International factoring has developed since the 1960s. The Convention on International Factoring was passed by the International Institute for the Unification of Private Law in May 1988.

International factoring may increase sales in foreign markets by offering competitive terms of sale, protecting against export credit losses, accelerating cash flow through faster collections, lowering costs involved with letter of credit, increasing liquidity to finance working capital, and enhancing borrowing potential. Normally, the supplier (exporter) signs a factoring contract with an export factor in its own country, under which the supplier assigns all export receivables to the export factor and the export factor is responsible for all aspects of the factoring service. The export factor then selects a correspondent to act as import factor in the country to which the exports are being sent. The receivables are reassigned by the export factor to the import factor. Then the import factor will establish credit lines for each of the debtors (importers). The credit lines will be for a specific amount and terms of sales. The export factor confirms the details of the credit lines to the supplier. After the supplier ships the goods and sends an invoice to the importer, the import factor handles the collection of the receivable and promptly remits the payment of the proceeds to the supplier's account with the export factor. If the buyer goes bankrupt when the invoice matures, the factor will assume the credit risk. This is the most advantageous benefit of factoring to the exporter.

⁸ See The Convention on International Factoring (issued by the International Institute for the Unification of Private Law in May 1988).

⁹ Peng Lv, *The Origin of International Factoring and its Development Domestically and Internationally*, 24 MODERN BUSINESS (2011).

Factoring started in China from 1980s. In October 1987, Bank of China signed a general factoring agreement with a German loan company, symbolizing the official start of the factoring business in China. In 1992, Bank of China joined the Factors Chain International (FCI), thus becoming the first financial institution engaged in the factoring business in China. The FCI was established in the Netherlands in 1968, with its headquarters in Amsterdam, having more than 100 members. The purpose of the FCI is to provide its members with standard criteria, procedures, law, and technological consulting relating to international factoring. The FCI Code of International Factoring Customs, developed by the FCI Legal Committee, became the world's most widely recognized legal framework for international factoring and served as the prime example for the final text of the Unidroit Convention of International Factoring.¹⁰ In July 2002, the FCI Code was replaced by a newly drafted document, the General Rules for International Factoring (GRIF). The GRIF has provide a new standard for correspondent factoring relationships and probably more than 80% of the world cross-border factoring volume are governed by those rules.

The factoring business in China has thus developed greatly over the past twenty years. However, the laws governing factoring have not been unified but only scattered in the Civil Law, Contract Law, and Property Law. In April 2014, China Banking Regulatory Commission issued Provisional Measures on Administration of Factoring Business Conducted by Commercial Banks. In addition, Ministry of Commerce of China has also approved factoring by non-bank institutions in a couple areas, including Pudong New Area of Shanghai City, allowing business entities to be established within these areas specifically engaging in factoring business. It can be predicted that in the near future, Chinese legislature may consider promulgating a nation-wide law to specify the legal issues in factoring transactions.

2.2.2. Forfaiting

“Forfaiting” is a form of debt discounting for exporters in which a forfaiter accepts at a discount and without recourse promissory notes, bills of exchange, or letters of credit received from a foreign buyer by an exporter. Maturities are normally from one to three

¹⁰ Stilwell Tu, *International Factoring*, electronically published at <http://www.66law.cn> (2006).

years.¹¹ The exporter receives payment without risk, at the cost of the discount. Forfaiting is a payment technique an exporter can use to promote sales on a deferred payment basis. By purchasing the credit instruments, the forfaiter deducts interest at an agreed discount rate for the full credit period covered by the notes. In the case of a draft, the debt instrument is drawn by the exporter, accepted by the importer, and will bear an unconditional guarantee. The letter of guarantee will normally be opened by the importer's bank. In exchange for a payment, the forfaiter obtains the right of claiming the debt from the importer, and the forfaiter either holds the drafts or notes until maturity or sells them to another investor on a non-recourse basis.

Forfaiting in its modern form was developed by west European exporters and their banks to finance equipment sales to eastern Europe in the 1950s and 1960s, and has been used in developing markets since the mid-1970s. At that time, east European countries were eager to obtain western technology, but they had little hard currency. On the one hand, east European importer had no access to longer trade credits, for the trade credits provided to them were usually up to six months, not long enough to finance the imports of capital goods. On the other hand, West German manufacturers of capital goods were anxious to expand their markets to east European countries. Since the deals were profitable, West German manufacturers were willing to wait up to five years for payment against negotiable instruments, which had been guaranteed by a state bank of the relevant east European country. However, the difficulty encountered by the West German manufacturers was that they had no access to sufficient funds to offer such extended credits to their buyers. Under these conditions, banks, as crucial important financial intermediaries, stepped into the gap. Swiss, German, and Italian forfaiters played a key role in the evolution of the forfaiting market. These forfaiters agreed to purchase these trade receivables from West German manufacturers for cash, which in turn allowed the manufacturers to continue to expand trade. According to the then applicable negotiable instrument law in Europe, a holder of commercial papers at maturity had a right of recourse against all previous parties of the paper and ultimately the drawer, in the event of being not paid on the due date. But in order to keep the trade simple, no matter whether they were bills of exchange drawn by the exporter or promissory notes made out by the importer, once the exporter became the bona fide holder of the negotiable

¹¹ Liming Xu, *Research on Functions of Forfaiting*, 30 CREDIT REFERENCE 2 (2012).

instruments, the exporter could sell it to a forfaiter at a discount and obtained immediate payment. This sale was without recourse to the exporter, but the security for the forfaiter was the guarantee of the importer's bank.

Among the advantages of forfaiting are that it eliminates political, transfer, and commercial risks; and it protects against risks arising from the fluctuation of exchange rates. In addition, the exporter obtains 100% of finance for the contract value, making its exports more competitive and facilitating its exports to high risk areas. Forfaiting turns credits into cash, thus not tying up the exporter's working capital and bettering the exporter's financial conditions. The documents and procedures are quite simple.

Forfaiting started in China since 1994, but there is no specific law governing forfaiting in China. The relevant rules are also scattered in the Civil Law, Contract Law, and Property Law.

2.2.3. Securitization

Securitization originated in the 1970s firstly from the United States and later developed in many countries including civil law countries. Securitization is one type of structured financing under which the enterprise that needs financing sets aside part of its assets which may bring about stable cash flow in the future; then divide them into smaller units; and finally sell them to the capital market's investors. Most of the time, the assets are financial assets, i.e., account receivables. By doing so, the enterprise that needs financing (sometimes called "initiator") converts the account receivables into cash, diversifying the risks and obtaining financing with lower costs.¹² Through securitization, the enterprise that generates the account receivables is able to sell them directly to investors.

Generally, securitization is designed through establishing a special purpose vehicle (SPV) which may take the form of a trust or a corporation. In order to achieve the goal of "bankruptcy-remoteness," local law may require the transfer of the account receivables to be "true sale" so that the bankruptcy law will not regard the securitized account receivables as

¹² Steven L. Schwarcz, *Commercial Trusts as Business Organizations: Unraveling the Mystery*, 58 BUS. LAW. 559, 562-63 (2003).

part of a bankruptcy estate. The SPV needs to pay consideration to the initiator for receiving the account receivables. The money paid to the initiator can be raised through loans, or through issuing securities to the capital market.¹³

While securitization has developed furthest in the United States, it has also expanded to many other countries, even including civil law countries such as Japan and Korea. China also allows banks and financial institutions to securitize their account receivables as a way of financing.

Although the aforementioned three ways of assigning account receivables are different, they all involve the laws governing the assignment of contractual rights. Since national laws vary in this regard, the following section tries to compare the different rules.

2.3. Comparison

While economic development pushes each country to encourage business transactions and promote various ways of financing, the law of every country may be different regarding the assignment of account receivables. This section will introduce the laws of a few countries governing the assignment of account receivables, namely, the English common law, US law, and Chinese law. The reason for selecting laws of these three countries is partly because the UK and the US are typical common law countries and China is a civil law country. While the laws on assignment of contractual rights have been quite developed in the UK and the US, Chinese law in this regard is still at its developing stage. The introduction of the relevant laws in these countries has different focus. The introduction to the UK law mainly illustrates the historical development of the law in this area, the introduction to the US law focuses on its current effect, and the introduction to the Chinese law is aimed to identifying the issues.

¹³ See generally, Lingyun Gao, *Trust Law – A Misunderstood System* Ch.8 (4) (Fudan University Press 2010).

2.3.1. English common law

The early common law developed a general rule that an attempted assignment of a contract right was of no legal effect whatever.¹⁴ The common law refused to acknowledge assignments of contractual rights because the contractual rights were regarded as “choses in action,” which means it could only be asserted by bringing an action and not by taking possession of a physical thing. “The early lawyers found it hard to think of a transfer of something intangible like a contractual right.”¹⁵ However, contractual rights were transferrable in equity in England based on commercial convenience.¹⁶ But according to English common law certain contractual rights even now may not be assigned. These include contracts expressed to be not assignable, personal contracts, and mere rights of action.

The first restriction is that if a contract provides that the right arising under it shall not be assigned, a purported assignment of such rights is not only a breach of that contract but is also ineffective, in the sense that it does not give the assignee any rights against the obligor.¹⁷ However, an assignment of the benefit of a contract which is expressed to be not assignable may be binding as a contract between assignor and assignee. Another important restriction is that the benefit of a contract cannot be assigned if it is clear that the obligor is only willing to perform in favor of one particular creditor, and if it would be unjust to force him to perform in favor of another. In other words, the personal nature of the contract prevents assignment.¹⁸

2.3.2. US law

Laws within the United States favor the free transferability of contractual rights and are inclined to uphold the right of a party to make such a transfer. The general rule is that unless a contract specifically prohibits a party from transferring his rights acquired under it, or the nature of the contract is such that the transfer would impair the other party’s reasonable

¹⁴ See generally Bailey (1998) *Assignments of Debts in England from the Twelfth to the Twentieth Century*, in Blum, Brian (1998) *Contracts*. Aspen Law & Business.

¹⁵ Pollock and Maitland, II *History of English Law* 226, cited in G.H. Treitel, *The Law of Contract* 590 (Sweet & Maxwell 1995).

¹⁶ G.H. Treitel, *The Law of Contract* 591 (Sweet & Maxwell 1995).

¹⁷ *Helstan Securities Ltd. V. Hertfordshire C.C.* [1978] 3 ALL E.R. 262, cited in G.H. Treitel, *THE LAW OF CONTRACT* 610 (Sweet & Maxwell 1995).

¹⁸ G.H. Treitel, *The Law of Contract* 610 (Sweet & Maxwell 1995).

expectations or would offend public policy, a party has the power to transfer contractual rights and obligations.¹⁹ This principle is well established by US law. The underlying rationale is that an obligee's right to performance under the contract is one of his assets – an item of property with some value. Although it is intangible, it is his property all the same, and he should be able to dispose of it if he so desires.

As with English law, US law has also imposed restrictions on the right to assign contractual rights. The first restriction is that an assignment cannot be validly made if the contract prohibits it. However, US law requires that such a prohibition must be clearly expressed in the contract, since the law generally favors assignment. Actually, the Restatement of Contract (2nd) and the Uniform Commercial Code (UCC) restrictively interpret contract provisions that preclude assignment of contractual rights.²⁰ Any doubt or ambiguity should be resolved in favor of transferability, and most of the time, a provision that prohibits “assignment of the contract” should be taken to forbid only the delegation of duties. Even if a provision of the contract definitely does prohibit assignment, unless the contrary intent is clear a US court would assume that the assignment of contractual rights is itself effective. At the same time, however, there is a breach so that the obligor could seek a remedy.

Other restrictions may include that an assignment would not be effective if the nature of the contract prevents the assignment; or if the assignment would materially change the obligor's duty, increase the burden or risk imposed by the contract, impair the other party's prospects of getting return performance, or otherwise substantially reduce its value to the other party. Every assignment is likely to have some effect on the obligor's duty, even if nothing more than having to make a payment to someone other than the person with whom the party contracted. There must be a balance between stability and flexibility. Therefore, the requirement of material impact prevents the obligor from resisting an assignment on the basis of some trivial change in his performance obligation.

After a valid assignment is made, the assignee substitutes for the assignor as the person to whom performance must be rendered. It therefore follows that although the obligor need not be a party to or assent to the assignment to make it effective, he must be notified of it so that

¹⁹ Brian Blum, *Contracts* 673 (Aspen Law & Business 1998).

²⁰ Restatement of Contract (2nd) § 322; UCC § 2.210(3).

he knows the person to whom performance is now due. There is no particular formality required for the notice, provided that it coherently indicates what right has been assigned, and to whom. The notice must be received by the obligor – that is, it must either come to his attention, or be delivered so that he reasonably should be aware of it. Either the assignor or the assignee may give this notice, but if it comes from the assignee the obligor is entitled to adequate proof of the assignment.

When rights are assigned, the general rule is that the assignee can get no greater right against the obligor than the assignor had. This means that the assignee takes the rights subject to any conditions and defenses that the obligor may have against the assignor arising out of the contract. The obligor may only use the assignor's breach defensively against the assignee. That is, the assignor's breach operates as a defense to the assignee's claim, and damages due to the obligor by the assignor may be offset against the assignee's claim. However, the assignee has no liability for the obligor's damages to the extent that they exceed the amount of the offset.

The obligor's right to assert defenses arising out of the contract is not cut off by the notice of assignment, so the defense is available against the assignee whether the basis for it arose before or after the obligor received notice. However, the notice does affect any claim of set-off that the obligor may have against the assignor, arising out of a different transaction. The rule is that the assignee's rights are subject to any such right of set-off that arose before a notice of assignment, but cannot be defeated by one that arose afterwards.

Unless the assignment indicates an intent to the contrary, the assignor impliedly warrants to the assignee that the rights assigned are valid and not subject to any defenses. Therefore, if the obligor successfully raises a defense against the assignee, the assignee usually has a cause of action against the assignor for breach of this warranty.²¹

²¹ See generally, Brian Blum, CONTRACTS 676-79 (Aspen Law & Business 1998).

2.3.3. Chinese law

The Chinese law also recognizes the assignment of contractual rights and regards it as a change of parties to the contract. In essence, under Chinese law, assignment of contractual rights means that the parties to a duly formed contract may assign their contractual rights to a third person without changing the terms of the contract.²² Article 79 of the Chinese Contract Law provides that the obligee may assign all or part of its contractual rights to a third party. Chinese law allows the obligee to assign its contractual rights to a third party as long as the assignment does not violate law or social ethics. The underlying rationale is that the assignment of contracts may encourage transactions and promote development of the market economy. However, in order to protect the public interest and maintain an orderly marketplace, as well as to balance the rights and interests of both parties, Chinese law also limits the scope of the assignment of contractual rights.²³

According to Chinese law, there are three situations in which the contractual rights are not assignable: First, if the nature of the contractual rights makes them un-assignable, then the contractual rights may not be assigned to a third party. Similarly to the restrictions imposed by the English law and US law, this is the case mainly for contracts that are personal, or that are secondary to a primary contract. Second, if on concluding the contract the parties agree that the obligee must not assign its contractual rights to a third party, then the contractual rights are not assignable as long as such an agreement does not in itself violate the law. This resembles English law. However, such an anti-assignment agreement is not effective against a bona fide third party. Third, if the law prohibits a transfer of contractual rights, then they cannot be transferred.²⁴ If the law imposes any special requirements on the assignment of contractual rights, those requirements must be complied with.²⁵

When assigning contractual rights, the assignor and assignee must agree on the assignment and cannot change the terms of the original contract. The assignor must be the obligee, with

²² Lingyun Gao, et al, II SERIES ON CONTEMPORARY CHINESE LAW: CHINESE BUSINESS LAW 151 (Thomson West 2008).

²³ *Contract Law of the People's Republic of China* (hereinafter, "*Chinese Contract Law*") art. 79 (1999).

²⁴ *Chinese Contract Law* art.79 (1999).

²⁵ *Chinese Contract Law* art. 87 (1999).

full legal capacity to dispose of its rights. The assignment by an obligee with only limited legal capacity will not be completed unless made by its legal representative or duly authorized agent. Article 91 of the General Provisions of Chinese Civil Law (hereinafter, “Chinese Civil Law”) requires an assignor of contractual rights to obtain prior consent from the other party before the assignment. The Chinese Civil Law also prohibits the assignor from making profits from the assignment or delegation.²⁶ However, article 80 of the Chinese Contract Law does not require an assignor to obtain prior consent from the other party, but only requires that the assignor notify the other party about the assignment. The law does not mention the profit-making prohibition, either.²⁷ The discrepancy between the two laws on this point is quite obvious. However, if the assignment of contractual rights will not infringe the other party’s lawful interests or increase the other party’s burden, the law does not need to intervene as long as the assignment is free from fraud, duress, undue influence, significant misunderstanding, or unconscionability.

After assignment has been completed, it becomes effective both between the assignor and the assignee, and among the assignor (obligee), assignee, and the obligor of the original contract. As between the assignor and the assignee, the contractual rights have been assigned by the assignor to the assignee. The assignment will be effective after the obligor has received the notice according to Article 80 of the Chinese Contract Law. If the assignor assigns all of its contractual rights to the assignee, then the assignee will become a new obligee having the same rights as the original obligee, and may request the obligor to perform the contract to the new obligee. If the assignor assigns only part of its contractual rights to the assignee, then the assignee will join the contractual relationship to be a co-obligee. The assignment contract may clarify whether the assignor and the assignee will enjoy their contractual rights in shares or jointly. If the contract is silent on the point, then the law will presume that they will jointly exercise their contractual rights. Upon assignment, any secondary rights affiliated with the primary rights also are assigned to the assignee, except for those that are personal.²⁸ In addition, upon assignment, the assignor warrants that the assigned rights are free from defects and that the assignor will be liable for any damage caused by defects.

²⁶ *Chinese Civil Law* art. 91 (1986).

²⁷ *Chinese Contract Law* art. 80 (1999).

²⁸ *Chinese Contract Law* art. 81 (1999).

Concerning the assignor (obligee), assignee, and the obligor, if the contractual rights have been completely assigned to an assignee, then the original obligee is out of the original contractual relationship and can no longer ask the obligor to perform the contract. If only part of the contractual rights have been assigned, and the assignor and assignee have their interests in shares, then the obligor must satisfy contractual obligations to both of them, provided that any increased cost of performance is borne by the original obligee based on the principle of honesty and good faith. After receiving the notice of assignment, the obligor must perform its contractual obligations to the new obligee to the extent that the contractual rights are assigned. However, the obligor may have a claim against the assignee on the ground of defenses he has against the original obligee, including the concurrent-performance defense, later-performance defense, and defense of insecurity. Furthermore, if the obligor has a creditor's right against the assignor, the obligor may claim a set-off against the assignee when it is due. In addition, if the assignee sues the obligor to resolve disputes arising from performance of the contract, and if the obligor raises a defense against the obligee's rights, the court may ask the obligee to be a third party to the litigation.²⁹

2.3.4. Summary

The above introduction illustrates the development of the laws governing assignment of account receivables in a few different countries and demonstrates that both the civil law and the common law allow assignment of contractual rights, but subject to certain restrictions. While the nature of the contract and a prohibitive article of any law may prevent an assignment, the parties may also agree in the contract that the contractual rights are not assignable. Most of the countries would give effect to such an anti-assignment clause, but each country may adopt a different view. For example, the United States would assume transferability is the general rule, and an anti-assignment clause must be clearly stated in the contract and not violate other laws. Also, even if such a clause will be given effect, the Chinese law, for example, would only regard such a prohibitive clause as effective between the parties, but not against bona fide third party.

²⁹ Interpretation of the Supreme People's Court of the People's Republic of China on the Application of the Contract Law (hereinafter, "SPC's Interpretation on Contract Law) art. 7 (1999).

2.4. Main issues and solutions

Various problems arise from assignment of contractual rights, and account receivables in particular. These include the legal prohibition of transfer of contractual rights, the effect of the anti-assignment clause in the contract, the effect of the transfer of future account receivables, and the form of assignment. Below are some refinements of these problems, and some suggested solutions, based mainly on Chinese law.

The first issue is quite fundamental. Although Chinese law generally allows assignment of contractual rights, the definition of contract for sale as defined in the Chinese Civil Law and Contract Law is too narrow and has not considered the transfer of contractual rights. Unlike the German Civil Code which provides that a contract for sale is not only for goods, but also for rights (including the sale of creditor's rights, i.e., contractual rights³⁰), the Chinese Contract Law only recognizes the sale of goods, not the sale of rights, as a sales contract.³¹ Therefore, the assignment of contractual rights may need to be protected and regulated by the laws other than the Contract Law in China. Actually, Chinese Property Law has recognized the account receivables as a right which may be pledged in order to facilitate the assignment of the account receivables. However, there are two conditions: first, there must be a certificate of rights or registration system; second, there must be possession of the certificate of rights or through registration. Currently there is no certificate of rights that can be issued to account receivable holders, and neither is there a registration system.

The second issue is that article 91 of the Chinese Civil Law of 1986 allows the assignment of contractual rights but prohibits the assignor from making profits out of the assignment. It also requires that the assignor must obtain the obligor's consent regarding the assignment. This provision has actually prevented the development of the assignment of account receivables in China. The Chinese Contract Law of 1999 has removed the "consent" requirement and only required the assignor to notify the obligor. It has also eliminated the non-profit prohibition. Although the Contract Law has made significant improvement in this regard, it does not resolve all the issues. For instance, articles 79-83 and 87 have only considered general

³⁰ Liming Wang, *A Comparison of Sales Contract between China and Germany*, 1 RESEARCH ON COMPARITIVE LAW (2001).

³¹ *Chinese Contract Law* art.174 (1999).

situations such as the situations where contractual rights are non-assignable, the notification requirement, the defenses and right to set-off that the obligor may have, etc. It does not make further detailed regulations on the important issues regarding whether future account receivables are assignable, the forms of assignment of account receivables, the effect of an anti-assignment clause, or the resolution of priority issues.

The third issue regards the effect of the anti-assignment clause in the contract. As introduced above, both UK law and US law allow the assignment of account receivables, with US courts adopting a more liberal attitude toward assignability. The UK law recognizes the effect of the anti-assignment clause as against third parties, but under US law, even if the parties clearly stipulate in the contract that the contractual rights cannot be assigned, such an anti-assignment clause is not effective against bona fide third party. Section 210 (2) of the UCC provides the general rule that all contractual rights are assignable, except if the assignment will materially change the other party's obligation, or materially increase the other party's burden or risk. The anti-assignment clause is narrowly interpreted as a prohibition of transfer of the contractual duties only. The civil law attitude toward the anti-assignment clause is also different. The German Civil Code gives full effect to the anti-assignment clause like UK law, while the French Civil Code does not give any effect to the clause. Chinese law basically recognizes the effect of such anti-assignment clause according to article 79 of the Contract Law, but it does not specify various situations.

Based on the above analysis, solutions are proposed that the Chinese law should make changes.

First, its Contract Law should clearly allow the assignment of contractual rights so that contract flexibility in business transactions is to be enhanced. To this end, the Contract Law should clearly cover the sale of rights, especially after the Property Law which was promulgated later than the Contract Law already recognized the sale of rights. It should also clearly recognize the effect of assignment of future receivables considering the Chinese government is promoting asset securitization in the recent years. Actually, the UN Convention on the Assignment of Receivables in International Trade ("Convention on

Assignment of Receivables”) has explicitly recognized that future receivables are assignable.³²

Secondly, in order to facilitate the assignment of contractual rights, Chinese law should stick to the mere notification requirement and not require the assignor to obtain consent from the obligor upon assignment of the contractual rights. By doing so, the Chinese practice will be in line with the other countries’ practice as well as the UN Convention on the Assignment of Receivables. The Convention adopts the “notification” approach to invalidate the assignment of contractual rights.³³

Thirdly, the effect of anti-assignment clause should be given deference, but subject to certain restrictions. The law should be changed to at least recognize that the anti-assignment clause should not be effective against a bona fide third party. The UN Convention on Assignment of Account Receivables adopts an attitude in disfavor of the anti-assignment clause which is also in line with some countries’ practice, and it provides that: “[a]n assignment of a receivable is effective notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee limiting in any way the assignor’s right to assign its receivables.”³⁴

In addition, China needs to consider joining the United Nations Convention on the Assignment of Receivables in International Trade of 2001, or at least participate in discussions and cooperations with the other countries with regard to the assignment of account receivables, and revise its laws accordingly.

³² See article 8.1 of the Convention, which provides: “[a]n assignment is not ineffective as between the assignor and the assignee or as against the debtor or as against a competing claimant, and the right of an assignee may not be denied priority, on the ground that it is an assignment of ... future receivables...”

³³ See article 13.1 of the UN Convention on Assignment of Account Receivables, which provides: “[u]nless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor notification of the assignment...”

³⁴ See article 9.1 of the UN Convention on Assignment of Account Receivables.

3. Conclusive remarks

The title of this chapter covers a wide range, but owing to various limitations, this chapter mainly focuses on issues regarding assignment of contractual rights. Flexibility in contracting may have various layers of meaning, but the assignment of contractual rights is vital to the commercial well-being of many businesses. If the laws of different countries could be reconciled regarding such an assignment, business transactions will be further promoted and facilitated.

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