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## **The rationale of publicity in the law of corporeal movables and claims**

Zhang, J.

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**Author:** Zhang, J.

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## Summary

In general, this research focuses on the principle of publicity in the law of corporeal movables and claims. It deals with two central issues. One issue is whether and to what extent the principle of publicity is still tenable in the field of corporeal movables and claims. The other issue is whether and how registration should be introduced in the law of corporeal movables and claims to strengthen the principle of publicity. Possession is treated commonly as a means of publicity for corporeal movables, and notification acts as a means of publicity for claims in some jurisdictions. In some special fields, such as goods warehoused and transported, securities perform a function of publicity. Chapter Three and Chapter Four address the following question: whether and in what sense these methods of publicity just mentioned can make property rights visible to third parties. Chapter Five focuses on the issue of whether and how registration should be introduced for corporeal movables and claims. Chapter Six reveals some implications of the preceding studies for Chinese law.

This research begins with an introduction to the concept of property rights. In CHAPTER 2, property rights are argued as a legal relationship between persons instead of a relationship between persons and things. After a comparison with the other types of rights, especially personal rights, we conclude that property rights have two basic distinctive features: “thinghood” and absoluteness. The first feature denotes that property rights have to exist with respect to a specific thing, whether tangible or intangible. The second feature means that property rights can be enforced against general third parties. Property rights impose a duty of abstention over others than the proprietor and have the effect of preference and the effect of following (*droit de suite*). However, the boundary between property rights and personal rights is not completely crystal. As a result, there are a number of intermediary rights that exist in between property rights and personal rights.

Third parties are a general and ambiguous concept in the law of property. In general, this concept includes three types of third parties: strange interferers, subsequent acquirers, and general creditors. A property right is effective against these three types of third parties. However, it should be noted that some personal rights also have binding force on one or two of these types of third parties. In general, the three types have different interests and demands for information in relation to property rights. Strange interferers only want to know the boundaries between the scope their freedom to act and the property right of others. The details of a property

right are often useless for this type of third party. Different from strange interferers, subsequent acquirers have a desire to know about the details of property rights existing on the object because of the *prior tempore* rule. According to this rule, property rights coming into existence earlier will have a higher ranking. General creditors are those parties who are subject to the *paritas creditorum* rule in the event of the debtor's bankruptcy. They have no proprietary rights of security and cannot realize their claim with respect to specific collateral in priority. In general, unsecured creditors are concerned about the overall financial health of the debtor. The main reason why an unsecured creditor does not request proprietary security is that he or she believes that the debtor is able to perform the obligation.

Since property rights are effective against third parties, a problem arises for third parties about how to know about the property right. This problem is known as information asymmetry. To address the problem of information asymmetry, there should be a channel through which third parties are able to collect proprietary information, the information concerning the legal relationship of property rights. In property law, publicity is a way in which proprietary information is communicated. The existence of property rights will give rise to information asymmetry to third parties, thus they should be subject to the requirement of publicity. In practice, there are also other ways in which proprietary information can be obtained by third parties. Compared with these other ways, publicity has special qualities: it is objective, singular and statutory.

CHAPTER 3 discusses the publicity of possession. In that Chapter, we observe that possession is a legal concept designed by the legislature to serve certain purposes. Publicity is not a purpose taken into consideration in the process of defining this concept. In general, it is acquisitive prescription and the protection of factual control that determine the question of how to define the concept of possession in contemporary law. In fact, these two are also important for understanding the concept of *possessio* in Roman law. Without noting the two aspects, it is difficult to comprehend the following fact: one is that a person who has physical control might have no possession, while a person who has no physical control might be treated as a possessor in law.

In general, possession performs a function of publicity through the physical proximity between the possessor and the object possessed. In understanding this function, two aspects should be noted. One aspect is that possession is in practice associated with a great diversity of rights. Thus, possession is an abstract and ambiguous means of publicity. It neither is an outward appearance of ownership, nor does it have any effect of publicity. The other aspect is that indirect possession is invisible and cannot act as a method of publicity to convey proprietary information to third parties. The concept of indirect possession is accepted for other purposes, in particular broadening the scope of possessory protection. Therefore, only direct possession is an ambiguous means of publicity capable of informing third parties that the possessor has a certain right with respect to the thing possessed.

As an abstract and ambiguous method of publicity, possession is a navigating system for strange interferers. Thanks to possession, individuals can easily live with others without interfering with others' property rights in this world crowded with things. In daily life, people can respond to possession quickly and instinctively, which lays a foundation for the order of possession. People should respect the state of possession because the possessor has shown his or her right through possession to the outside world. In this sense, possession has a function to visibly draw the boundaries around the sphere of the freedom to act. Therefore, the abstract indication conveyed by possession can satisfy the demand for information by strange interferers to avoid conducting illegal interference.

However, (direct) possession is not a sufficient method of publicity for subsequent acquirers. As a type of third parties, the subsequent acquirer has a demand for detailed information regarding the property rights of a specific object. For example, a potential buyer has to ascertain whether the seller has ownership and whether the object is encumbered with any limited property rights. Possession cannot satisfy this demand. Under contemporary law, corporeal movables can be disposed of independently from direct possession even under a *traditio* system because of the recognition of invisible delivery, such as *traditio per constitutum possessorium*. An outcome of recognizing invisible delivery is that the right of ownership and of direct possession operate in separate ways. On the other hand, possession remains to be a trigger for *bona fide* acquisition of corporeal movables under contemporary law. However, this should not be treated as a sufficient basis to say that possession is an outward appearance of ownership. In general, the rule of *bona fide* acquisition is mainly a result of legal policy, especially the policy of facilitating the security of transactions. The rule cannot be explained fully from the perspective of the publicity effect of possession. Possession is ambiguous and thus cannot be a reliable outward appearance. In sum, property rights of corporeal movables are generally hidden to third parties, and conflicts are ubiquitous in practice. The rule of *bona fide* acquisition is at most an *ex-post* approach to resolve conflicts after they have arisen.

In general, possession as a means of publicity is not adequate for general creditors either. General creditors are concerned mainly about the overall financial health of the debtor. The quantity of unencumbered assets is only a minor factor for evaluating the debtor's overall financial health. Even in this aspect, possession is incapable of conveying any useful indication about the quantity of unencumbered assets to unsecured creditors. This is because a corporeal movable possessed by the bankrupt debtor might belong to another person, while corporeal movables not possessed by the debtor might fall within the insolvency assets. In practice, potential creditors will not pay attention to the state of possession of corporeal movables by the debtor. Possession is not a reliable indicator of either the bankruptcy assets or of overall financial health. Thus, there is no sufficient reason to say that a divergence between ownership and possession will cause a problem of false wealth or ostensible ownership to unsecured creditors.

In CHAPTER 4, attention shifts to the problem of publicity of claims. This chapter starts with pointing out the double characteristic of claims. First of all, claims are an internal relationship between the creditor and the debtor under the principle of relativity, and the existence of a claim does not cause a problem of information asymmetry to third parties. As a result, the principle of publicity does not exist in the law of obligations. On the other hand, claims have a proprietary characteristic if they are treated as a type of wealth and included in transactions. Like the disposal of corporeal movables, the disposal of claims also has a problem of information asymmetry. For example, a claim might be assigned twice, which will give rise to a conflict of double assignments: which of the two assignees should win in this conflict? Therefore, there is also a demand of publicity in the area of transactions concerning claims.

For ordinary claims, claims not embodied within a document, notification to the debtor is often treated as a method of publicity. By notifying the debtor of the claim involved, third parties are able to know about the disposal of the claim by inquiring with the debtor. However, this research argues that notification is too defective to be a means of publicity for claims. The first reason is that notification does not make the disposal of claims visible to third parties. Even if the debtor receives a notification of the disposal, there is no sufficient reason to believe that he or she will provide correct and full information to third parties. The debtor has no obligation of disclosure in law. Moreover, the debtor might conspire with the assignor or the pledgor to mislead third parties. Even if the debtor is willing to cooperate, he or she might forget the notification or fail to disclose the disposal to third parties correctly. More importantly, as a principle, *bona fide* acquisition of claims is not recognized when the third party has reliance on the debtor's disclosure. Also for some practical reasons, notification is not a suitable method of publicity for claims. For example, notification is too costly in the situation of the assignment of a bulk of claims, on account of the difficulty in notifying each debtor involved. In addition, the formality of notification excludes the possibility of disposing of future claims, which forms an obstacle to the modern transaction of receivables. In fact, notification only relates to the issue of performance: the debtor is entitled to perform to the original creditor before being informed of the disposal.

The lack of a publicity function of notification is in line with current legal practice in most jurisdictions. In principle, notification is either irrelevant or treated as a formality that can be averted by another formality in the situation of the disposal of claims. For example, German law does not require notification for valid assignment of claims. Though notification is necessary for pledging claims, it can be easily averted by choosing the device of security assignment. In Dutch law, the disposal of claims can be realized in the way of, in addition to notification, notarization or private registration. Moreover, where a conflict arises between two disposals of the same claim, it is the *nemo dat* rule that will be applied. In sum, claims remain generally invisible as a type of property, and the transaction of

claims has a problem of information asymmetry that cannot be addressed by notification.

In the aspect of publicity, documental claims, a kind of claim embodied within securities, are different from ordinary claims. In practice, documental claims exist in the area of goods in storage and transportation (securities to goods) as well as in the field of payment (securities to payment). In general, these two types of securities can make the right embodied visible to third parties, and the problem of information asymmetry can be resolved to a large extent. Moreover, the reliance of third parties acting in good faith on the documental recordation is generally protected. This forms an important exception to the rule that claims are not an object of *bona fide* acquisition. In addition to the possibility of *bona fide* acquisition, the debtor is not allowed to refuse performance on the ground that there is a defect in the legal relationship between the debtor and the original creditor. These two forms of protection guarantee that documental claims can be disposed of like a corporeal movable.

On the basis of the preceding discussion, CHAPTER 5 seeks to provide a conclusive analysis of the rationale of publicity in the law of corporeal movables and claims. Firstly, publicity is a formality, as a contrast to the substance of parties' will. It has both merits and downsides. For the parties to a transaction, publicity has a function of evidence. For third parties, it has a function of communicating proprietary information. Publicity can facilitate the certainty of property rights. However, it also causes some problems, such as increasing the costs of transactions, causing unfair outcomes, and restricting parties' autonomy. The merits and downsides imply that a careful trade-off is necessary before the introduction of a means of publicity. Under the principle of proportionality, publicity is only justifiable when it is really necessary and appropriate.

In this research, it is argued that the consensual principle (system) and the causation principle are more in line with the rationale of publicity, compared with the formalist principle (system) and the abstraction principle. As a starting point, valid mutual consent is sufficient for the acquisition of property rights between the transacting parties, and publicity should not be treated as an additional condition. In the absence of publicity, the acquisition should not be treated as ineffective against strange interferers, general creditors, or subsequent acquirers acting in bad faith. This is because publicity is of no use for these three types of third parties. By the same token, where transfer is made on the basis of a defective legal ground, the original owner should not be restricted in enforcing his or her right against strange interferers, general creditors or subsequent acquirers acting in bad faith. Inevitably, the consensual principle (system) and the causation principle give rise to a phenomenon of the relativity of property rights: the exclusivity of property rights is restricted for the benefit of third parties acting in good faith.

On the basis of the preceding discussion on possession, notification, and documental recordation, it can be found that many property rights exist in a hidden state in the law of corporeal movables and claims. Among these

three formalities, only documental recordation can convey adequate proprietary information to subsequent acquirers for whom *bona fide* protection is available. Possession is an abstract and ambiguous method of publicity that is sufficient only for strange interferers. Notification is too defective to be a method of publicity for claims, and the transaction of claims often has a severe problem of information asymmetry. As a result, it is difficult to say that the principle of publicity is tenable in the law of corporeal movables and claims. The *status quo* induces us to raise the following question: whether and to what extent registration should be introduced to strengthen the principle of publicity. Should registration be used to meet the requirement of publicity in the law of corporeal movables and claims?

In comparison with other types of publicity, registration has advantages and disadvantages. It is clear, comprehensive and reliable. Different from possession, registration is able to clearly communicate comprehensive proprietary information in the form of words. Moreover, the law can provide that the proprietary information derived from the register is reliable and enables third parties to securely make transactions according to the register. However, registration is costly. Constructing and maintaining a system of registration is not cheap. Moreover, entry of creation and acquisition of property rights in the system is not without costs and forms a restriction on parties' autonomy. Because of the advantages and disadvantages of registration, a trade-off has to be made before determining to introduce this formality into the law of corporeal movables and claims.

In CHAPTER 5, twenty proposals are provided to construct a subject-based system of registration for corporeal movables and claims. These proposals concern three general aspects: the way of construction and operation of the system, the scope of application of the system, and the legal effect of registration.

**PROPOSAL 1:** The register should be constructed as a subject-based system according to the party's identifier. The identifiers of legal persons include the name, the enterprise code, the address of the legal person and so on. For organizations without legal capacity, the information provided includes the name, the enterprise code (if possible), and the address of the organization. The identifiers of natural persons should be the name, the date of birth, the address and other relevant information included in the identity certificate, driver's license, and birth certificate.

**PROPOSAL 2:** The description of the object should be sufficiently accurate so that third parties are able to identify the object. The register should provide a classification of corporeal movables and claims, which includes, for example, inventory, equipment, livestock, crops, and receivables. There should also be a free text area so that the object can be further described in a general clause by indicating the name, type, location and other relevant features.

**PROPOSAL 3:** The register should include a brief description of the transaction type, so that searchers are able to have a preliminary rough understanding of the transaction. A list of the transaction types should be

provided under the principle of *numerus clausus* of the national law, such as by including reservation of title, financial lease, security transfer, sale and leaseback, non-possessory pledge, operational lease. There should be a free text area in which further information concerning the transaction type can be provided.

PROPOSAL 4: The system should be digital and computerized by taking advantage of new information technologies.

PROPOSAL 5: The register should be a self-service system, allowing users to finish registration and conduct searches without involving any registrar. It suffices that the entire system is maintained by a group of technicians.

PROPOSAL 6: The register should be a notice-filing system without requiring individuals to record the contract on the basis of which the property right is transferred or created. Advance registration, registration in the absence of any underlying contract created, should be recognized. However, the requirement of describing the transaction type must be fulfilled.

PROPOSAL 7: At the request of searchers, the parties to the transaction would need to provide further information concerning the transaction in the prescribed manner. The disclosure of further information by one party might be restricted by granting the other party a right of approval.

PROPOSAL 8: The register should be fully open to the public.

PROPOSAL 9: Money, securities to goods and securities of payment should be excluded from the system of registration.

PROPOSAL 10: As a starting point, the register should be allowed to include all transactions that give rise to a divergence between ownership and actual possession of corporeal movables. Transfer of corporeal movables under a condition or term able to give rise to proprietary effect and creation of a limited property right on corporeal movables should be able to be registered.

PROPOSAL 11: Assignment of claims and creation of proprietary rights on claims should be included in the register. Acquisition of claims through novation, merge and division of companies, and giro transfer should be excluded from the register.

PROPOSAL 12: A minimum amount of the object should be determined as a threshold of entry in the register. A transaction concerning the assets the total value of which is below the minimum amount does not need to be registered.

PROPOSAL 13: A folio should be available to natural persons so that consumer transactions can also be included in the register. The identifier of natural persons should be determined according to Proposal 1.

PROPOSAL 14: The duration of the hidden state should be taken into consideration in defining the scope of registration. Short-term transactions should not be required to be entered in the register. A grace period should be granted to reservation of title. The specific length of this grace period should be determined according to the period within which the purchase price will usually be paid. Short-term lease should not be entered in the register. It is up to the legislature to determine which term of lease is short.

PROPOSAL 15: Registration has declaratory effect and should not be treated as a prerequisite of valid transfer or creation of property rights in the law of corporeal movables and claims.

PROPOSAL 16: Registration can make property rights effective against subsequent acquirers. The absence of registration does not affect the proprietor's legal position against illegal interference and the debtor's bankruptcy.

PROPOSAL 17: Registration should not affect transactions in the ordinary course of the debtor's business. Third parties in the ordinary course of the debtor's business cannot be reasonably expected to search the register and thus cannot be assumed to be aware of the property right registered.

PROPOSAL 18: For acquisition by a third party free of the property right which is created but not registered, it is necessary that this third party acts in good faith.

PROPOSAL 19: The register might be a reliable means of publicity for third parties acting in good faith, so that *bona fide* acquisition is possible on the basis of the register. Inquirers, as a third party, should be allowed to rely on the information provided by the relevant parties. If the information provided proves to be incorrect or incomplete, *bona fide* acquisition and damages should be available to the inquirer.

PROPOSAL 20: To guarantee the smooth operation of the register, a maximum period of the validity of registration should be prescribed. This maximum period applies not only when no definite period is determined by the parties, but also when the parties specify a definite period. Parties are entitled to cancel the registration before the expiry of the maximum period and renew the registration after the expiry of the maximum period.

After getting the twenty proposals, three specific examples are discussed in detail: the secured transaction of corporeal movables and claims, the trust of corporeal movables and claims, and the transaction of motor vehicles. In sum, both the secured transaction and the trust should be included in the system proposed, but a separate system should be created for the transaction of motor vehicles.

In the modern finance market, corporeal movables and claims are gaining increasing importance as a type of collateral. To cater at the same time to the debtor's demand for possession of the corporeal collateral and the creditor's need of priority in payment, various non-possessory devices of security have been used. Some of them take the form of a limited right of security, and others are ownership-based or title-based. A common problem of these security devices is that they are invisible to third parties. In the situation where claims are used as collateral, the problem also exists because claims lack a means of publicity. The ubiquitous existence of hidden security interests raises the question of whether registration should be introduced to make these interests transparent to third parties. Different jurisdictions might differ with respect to this question.

In this research, it is argued that the secured transaction of corporeal movables and claims should be included in the system of registration proposed in 5.3, regardless of the legal form the transaction takes. In other

words, the system is to publicize not only limited property rights of security, but also reservation of ownership (including financial lease) and security transfer of ownership (including sale and lease-back). Under the twenty proposals, the formality of registration will not exert an unacceptable impact on the smoothness of secured transactions. Moreover, this research also contends that possessory pledge also falls short of the principle of publicity, because the requirement of dispossession of the collateral fails to make the right of pledge visible to third parties. Possession should not be treated as a means of publicity for secured transactions of corporeal movables. Thus, it is also desirable to include possessory pledge in the system of registration.

The trust of corporeal movables and claims is another specific case discussed in this research. In general, there are four obstacles to the introduction of the trust in the civil law system: the uniformity of ownership, the singularity of patrimony, the principle of *numerus clausus*, and the principle of publicity. Among these four obstacles, only the last seems to be actual. The beneficiary's right is partially proprietary. Thus, there is a need to inform third parties, in particular subsequent acquirers, of the trust. Publicity of trust includes two principal issues: one is the visible separation of the trust assets from the trustee's personal assets, and the other is how to show the content of the trust to third parties.

In this research, it is argued that the system of registration proposed in 5.3 should include trusts of corporeal movables and claims. A sufficiently precise description of the trust property should be provided in the register, so that third parties are able to know which assets are under the trust. In addition to the description of the object, a mark of trust and a short description of the trust should be recorded in the system. There is no need to record the complete agreement of trust. In general, this will guarantee that the formality of registration will not constitute an unacceptable influence on the smooth transaction of the trust property.

The last example concerns the transaction of motor vehicles. Unlike vessels and aircraft, motor vehicles are mainly regulated by the *nemo dat* rule and the rule of *bona fide* acquisition, a rule centering on possession, in some jurisdictions. In general, these two rules fall under an *ex-post* approach: instead of preventing the occurrence of conflicts, they focus on how to resolve conflicts. In practice, possession and the registration certificate of motor vehicles play an important role in determining the priority of conflicting interests. However, possession is ambiguous, and the registration certificate does not qualify as a means of publicity. As a result, the problem of information asymmetry is not resolved in the transaction of motor vehicles.

In this research, it is argued that a comprehensive and central system of registration should be introduced for motor vehicles. It is better to exclude motor vehicles from the subject-based and notice-filing system proposed in 5.3. In most jurisdictions, there is a register for administrative regulation of motor vehicles, and it is possible to modify this system so that it also performs a private law function. In brief, creation and acquisition of property rights are allowed to be entered in the system, and third parties are entitled

to search the system. Like the land register and the register for aircraft and vessels, the system for motor vehicles is also object-based with reference to the VIN. There seems to be no reason to treat motor vehicles differently from vessels and aircraft. In the central register for motor vehicles, both ownership and limited property rights are registerable. As a result, the system will perform not only a public law function, such as cracking down on crimes, but also a private law function, namely publicity of property rights of motor vehicles.

CHAPTER 6 provides a short introduction of the CCC (2020) and a brief review of the system of publicity for corporeal movables and claims under the CCC. In general, the CCC extends the scope of registration and aims to construct a unified system of registration for corporeal movables and claims. Under the Property Law (2007), only the charge of corporeal movables and the pledge of receivables are registerable. The CCC includes reservation of ownership, financial lease, and factoring in a system of registration. However, the extension is insufficient, and some types of invisible property rights remain outside the register. Possessory pledge, true lease, sale and lease-back, non-factoring assignment of receivables, and trust are still not registerable. Moreover, registration has different legal effects under the Chinese Civil Code: registration makes the security interest effective against third parties where corporeal movables are involved, while it has constitutive effect in the situation of pledge of receivables. This different treatment is groundless, and the constitutive effect of registration is not in line with the rationale of publicity. In the end, recognizing a grace period for the registration of the purchase money charge but denying a grace period for the registration of reservation of ownership is not reasonable.

The Property Law (2007) establishes a decentralized system of registration: three registers are involved in the secured transaction concerning ordinary corporeal movables and receivables. Moreover, some of the registers are paper-based. The triple systems give rise to inconvenience to practitioners and increase the costs of obtaining proprietary information. The CCC attempts to unify the three registers. In this research, it is proposed that the unified system should be self-service, fully open, digital, notice-based and supplementary with a duty of disclosure. This is desirable and will reduce the influence of registration on the smoothness of secured transactions.

Under Property Law (2007), a separate register is constructed for motor vehicles. This register, administered by the Ministry of Transportation, includes every property right that can be created on motor vehicles. For example, the acquisition of motor vehicles is ineffective against third parties acting in good faith until registration is completed. In general, the register performs a private law function and a function of public regulation. In the future, the register should be allowed to operate independently without being absorbed in the unified system of registration for ordinary corporeal movables and claims.