Study on the effectiveness of fluidity clause in the era of Civil Code

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Abstract. In the background of the concept of substantive guarantee introducing in the Civil Code, invalidating the effectiveness of liquidity pledge clauses rigidly in the sales guarantee is no longer appropriate. Although there is a new development in the Civil Code for liquidity pledge clauses, which tends to moderate the legitimacy of liquidity pledge clauses, it does not specify the effectiveness of the clause, and there is a certain legislative gap. With the loss of the necessity of the legislative purpose of the foundation of liquidity pledge clauses and the decline of the comparative law, the analogous application of liquidity pledge clauses to the sales guarantee will result in an undue generalization of the validity range of the liquidity pledge rule. Therefore, the legitimacy of liquidity pledge clauses should be permitted in the case of the sales guarantee. At the same time, vesting liquidation obligation should be introduced in this form of guarantee, and the obligation to liquidate should be imposed on the creditor, which is a way to clear the obstacles faced by the lifting of the ban on liquidity pledge clauses and to protect the balance of interests of both parties. At the same time, if the difference between the value of the collateral and the claim does not "exceed 24% per year", the liquidation procedure can not be requested, thus maximizing the efficiency value of liquidity pledge clauses.

Keywords: the sales guarantee; liquidity pledge clauses; fairness.

1. Introduction

With the rapid development of China's market economy, the demand for private financing is constantly increasing. The demand for guarantee types is also becoming increasingly diverse. In practice, a new type of guarantee agreement, known as the "sales guarantee agreement", has emerged where the parties agree to guarantee the loan contract by fulfilling the house purchase and sale contract. [1] Article 388 of the newly promulgated Civil Code of the Civil Code of the People's Republic of China (hereinafter referred to as the "Civil Code") introduces the concept of substantive guarantee, and introduces other contracts with guarantee functions into the guarantee relationship. The introduction of the dual guarantee concept undoubtedly expands the application space of sales guarantee, provides more financing opportunities for society, and promotes economic development.[2] Scholars have highly praised this, believing that allowing non-typical guarantees to enter the security field on the basis of traditional security systems is conducive to easing the strict traditional security rights system, providing legal basis for parties to create new forms of security to meet financing needs and obtain transaction opportunities. [3] Although Article 388 of the Civil Code is a major innovation in legislation, making the atypical security contract free from the shackles of the strict principle of legal property rights, leaving a certain space for the application of sales security in practice, in judicial practice, most disputes involving sales security are mainly about the effectiveness of the liquidity pledge clauses, which indicates that whether to recognize the effectiveness of the liquidity pledge clause directly affects the effectiveness of the sales security.[4] As a contract clause originated in the era of Roman law, the liquidity pledge clause plays an important role in the civil and commercial transactions of the parties.

After reviewing the provisions of Article 428 of the Civil Code on the liquidity pledge clause, we found that it did not give a clear attitude to the question of whether the liquidity pledge contract was effective, but only stipulated that if the parties agreed on the liquidity pledge clause, they could only have priority in the payment of the collateral property. Although compared with the attitude of absolute prohibition in the past, the attitude of the Civil Code tends to loosen. However, if the attitude
of the Civil Code towards the prohibition of liquid is relaxed, so there is room for the liquidation system. [5] then the provision of Paragraph 2 of Article 68 in the newly issued Interpretation of the Supreme People's Court on the Application of the Guarantee System of the Civil Code of the Civil Code of the People's Republic of China returns the sales guarantee to the system cage of prohibition of liquidity pledge. As is well known, many commercial entities choose to use sales guarantees for financing because in today's social order, typical guarantees are no longer sufficient to meet the financing needs of market entities. If the one size fits all liquidity prohibition rules are still applied to the sales guarantee, it is bound to affect the financing credit of the market subject and cause the instability of the transaction, thus hindering the healthy development of the Socialist market economy. However, if the liquidity pledge clause is completely allowed, there is a suspicion of harming the debtor's interests. Therefore, this paper will discuss the shortcomings of the liquidity pledge clause and its future development trend, and on this basis, demonstrate that in the era of the Civil Code, the sales guarantee should not be restricted by the liquidity pledge clause, and put forward relevant suggestions for improvement.

2. **Current situation investigation and problem inspection of liquidity pledge clauses in the era of Civil Code**

2.1 **Text and current status of liquidity pledge clauses in the Civil Code**

The liquidity pledge clause, like other rules of conduct in the legal system, has evolved gradually from customs formed by private entities in a series of civil and commercial activities.[6] Liquidity pledge clauses have always existed in China's civil law system, the Guaranty Law of the People's Republic of China(hereinafter referred to as the "Guarantee Law"), passed in 1995, for the first time incorporated liquidity pledge clauses into its legal provisions, with Articles 40 and 66 adopting a strict prohibition attitude towards liquidity pledge clauses, clearly stipulating that parties shall not agree on liquidity pledge clauses. Subsequently, the Property Law of the People's Republic of China (hereinafter referred to as the "Property Law") was passed in 2007, the rule prohibiting the use of liquidity pledge clauses continues to be adopted by legislators. Although the prohibition of liquid clauses by Chinese law has become a common practice, there has always been controversy in the academic community and judicial practice regarding the effectiveness of liquidity pledge clauses. In 2020, the Civil Code was promulgated. However, in the legislative process, the discussion on whether liquidity pledge term is effective can be described as ups and downs. Experts and scholars have different opinions on this. Firstly, Property Law stipulates that no liquidity pledge term may be agreed upon, but there is no provision on the legal effect of such an agreement; Secondly, it is necessary to explicitly prohibit the effectiveness of liquidity pledge clauses, in order to comply with the nature of the security interest; Thirdly, if the parties have agreed on a liquidity pledge clause, it is necessary to clarify the effectiveness of their guarantee legal relationship, and may impose liquidation obligations on creditors under the premise of allowing liquidity. In March 2018, the Civil Code Property Rights Edition (indoor draft) confirmed the validity of liquidity pledge clauses, but six months later, the Civil Code Subdivisions (drafts) submitted by the Civil Law Office adopted the principle of "not allowed". [7] Indeed, when the parties establish a guarantee relationship, the secured party intends to dispose of the collateral property when the debt is not repaid at the end of the term, rather than acquiring its ownership. If the creditor directly obtains ownership of the collateral without any liquidation, it is contrary to the essence of the security interest. However, denying the effectiveness of the security interest will lead the creditor's claim to become a pure ordinary claim and cannot be compensated on the collateral, which not only violates the free will of the parties to the contract, but also damages the interests of the creditor. During the second discussion and consultation, some experts and scholars proposed that the Civil Code should refine the legal structure of the mobility clause and modify it to better adapt to the constantly optimized business environment. It should be stipulated that the parties' agreement on a liquidity pledge term can only result in legal consequences of priority compensation in accordance with the law. After comprehensive and thorough review, the Constitutional and Legal
Commission recommended the adoption of this opinion. [8] Therefore, the property rights section of the Civil Code has revised the provisions of the liquid clause, showing a trend of easing the attitude towards the liquidity pledge term prohibition.

Compared with the Guarantee Law and the Property Law, the provisions of Article 428 of the Civil Code on the liquidity pledge clause are quite different. In the past, China adopted the absolute prohibition doctrine, which explicitly prohibited the parties from agreeing on the liquidity pledge term in the contract through the word "shall not". [9] However, the Civil Code has made major changes, and its provisions no longer use the word "shall not", and no longer directly prohibit the agreed liquidity pledge term. Instead, it stipulates that the legal effect of signing the liquidity pledge term is that if the parties agree on the liquidity pledge term, the creditor can only be paid in priority according to law, a certain amount of blank space has been left regarding the specific effectiveness of the liquidity pledge term. This indicates that liquidity pledge term is not a path that can only be attributed to invalidity, leaving sufficient space for further interpretation and application in academia and judicial practice. The law should not only serve as a Code of conduct to regulate the legal relationship between subjects, but should also serve as a standard of judgment, providing judges with legal basis for their judgments in case of disputes in practice. From the above revision of the Civil Code, we can see the change of the liquid clause from the Code of conduct to the Code of adjudication, which means the progress and maturity of the Civil Code at the legislative technical level. In addition, this revision gives priority to respecting the party's autonomy of will, that is, when the relationship between them does not violate Public policy doctrine, and damage public interests, it should intervene in the transaction activities of civil subjects as little as possible, giving them more space for free behavior.

The Civil Code no longer uses the word "shall not" for the change of liquidity pledge term from the Code of conduct to the Code of adjudication, which is actually a relaxation of the effect of liquidity pledge term. In judicial practice, it is no longer possible to directly cite the prohibition of liquidity pledge to render the retention of paper notes invalid. As mentioned above, the Property Law expressly prohibits liquidity pledge clause, so in practice, most of the acts that agree on liquidity pledge term violate the provisions of Article 52 of the Contract Law of the China, and that they violate the laws and mandatory provisions of the law and should be invalid. However, after modification, the Civil Code no longer blindly forbids fluidity, but turns the Code of conduct into the Code of adjudication. Therefore, if the Civil Code does not expressly prohibit the agreement of liquidity pledge contract, the trial practice should no longer judge that the parties' agreement of the liquidity pledge contract violates the mandatory validity. It can be seen that the amendment of the Civil Code to the liquidity pledge clause has improved the guarantee system to a certain extent, which is a great progress in civil legislation. However, we have also noticed that there are still some gaps in the provisions of the legislative body on the provisions of the liquid clause, which has sparked many controversies in the academic community and judicial practice. Therefore, this paper will further explore the deficiencies of the provisions of the Civil Code on the liquid contract, in order to further improve the security interest system.

2.2. Realistic problems of liquidity pledge clauses in the era of Civil Code

2.2.1 There is controversy over the effectiveness of liquidity pledge clauses

Compared with the provisions of the Security Law and the Property Law, the Civil Code has changed the nature of the rules of its liquid clauses from the norms of conduct to the norms of adjudication, which has greatly changed both in clauses of wording and legislative technology. However, the specific provisions can be found that they do not explicitly recognize or deny the validity of the liquidity pledge contract, but directly stipulate the legal effect of "only the priority of compensation according to law". The current Civil Code does not clearly stipulate whether the liquidity pledge contract concluded by the parties is effective. There are different positions in this academic circle. Firstly, although the Civil Code has improved its expression, its legal effect and legislative spirit have not changed. Its provisions are intended to show that the liquidity pledge clause
is still invalid, but only reiterate the priority of the Hypothec and the pledger. [10] Secondly, Article 428 of the Second Civil Code only applies the legal principle of conversion of invalid legal acts to soften the liquidity pledge clause, which is still invalid in essence. [11] Third, the real rights section of the Civil Code should comply with the development of the times and gradually relax the prohibition of liquidity pledge contracts, which not only saves the high cost of realizing security interests, but also fully respects the autonomy of the parties. [12] The regulations on liquidity pledge clauses in Taiwan, China, have also shown a loosening trend, changing from explicit prohibition to conditional recognition based on registration. The above practices all imply that the liquidity pledge clauses cannot only be deemed invalid.

The fundamental significance of the existence of civil law is to be understood and applied in judicial practice. When disputes arise between parties in commercial transactions due to the agreement on liquidity pledge clauses, the law needs to play its guiding role and provide a clear legal basis for the effectiveness of liquidity pledge clauses. As mentioned above, the change of the provisions of the liquidity clause in the Civil Code contains an important change in the legislative concept, that is, as a private law, priority should be given to the autonomy of the parties in the legislative process. The Civil Code does not stipulate the effect of the liquidity pledge clause agreed by everyone, but directly stipulates the legal effect. Compared with previous laws, its attitude is more inclusive and open. At the same time, respect for party autonomy also reflects the development and improvement of security interests. Therefore, the author believes that, on the basis of the looseness of the prohibition rules of liquidity in the Civil Code, we should comply with the development of social economy, and constantly improve the effectiveness system of liquidity pledge clauses by allowing liquidity, so as to more efficiently serve the secured transactions in practice.

2.2.2. Application of the liquidity pledge clause prohibitions in judicial practice

Since the establishment of sales guarantees, there has been controversy over the effectiveness of the liquidity pledge clause in sales guarantees. Due to different understandings of the application standards of the liquidity pledge clause by courts in different regions, when faced with the various transaction forms set by the parties, they often give vastly different interpretations as to whether the liquidity pledge clause is applicable. This will inevitably result in similar cases, but the verdict results are diametrically opposed. The most typical cases of different judgments in practice are the Zhu Junfang case[13] and the Jiamei company case[14]. In the Zhu Junfang case, the Supreme Court's ruling held that both the sales contract and the loan contract were valid and effective, and the creditor requested performance of the former to offset the loan, while the commercial housing sales contract was not a liquidity pledge clause and therefore cannot be deemed invalid. However, the verdict in the "Jiamei Company Case" and the "Zhu Junfang Case" is vastly different. The Supreme Court, based on the true intentions of both parties, revealed the true intention of borrowing under the sales contract, and believed that the actions of both parties constituted an atypical guarantee relationship, and should be invalidated by the prohibition of the liquidity pledge rule of property law.

At the same time, the author through the China Judgment Documents Network has collected 1806 cases related to the retention of liquidity pledge clause in the past five years, of which 31.19% support the invalidity of liquidity pledge clause judgments; The proportion of rejecting invalid claims for liquidity pledge clause is 9.27%; The proportion of second instance judgment revision is 10.86%; The proportion of retrial and judgment revision is 6.71%. From the above data and judgments, it is not difficult to see that there are disputes that are difficult to reconcile in the application of the prohibition of liquidity pledge rule in judicial practice. The occurrence of such results in judicial practice not only damages judicial authority, but also is not conducive to balancing the interests of all parties involved in civil and commercial activities. The confusion of inconsistent standards for the application of liquidity pledge rules in judicial practice will undoubtedly lead to the continued controversy over the effectiveness of liquidity pledge clauses in sales guarantees.
3. Sales guarantee is not subject to the prohibition of liquidity pledge rules

3.1 The necessity of liquidity pledge rules in the era of Civil Code

Since the first appearance of the prohibition of the liquid pledge rule in the guarantee law, it has caused doubts and controversies in both academic and judicial circles. The most core reason is that the fluidity pledge clause does not necessarily violate the principle of fairness, damages the balance of interests between both parties, and prohibits the application of fluidity pledge rules from being too rigid. Admittedly, the liquidity pledge clause is based on a series of assumptions, aimed at maintaining potential risks in the future, and has great uncertainty, but it cannot negate the rationality of the prohibition of liquidity pledge rules. Firstly, prohibiting the use of the liquidity pledge clause is a preventive measure rather than a remedial measure, aimed at preventing potential threats from creditors to harm the interests of the guarantor, rather than remedying the already shown imbalance of interests. Secondly, the liquidity clause carries the risk of creditors harming the interests of the debtor through violent means, leading to the frequent questioning of sales guarantees. However, the above reasons do not mean that scholars have no basis for doubting the rationality of liquidity pledge clauses. Whether to insist on prohibiting liquidity pledge clauses or not, it is crucial to analyze from the perspective of whether the legislative purpose of the liquidity pledge clause matches the current social foundation. The superstructure serves the development of the economy and society. If the social background has undergone significant changes, the effectiveness of liquidity pledge contract and its adjustment scope should be adjusted to adapt to the development of the economy and society.

Back in the Roman law period, debtors were mostly weak people who borrowed money to meet their living needs. If a liquidity pledge contract is allowed to be agreed upon, the creditor can exploit the debtor in a state of urgency and demand that the debtor provide collateral that differs significantly from the amount of the debt, often forcing the debtor to accept it. If the debt period expires, the creditor can directly obtain the ownership of the collateral without any prior procedures, causing the debtor to be exploited by windfall profits, bearing the risk of bankruptcy, and giving the liquid contract an unethical and dishonest color. [15] However, with the growth of national economic wealth, private lending for living purposes due to distress has significantly decreased, while productive and operational lending is on the contrary increasing significantly. The debtor is no longer a weak person in the imagination of legislators. It is inappropriate for the law to intervene in civil and commercial transactions through mandatory provisions. At the same time, from the current trial practice, it can be observed that in most cases involving liquidity pledge clauses, especially in the popular guarantee for the purchase and sale of commercial housing in today’s society, the debtors are mostly legal persons and other commercial organizations. Most of them agree on liquidity pledge clauses for financing purposes, and often have a full and objective understanding of the legal consequences of the guarantee. Continuing to determine the invalidity of the liquidity pledge clause undoubtedly violates the most basic principle of good faith that civil subjects should abide by when engaging in civil acts, and goes against the agreed outcome of the original parties. Therefore, recognizing the effectiveness of the liquidity pledge contract and making it more efficient in serving the practice of secured transactions can better achieve a balance of interests among all parties and achieve a win-win effect.

With rapid socio-economic development, civil and commercial activities are more active than before, and transaction forms are becoming increasingly complex and diverse. From the perspective of Comparative law, many civil law countries and regions have also adjusted their provisions on the liquidity pledge clause. They gradually show a loose trend in prohibiting liquidity pledge. Firstly, France has always followed the provisions of Roman law Law before the reform of the guarantee law. The original article 2078 of the Napoleonic Code strictly prohibited the liquidity clause and expressly denied the validity of the liquidity clause. However, after the reform Article 2459 adopts a legislative model that allows for liquidity, but it does not neglect the protection of the rights and interests of debtors and other creditors. A liquidation system has been established, and the difference between the value of collateral and the creditor's rights must be objectively and fairly evaluated by professional institutions. Measures such as refunding more and compensating less are taken to avoid liquidity
pledge clauses becoming a means for creditors to obtain windfall profits. Secondly, the Taiwan region of China has changed the provision that completely prohibits the use of liquidity pledge clauses, and adopted a conditional permission attitude towards the use of liquidity pledge clauses in Article 873-1 of its "Civil Law". While confirming the validity of the offset clause, the creditor is subject to a mandatory liquidation obligation, meaning that the creditor has to go through any liquidation procedure to obtain ownership of the collateral. At the same time, granting the debtor the right to simultaneously fulfill the defense, the creditor may not fulfill the obligation to transfer ownership of the collateral when the secured debt is not liquidated, in order to avoid situations where the creditor damages the legitimate interests of the guarantor through excessive profits, and its provision must go through a registration and publicity system to confront bona fide third parties. The third draft of the European Model Civil Code alleviates the rigid application of the liquidity pledge ban by setting exceptions. Although it inherits the legislative tradition of prohibiting liquidity pledge in Roman law, it recognizes the validity of the liquidity pledge clause in exceptional circumstances. Firstly, if the parties have agreed on a liquidation obligation in advance, or if there are recognized substitutes for the collateral in the market. It is allowed to agree on the fluid quality. Secondly, for the collateral with a high price difference compared to the bond, a method of refunding more and compensating less will be implemented to compensate for the losses. Finally, the creditor has the obligation to notify the debtor in advance to settle the debt with the ownership of the collateral. If the debtor has no objections within a certain period, the liquidity clause can be implemented. The content of this draft also suggests to some extent the legislative trends of future European countries.

In addition, some Common law countries have always adopted laissez-faire for the liquidity pledge clause. Firstly, the United States adopts a completely laissez-faire approach to the liquidity clause, which is explicitly recognized by the Uniform Commercial Code as effective. It stipulates that creditors can dispose of collateral in any way if the debtor fails to fulfill their repayment obligations by the end of the period. Secondly, the UK adopts conditional permissionism, which does not explicitly deny the effectiveness of the liquidity pledge clause, but grants the debtor the right to redemption. [16] As mentioned above, the attitude of most civil law countries towards the liquidity pledge clause gradually shows a loose attitude from complete prohibition to conditional prohibition. In addition, Common law law countries have always taken a laissez-faire attitude towards the liquidity pledge clause, which has become increasingly weak in Comparative law. In this regard, based on the current situation that the effectiveness of the liquidity pledge clause has not been clarified in our Civil Code, it is necessary to advocate that China actively link up with the legislative attitude of the world and respond to the liberalization of the liquidity pledge clause.

3.2 Generalization of the application scope of liquidity pledge clauses under the dual guarantee view

It can be seen from the above that there has been continuous controversy in the academic and judicial circles regarding the effectiveness of the liquidity pledge clause in the sales guarantee. For the traditional view of formal security, it places more emphasis on implementing the principle of legal real rights, believing that if the transaction activities carried out by the parties are not within the scope of traditional security rights, such as sales guarantee, which has the economic function of security but is not a typical form of security in traditional security, then it should not be restricted by the provisions of the security law. For transactions within the scope of traditional security interests, they must be subject to adjustment by security rules. The liquidity pledge clause does not apply to atypical forms of guarantee, including sales guarantees. [17] The substantive guarantee view believes that all contracts with guarantee functions should be analogically applied to the liquidity pledge clause, but it does not consider whether this extension is reasonable. The substantive security view believes that as long as it is to obtain the priority of repayment of the exchange value of the collateral, no matter what the transaction form, it constitutes a security.[18] This undermines contractual freedom on another level. The key reason why the Supreme Court considers the Zhu Junfang case not to be a liquidity pledge clause is that the agreement between the two parties is that if Jiahetai Company fails
to repay its debts by the end of the period, Zhu Junfang can request the performance of the commercial housing sales contract, not the ownership is directly transferred to the creditor. This means that the prohibition on the use of liquidity pledge clauses only restricts the act of disposing of ownership, rather than the burden of ownership changes. [19] According to the principle of the Dualistic Structure of Property Rights, the claim that the liquidity pledge ban can only be applied in the field of real rights seems logical. [20] Further consideration of whether this viewpoint is legitimate should be analyzed in conjunction with the legislative purpose of the liquidity pledge clause.

The main reason that contemporary scholars advocate for the prohibition of liquidity pledge originated from the "lex commssoria" of Roman law, because it was unfavorable to the balance of interests of the parties. [21] The legislative reason book of the German Civil Code clearly stipulates that the application of the prohibited liquidity pledge rules cannot be distinguished by the principle of the Dualistic Structure of Property Rights, otherwise it will help creditors to exploit creditors by means of excessive profits. Therefore, when drafting the civil Code, although some experts and scholars believe that the liquidity pledge ban should be applied to the field of property law. But the German civil Code does not adopt this opinion. [22] From the perspective of legislative purpose, the liquidity pledge contract in the field of real right or the field of creditor's rights should be invalid to protect the rights and interests of the debtor. However, the sales guarantee discussed in this paper refers to the realization of the loan agreement by setting a sale contract. It is still worth exploring whether such a contract is within the range of the liquidity pledge prohibition rule. In this regard, most scholars advocate that the analogy of liquidity pledge clauses, that is, both typical guarantee and atypical guarantee are within the scope of liquidity pledge rules. The reason is not that the specific contract causes the interests of the debtor because of the profiteering, but to prevent the potential danger. Therefore, as long as the parties agree that before the expiration of the debt performance period, the debtor has the obligation to transfer the ownership of the security to the debt to the creditor, there will be the threat of abstraction. The decisive role is whether the guarantee mode agreed by the parties is sufficient to cause the threat to damage the rights and interests of the debtor rather than the agreed form of guarantee. However, some scholars point out that the requirements of using the analogy are strict and must meet the requirements of justice. [23] Thus, the requirement for the application of analogy is harsh. It is obviously unreasonable to apply the liquidity pledge clause to the field of sales guarantee only through the legislative purpose of safeguarding the interests of the debtor.

Firstly, with the development and growth of private lending, the guarantors are no longer considered weak in legal relationships by legislators. It is rare for creditors to harm debtors through excessive profits. In order to respect the freedom of contract, civil law tends to establish the validity of contracts when interpreting the validity of contracts. Sales guarantee is the product of party autonomy, and naturally should be protected by the freedom of contract. Moreover, there has long been a consensus in academic theory and judicial practice that the use of caution is significantly unfair. If a sales guarantee is deemed invalid due to the liquidity pledge rule, it will harm the contractual freedom between the parties. [24] Sales guarantees are different from civil guarantees established to meet daily needs. Generally speaking, such civil disputes involve a large amount of money, and the debtors are mostly shrewd and self interested small and medium-sized real estate developers. Continuing to analogize and apply the liquidity clause to determine the invalidity of a sales guarantee will result in excessive legal intervention in the autonomy of the parties involved in the contract. Secondly, in the context of comprehensively deepening the reform of the business environment today, the financing needs of parties in commercial practice are constantly increasing. Due to the consideration of the prohibition of liquidity rules, many commercial entities often put on a "legal" appearance by creating other atypical guarantees to obtain investment and trading opportunities by disregarding general legal provisions, and sales guarantees are one form of guarantee. Commercial entities often protect their financing purposes by establishing "legal" sales contracts. Even though some judges can recognize the true purpose of the sales contract in judicial practice, there are still different opinions on the effectiveness of the liquidity clauses in the contract. In some cases, including
the Zhu Junfang case mentioned above, the judge recognized the effectiveness of the liquidity pledge clause. [25] In some cases, the judge ruled that the contract was invalid due to a violation of the fluid clause. [26] In some cases, judges have made revocable judgments that violate the principle of obvious unfairness. [27] This phenomenon reflects the disorderly phenomenon in judicial practice caused by the extension of the scope of the prohibition of liquidity rule to the commercial field. At this point, the liquidity clause not only failed to fill the loopholes in the legal system, but also affected the effectiveness of trial practice and had a certain impact on the guarantee system. Finally, as mentioned above, the legislative purpose of the liquidity pledge prohibition rule has gradually lost its necessity of existence, and it is also declining in Comparative law. On this basis, it is really difficult to expand the scope of application of the liquidity pledge clause by analogy. Therefore, generalizing the prohibition of liquidity pledge in the commercial field will lead to improper generalization of the range of liquidity pledge effectiveness. This not only affects the integrity of the legal system and the order of judicial practice, but also causes difficulties in financing for commercial entities, hinders the development of the market economy, and truly goes against the overall goal of comprehensively deepening reform.

3.3 The positive value of commercial liquidity pledge

When setting up a legal system, legislators cannot abandon multiple values in order to take into account one basic value. The rigid prohibition of liquidity pledge rules only safeguard and highlight the fair value, while ignoring the values of freedom and efficiency. Liquidity permissionism can not only maintain the value of efficiency and freedom, but also give consideration to Fair value, which is a better choice for legislators. [28] In judicial practice, the main contract of the sales guarantee is mostly a loan agreement with commercial transaction functions. The guarantor is mostly a commercial entity with objective analysis ability, able to accurately calculate the value of the guaranteed property, and has a reasonable expectation of future commercial risks, so it clearly does not require excessive intervention from legislators.

Firstly, allowing liquidity pledge is beneficial for maintaining the free value of the law. Freedom of contract is one of the three principles of civil law and the foundation of contract law. [29] The mission of civil law lies in endowing, respecting, and protecting this principle of freedom of will. [30] The civil law should not only allow the parties to create legal relationships based on their own autonomy, but also recognize the legal effects of the parties' agreement, rather than improperly determining the validity of the contract. As a private law, civil law does not have reversibility in declaring invalid legal acts, just like the death sentence in the field of criminal law, which is irreversible. Therefore, the determination of invalid legal acts needs careful consideration. Under the condition that it does not violate the public interest and Public policy doctrine, the validity of contracts should not be evaluated as invalid. [31] Entering into a liquidity pledge clause may not necessarily be an act of excessive profit by the creditor towards the guarantor. In most sales guarantees, the liquidity pledge contract is entered into by both parties on a consensual basis, and does not cause an imbalance in the interests of both parties. In this case, the liquidity pledge contract is no different from the general contract clauses. Even in cases where the value of the collateral clearly exceeds the amount of the debt value, it may be a free expression of intent by both parties. To put it a step further, even if the liquidity pledge contract is entered into due to the creditor's coercion of the guarantor or taking advantage of the danger of others, there is no need to determine the invalidity of the act through the liquidity pledge clause. The guarantor can use the revocation system in the contract field as a means of relief for their own interests. Therefore, the legislative model of prohibiting the rule of liquidity pledge clause undoubtedly hinders the path of realizing free value. Whether it is the debtor or the borrower, their economic purpose of obtaining benefits cannot be achieved. On the contrary, under the legislative model of allowing liquidity pledge clause, the parties enjoy a higher degree of freedom in achieving their economic goals.

Second, allowing liquidity pledge clause is conducive to maintaining the efficiency value of the law. From the perspective of legal economics, " the basic function of the law is to change the
stimulus.”[32] In fact, as Posner said in his book Economic Analysis of Law, man is the greatest guardian of self-interest. If the environment around a person changes, he will change his behavior according to his rational analysis, so as to satisfy his purpose of acquiring interests.[33] Due to the high cost of the traditional security real right realization form and the complicated realization procedure, it not only leads to the loss of the guarantee incentive, but also hinders the cooperation between the transaction subjects, which is a major drawback in the guarantee system. Traditional way of auction and selling need after a long judicial process, a huge cost of the cost of manpower and time, discount agreement on the surface to help to improve the efficiency of the realization of security, but need the height of the guarantor to cooperate, and may cause new disputes, lead to the efficiency of real rights of security value.[34] Specification, if allowed, by contrast, can save traditional guarantee form need a series of time-consuming legal procedures, is conducive to the realization of maximum guarantee creditor's rights, at the same time, the guarantee cost reduction will motivate more market main body engaged in financing guarantee transactions, promote the development of market economy, better play to the function of the guarantee system.

The third is to allow liquidity pledge clauses to take into account the fair value of the law. Firstly, as mentioned above, due to the special nature of the commercial subject of the sales guarantee, agreeing on a liquidity pledge contract does not necessarily result in harm to the debtor's interests. Blindly adhering to the one-size-fits-all prohibition of liquidity pledge rules will lead the commercial subject as the debtor to use the "liquidity pledge clause" as the trump card for its defense against not fulfilling the contract clauses. At this time, the legal system will put the creditor at a disadvantage, which is detrimental to the interests of the creditor. Secondly, the unfair phenomenon that may be caused by liquidity pledge clauses is actually a one-sided understanding of transaction fairness, and this consequence can be remedied through legal rules afterwards. If the debtor believes that the contents of the contract seriously damage his interests, he can cancel or invalidate the contract through the principle of unconscionability in the Civil Code. [35] At the same time, it is also possible to learn from France's agreement on liquidity pledge clauses, and avoid the risk of potential interest imbalance by attaching creditors to liquidation obligations in advance. Therefore, the legislative model of licensing for liquidity pledge clauses can also take into account the realization of fair value.

4. Suggestions for perfecting the liquidity pledge clause of the Civil Code

4.1. Conditional recognition of the validity of liquidity pledge clauses

In China, civil legislation has always adhered to the principle of civil and commercial integration. The reason why the Civil Code adopts the principle of prohibition against liquidity pledge clauses is mainly based on the principle of fairness in the civil field. At the same time, transactions in the commercial field also follow the basic principles stipulated in the Civil Code. However, blindly pursuing the fairness of both parties in the civil field will completely ignore the efficiency value of commercial activities. For the improvement of the liquidity pledge system, not only the need to maintain fairness in the civil field should be taken into account, but also the pursuit of efficiency in the commercial field. Therefore, it is necessary to consider and adjust different improvement measures according to the different characteristics of the civil and commercial fields, in order to improve the security property system.

Firstly, in the commercial field, the liquidity pledge clause is allowed, and the premise is that a reasonable valuation obligation is agreed upon in the contract in advance. Commercial law relies on efficiency, and the core consideration for the application of liquidity pledge clauses in the commercial field lies in efficiency. Prohibiting the use of liquidity pledge will result in higher economic costs for the realization of security interests, thereby reducing the efficiency of creditors' compensation. However, this has earned the debtor time to transfer and squander property, reducing the likelihood of creditors being compensated, which undoubtedly harms the interests of the secured party, and inefficiency directly leads to unfair consequences.[36] In the context of a free market economy, market prices are adjusted through supply and demand relationships, thus possessing timeliness and
uncertainty. This characteristic means that the traditional system of realizing security rights, which is lengthy, complex, costly, and inefficient, cannot adapt to it. [37] In sales guarantee, most of the guarantors are small and medium-sized real estate enterprises, who know more about the market value of the collateral than legislators. The law should not interfere too much with the Free will of the parties. Therefore, in the commercial field where sales exist, a liquidity pledge system can be adopted, so that liquidity pledge clauses can play a positive role in promoting commercial trading activities and helping commercial entities obtain trading opportunities. Of course, this kind of permission is not unlimited. The permission for liquidity pledge clauses must be based on the parties' prior evaluation procedures set in the contract, and a policy of more refunds and less compensation must be implemented to ensure the balance of interests between both parties. Without prior and reasonable value evaluation, it is difficult to ensure fairness between the parties involved. At the same time, if there is a significant change in the value of the collateral at the expiration of the debt performance period, the parties have the right to request confirmation of the invalidity of the liquidity pledge clause on the grounds of a change in circumstances. Due to the fact that commercial entities generally have an objective understanding of the value of collateral, if they can reach a consensus before entering into a liquidity pledge clause, the law does not need to intervene too much in this regard.

Secondly, in the civil field, there is generally no intervention in the agreed upon liquidity pledge clauses between the parties. At the same time, a series of drawbacks arising from the implementation of liquidity pledge clauses can be remedied through a series of legal systems. Considering the current social development, the living standards of civil subjects have significantly improved, and the level of national quality has improved. The parties involved are often able to conduct a more objective and reasonable analysis when signing the collateral clause, and have a more rational and clear understanding of the consequences of the guarantee. The economic foundation determines the superstructure. With the further optimization of the business environment, civil and commercial activities intersect and are to some extent difficult to part with. If the liquidity pledge clause is forced to distinguish between civil and commercial matters, and only the liquidity pledge contract is opened up in the commercial field, while the rigid use of the liquidity pledge prohibition rule in the civil law field is still impractical, it will only increase the phenomenon of misuse of the liquidity pledge clause in judicial practice. Therefore, the application of liquidity pledge clauses in the civil field should not be rigidly prohibited. However, because more attention is paid to the realization of Fair value in the civil field, the drawbacks caused by adopting the legislative model of liquidity pledge licensing can be remedied through other legal systems. One is the general principle in the Civil Code, where the parties can directly bring a lawsuit to the court to remedy their rights. For example, Japan and Germany have similar legal practices. [38] The second is to use a liquidation pledge system to reasonably value collateral and establish specific standards. For the part "more than" or "less than", refund the excess and supplement the deficiency. For this, please refer to the Italian Civil Code The provisions of Article 1448, Paragraph 2.[39] The third is to make legal acts invalid or revocable through the principle of obvious unfairness. Therefore, in order to avoid the drawbacks of distorting the balance of parties' interests caused by the release of liquidity pledge clauses, the above three methods can be used as auxiliary conditions to promote the implementation of liquidity pledge clauses and fully leverage the institutional advantages brought by liquidity pledge clauses.

4.2 Emphasize the creditors' liquidation obligations

As can be seen from the previous text, the application of analogical interpretation to extend the application of the liquidity pledge rule to the field of atypical guarantees can lead to improper generalization of the effectiveness range of liquidity pledge clauses. Therefore, sales guarantees should not be constrained by the effectiveness of liquidity pledge clauses. However, it should be clear that implementing measures that completely liberalize or prohibit the implementation of liquidity pledge rules is not the best solution to a series of problems caused by liquidity pledge clauses. For the sake of fairness, the risk of excessive profits associated with liquidity pledge needs to be addressed through corresponding systems. In this regard, the author believes that in a sales guarantee, the
creditor should be subject to a liquidation obligation, that is, before the creditor claims ownership of the subject matter, a reasonable evaluation of its value should be made, and the portion higher than the debt amount should be returned to the debtor. This can not only solve the concerns about the Fair value goal of the liquidity pledge clause, but also maintain the efficiency of the security system and the value goal of autonomy of the will. In the guarantee system, if the debtor fails to repay the debt within the specified period, the creditor can receive compensation from the collateral. This process usually includes two forms of implementation: disposal liquidation and attribution liquidation. [40] The former refers to the liquidation method of requesting the sale or auction of the subject matter, and prioritizing the payment of the proceeds; The latter refers to the creditor's claim to obtain ownership of the collateral while fulfilling the liquidation obligation, and balancing the interests of both parties based on the principle of returning more and compensating less. For disposal liquidation, realization methods such as variable price auction can make collateral flow freely in the trading market and obtain a fair and reasonable price; For attribution liquidation, it requires both liquidation procedures and ownership transfer to be performed simultaneously. Creditors must objectively and fairly evaluate the collateral through liquidation obligations while claiming ownership of the collateral, and return the excess amount to the guarantor. In contrast, dispositional liquidation requires cumbersome judicial and sale procedures, resulting in high costs and low efficiency in realizing security interests, which is not conducive to achieving the efficiency benefits brought by allowing liquidity pledge. Therefore, attribution based liquidation should be introduced into sales based guarantees. If attributional liquidation is introduced in this field and liquidation obligations are established for creditors, the market value of collateral and the amount of debt can be balanced, which can prevent a series of unfair windfall risks that may be caused by lifting the ban on liquidity pledge clauses. The liquidation obligation not only solves the dilemma of balancing fairness and efficiency brought about by the ban on liquidity pledge, but also helps to strengthen the rationality of allowing liquidity pledge. Therefore, there is no need to adhere to the legislative model of prohibiting liquidity pledge in the field of sales guarantees.

It should be noted that if the parties voluntarily agree on the liquidation obligation when formulating the liquidity pledge contract, there is no risk of imbalance in the interests of both parties. However, if the parties have not agreed on the liquidation obligation or have explicitly agreed to exclude the liquidation obligation, can judicial practice continue to initiate liquidation procedures in order to avoid the risk of imbalanced interests of the parties caused by allowing for liquidity pledge? There are different views in the academic community on this, and scholars with positive opinions advocate that imposing a mandatory creditor liquidation obligation can solve the adverse effects that a liquid contract may have on the interests of the guarantor. [41] Scholars in Taiwan, China, have a consistent view that the liquidation obligation of a liquidity pledge contract should be a mandatory obligation, which naturally exists and cannot be excluded by agreement between the parties. Scholars who hold a negative opinion argue from the perspective of efficiency value that imposing liquidation obligations in secured transactions will greatly discount the efficiency benefits created by the lifting of the ban on liquidity pledge clause, which is a violation of the spirit of contractual autonomy.[42] However, it cannot be ignored that in commercial transactions, in order to maximize profits, few transaction owners voluntarily agree on liquidation obligations. If the creditor is not subject to mandatory liquidation obligations, the aforementioned liquidation obligations cannot achieve the effect of balancing the interests of the parties, and the argument for the reasonableness of allowing liquidity pledge in sales guarantees is lost. Therefore, the liquidation obligation referred to here naturally exists and cannot be excluded by agreement, and the liquidity pledge clause should be applied in conjunction with the liquidation system. However, the compulsory liquidation obligation mentioned here is derived based on the characteristics of the market economy and the order of the law, which is different from the way that the Comparative law directly imposes liquidation obligations on creditors through legislation. Although the mandatory vesting of liquidation obligations will affect the autonomy of the parties to a certain extent, Comparative law has recognized liquidation as a mandatory obligation in liquid clauses in most countries. One is that France has clearly stipulated in
its Civil Code that liquidation certainly exists and cannot be excluded by agreement. Secondly, the "civil law" in Taiwan also states the need to prevent the unfair consequences that may arise from liquidity pledge clauses through liquidation obligations. Thirdly, Japan's "False Registration Guarantee Law" stipulates that all atypical guarantees should have a liquidation obligation.[43]

However, there is no clear provision in China's legislation that it is necessary to impose a liquidation obligation on the parties involved in atypical guarantees, in order to cure the invalidity function of the liquidity pledge clause. The trial practice can not apply this system to the guarantee relationship in our country by the way of Comparative law alone. If the judge continues to force liquidation when the parties clearly agree to exclude the liquidation obligation, it is inevitable that the principle of fairness will be cited as the basis for the trial. Indeed, the principle of fairness, as a fundamental principle in the civil law system, is a principle that any judicial authority should follow when applying the law and handling cases. Deriving from the principle of fairness, it is appropriate and reasonable to allow liquid collateral to be subject to mandatory liquidation procedures in sales guarantees. However, if only the principle of fairness is cited as the legal basis for mandatory liquidation, it is inevitably not appropriate and lacks a certain degree of persuasiveness. In the Guiding Case No. 72 issued by the Supreme Court of China, judges used the legal principle of liquidation to interpret and adjudicate this type of dispute, thus serving as a reference case for us to handle such cases.[44]

In the guidance case No. 72, the court held that the two parties negotiated and reconciled after the expiration of the creditor's rights, and transformed the loan contract into a commercial housing sales contract relationship. This transaction arrangement safeguarded the interests of both parties, did not violate the mandatory provisions of laws and administrative regulations, and should confirm the effectiveness of the sales guarantee agreed by both parties according to the Freedom of contract. This is actually the application of liquidation legal principles to ensure the balance of interests between both parties in the transaction type guarantee, thereby determining the legitimacy of the transaction type guarantee. Although the system of imposing a liquidation obligation on creditors in a sales type of guarantee and cannot be excluded by agreement is conducive to strengthening the legitimacy of the liquidity clause and ensuring a balance of interests between both parties. However, if creditors are only given a general obligation to liquidate, without determining the timing of liquidation initiation and valuation standards, it is highly likely to lead to ongoing disputes between the guarantor and creditors, and efforts to ensure the efficiency value brought by the allowed liquidity pledge will disappear, thereby rendering the liquidation system ineffective and greatly reducing its effectiveness. Some scholars have pointed out that the biggest advantage of the liquidity pledge clause is that it can eliminate the cumbersome liquidation and execution procedures in traditional security rights implementation methods. If blindly requires liquidation and evaluation in such agreements, it will incur many additional costs, which is not in line with the principle of economic efficiency. This is to some extent equivalent to denying the effectiveness of the liquid clause.[45] Therefore, it is necessary to rationalize and concretize the improvement of the liquidation system. In its Guiding Case No. 72, the Supreme Court held that the standard for calculating loan interest between the parties should not exceed the "24% annual interest rate" stipulated in Article 26 of the Interpretation of Private Lending, in order to avoid the risk of both parties illegally setting high interest rates and exploiting the debtor through sales guarantees. Due to the close similarity between the characteristics of Guidance Case No. 72 and the sales type guarantee, it has high guidance and reference significance for the trial and judgment of such disputes. Among them, the 24% annual interest rate standard helps judges to clearly distinguish whether there is a risk of excessive profit in the liquid clause in trial practice. Some scholars, based on the principle of fairness, believe that the standards for liquidation in commercial disputes can be referred to in the Supreme People's Court's "Interpretation (II) on Several Issues Concerning the Application of the Contract Law of the China" stipulates that "no more than 30%" as a compensation standard and granting the parties the right to revoke as their own remedy system, if either party believes that the difference is too high and causes damage to their own rights and interests, they can claim to revoke the clause.[46] In comparison, for the application of liquidation obligations in sales guarantees, Guidance Case No. 72 is highly relevant
and has higher reference value. Therefore, the author believes that due to the nature of sales guarantees, the setting of liquidation obligations for creditors in sales guarantees should be based on Article 26 of the Judicial Interpretation of Private Lending, where the annual interest rate does not exceed 24% as the liquidation upper limit. To achieve the effect of prioritizing respect for party autonomy.

5. Conclusion

As a product of the times, law should adapt to the development of society and make changes. Indeed, the liquidity pledge clause has its rationality. However, with the further optimization of the business environment, the financing needs of civil and commercial entities have also increased, and more and more parties are using sales guarantees to avoid liquidity pledge clauses. At the same time, most civil law countries and regions have also shown a relaxed attitude towards the effectiveness of the liquidity pledge clause, exploring ways to lift the ban on liquidity pledge. In fact, in the era of the Civil Code, it is inappropriate to stick to the liquidity pledge clause. Allowing liquidity not only meets the needs of transaction entities for achieving the efficiency of guarantees, but also enables greater implementation of the principle of autonomy of will. On the basis of introducing the concept of double guarantee, the Civil Code has changed its attitude of strictly prohibiting liquidity pledge contracts, which is a new development of the guarantee system. Although there are still a series of problems in the Civil Code, such as unclear effectiveness of the liquidity pledge clause and inconsistent judicial judgment standards, the Civil Code's recognition of the legal effect of the priority of compensation of the liquidity pledge clause for the first time implies that China's legislative trend is also more inclined to the liquidity pledge lifting. Many civil law countries and regions have explored the path of lifting the ban on liquidity pledge clauses, which has also provided experience and ideas for China's lifting of the liquidity pledge ban, such as establishing a liquidation system. The improvement of the liquidity pledge clause in the Civil Code of China should also meet the trend of the development of the times. First of all, whether in the civil field or the commercial field, the validity of the liquidity pledge clause should be conditionally recognized, so as to provide a legal basis for judges to try cases about the liquidity pledge clause and maintain the unity of judicial adjudication. On this basis, introduce a attribution based liquidation system to ensure a balance of interests between both parties and strive to maintain legal fairness and justice. As a product of the optimization and development of the market environment, sales guarantee should not be stifled by judicial practice on the grounds of invalidity of liquidity pledge clauses. Moreover, under the premise of introducing a liquidation system, the sales guarantee should be gradually improved to better serve the financing needs of the transaction subjects.

References


[2] Formal guarantee view: the legal principle of real right is implemented in the field of security real right, and the real right of security is limited to the creditor setting the limit real right on the exchange value of others' property. Substantial guarantee view: it is based on the standard of the economic function of the transaction, as long as its purpose is to obtain the priority right of compensation of the exchange value of the security, it is all constitute the guarantee. Xie Hongfei. Rule application and conflict resolution of the substantial guarantee concept in the Civil Code [J]. Law, 2020 (09): 3-20.


[4] The broad sense refers to the agreement concluded between the guarantee obligor fails to fulfill the obligations as agreed, the ownership of the security directly belongs to the security obligee and settles the creditor's right and debt relationship. The narrow sense of the liquid contract is limited to the relevant provisions in the pledge contract. See for details Liu Jun. Regeneration of the fluid quality model [J]. Chinese Law, 2006 (04): 95-101.


[11] Invalid behavior conversion means that if the party knows that a certain legal act concluded by him is invalid but meets the requirements of another alternative act, and is willing to conclude the alternative act, the alternative act is effective, and the invalid act is therefore "converted" into an effective act. See Yin Qiushi for details. Conversion of invalid behavior and interpretation of legal behavior —— On the necessity and legitimacy of the conversion system [J]. Law, 2018 (02): 106-118.


[20] Trennungsgrundsatz:the burden behavior and punishment behavior follow the principle of separation. That is, when the real right is changed while performing the debt law obligation, the legal act of changing the real right (real right behavior) and the legal act of setting the debt law obligation (creditor's right behavior) are separated and independent of each other. See for details Zhu Qingyu. The General Theory of the Civil Law [M]. Beijing: Peking University Press, 2016.


[38] Article 90 of the Japanese Civil Code stipulates that " a legal act matter against public order or good customs shall be invalid." The German Civil Code stipulates that "especially when the legal act is taken by the other party is poor, inexperienced, lack of judgment or weak in will, and makes it agree or guarantee the benefits of oneself or the third party, and the benefits of such property are obviously not commensurate with the payment, the legal act is invalid".See for details Liu Jun. Regeneration of the fluid quality model [J]. Chinese Law, 2006 (04): 95-101.

[39] Article 1448, paragraph 2, of the Italian Civil Code states: "If the damage does not exceed half of the value of the injured party or the promise of payment at the conclusion of the contract, the exercise of the rights prescribed in the preceding paragraph shall not be accepted." The Italian Civil Code.See for details Fei Anling, Ding Yimei, Beijing: China University of Political Science and Law Press, 1997.


