# On the Effectiveness of Real Estate Mortgage Contracts without Mortgage Registration

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***Abstract**: In the case where a mortgage contract on real estate is concluded but not registered, the validity of the mortgage contract shall be recognized if there is no defect in the validity of the contract itself. Before the creditor requests the mortgagee to assist in the registration of the mortgage based on the mortgage contract in force, the mortgagee does not constitute a breach of obligation and is not liable for compensation. If the mortgagee refuses the creditor's request for assistance in registering the mortgage, and the mortgagee is unable to do so for reasons attributable to the mortgagee, the mortgagee shall bear supplementary liability to the extent of the value of the mortgaged property if the debtor is unable to pay.*

***Key words**: Mortgage registration; Real estate mortgage contract; Liability; Conversion of invalid legal acts; Principle of distinction*

## Introduction

The Supreme People's Court held in the dispute between Liu Junrui and Xinjiang Shihezi Rural Cooperative Bank and Bu Chunhua that, based on the interpretation of invalid legal acts, the real estate mortgage contract can be transformed into a joint and several liability guarantee contract when the mortgage is not registered, and the mortgagee should assume joint and several liability with the value of the mortgage. The mortgagee should be jointly and severally liable up to the value of the mortgage. After the ruling was made, scholars began to discuss the adjudication idea therein, and a big controversy arose over the validity of the real estate mortgage contract when the mortgage was not registered.

In order to resolve the above dispute, the Second Division of Civil Trials of the Supreme People's Court was the first to state its adjudicative position in its published Minutes of the Judges' Meeting of the Second Division of Civil Trials of the Supreme People's Court (He, 2018), and Article 60 of the Minutes of the National Courts' Civil and Commercial Trial Work Conference (hereinafter referred to as the "Nine Civil Minutes") made more comprehensive provisions on this basis. Article 46 of the Interpretation of the Supreme People's Court on the Application of the Security System of the Civil Code (hereinafter referred to as the "Interpretation of the Security System of the Civil Code") has further improved the provisions of Article 60 of the Ninth Civil Minute. This paper tries to interpret the understanding and application of Article 46 of the Interpretation of the Security System of the Civil Code and discuss some issues that are not clarified in this

article.

## Principle of Distinction: The Distinction between Contractual and Property Effects

According to Article 41 of the original Security Law, if the parties establish a mortgage on real estate such as housing, the mortgage contract cannot take effect if the mortgage is not registered. Then, if the debtor fails to settle the debt on time, the creditor can only claim the default liability from the debtor, but in most cases, the debtor is already in the state of insolvency at this time, and the creditor's rights can hardly be substantially protected. Article 41 of the original Security Law makes registration of mortgage as the effective element of real estate mortgage contract, resulting in a high degree of overlap between contractual and property effects, which cannot be distinguished. This provision actually confuses the cause and effect of change of property rights, and wrongly assumes that the mortgage contract cannot be effective even if there is no registration of real estate mortgage. It is to correct this wrong legislative provisions, the original "Property Law" Article 15 established the principle of distinction, that is, "between the parties to enter into a contract on the establishment, change, transfer and extinguishment of real property rights, unless otherwise provided by law or agreed upon in the contract, from the establishment of the contract; failure to register the property rights does not affect the effectiveness of the contract. " The significance of establishing the principle of distinction is that the cause of change of property rights and the result of change of property rights will be as two legal facts, each of which is established and effective based on different legal basis (Sun, 1999). Compared to the provisions of Article 15 of the original Property Law, Article 215 of the Civil Code has not been modified in any way and continues to adhere to the principle of distinction established in that Article.

Specifically in the case of real estate mortgage, the establishment of mortgage right requires the completion of mortgage contract and mortgage registration in force, but it is worth noting that although the completion of mortgage registration will enable the effective establishment of mortgage right, it cannot in turn affect the effectiveness of mortgage contract, which is the proper meaning of the principle of distinction. Therefore, the decision of the Supreme People's Court in the case of Liu Junrui and Xinjiang Shihezi Rural Cooperative Bank and Bu Chunhua's loan contract dispute is open to question. Specifically, the Supreme People's Court's decision in this case was based on the conversion of the mortgage contract into a joint and several liability guarantee contract based on the conversion of invalid legal acts. Although the parties to the mortgage contract did not register the real estate mortgage, the mortgage contract itself is based on the true intention of the parties and does not violate the laws and administrative regulations, and should be considered as a legal and valid contract. Since the mortgage contract is legal and valid, there is no room for the application of the transformation of invalid legal acts.

## Mortgage Contract after the Effective Mortgage Registration Obligation

The purpose of the real estate mortgage contract between the creditor and the mortgagee is to specify what kind of collateral the mortgagee uses to secure the debt between the creditor and the debtor, and to agree that the mortgagee is willing to cooperate with the creditor in registering the mortgage against the collateral. Then

one cannot help but ask whose obligation is it to register the mortgage against the mortgage? According to Article 14(1) of the Provisional Regulations on Real Estate Registration, the application for registration of real estate due to the creation of a mortgage shall be jointly applied for by both parties. Just from a textual reading of the provision, it seems that this should be a joint obligation of the creditor and the mortgagee. It should be noted, however, that the Provisional Regulations on Real Estate Registration are administrative regulations, which are more concerned with the administrative steps for the registration of mortgages and related matters, and do not give much consideration to the rights and obligations in civil law. Therefore, in order to interpret Article 14(1) of the Provisional Regulations on Real Estate Registration in the civil law sense, it is necessary to return to the civil law perspective. The types of obligations can be divided into obligations to pay (including the main obligation to pay and subordinate obligation to pay), the accompanying obligation and the untrue obligation: the difference between the main obligation to pay and the subordinate obligation to pay is that the former is determined from the beginning and determines the basic type of debt, constitutes a dual contract to pay; the difference between the accompanying obligation and the subordinate obligation to pay is that the latter cannot be requested independently by a lawsuit; and the characteristic of the untrue obligation is that the opposite party The distinction between the obligation of attachment and the obligation of subordination is that the latter cannot be claimed independently; while the characteristic of the obligation of insincerity is that the opposite party cannot request the insincere obligor to perform, and the insincere obligor is not liable for damages for the breach of the obligation, but only the insincere obligor suffers a diminution of rights or a disbenefit (Wang, 2006). Therefore, in the case discussed in this article, the registration of mortgage is indeed a common obligation of the creditor and the mortgagor, but the type of obligation is not the same, the creditor's corresponding obligation is an insincere obligation, while the mortgagor's obligation should be the main payment obligation. Specifically, the purpose of the mortgage contract signed between the creditor and the mortgagor is to establish the mortgage right for the creditor, even if the creditor does not go to register the mortgage, it is essentially a waiver of its own rights and does not need to bear any liability to the mortgagor, and the adverse consequences it suffers are the failure to register the mortgage resulting in the establishment of the mortgage right. From the mortgagee's point of view, since the purpose of the mortgage contract is to establish the mortgage for the creditor, and the registration of the mortgage is an essential part, it should be evaluated as the mortgagee's main obligation to pay.

After determining that the creditor's obligation to register the mortgage is a bona fide obligation and the mortgagor's obligation to register the mortgage is a principal obligation to pay, there is still the question of how to determine whether the mortgagor is in breach of the principal obligation to pay that needs further discussion. It is argued that if the mortgagor fails to claim performance from the creditor after the real estate mortgage contract is concluded, the mortgagee is in breach of the contract (Gao, 2019). This view is debatable. Firstly, the creditor, as the right holder, should claim performance from the mortgagee, not from the mortgagee. Secondly, although the mortgagor's obligation under the mortgage contract is the main payment obligation, the main payment obligation is the mortgagor's cooperation with the creditor's request for assistance in the registration of the mortgage, and the mortgagor should cooperate with the creditor at any time after the creditor signs the mortgage contract with the mortgagor.

Although Article 46, paragraph 1 of the Interpretation of the Security System of the Civil Code provides that the mortgagee shall assist in the registration of the mortgage, and paragraphs 2 and 3 provide for

the mortgagee's liability, although Article 46 itself does not take a position on the order of application of paragraphs 1, 2 and 3, based on the above analysis, it should be considered that the application of paragraphs 2 and 3 of the Article presupposes the application of paragraph 1. In other words, if the creditor has not requested the mortgagee to assist in the registration of the mortgage after the mortgage contract of the real estate has come into effect, it is not entitled to directly hold the mortgagee liable. The reason is that the registration of real estate mortgage requires the cooperation of both the creditor and the mortgagee, and under normal circumstances, either party cannot do so, and the breach of the mortgagee's contractual obligation is premised on the refusal of the creditor's request for assistance in the registration of the mortgage, and if the creditor has not made such a request, the mortgagee is not in breach of contract and is not liable. For example, the Supreme People's Court held in the dispute between China Eastern Asset Management Company Limited Hunan Province Branch and Hunan Yahwa Dairy Company Limited over the financial loan contract that the registration of the equity pledge in question was a common contractual obligation of the pledgee and the pledgee. As the right holder of the pledge contract did not provide evidence to prove that it requested the pledgee to fulfill the registration of the pledge within a reasonable period of time, the request of the right holder of the pledge contract to hold the pledgee liable for compensation was not supported. Although the case involved the registration of the pledge of equity, the jurisprudence behind it is consistent with the situation discussed in this article, and the view of the decision is worthy of affirmation.

If there is no defect in the validity of the real estate mortgage contract, the contract shall be deemed valid according to law and the creditor is certainly entitled to request the mortgagee to assist in the registration of the real estate mortgage based on a valid mortgage contract, as stipulated in Article 46(1) of the Interpretation of the Security System of the Civil Code. It is worth noting that the practical application of this paragraph needs to be coupled with the relevant provisions of the Civil Procedure Law. Specifically, if a creditor's request to the mortgagee for assistance in registering the mortgage is denied after the mortgage contract on the real estate has entered into force, he or she may file a suit for payment with the court. If the mortgagor still refuses to fulfill its obligations after the court's decision on the payment lawsuit is made, the creditor may apply to the enforcement court for enforcement in accordance with Article 251 of the Civil Procedure Law and Article 502 of the Interpretation of the Civil Procedure Law, and the enforcement court will first issue a notice of assistance in enforcement to the real estate registration department, and then the real estate registration department will register the real estate mortgage for the creditor.

## Mortgagee's Liability in the Event of Failure to Register the Mortgage after the Mortgage Contract becomes Effective

Article 60 of the Ninth Civil Code only provides in general terms that the mortgagee shall bear the corresponding liability if the mortgage cannot be registered due to the loss of the mortgage or the transfer of the mortgage to another person, but does not distinguish the reasons for the failure to register the mortgage. In other words, according to this article, the mortgagee shall bear the corresponding liability as long as the mortgage cannot be registered, regardless of whether the cause of failure to register the mortgage is attributable to the mortgagor, which is obviously inappropriate. Article 46 of the Interpretation of the Security System of the Civil Code is aware of such problem and amended the provisions of Article 60 of the Ninth

Civil Code accordingly.

## Failure to Register due to Reasons not Attributable to the Mortgagor

According to the first half of the second sentence of Article 46 of the Interpretation of the Security System of the Civil Code, the mortgagee is not liable to the creditor if the mortgage cannot be registered due to reasons not attributable to the mortgagor itself. "For the former, Article 90(1) of the Civil Code stipulates that if a party is unable to perform a contract due to force majeure, it shall be partially or fully exempted from liability according to the effects of force majeure, but for the latter, the Civil Code does not have Article 46(2) of the Interpretation of the Security System of the Civil Code actually expands the mortgagee's exclusion of liability in the mortgage contract by means of judicial interpretation.

According to the second half of the second sentence of Article 46 of the Interpretation of the Security System of the Civil Code, although the mortgagor is not liable to the creditor if the mortgaged property cannot be registered due to reasons not attributable to the mortgagor itself, the mortgagee shall be liable for the costs of insurance, indemnity or compensation up to the amount of the said costs. This provision is related to the creditor's right to claim for compensation, and is based on the provisions of Article 225 of the Civil Law of Taiwan, but is slightly different from the provisions of the latter (Cheng, Gao & Xie, 2021). Specifically, according to Article 225 of the Civil Law of Taiwan, if the debtor is unable to pay due to reasons not attributable to the debtor, the debtor is exempted from the obligation to pay, but if the debtor has the right to claim damages against a third party, the creditor may request the debtor to assign its right to claim damages or request the debtor to deliver its The debtor may request the debtor to assign his right to claim damages or request the debtor to deliver the damages he has received. By way of comparison, it can be found that the latter half of Article 46(2) of the Interpretation of the Security System of the Civil Code only stipulates that the creditor can request the mortgagor to deliver the indemnity it has received, but does not stipulate that the creditor can request the mortgagor to assign its claim for damages, which has certain legal loopholes. Specifically, if the debtor himself is the mortgagee, the property under the mortgage contract itself is also the debtor's liability property that should be used to settle the debt, and it is meaningless to stipulate that the creditor can request the mortgagee to deliver the compensation received by him. This is because it is entirely possible that a situation may exist where the mortgagor is negligent in asserting its rights against another person, and the creditor cannot assert its rights against the mortgagor until the mortgagor obtains compensation from that other person in the form of insurance money, indemnity, etc., which would put the creditor in a very awkward situation according to the second half of Article 46(2) of the Interpretation of the Security System of the Civil Code.

## Failure to Register because of the Reasons Attributable to the Mortgagor

According to Article 46(3) of the Interpretation of the Security System of the Civil Code, if the mortgage cannot be registered due to reasons attributable to the mortgagee itself, the mortgagee shall bear the corresponding liability. However, there is a controversy between the joint and several liability theory and the supplementary liability theory regarding the characterization of the liability. According to the supplementary liability theory, the liability is supplementary in nature, because if the court directly decides that the

mortgagor is jointly and severally liable for the secured debt together with the debtor, it will confuse the contractual liability and the guarantee liability after the establishment of the property right (Zhang, 2010). However, there are also joint and several liability arguments that even if the liability is in the nature of breach of contract, it should be awarded jointly and severally instead of supplementary liability because the loss has already been determined since the mortgagor defaulted, and even if joint and several liability is awarded, it does not confuse the liability for breach of contract and the liability for security (Ni, 2019). There is also the joint and several liability argument that the mortgage contract is converted into a guarantee contract according to the civil law principle of conversion of invalid legal acts, and thus assumes joint and several liability.

The view of joint and several liability is debatable. First of all, according to Article 178, paragraph 3 of the Civil Code, joint and several liability, is stipulated by law or agreed by the parties. The parties to the mortgage contract sign the mortgage contract for the purpose of registering the mortgage, and will not make the agreement of joint and several liability in the mortgage contract, and there is no law stipulating that the contractual liability of the mortgagee is joint and several. Secondly, if the mortgage contract itself is not defective, it is a legal and valid contract, and there is no room for the application of the conversion of invalid legal acts. Even if we acknowledge the distinction between the act of claim and the act of property, before the registration of the mortgage, the parties only have a valid contract of claim, and there is no need to convert it, while the act of property has not yet existed (only when the registration is done, there is the agreement of property), and there is no need to discuss the conversion of the act (Ni, 2019). Therefore, it is more reasonable to adopt the view of supplementary liability interpretation.

More precisely, the mortgagee in this case assumes a supplementary liability for breach of contract, and since this is the case, the scope of the mortgagee's liability for breach of contract should also be regulated by the foreseeability rule and the creditor and negligence rule. As for the foreseeable rule, Article 584 of the Civil Code stipulates that the amount of liability for breach of contract shall not exceed the loss that the party in breach of contract foresaw or should have foreseen at the time of the conclusion of the contract. Theoretically, it is generally believed that the standard of "foreseeing or should have foreseen" should be the objective standard of a rational person, and can be further judged with specific circumstances (Huang, 2020; Zhu & Xie, 2020). Specifically, in the case discussed in this article, if the failure to register the mortgage is indeed attributable to the mortgagee itself, the mortgagee is certainly liable for the breach of contract, but the maximum amount of liability for breach of contract shall not exceed the value of the mortgage, and if there is already another security right over the mortgage involved when the creditor and the mortgagee enter into the mortgage contract, the amount of the prior security right shall be deducted. The amount of the value should be deducted before the mortgagor's liability for default is capped. For the creditor and negligence rule, Article 592(2) of the Civil Code provides that if one party causes damage to the other party by default, and the other party is at fault for the occurrence of the damage, the amount of compensation for the corresponding damage may be reduced. Specifically, in the situation discussed in this article, it is mainly reflected in the creditors' lack of risk prevention awareness (Ran, 2020), for example, although the real estate mortgage contract is signed, but the mortgage has not been registered, the creditor chooses to actually lend the money to the borrower, resulting in the creditor's inability to recover the claim after the debt expires. In this case, the mortgagee cannot be solely responsible for all the losses, but the creditor itself is also at fault and should share the losses accordingly.

The scope of the supplementary liability of the mortgagee shall be limited by a double amount: the first limit is that the supplementary liability of the mortgagee shall be capped at the value of the collateral; the second limit is that the mortgagee shall be liable for the amount of the debt that the debtor is unable to satisfy, since the loss suffered by the creditor can only be determined when the debtor is unable to satisfy. As for the determination of the "insolvency" of the debtor, the provisions of Article 687 of the Civil Code shall apply by analogy, i.e. the mortgagee shall be liable only if the debtor is unable to perform the debt after a trial or arbitration, and if the debtor's property is legally enforced. In this regard, the mortgagee is in fact granted a right of defense similar to that of a general guarantor, so if the creditor sues both the debtor and the mortgagee, the court should, in principle, specify in the main text of the judgment that the mortgagee is only liable for the part of the debtor's property that cannot be fulfilled even after the debtor's property is enforced by law.

With regard to the supplementary liability argument, there may be a dispute as to whether the mortgagor, if defined as a supplementary liability for breach of contract in the above circumstances, still has a right of recovery against the debtor after the mortgagor then assumes liability. The answer is yes, the debtor, as the ultimate debtor, should be allowed to recover from the debtor after the mortgagee has assumed liability. Moreover, according to Article 18 of the Interpretation of the Security System of the Civil Code, if the security contract is invalid, the guarantor who has assumed liability is entitled to recover from the debtor to the extent of its liability, then, to put it in perspective, if the mortgage contract is a valid contract, the mortgagee is entitled to recover from the debtor after assuming supplementary liability, which is not affected by the fact that such supplementary liability is a breach of contract. This is not affected by the fact that this supplementary liability is a breach of contract. In judicial practice, some courts also hold this view, which is worthy of recognition.

## Conclusion

In practice, there are other similar types of mortgage contract validity issues. For example, the parties to a mortgage contract agree in advance that if both parties fail to register the mortgage, the mortgagee shall be jointly and severally liable to the extent of the value of the mortgage. For such an agreement, the autonomy of the parties should be respected and the validity of the agreement should be recognized. In addition, there is also a general agreement in the mortgage contract that "the mortgagor shall mortgage all of the property" without registering the mortgage of the real estate, it should be noted that this type of mortgage contract should be not established, not that the mortgage contract has been established and effective but the mortgage has not been established. The reason is that "all=uncertain", because the mortgaged property is unknown and the mortgage contract lacks the necessary clauses, the mortgage contract should not be established (Cao, 2020). In conclusion, when determining the validity of several similar types of mortgage contracts, while finding the similarities, special attention should be paid to the differences between each type of contract so that the validity of the mortgage contract can be correctly determined.

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