

# Study on the Application of Rules for Normal Business Buyers

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**Abstract:** Effectively allocating rights and obligations between parties in guarantee relationships is essential to balancing the guarantor's discretionary freedom and the security interests of the guarantee right holder. This issue has long been a focal point in the reform of the chattel guarantee system. The "normal business buyer rule" stipulated in Article 320(a) of Part 9 of the Uniform Commercial Code (UCC) in the United States is a legislative approach aimed at harmonizing the inherent conflict between efficiency and security in commercial transactions. Similar provisions exist in Article 102 of the Model European Civil Code and Article 34 of the Model Law on Secured Transactions. However, despite its global prominence in chattel guarantee reforms, this system faces challenges of "acclimatization" when transplanted into the Civil Code. Critics argue that while comparative law establishes "normal business buyer rules" to sever the pursuit of security interests in chattel guarantees, it simultaneously allows for the extension of guarantee rights to income derived from the secured property, preventing excessive disposal freedoms granted to debtors from undermining security interests. In contrast, China's chattel guarantee system reform adopts the "normal business buyer rules" from foreign legal frameworks but neglects corresponding "income disposal" provisions to mitigate risks. This omission raises concerns about protecting mortgagees' interests.

**Keywords:** Normal business buyer; Guarantee system; Ownership

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**Online publication:** March 26, 2025

## 1. The interpretation logic of the "normal business buyer rules"

### 1.1. Examining the premise of the rules: Choosing a protection scheme for mortgagees

The extent to which mortgagees are protected during the transfer of mortgaged property significantly influences the structural design of the "normal business buyer rule." If mortgagees receive comprehensive protection, there is no inherent conflict between their rights and those of buyers, naturally facilitating trust protection for buyers. However, if mortgagees risk being reduced to ordinary creditors, the structure and application of the "normal business buyer

rules” must carefully balance the interests of both parties <sup>[1]</sup>. In the context of mortgaged chattel transfers, scholars propose three main protection schemes: (1) automatic extension of chattel security interests, (2) conditional extension (non-automatic extension), and (3) subrogation of property. Some scholars argue that the legal effects of subrogation and automatic extension are fundamentally similar, as guarantee rights are automatically extended to income subrogation. Consequently, subrogation can be classified under the automatic extension scheme.

## **1.2. The role of trust protection: Right of appearance and responsibility in application**

The core issue addressed by the “normal business buyer rules” is how to reconcile the competing interests of mortgagees and buyers when their rights are in exclusive competition. The legal framework should effectively coordinate these interests while ensuring buyers’ reasonable trust in transactions <sup>[2]</sup>. Legal order should reflect and integrate societal order. Trust, with its indispensable social function, naturally forms part of this order. From a legal ethics perspective, the law protects trust to uphold the freedom and security of trustworthy transactions. If reasonable trust is not safeguarded, individuals will lose predictability in their actions, leading to uncertainty, diminished confidence in the future, and ultimately, a decline in societal security and stability. Karl Larenz also contends that trust protection aligns with the stabilizing function of the legal system and is a fundamental requirement of legal order <sup>[3]</sup>. The German Civil Code emphasizes that trust must be broadly maintained as a foundation for interpersonal relationships, enabling peaceful coexistence even in loosely structured communities. Furthermore, the principles of trust, mutual respect, self-determination (private law autonomy), and self-discipline collectively form legitimate legal principles. “Promoting trust and protecting legitimate trust are among the most basic requirements that legal order must fulfill” <sup>[4]</sup>.

## **2. Conditions for the application of the “normal business buyer rules”**

### **2.1. Normal trading of inventory: an objective basis for reasonable trust**

The rationality of trust primarily refers to whether there is a reasonable basis for the trust placed by the trusting party. This reasonable basis is derived from the apparent facts that allow the trusting party to form a judgment and develop trust. The function of apparent facts is to convey accurate information. Trust can be deemed reasonable only when the information conveyed by these apparent facts is sufficient and free from defects that could raise doubts <sup>[5]</sup>. From this perspective, the determination of reliable rationality is centered on apparent facts. These apparent facts may lead others to form a definite understanding that does not align with the actual state of the right, thereby shaping behavioral expectations for the trusting party. However, not all apparent facts provide a legal basis for trust. Trust is justified only when the apparent facts generally reflect the true state of the right. If certain facts lead to an understanding that deviates from reality, but the likelihood of this deviation is low, the trusting party has a duty to further verify the authenticity of the facts. Additionally, some facts may be inconsistent with common societal understanding, making it easy for anyone to distinguish the truth and recognize that the appearance is unreliable. In such cases, the trust generated is not reasonable. Accordingly, the appearance of the right is essentially an inference

based on general social experience and the facts that give rise to this appearance <sup>[6]</sup>.

## **2.2. The buyer's subjective good faith: The subjective orientation of reasonable trust**

The question of whether the “normal business buyer rules” system, as established in Article 404 of the Civil Code and Article 56 of the Interpretation of the Guarantee System, should be included has been a topic of considerable debate in academic circles. However, this issue can be resolved by examining the “normal business buyer rules” from the perspective of trust protection. Good faith is an evaluative concept that reflects the cognitive state of a private law subject. It refers to the trusting party's belief that the apparent facts are consistent with reality <sup>[7]</sup>. In essence, the question of whether trust is reasonable and whether the trusting party acted in good faith are essentially the same—they both concern whether the trusting party exercised sufficient caution before placing trust. If a fact is evidently unreliable—meaning the inconsistency between its appearance and reality is obvious—then the trusting party cannot claim ignorance of this inconsistency, and their trust cannot be regarded as having been made in good faith.

## **2.3. The mortgagee's risk liability: The principle of liability determination**

Trust, as a core element of trust protection theory, plays a crucial role in the application of trust protection rules. However, identifying and evaluating trust can only explain why trust is worth protecting and why it gives rise to a right to claim; it does not clarify why the consequences of trust should be borne by the counterparty. Carnaris, a leading scholar in German trust protection theory, argues that the general requirements of apparent rights responsibility (also known as active trust protection responsibility) must include the attributability of the liability holder <sup>[8]</sup>, in addition to the appearance of the right, the trusting party's good faith, and the presence of trust. The inclusion of attributability ensures that the interests of the responsible party are not unjustly deprived and that they have an opportunity to prevent adverse legal consequences for themselves. This approach allows trust protection and the responsible party's freedom to coexist. Professor Xinyan Ma summarized these principles in what is known as the “ABC Trust Law”: when the apparent trust (C) demonstrated by B can be attributed to A, A must bear the responsibility of trust, thereby ensuring that legal fairness is upheld <sup>[9]</sup>.

## **3. The legal effect of the “normal business buyer rule”**

### **3.1. The buyer obtains unencumbered ownership**

According to Article 404 of the Civil Code, the legal effect of the “normal business buyer rule” is that the mortgage cannot be enforced against a buyer engaged in normal business activities. To clarify, “non-confrontation” refers to the inability to pursue mortgage claims rather than the elimination of the mortgage itself <sup>[10]</sup>. Some scholars argue that applying the “normal business buyer rule” results in the complete elimination of the chattel mortgage. However, this interpretation conflates two distinct concepts—mortgage elimination and the inability to enforce mortgage

claims—and lacks both legal and doctrinal support. In fact, cases involving mortgage elimination (such as the extinguishment of the principal creditor’s right or the creditor’s voluntary abandonment) do not align with this rule<sup>[11]</sup>. In legal interpretation, “non-confrontation” simply means that the chattel mortgage does not hold legal effect against a specific party. An unregistered chattel mortgage cannot be enforced against a third party, but this does not imply that the mortgage ceases to exist or is extinguished. While the mortgagee cannot exercise the right to pursue the buyer engaged in normal business activities, this does not preclude the mortgagee from asserting claims—such as demanding the transfer price from the mortgagor—based on the mortgage right. An excessively broad interpretation of “non-confrontation” would unjustly diminish the mortgagee’s interests, leaving their rights inadequately protected and difficult to remedy, which is legally unsound<sup>[12]</sup>.

The core effect of the “normal business buyer rule” is to sever the enforceability of the chattel mortgage. In this context, a buyer engaged in normal business activities acquires unencumbered ownership, and the mortgagee loses the right to reclaim the movable property. However, if the buyer’s acquired property is auctioned or resold, the mortgagee may still claim priority in compensation from the proceeds. It is important to note that Article 404 of the Civil Code specifically applies the “normal business buyer rule” to chattel mortgages. However, Paragraph 2 of Article 56 in the Judicial Interpretation on the Guarantee System expands the applicability of this rule beyond chattel mortgages to include ownership-retention sales and financial lease transactions. Consequently, both the buyer in an ownership-retention sale and the lessee in a financial lease transaction are brought under its protection<sup>[13]</sup>. The Civil Code not only partially incorporates the functional concept of guarantees but also extensively discusses the nature of ownership within secured transactions involving ownership-retention sales and financial leases. Different interpretations of ownership can lead to varying legal conclusions. Taking ownership-retention sales as an example, if the seller’s retained ownership is considered true ownership, and the buyer transfers the goods without authorization, the legal basis for the buyer to obtain unencumbered ownership would fall under the bona fide acquisition system of Article 311 of the Civil Code. Conversely, if the seller’s retained ownership is functionally equivalent to a security right, then ownership-retention sales resemble chattel mortgage arrangements and should follow the provisions of Article 404 of the Civil Code.

### **3.2. Risk distribution between the mortgagee and the buyer**

In a broad sense, the legal effect of the “normal business buyer rule” should not only allow the buyer to acquire ownership of the chattel free from encumbrances but also include the mortgagee’s right to relief<sup>[14]</sup>. The application of the risk principle serves only to allocate risk between the real right holder and the trusted subject. The mortgagee’s non-interest state is a consequence of risk rather than a legal responsibility in the strict sense, similar to how an apparent agent bears an obligation only to themselves. Compared to the real right holder, the apparent right holder clearly assumes actual liability. The trust protection theory primarily addresses the initial allocation of liability between the buyer and the real right holder, while the latter must ultimately seek liability claims against the apparent right holder based on the fundamental legal relationship. Current academic criticism of the legislative expansion of the “normal business buyer rule” mainly focuses on its potential negative systemic effects. For instance, Professor

Hailin Zou argued that expanding this rule disrupts the structured framework of mortgage enforcement and effectiveness, potentially undermining the institutional foundation of chattel mortgage guarantees. While this paper acknowledges the validity of such concerns, it does not agree that legislative progress should be impeded solely due to negative systemic effects. By enhancing the relief mechanisms available to the real right holder, these adverse effects can be effectively mitigated <sup>[15]</sup>.

## 4. Conclusion

Similar to foreign legal frameworks, the “normal business buyer rule” in the Civil Code is fundamentally based on the principle of trust protection. However, a key distinction lies in the fact that the Uniform Commercial Code of the United States and the United Nations Commission on Trade Law explicitly stipulate that security interests automatically extend to the income generated from the secured property, thereby ensuring logical trust protection for the buyer. In contrast, under Chinese law, the application of the “normal business buyer rule” necessitates additional protection for the mortgagee. This stems from the prevailing legal stance that security interests in chattel do not automatically extend to the income derived from the collateral, making it difficult to safeguard mortgagee interests within the framework of the “normal business buyer rule.” The realization of secured creditor rights is the mortgagee’s primary concern. While trust protection and transaction security are important, they should not come at the undue expense of the mortgagee’s rights. Excessively prioritizing local efficiency at the cost of overall systemic benefits may weaken the practical viability of the chattel mortgage system, leading to undesirable outcomes.

Transaction orders can emerge either spontaneously or through legal regulation. In American law, the “normal business buyer rule” acknowledges and upholds existing market practices. Article 404 of the Civil Code of China must take into account the social and economic conditions that underpin foreign legal provisions to avoid conflicts in adaptation. The property law implications of collateral transfer must be carefully considered. Since the Civil Code does not recognize the automatic extension of chattel security interests, and mortgage enforcement mechanisms remain insufficient to fully protect the mortgagee, the application of the “normal business buyer rule” must align with the practical realities of the chattel mortgage system. It must also adequately address the mortgagee’s interests. Regarding the composition of the “normal business buyer rule,” the definition of the buyer’s subjective good faith should be refined in accordance with the interpretation of apparent rights. Additionally, mortgagee liability should be incorporated as a factor in the system’s design to balance the buyer’s reliance interests with the broader legal framework.

## Disclosure statement

The author declares no conflict of interest.

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