Academic Journal of Law and Society
ISSN: 3080-9908 (Print), ISSN: 3080-9916 (Online) | Vol. 1, No. 3, 2026

Protecting Factors' Interests in Bankruptcy Proceedings

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Abstract: The Civil Code of the People's Republic of China recognizes the factoring contract as a nominate contract for the first time, but it does not resolve the longstanding dispute over the contract's legal nature. This article examines the competing theories of assignment of claims and assignment by way of security through bankruptcy-law questions such as the filing of claims and the scope of the bankruptcy estate. It argues that the security-assignment theory better reflects the structure and commercial purpose of recourse factoring. On that basis, the article analyzes imbalances in the protection of factors during bankruptcy proceedings, including the stay of security rights in reorganization, conflicts between bankruptcy set-off and security assignments, and the risks associated with future receivables. It proposes a necessity test and a compensation mechanism for staying security rights in reorganization, clearer priority rules for conflicts between bankruptcy set-off and the rights of a recourse factor, and a registration-based framework for the third-party effectiveness of assignments of future receivables. These reforms would improve the protection of factors while preserving the collective purposes of bankruptcy law.

Keywords: Factoring; assignment by way of security; bankruptcy proceedings; protection of interests.

1. Introduction

Factoring originated in fourteenth-century Europe. It is a commercial activity centered on the assignment of receivables and may combine collection, credit protection, receivables administration, and commercial financing. Factoring in China initially developed largely through international instruments such as the UNIDROIT Convention on International Factoring. As Chinese commerce expanded, factoring transactions became more common and the resulting disputes more diverse and complex. Courts across the country reached different conclusions on the effectiveness of assignments, the factoring of future receivables, the nature and validity of factoring contracts, fictitious receivables, and repurchase of factoring advances. These cases exposed both an insufficient legal basis for decision and inconsistent adjudicative standards.

The contract title of the Civil Code for the first time treats factoring as a nominate contract [1]. The Code supplies clear rules on matters such as the validity of factoring, multiple factoring, and fictitious receivables, substantially reducing the prior lack of governing law. Important questions nevertheless remain unresolved, especially the legal characterization of the factoring relationship. When the original receivables creditor enters bankruptcy, that characterization determines the factor's status and the legal basis of its rights. Assignment theory and security-assignment theory produce materially different answers. For clarity, this article uses "factor" to mean the assignee of receivables. The party assigning the receivables is called the assignor or original receivables creditor and, when it enters bankruptcy, the debtor in bankruptcy; the obligor on the receivables is called the account debtor. If recourse factoring is treated as an assignment by way of security, several bankruptcy questions immediately arise. Although the Civil Code recognizes the factoring of future receivables, it does not specify when the security interest in those receivables becomes effective. If the administrator continues the underlying transaction after the bankruptcy application has been accepted, it remains uncertain whether the factor has a security right in newly arising receivables. The priority between the factor's security right and an account debtor's right of set-off in bankruptcy is also unclear. Nor is it settled whether a factor may set an unpaid portion of the factoring advance against its claim that the bankrupt assignor repurchase the receivables. Finally, the Bankruptcy Law's stay of security rights during reorganization may operate unreasonably when applied to a factor.

This article begins with the debate over the legal nature of factoring. It explains why the security function of a recourse factoring arrangement should be recognized and identifies the factor's status and legal basis of rights in bankruptcy. It then examines the institutions that affect the protection of factors in bankruptcy, identifies deficiencies in the current framework, and proposes corresponding reforms.

2. Theoretical Debate over Factoring Contracts and the Factor's Status in Bankruptcy

2.1. Distinguishing Recourse and Non-Recourse Factoring

The Civil Code distinguishes recourse from non-recourse factoring according to whether the parties have agreed on a right of recourse. The legal nature of recourse factoring remains contested. In bankruptcy it may be subject simultaneously to rules on insolvency, security, assignment of claims, and factoring contracts, producing numerous issues and complex doctrinal disputes. Non-recourse factoring is simpler and its legal structure is much less controversial. The prevailing view regards it as an assignment of claims [2]. The receivables creditor receives financing from the factor and transfers the receivables to it; the factor enforces the receivables without recourse against the assignor, as contemplated by Article 767 of the Civil Code [1]. For the assignor, early access to financing can relieve cash-flow pressure, reduce the costs of administering and collecting receivables, and insulate the enterprise from bad-debt risk.

For the factor, an assessment of the receivables, together with the assumption of collection costs and some bad-debt risk, permits it to earn the difference between the factoring advance and the face value of the receivables. In theory, that spread is generally larger where there is no recourse; the risk that the receivables will not be paid is therefore a commercially reasonable risk for the factor to bear. Because the assignor's bankruptcy creates relatively little controversy in non-recourse factoring, the discussion below focuses on the exercise of rights and protection of interests of a recourse factor. Unless otherwise indicated, "factor" and "factoring contract" below refer to a recourse factor and a recourse factoring contract.

2.2. Competing Accounts of the Legal Nature of Recourse Factoring

Scholars have long disputed the legal nature of recourse factoring. Although the Civil Code achieved the important step of naming and regulating the factoring contract, it did not squarely characterize that contract. This section organizes the principal theories - assignment of claims and assignment by way of security - and compares the legal authorities and outcomes they generate in factoring disputes. It then considers the factor's legal status and basis of rights in bankruptcy as groundwork for the later analysis of protective mechanisms.

2.2.1. Conditional Assignment of Claims

Early scholarship approached the issue through the legal nature of international factoring. It argued that assignment of receivables is the core of international factoring [3]. Because China's initial factoring rules were derived from international factoring practice, domestic factoring should, on this view, be understood by reference to that practice and disputes should be adjudicated under assignment theory.

Assignment theory later developed along four lines. First, Chinese law identifies nominate contracts by their principal performance obligations. Assignment of receivables is essential to a factoring contract because the factor's ability to exercise its rights depends on that transfer. The transaction therefore consists, in substance, of the factor advancing financing and taking an assignment that makes it the new creditor. Second, after taking the receivables, the factor may enforce them directly against the account debtor, which is the ordinary route for enforcement by an assignee. Third, the factor may obtain payment directly from the receivables without using the statutory enforcement procedures applicable to real security rights. Fourth, a recourse factoring agreement requires the assignor to notify the account debtor of the transfer, and notice furnishes the basis on which the debtor performs to the factor. This corresponds to the notice requirement and its consequences under the civil law of assignment. Assignment theory accordingly treats factoring as an assignment of claims in private and commercial law: the original creditor exits the underlying transaction, while recourse is an additional payment-protection mechanism attached to the transfer [4]. Another view characterizes recourse as a contractually agreed right of rescission [5].

2.2.2. Assignment by Way of Security

Security-assignment theory begins with the purpose of the contract. First, a recourse factor undertakes collection and administration of receivables but does not assume bad-debt risk without qualification. Second, the purpose of taking the receivables is to secure recovery of the factoring advance rather than to capture the entire difference between the face value of the receivables and the advance. Third, a factoring contract may cover future receivables, whereas an ordinary assignment traditionally concerns existing claims. Fourth, under the Civil Code, the factor enjoys priority only to the extent of principal and interest on the factoring advance, rather than an unconditional entitlement to the full amount collected. Recourse factoring should therefore be understood as a transfer of receivables that secures repayment of the advance and interest. The Supreme People's Court has adopted this approach, holding that although the assignment in a recourse factoring contract has the appearance of an assignment of claims, its substance is to secure recovery of the factoring advance [6]. Article 388 of the Civil Code recognizes the security effect of "other contracts with a security function" [1]. Security-assignment theory accordingly treats that category as including a factoring contract that provides for repurchase.

2.2.3. Other Theories

The mixed-contract theory argues that the principal obligations under factoring are not limited to assignment of receivables and disbursement of financing. Factoring combines the transfer and security of receivables, collection, account administration, and commercial finance; it is therefore a mixed contract integrating assignment and secured financing. Each of these elements may be an operative performance obligation in a particular agreement, and they cannot invariably be divided into principal and ancillary obligations [7]. The Russian Civil Code already provides a precedent for recognizing a mixed contract as a nominate contract [8], and there is no conceptual obstacle to the Chinese Civil Code doing the same. Considered solely as a description of contractual composition, the mixed-contract theory is persuasive. It does not, however, resolve which rules a court should apply to a factoring dispute.

The agency theory has not appeared in recent Chinese case law. It originated in early studies of international factoring and no longer fits contemporary domestic and international commerce or judicial practice. It is therefore not examined further here.

2.2.4. Summary

The competing theories allocate rights and obligations differently. Clarifying the legal nature of the factoring contract is thus a prerequisite to defining the parties' relationship, establishing the factor's status in bankruptcy, and analyzing the protection of its interests during bankruptcy proceedings.

2.3. How Uncertain Characterization Obscures the Recourse Factor's Status in Bankruptcy

Since promulgation of the Civil Code, scholarship on factoring has expanded, concentrating on the nature, formation, and validity of the contract, fictitious claims and debts, and future receivables. When the original receivables creditor enters bankruptcy, however, different theories supply markedly different legal bases for recourse. The chosen characterization directly affects the scope of the bankruptcy estate, the factor's proof of claim, and the exercise of rights during reorganization.

The first question is whether the factor may proceed against both the assignor and the account debtor and, relatedly, what right supports its bankruptcy claim. The Civil Code expressly permits a recourse factor either to collect from the account debtor or, under the agreed right of recourse, to require the original creditor to repurchase the receivables [1]. That rule does not by itself determine the factor's status or basis of rights in bankruptcy. Whether the factor may assert rights against both parties determines the extent to which it can mitigate loss.

Under assignment theory, the original creditor transfers the receivables to the factor, and the object of the factor's repurchase right is those same receivables [9]. If the factoring contract is treated as an outright assignment, the factor acquires the receivables and they do not form part of the bankruptcy estate. Both collection from the account debtor and a proof of claim against the bankrupt assignor under the recourse clause nevertheless derive from the same receivable. In principle, the factor must elect between the two remedies [10].

Security-assignment theory instead treats the transfer as security for repayment of the factoring advance and interest. Although title to the receivables is formally placed in the factor, the purpose is security. The factor provides financing and administers the accounts; if collections exceed the agreed principal and interest, the surplus must be returned to the assignor. Because the factor is not the ultimate beneficial owner and the transfer serves as security rather than an absolute disposition, the receivables remain within the bankruptcy estate. When the assignor enters bankruptcy, the factor may therefore assert recourse against it while also collecting from the account debtor [11]. In procedural terms, the factor may file a bankruptcy claim and pursue collection concurrently, subject of course to the rule against double recovery.

Assignment theory and security-assignment theory thus produce different statuses for the factor in bankruptcy. Because a secured bankruptcy creditor receives materially different protection from an ordinary creditor, the factor's status must be resolved before the subsidiary issues can be addressed.

2.4. Clarifying the Recourse Factor's Status in Bankruptcy

Under assignment theory, if the assignor enters bankruptcy, the factor may either prove a claim based on the repurchase obligation or forgo that claim and collect from the account debtor. Seeking repurchase from the bankrupt assignor means proving the claim for return of the factoring advance as an ordinary bankruptcy claim and abandoning enforcement against the account debtor. Given the generally low dividend in bankruptcy, the factor is often compelled to choose collection from the account debtor. What appears formally to be an election is, in the special setting of bankruptcy, a forced choice that shifts bad-debt risk to the factor.

With the continuing development of international factoring, factors often no longer assume bad-debt risk [12], and a factoring contract need contain only one or more of the following elements: commercial financing, collection and administration, and payment protection [10]. In a recourse arrangement, the factor's return ordinarily corresponds to its collection and administration functions. That return is not commensurate with wholesale bad-debt risk, and imposing the risk would violate the principle that rights and obligations should correspond. The structural difference between recourse and non-recourse factoring lies precisely in the parties' allocation of risk and return. A repurchase clause in recourse factoring is designed to avoid excessive bad-debt exposure and preserve stable earnings. In commercial practice, the factor and assignor often establish separate accounts for the factoring advance and for receivables collected by the factor. The factor administers the collection account but has no general power to dispose of its funds. The transferred receivables therefore secure recovery of principal and interest rather than operate as an ordinary absolute assignment. Assignment theory overlooks this security function in the hierarchy of contractual performance and, in bankruptcy, imposes an additional burden that may impede factoring activity.

Security-assignment theory permits the factor both to assert recourse against the assignor and to enforce the receivables against the account debtor; in bankruptcy, that becomes concurrent proof of claim and collection. Compared with outright-assignment theory, this approach better protects the factor and better reflects the purpose of recourse as protection against bad-debt risk. It also stabilizes the expected return on factoring and supports the continuing operation of the market.

For these reasons, purposive interpretation favors assignment by way of security. In the context of proving claims, it better implements the parties' reason for agreeing to recourse and better protects the factor's interests. The Civil Code's recognition of "other contracts with a security function" supplies an institutional foundation for the security effect of a factoring contract. Characterizing recourse factoring as an assignment by way of security, and the exercise of repurchase rights as realization of that security, accords more closely with market practice and the legislative purpose of the factoring provisions. The remainder of this article therefore adopts security-assignment theory when considering protection of factors in bankruptcy.

3. Practical Difficulties in Protecting Factors during Bankruptcy

The preceding section characterized recourse factoring as an assignment by way of security and explained the factor's status and basis of rights in bankruptcy. The Civil Code has brought atypical devices such as security assignments into the legal system. Bankruptcy law and security law, however, begin from substantially different premises. Bankruptcy law emphasizes protection of the debtor, equal treatment of creditors, and the public interest, while security law protects the secured creditor's priority [13]. Factoring also has a commercial character that distinguishes it from traditional civil-law security. Bankruptcy law has historically dealt mainly with security over movables and immovables, but the urgent need for liquidity in commercial finance has led to increasing use of claims as collateral [14]. At the intersection of the current bankruptcy system and modern factoring, several conflicts and practical challenges therefore emerge.

3.1. Restrictions on a Recourse Factor as a Secured Creditor and the Resulting Imbalance

Reorganization seeks to rescue an enterprise in financial distress and restore normal operations. For a secured creditor confronting uncontrollable commercial risk, however, promptly enforcing security may be preferable to relying on a successful reorganization. An unsecured creditor, by contrast, may favor rehabilitation because the expected liquidation dividend is low and revival offers a chance of greater recovery.

Property subject to security often constitutes a large share of the debtor's assets and may be indispensable to continued operation; restricting enforcement can therefore support the debtor's use of existing assets during the rescue. As Section 1 established, a recourse factor has a security assignment over receivables. Security over a claim differs from a conventional real security right, giving the factor a distinctive position in the assignor's reorganization. The main problems are the stay of that security and the inadequate protection of a factor that dissents from the reorganization plan.

3.1.1. Uncertain Scope of the Stay of Secured Claims

Current law primarily restricts secured claims through a stay, although a creditor may seek restoration of enforcement when specified conditions are met. Comparative law reflects two principal models: a stay imposed upon application and an automatic stay [15]. Under German insolvency law, the debtor must apply for a stay and show that the property is needed for the reorganization. United States bankruptcy law employs an automatic stay but makes the relationship between the collateral and the reorganization relevant to relief from that stay [16]. Comparative systems thus subject either the mode of imposing the stay or its necessity to meaningful limits. Article 75 of China's Enterprise Bankruptcy Law makes suspension of security rights the rule during reorganization and restoration the exception [17]. China accordingly combines an automatic stay with an application for relief. Yet the statutory threshold - that the collateral be damaged or markedly depreciate in value so as to jeopardize the secured creditor's rights - affords less protection than an affirmative necessity test and leaves courts with broad discretion.

The factor's secured status has already been established. An assignment by way of security over receivables is not equivalent to security over a tangible asset. Unlike land, buildings, or essential machinery pledged by a distressed enterprise, receivables are generally not necessary to the continued physical operation of the business. Administrators nevertheless tend to suspend enforcement without differentiating among forms of collateral, exposing the factor to the risk that its security will become ineffective.

3.1.2. Absence of Adequate Protection for Dissenting Creditors

The reorganization plan is the core of the proceeding. Chinese bankruptcy law allows both ordinary approval and compulsory approval, but it affords limited protection to a creditor that objects to the plan. Under ordinary approval, a class of secured creditors may approve a plan with claims representing at least two-thirds of the total amount in the class. The law does not, however, supply an adequate remedy if reorganization later fails or yields less than liquidation would have paid. For compulsory approval, protection of secured claims is framed in terms of the absence of "substantial impairment" or approval by the class. The content of substantial impairment is not defined [18], and treating class approval as sufficient for a cramdown leaves a dissenting minority without effective protection.

A factor's security assignment differs from security over tangible property, and the factor's interests may diverge from those of most secured creditors. Although factoring is treated as a security assignment, the Civil Code's specialized rules allow the factor to enforce the receivables directly, retain the principal and interest on its advance, and return the surplus to the debtor in bankruptcy. It need not employ the formal realization procedures that govern a conventional security right. That flexibility may be important to preserving liquidity. If the factor and the other secured creditors favor different outcomes, the current lack of a mechanism for protecting dissenters leaves the factor without an adequate remedy.

3.2. Conflict between Bankruptcy Set-Off and the Factor's Security

Bankruptcy set-off permits a creditor and the debtor in bankruptcy, where they owed mutual obligations before the bankruptcy application was accepted, to extinguish those obligations without awaiting a distribution in the collective proceeding. It differs from ordinary civil-law set-off, which generally requires mutual obligations of the same kind and quality. First, only a bankruptcy creditor may invoke the bankruptcy right. Second, the claims need not satisfy the same requirements of kind that apply to ordinary set-off. Third, the relevant claim must have arisen before acceptance of the bankruptcy application. Fourth, set-off must be asserted through the administrator and in accordance with the prescribed procedure.

Although these conditions restrict the right, a conflict arises when the debtor in bankruptcy and the account debtor owe mutual obligations and the account debtor invokes bankruptcy set-off. Exercise of set-off may eliminate the receivable in which the factor holds security, depriving the factor of priority. Conflicts of this kind are frequently produced by uncertain boundaries between rights [19]. The limited factoring provisions do not clearly delineate the scope of a recourse factor's security assignment. Courts consequently lack a determinate rule when that security conflicts with bankruptcy set-off, and the factor faces the risk that its security will fail.

3.3. Bankruptcy Risks in the Creation of Security over Future Receivables

3.3.1. Legal Validity of Factoring Future Receivables

Before the Civil Code, whether future receivables could be factored was highly controversial. The Code expressly permits "future receivables" to be assigned under a factoring contract [1]. A problem remains if the administrator exercises its power under the Bankruptcy Law to terminate an incompletely performed underlying contract. Because the factor's receivables depend on the existence and performance of that underlying transaction, it is unclear how a factor that has already advanced funds and contracted for future receivables can protect itself after termination. The Interim Measures for the Administration of Commercial Bank Factoring prohibit commercial banks from conducting factoring based on future receivables. Some scholars contend that the Measures, issued in 2014, predate and rank below the Civil Code, so the Code should control and banks should be able to factor future receivables [20]. The prevailing view is that the Measures are administrative rules governing bank conduct rather than the validity of contracts; they therefore do not invalidate a bank's factoring contract over future receivables [21].

3.3.2. Risks When the Underlying Contract Continues

The central question in assigning future receivables is when the security assignment becomes effective. The Civil Code does not answer it. Under the general principle governing dispositions, a right ordinarily must exist and be effective before it can be disposed of. At the time the factoring agreement and assignment of future receivables are concluded, the claim under the underlying transaction does not yet exist; on this reasoning, the factor can acquire it only when it arises [2]. That logic does not meet the practical needs of factoring. A factor must know how an agreement can capture the future receivable at inception and thereby mitigate the assignor's bankruptcy risk. Suppose, for example, that a factor advances funds against all receivables to arise from a transaction over the next two years and the assignor files for bankruptcy one year later. Under Article 30 of the Enterprise Bankruptcy Law, proceeds generated by the administrator's continued performance of the transaction become property of the bankruptcy estate [17]. If the factor has no priority in receivables arising thereafter, it bears substantial risk inconsistent with the purpose of the contract and has no practical means of avoiding that risk.

4. Institutional Reform for Protecting Factors in Bankruptcy

4.1. Reconstructing Protection in Reorganization

4.1.1. Establishing a Necessity Review for Staying Secured Claims

First, any restriction on enforcing security should be assessed for its necessity to the reorganization. A stay should advance the objective of increasing the collective return to creditors without diminishing the secured creditor's substantive interest. The inquiry should ask whether the collateral is necessary to the rescue and, in light of the enterprise's actual operations, how strongly the reorganization depends on that particular asset [22]. Assets ordinarily essential to a reorganization include factories, indispensable machinery, and raw materials capable of generating going-concern value. Such assets may be difficult to replace, and purchasing substitutes may reduce the collective recovery.

Second, the law should distinguish among immovables, movables, and property rights. Immovables often form the foundation of a going-concern reorganization and are important to continued operations. Enforcing security over them may directly cause the rescue to fail. An automatic-stay model is therefore appropriate, with the secured creditor bearing the burden of showing that the property is unnecessary before enforcement resumes. Movables and property rights are generally more substitutable and less likely to be essential. For those assets, a stay imposed only upon the administrator's application would reduce unnecessary infringement of secured creditors' rights.

A security assignment of receivables concerns an intangible property right, not an asset whose physical use will appreciate through the reorganization. It will rarely be a means of production indispensable to the rescue. A security right includes both the power to realize value and the right to priority in the proceeds. A stay properly restricts only realization; it should not extinguish priority or diminish the value of the collateral. A necessity review, combined with differentiation among kinds of assets, would protect factors and other secured creditors and furnish the factor with a meaningful avenue of relief.

4.1.2. Creating a Quantifiable Compensation Mechanism

If the collateral is genuinely at risk of impairment, legislation should specify the scope of compensation owed to the secured creditor. Where the collateral is necessary to the reorganization and the administrator seeks to stay the factor's security, the debtor should satisfy the secured obligation or provide alternative protection acceptable to the factor, as contemplated by Article 37 of the Enterprise Bankruptcy Law [17]. The rules should identify concrete forms of compensation. First, the debtor may provide substitute security over property equivalent in value to the original collateral. Second, it may pay the loss caused by suspension of the security right.

4.1.3. Protecting Dissenting Creditors

Scholarship has discussed the protection of dissenting creditors extensively. Two legislative measures are particularly relevant here. First, the law may encourage another bankruptcy creditor or a person outside the proceeding to purchase the dissenting creditor's claim. That would permit an approved plan to proceed while protecting the dissenter. A factor, as a distinctive secured creditor, could recover liquidity promptly and avoid being bound by a majority whose interests differ from its own. Second, China should establish a hearing procedure for reorganization [23]. Approval of a plan depends on commercial considerations and expertise beyond law, making substantive review difficult for a court acting alone. A hearing would allow dissenting creditors to present their views and would enable a more informed assessment with third-party participation.

4.2. Further Limiting the Right of Set-Off in Bankruptcy

4.2.1. Comparative Guidance on Conflicting Rights

Foreign legislation rarely addresses directly the conflict between a security assignment and bankruptcy set-off. Taiwan's rule on the conflict between a pledge of receivables and set-off nevertheless provides useful guidance. In 2007, Taiwan amended the security-rights provisions of its Civil Code and added a rule governing the conflict between a pledge of rights and set-off. Article 907-1 provides that where a claim is the object of a pledge, the debtor on that claim may not set off against it a claim acquired against the pledgor after receiving notice of creation of the pledge. A claim acquired before notice may therefore be set off, whereas a claim acquired after notice may not, whether the asserted set-off is contractual or statutory. Notice thus marks the boundary between the pledge and set-off. The rule likely responds to the possibility that an assignor and account debtor could create mutual obligations to evade the pledge. Giving a previously created and notified pledge priority over later set-off encourages the account debtor to consider the restriction before entering the offsetting transaction. Whatever the theoretical debate, a defined rule is preferable to a legislative vacuum and an uncertain boundary.

4.2.2. Clarifying the Boundary between Security and Bankruptcy Set-Off

By analogy to Taiwan's approach, the time of notice provides a reasonable boundary between a factor's security and bankruptcy set-off, especially when viewed in light of the purpose of factoring. In the absence of a current statutory basis, however, a court should not expand the factor's security by fiat. The legislature should address the issue and identify the boundary as soon as possible.

If legislation gives bankruptcy set-off priority over the factor's security, a factor can require the account debtor to waive set-off before the factoring agreement is signed or the advance is made. If legislation instead follows the Taiwan model and orders the rights by the time of notice and the time the competing claim arose, all three parties to the factoring relationship can assess their positions before creating rights and obligations and can adopt targeted risk-control measures.

4.3. Preventing Bankruptcy Risks in Factoring Future Receivables

4.3.1. Clarifying When Security over Future Receivables Becomes Effective

The time at which a security assignment is created determines whether the factor has priority. The Civil Code does not specify when security arises in a factoring relationship. Although recourse factoring should be characterized as assignment by way of security, its transaction form remains an assignment of claims, so the publicity rules for assignment provide a useful analogy [10]. Assignment takes effect between assignor and assignee when the contract becomes effective; notice determines effectiveness against the account debtor rather than creation of the assignment itself. Existing receivables are therefore transferred when the contract is concluded, and the security assignment is created at that time. Future receivables, however, do not yet exist at contracting, while priority in a security assignment ordinarily depends on transfer of the underlying right. Treating the contract date alone as the moment of third-party effectiveness is consequently difficult to justify under traditional disposition theory. China's rules on floating security nevertheless reveal a close analogy. Registration of a floating charge gives the secured party third-party effectiveness over after-acquired property. It is therefore reasonable to extend the registration logic of floating security to the factoring of future receivables.

Once recourse factoring is treated as assignment by way of security, its publicity should, except where the Civil Code supplies a special factoring rule, follow the general law of security. A registration-opposability system should apply, and priority should be determined by order of registration [24]. Future-receivables factoring has three dimensions of effectiveness: between the assignor and factor, between the factor and account debtor, and against third parties. Registration is public, visible, and discoverable by third parties. It reduces subsequent transaction risk and protects the party that registered first. The third-party effectiveness of a security assignment over future receivables should therefore be determined by the time of registration even though the underlying transaction has not yet generated the receivable.

4.3.2. Establishing a Supporting Registration System for Future Receivables

An electronic registration system for future receivables would be more convenient, secure, efficient, and reliable than traditional notice of assignment and would help resolve the time at which security becomes effective. China should improve the registration systems for assignments and security and provide electronic filing services, enabling prompt registration of security assignments under factoring contracts. More transparent notice and registration would reduce the priority risks created by fraudulent multiple factoring, limit conflicts over future receivables, and protect the factor's settled expectations.

5. Conclusion

Bankruptcy law reallocates the assets of a failed enterprise. Because claims are paid in a statutory order and the dividend is often low, even secured creditors encounter substantial restrictions on enforcement. The difference between outright assignment and assignment by way of security determines the factor's status in the proceeding. Chinese case law on factoring has moved from diverse characterizations, through a period favoring assignment theory, toward increasing recognition of the security-assignment theory. Since the Civil Code entered into force, a growing body of scholarship has likewise concluded that recourse factoring is, in substance, security over receivables. Bankruptcy law should therefore establish the factor's legal status and basis of rights on that premise. It should subject the stay of secured claims in reorganization to a necessity test and define the boundary between bankruptcy set-off and a recourse factor's security.

Extending analysis from the theory of the factoring relationship to the factor's concrete rights within bankruptcy demonstrates that protecting the factor can support the stable development of factoring. A coherent framework must preserve that commercial function while respecting bankruptcy law's collective and rehabilitative purposes.

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