Book Chapter

Purpose, content and implementation of the Hague Convention on Trusts : contracting States' room for manoeuvre

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Purpose, content and implementation of the Hague Convention on Trusts: Contracting States' room for manoeuvre

von
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Content

This introductory contribution to the present symposium is not and cannot serve as a full presentation of the 1985 Convention on the law applicable to trusts and on their recognition, prepared and signed under the auspices of the Hague Conference on Private International Law.[1] Others have done so, in various formats and languages; readers are referred to the books and articles listed below in our bibliographical notice.[2] Our aim is merely to outline the Convention's *Regelungstatbestand und Spielraum*, in other words its object and essential contents as well as the latitude enjoyed by Contracting States in defining the extent to which they are willing to give effect in their domestic legal system to trusts validly created under and governed by some other national law.

I. Trusts: the need for global recognition

Trusts are the children of equity, this unique body of rules and principles developed over a long time by specialised courts in the classic English legal system. One could describe equity as an organised system of remedies available to parties where common law cannot redress some wrong. Even though legal and equitable remedies are now administered by the same courts in England and other jurisdictions derived from English law („the common law family"), trusts have retained unique features, including what is generally described as the splitting of legal title or ownership, vested in the trustees, and equitable property or interests, vested in the beneficiaries. Both legal title and beneficial ownership are property rights, overlapping as to their object, the trust fund, but are governed by different rules and priorities.

It is therefore not surprising that legal systems that are not derived from English law or deeply infused by its principles, have not naturally developed trusts in this specific meaning. Obviously, the practical need to separate legal control from beneficial interest in a number of situations is perceived in most if not all jurisdictions and has produced a variety of institutions and vehicles – foundations, corporations, *fiducies* and *Treuhand*, etc. – having a closer or

1 See the full text of the Convention at http://www.hcch.net/e/status/stat30e.html.

2 See below at page 24.

more remote functional and structural similarity with trusts.[3] One often speaks of trust-like institutions, which suggests that they should be likened to trusts, while emphasising that they are different in respect of their legal structure as well as some of their properties and functions.

By virtue of their geography and history, some civil law jurisdictions are so close to common law that trusts have quite naturally become absorbed into them: this is the case, to varying degrees, of Scotland, South Africa, Louisiana, and Quebec, to mention the most prominent among them. For a number of reasons, several other non-common law jurisdictions have deliberately created their own form of trusts by an act of parliament: Liechtenstein, Panama, Japan, and Israel are notable examples.[4] In some of the largest jurisdictions of the Roman-Germanic tradition neither development has yet occurred: this is the case of France, Germany, Italy, Spain, etc., and also Switzerland.

Such a disparate world does not ensure an adequate level of recognition of trusts by non-trust legal systems. The need for better global recognition has increased with the mobility of people and capital, of lawyers and legal models. Trust is not only the vehicle of choice for many who wish to optimise the legal and tax structure of their wealth in their own and their family's interest. Some of the largest investment funds and pension funds are trusts. For trustees and management companies, investing these assets in foreign capital markets requires at the very least the assurance that the trusts' main features will be adequately recognised and enforced in all relevant jurisdictions. Without such legal certainty, capital markets of non-trust countries might find it difficult to attract or retain institutional investors on which they are increasingly dependent.

II. Purpose of the Convention

A legal system need not have developed its own trust or trust-like institution to adequately recognise trusts created under foreign laws. Rules of conflict can achieve this even in the absence of parallel domestic, substantive rules.

3 See D. HAYTON (ed.), Extending the Boundaries of Trusts and Similar Ring-Fenced Funds, The Hague, etc. Kluwer Law International 2002.

4 To get a large overview of common law and non-common law jurisdictions having some trust legislation, see M. LUPOI (ed.), Trust Laws of the World: A collection of original texts, 2 volumes, Rome: ETI 2000.

However, legal systems that have not developed their own trust law have generally failed to develop conflict rules specifically aimed at trusts. Insufficient knowledge of trusts and the difficulty of designing adequate rules of conflicts for a legal entity that is not well understood account for the lack of appropriate private international law rules on trusts in non-trust jurisdictions.

In this context, international instruments such as the Hague Convention on Trusts are the preferred means of introducing meaningful rules on the conflicts of laws and conflicts of jurisdictions. By creating uniform private international law they enhance legal certainty and facilitate cross-border transfer and investment of trust funds, the protection of trust beneficiary resident in non-trust jurisdictions, as well as the provision of trust services in non-trust jurisdictions.

Switzerland has already taken a step in this direction by ratifying the 1988 Lugano Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters.[5] In addition to the trustee's domicile, its articles 5(6) and 17(2) and (3) recognise within limits the jurisdiction of the courts of the place „in which the trust is domiciled" as well as the ones designated in the trust deed. It should be remembered however that, subject to a few exceptions, the Lugano Convention only applies to claims brought against a defendant residing in a Contracting State, thus excluding all actions against residents of the many trust jurisdictions that are not parties to that Convention.[6]

By contrast, the 1985 Hague Convention deals with conflict of laws, not conflict of jurisdictions. It applies *erga omnes* unless Contracting States want to restrict its application in accordance with Article 21, which none has done yet. Its purposes are set out in Article 1, which declares that the Convention „specifies the law applicable to trusts and governs their recognition." More specifically, the Convention:

- defines trusts for the purposes of its application,
- recognises the choice of law made by the settlor in the trust instrument,

5 SR/RS 0.275.11. SR/RS refers to the Systematic Collection of Federal Laws, accessible at www.admin.ch/ch/f/rs/rs.html in Switzerland's three official languages (German, French and Italian).

6 See G. KAUFMANN-KOHLER, Convention de Lugano et contentieux bancaire, in: Journée 1995 de droit bancaire et financier, Berne: Stämpfli 1995, 67-72.

- lists four criteria to be considered in determining the proper law of the trust absent a valid choice of law,
- defines the scope of the proper law of the trusts and lists the effects of a trust that every Contracting State must recognise as a minimum, and
- allows Contracting States to safeguard the integrity of their legal system by limiting in a number of ways the effects of a trust that would contradict mandatory rules and principles.

One might have the impression that the Convention unilaterally benefits trust jurisdictions by ensuring the recognition of trusts in non-trust jurisdictions. This however is not quite the case. First, as we shall see, the Convention defines trusts in such a way that trust-like vehicles may qualify and thus benefit from the same recognition as trusts in the Contracting States. Swiss investment funds and most probably the fiduciary operations of Swiss banks would qualify as trusts under the Convention. Second, the Convention is a significant help for trust jurisdictions too because, strange as it may seem, conflict rules vary greatly across traditional trust countries. One should thus not wonder that all of them, barring the United States, have signed and ratified the Hague Convention.[7]

There is no doubt however that the chief purpose of the Convention is to allow non-trust legal systems to identify trusts and recognise their proper effects through the incorporation of specific rules on conflict. Because the Convention is mainly directed at these States, their preoccupations have, in turn, had a significant impact on the extent of exceptions and reservations available to limit the effects of trusts which were perceived, rightly or wrongly, as a threat to their fundamental institutions. It has often been said that the Convention takes three steps forward and then two steps back. It would be more appropriate to say that it allows the Contracting States to retreat partially if they so wish. The many options give significant leeway to every jurisdiction to which the Convention applies: choices can be made at the time of signature and ratification or later on by the courts when deciding cases. In making such choices, national legislatures and courts should be guided by two (sometimes conflicting) principles: the need to protect one's own fundamental principles such as the protection of creditors

7 Australia, Canada (all provinces except for Quebec), Hong-Kong, and United Kingdom.

or heirs, and the need to enhance legal certainty and predictability as to the recognition of the effects of trusts.

III. A broad definition of trusts

For the purposes of the Convention, Article 2(1) defines trusts as

> „the legal *relationships* created – *inter vivos* or on death – by a person, the settlor, when assets have been placed *under the control of a trustee for the benefit of a beneficiary or for a specified purpose.*"

Placing assets under the control of someone for the benefit of someone else is a very broad definition that would apply not only to trusts, but also to a number of contracts as well as to foundations or corporations, to cite but a few examples. Article 2(2) then narrows don that definition by listing three characteristics that a legal institution must meet to qualify as a trust for the purposes of the Convention:

> „*a)* the assets constitute a *separate fund* and are not a part of the trustee's own estate;
>
> *b)* title to the trust assets stands *in the name of the trustee* or in the name of another person on behalf of the trustee;
>
> *c)* the *trustee has the power and the duty*, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law."

Article 3 limits the scope of the Convention to „trusts created voluntarily and evidenced in writing", though Article 20 allows Contracting States to extend it to „trusts declared by judicial decision", which includes implied, resulting, and constructive trusts.

The Convention thus defines trusts functionally – assets are placed under the control of A for the benefit of B – and structurally – a separate fund, in the name of the trustee who has powers and duties in respect of these assets. Commentators were quick to note that the definition in Article 2 is much wider than that of a typical Anglo-American trust. It does not rely on the legal title/ beneficial ownership model. It allows for the relationship to be created by way of a contract between settlor and trustee rather than by way of a unilateral transfer of property from settlor to trustee, as is definitional in the Anglo-

American tradition. Professor Maurizio Lupoi, of Genova, made only a slight exaggeration when speaking of a „shapeless trust."[8]

Although no one could teach the law of trusts by relying on this definition, the drafters' choice was necessary and fortunate. While the 1980 U.N. Convention on Contracts for the International Sale of Goods can be applied in 61 jurisdictions (at present) even though it does not define the sale of goods as such,[9] the 1985 Convention on Trusts cannot be applied so widely for the simple reason that some of its Contracting States do not have any domestic definition of trusts. Indeed, no commentator challenges the necessity of an autonomous definition of trusts in the Convention itself. It was wise nonetheless not to characterise trusts by reference to the Anglo-American model. Using notions such as equitable rights, interests, or remedies, would almost inevitably have failed in civil law jurisdictions where the mere distinction between legal and equitable interest is not only unknown, but appears to contradict head-on the *numerus clausus* of property rights principle. Only a definition using words and notions not overburdened with domestic legal connotations can be applied with some consistency in trust and non-trust jurisdictions alike.

This „open definition" of trusts has an additional advantage in that some trust-like institutions are eligible for the application of the Convention, attenuating the uneasy feeling in some quarters that „common law countries export their trusts to reluctant civil law jurisdictions".

Swiss investment funds (*fonds de placement, Anlagefonds*) created under the 1994 Act[10] are trusts as defined by Article 2: the assets of the fund are placed under the control and in the name of the management company for the benefit of investors; each fund is separate from all other funds managed by the same company and from the company's own assets; and the management company has the powers and the duty to administer, employ, invest and dispose of the fund assets in accordance with the terms of the collective management contract.[11]

8 M. LUPOI, Trusts: A Comparative Study, Cambridge University Press 2000, 331 ff., referring to a article he had published previously.

9 SR/RS 0.221.211.1. However, a definition of sale (if not goods) can be inferred from its Art. 30 & 53.

10 SR/RS 951.31.

11 See particularly Art. 6, 7, 12 and 16 of the Act.

While assets held on a fiduciary basis by Swiss banks are not subject to comprehensive rules, they should also meet the definition set out in Article 2 of the Convention.[12]

IV. Determining the proper law of the trust

1. Principle: free choice of law

Article 6(1) recognises and enforces the choice of law made by the settlor in the trust instrument in these terms:

> „A trust shall be governed by the law chosen by the settlor. The choice must be express or be implied in the terms of the instrument creating or the writing evidencing the trust, interpreted, if necessary, in the light of the circumstances of the case."

Errare humanum est. If the law chosen by the settlor does not allow for the trust or type of trust she wanted to create, Article 6(2) refers to Article 7 as a fallback provision.

The freedom of the settlor to choose the law she wants to govern „her" trust seems as broad as the freedom to choose the law governing contracts in the current conception. This is however not quite so if one looks ahead at Article 13, which reads:

> „No State shall be bound to recognize a trust the significant elements of which, except for the choice of the applicable law, the place of administration and the habitual residence of the trustee, are more closely connected with States which do not have the institution of the trust or the category of trust involved."

Here is one clear concession by the drafters to the fears of non-trust jurisdictions that trusts, like Trojan horses, might be used to compel national courts to give effects to purely or mostly domestic operations that would be unenforceable had

12 When a bank is insolvent, Art. 37b of the 1934 Federal Act on Banks (SR/RS 952.0) mandates that fiduciary assets as defined in Art. 16(2) („movable goods, securities and claims which the bank holds on a fiduciary basis for the depositing customer") be set aside from the bankruptcy and delivered to their beneficiaries; such assets are thus not available to the bank's general creditors. Fiduciary operations of banks are not subject to comprehensive regulation. Self-regulation merely sets out minimal contractual terms for fiduciary *deposits* and requires the bank to protect them against set-off from third parties, see the 1993 recommendation and model-contract of the Swiss Bankers Association at www.swissbanking.org under Self-regulation/Guidelines.

they not been shaped as trusts for the only purpose of taking advantage of the Convention's liberal principles. Article 13 is a powerful and dangerous provision; its application might substantially hamper the predictability the whole Convention tries to create.

First, it is difficult to conceive why one should be against recognising a trust that is compatible with the public policy (*ordre public*) of the forum,[13] its *lois de police* and all mandatory provisions of the many laws applicable under a title different from the trust (capacity, inheritance, matrimonial property, creditors protection in enforcement proceedings, etc.).[14] When all those safeguards have been cleared, it is difficult to admit that the forum has a legitimate interest not to recognise a given trust.

Second, and in addition to the above, if the application of Article 13 is left for the courts to decide, it creates a significant legal uncertainty and takes away a substantial degree of the predictability that the Convention should create. Indeed, it allows courts not to recognise the effects of a trust even if it meets all the legal constraints set out by the law of the forum. The reasons why Article 13 should nonetheless be used by Courts in particular cases lack all predictability.

This is why the choice whether and when to apply Article 13 should not be made by the courts *ex post factum*, but by the legislator *ex ante*. Trusts that are too closely connected with the forum should either not be recognised as a rule, or be recognised outright. For example, the United Kingdom decided that it does not want to apply Article 13 and thus deliberately left it out of the Schedule to the Recognition of Trusts Act 1987.[15]

Italy was the first „civilian" State to ratify the Convention. Italian courts have adopted a very liberal approach to the use of (foreign) trusts in purely domestic situations, so much so that Professor Lupoi suggests that Italy has created a *foro interno*. The deleterious effects of *not* applying Article 13 have not been proven in fact, either in Italy or in the Netherlands, which followed suit in 1995. But the risk in maintaining the possibility of its application strongly frustrates the need for legal certainty. This is why I have suggested elsewhere that Switzerland's

13 Article 18 of the Convention.

14 Articles 15, 16 and 18 of the Convention are discussed below under V.2. and 3.

15 The Schedule contains the provisions of the Convention that „shall have the force of law in the United Kingdom." See section 1(1) of Recognition of Trusts Act 1987.

ratification of the Convention should include a domestic provision clearly ruling out the application of Article 13.[16]

2. Fallback: the closest connection test

Trust deeds are difficult instruments which are normally drafted by skilled practitioners who will always include a choice of law clause in accordance with Article 6. Nonetheless, it sometimes happens that the trust instrument does not contain such a clause or contains a clause that is ineffective because it designates a law that does not allow for the creation of such trust.[17] Switzerland has not produced many reported cases on trusts until now, but its most famous one is certainly *Harrison v. Schweizerische Kreditanstalt* (1971) where the Federal Tribunal, Switzerland's highest court, had to deal with a settlement by a U.S. citizen whose deed did not include a choice of law clause.[18] Default conflict rules lead to the application of Swiss substantive law, which notoriously does not contain any provision dealing with trusts. Nevertheless, in order to comply with Mr. Harrison's intent as far as legally possible, the Court converted the invalid trust into a valid contractual patchwork of donations for the benefit of third parties with fiduciary substitution. The example shows the need for a default rule of conflict when the settlor has not (effectively) made a choice of the proper law of the trust.

Article 7 of the Convention relies on the „most closely connected" test. Paragraph (2) fails to set out a strict, univocal rule. It provides guidance through the following language:

> „In ascertaining the law with which a trust is most closely connected reference shall be made in particular to –
>
> *a)* the place of administration of the trust designated by the settlor;
>
> *b)* the situs of the assets of the trust;

16 See the draft Art. 149b(2) of the Private International Law Act below at page 28.

17 See Article 6(2) of the Convention.

18 BGE/ATF 96 II 79, translated into French and discussed by C. REYMOND in Journal des Tribunaux 1971 I 329, discussed by F. VISCHER in Annuaire suisse du droit international/Jahrbuch für internationales Recht 1971, 223 and by P. LALIVE in Journal du droit international 1976 695.

> *c)* the place of residence or business of the trustee;
>
> *d)* the objects of the trust and the places where they are to be fulfilled."

Critical comments have underlined the lack of predictability resulting from Article 7. This cannot be denied but it should not be overstated either. Given usual drafting practices, Article 7 should apply only in rare, pathological situations. In addition, the default conflict rule for trusts is a notorious pitfall for which even the legal systems to which the trust is native have not managed to develop a fully satisfactory test.

3. Splitting and modifying the proper law

The liberal approach taken by the Convention and its *favor validitatis* are reflected in two additional self-explanatory provisions.

Article 9 reads:

> „In applying this Chapter a severable aspect of the trust, particularly matters of administration, may be governed by a different law."

Article 10 states:

> „The law applicable to the validity of the trust shall determine whether that law or the law governing a severable aspect of the trust may be replaced by another law."

4. Scope of the proper law

The law applicable to a trust „shall govern the validity of the trust, its construction, its effects, and the administration of the trust."[19] This includes in particular:

> „*a)* the appointment, resignation and removal of trustees, the capacity to act as a trustee, and the devolution of the office of trustee;
>
> *b)* the rights and duties of trustees among themselves;
>
> *c)* the right of trustees to delegate in whole or in part the discharge of their duties or the exercise of their powers;

19 Article 8(1) of the Convention.

d) the power of trustees to administer or to dispose of trust assets, to create security interests in the trust assets, or to acquire new assets;

e) the powers of investment of trustees;

f) restrictions upon the duration of the trust, and upon the power to accumulate the income of the trust;

g) the relationships between the trustees and the beneficiaries including the personal liability of the trustees to the beneficiaries;

h) the variation or termination of the trust;

i) the distribution of the trust assets;

j) the duty of trustees to account for their administration."[20]

5. The rocket and the satellite

Article 4 of the Convention is worth a special mention. It reads:

> „The Convention does not apply to preliminary issues relating to the validity of wills or of other acts by virtue of which assets are transferred to the trustee."

It is a truism to state that for a trust to exist, it must meet the requirements of its proper law. This however may not be sufficient to create a valid trust. Since a trust requires the assets to be placed „under the control" and „in the name" of the trustee, a valid disposition of these assets to the trustee is necessary. Depending on the nature of the assets (money, securities, real estate, etc.), the disposition may be governed by a law other than the proper law of the trust. This may be the case when, for example, the *lex rei sitae* governing the disposition is different from the proper law of the trust. It is also the case for testamentary trusts when the *lex successionis* governing the will of the settlor and its estate upon death is not identical with the proper law of the trust.

The drafters of the Convention have used the metaphor of the rocket and the launcher.[21] There might be some technological misunderstanding, since rockets *are* launchers. But the metaphor remains apt at describing the relationship between the disposition of the asset and the creation of the trust, as well as the relationship between their respective proper laws: a testamentary trust cannot be

20 Article 8(2).

21 See A. von OVERBECK, „Explanatory Report", in Proceedings of the Fifteenth Session, Tome II: Trusts – applicable law and recognition, published by the Hague Conference on private international law, The Hague 1985, p. 381 para. 53.

put into orbit without an effective will to launch it. If the disposition, testamentary or other, is invalid for any reason under its proper law, the trust will fail, even if the requirements of its own proper law were satisfied.

V. „Recognition“: enforcing the effects of trusts

Besides deciding which law should apply, most private international law conventions include standard provisions on public policy (*ordre public*) and mandatory provisions (*lois de police ou d'application immédiate, Eingriffs-gesetze*). Not so with the Convention on Trusts. Identifying the proper law and describing its scope in general terms would not have been sufficient guidelines for jurisdictions unfamiliar with trusts. Indeed, the drafters of the Convention considered that it required specific provisions as to which effects of trusts must be recognised and enforced by Contracting States as a minimum, and which ones may be set aside because they interfere with the application of some mandatory rule or principle. Thus, chapter III on „Recognition“ really deals with the effects of trusts in Contracting States, the minimum extent to which they must be implemented and the possible limits that may be imposed on them.

1. General principle

Article 11 states as follows:

> „[1] A trust created in accordance with the law specified by the preceding Chapter shall be recognized *as a trust*.
>
> [2] Such recognition shall imply, *as a minimum*, that the trust property constitutes a separate fund, that the trustee may sue and be sued in his capacity as trustee, and that he may appear or act in this capacity before a notary or any person acting in an official capacity.
>
> [3] *In so far as the law applicable to the trust requires or provides*, such recognition shall imply, in particular –
>
> *a)* that personal creditors of the trustee shall have no recourse against the trust assets;
>
> *b)* that the trust assets shall not form part of the trustee's estate upon his insolvency or bankruptcy;
>
> *c)* that the trust assets shall not form part of the matrimonial property of the trustee or his spouse nor part of the trustee's estate upon his death;

> *d)* that the trust assets may be recovered when the trustee, in breach of trust, has mingled trust assets with his own property or has alienated trust assets. *However,* the rights and obligations of any third party holder of the assets shall remain subject to the law determined by the choice of law rules of the forum."[22]

Underlining that trusts must be recognised as trusts implies that they should not be „converted", „adapted", or „translated" into some similar or parallel domestic institution. This should be obvious but it remains a tall order because of the very different understanding of property rights on which non-trust legal systems generally rely. The challenge that chapter III is answering is to allow the effects of trusts to be recognised and implemented as prescribed by the proper law in a jurisdiction where such effects may be unknown. Converting the trust into some equivalent domestic institution would most likely result in a regime substantially different from the regime under the proper law. This is why trusts should be recognised as trusts and not as something similar or equivalent.

Paragraphs (2) and (3), as well as Article 12, give substance to the „recognition of trusts as trusts" requirement of paragraph (1). They do so by mirroring Article 1(2). Since the „minimal" characteristics of trusts as defined in Article 1 are a separate fund, title to assets in the name of the trustee, and the power and duty of trustee to deal with these assets in his capacity, giving effects to trusts requires that the trust fund should be kept separate from other funds to the extent called for by the proper law, that the trustee may act, sue and be sued in respect of the assets, and that he should appear in such capacity in the registries where trust assets are listed or at least that the trust relationship should be reflected in such registers.

Paragraphs (2) and (3) are distinct only because the former makes a broad statement that should always apply to any trust qualifying under the Convention while the latter sets out certain effects – for example the immunity of trust assets from trustee's personal creditors – that most trust laws subject to certain restrictions. The key words in paragraph (3) are „in so far as the law applicable to the trust requires or provides": recognition of trusts in other jurisdictions should not go beyond the actual effects of the trust under its proper law.

A good illustration of this can be found in the very ingenious decision of a Zurich *Bezirksrichter* in the W.K. Rey bankruptcy proceeding, the single largest

22 Emphasis added.

bankruptcy in Switzerland before the failure of Swissair.[23] Rey controlled his Omni Group through two holding companies whose shares he wanted to keep from his creditors. He had therefore set up a Guernsey trust on these shares, which indeed did not prevent him from actually controlling every single aspect of the Group. When Rey's personal creditors tried to reach these shares to satisfy their claims, the district court in Zurich had to decide whether the shares in the holding companies were part of Rey's personal insolvency. The temptation would have been great to disregard the trust under which those shares were held as against Swiss public policy or a fraud to Rey's creditors. The Court did however accept that the settlement was an „organised estate" – a term of art in the Swiss current Private International Law Act of 1987[24] – and, as such, subject to the laws of Guernsey. By applying the *donner et retenir ne vaut* principle inherent in Guernsey law,[25] it went on to declare that Rey having consistently failed to behave in accordance with the trust he alleged to have set up, is was a sham trust that Jersey law would consider as ineffective. In the language of Article 11(3) of the Convention, the Court accepted that the trust assets were not assets of the settlor, but only „in so far as the law applicable to the trust requires or provides", which was not the case since Jersey law would not protect sham trusts.

However, Article 11(3)(d) includes a restriction. It starts with the principle that, to the extent provided for by the law applicable to the trust, trust assets alienated by the trustee or mingled with the trustee's own assets in breach of trust may be recovered. This equitable remedy, usually called asset tracing, is not unlike our own *droit de suite* (*Folgerecht*): it is enforceable against third parties. However, tracing of trust assets goes well beyond Articles 933 and 934 of our Civil Code in a number of ways, in particular because it is available to the trustee and the beneficiaries despite the fact that the trustee who disposed of the assets had legal title; under Swiss law, a disposition by the legal owner is valid even if made in breach of the owner's obligations towards beneficiaries. A major difference between asset tracing and *droit de suite* lies in the extent and depth of the tracing

23 Blätter für Zürcherische Rechtsprechung 98/1999 No. 52, 225 ff., at 228-234.

24 SR/RS 291.

25 *Donner et retenir ne vaut* was the foundation on which the Royal Court of Jersey declared a trust to be a sham in the (in)famous *Abdel Rahman v. Chase Bank Trust Co. Ltd.*, [1991] Jersey Law Reports 103. The Zurich court admitted that the same principle applies under the laws of Guernsey.

in spite of gratuitous acquisition by innocent third parties. To mitigate the liability of banks and securities houses with which trust assets are deposited, the drafters added a restriction by subjecting the liability of third party holders of trust assets „to the law determined by the choice of law rules of the forum.“

2. Public policy and lois de police

Like any other private international law convention, the 1985 Convention on Trusts reserves

- the public policy of the forum: *ordre public*, Article 18;
- the application of those provisions of the forum which must be applied even to international situations, irrespective of rules of conflict of laws: *lois de police* or *lois d'application immédiate, Eingriffsgesetze*, Article 16(1);
- the application in exceptional circumstances of similar provisions of another State which has a sufficiently close connection with the case, Article 16(2), unless a reservation was made in accordance with Article 16(3).

There is nothing very special in these exceptions. What is quite unique to this Convention is the catalogue of mandatory provisions listed in Article 15.

3. Other mandatory provisions

Trusts are such a powerful and flexible model that they are used in a number of situations where non-trust jurisdictions resort to entirely different rules and devices. To name just a few examples:

- trusts are favourite instruments of estate planning where civil law mostly resorts to dispositions *mortis causa* governed by the law of successions;
- trusts are often used as substitutes for our *contrats de mariage* (*Eheverträge*), obviously with significantly different effects on matrimonial property;

- the execution or administration of an estate upon death is mostly construed as legal trusts in trust jurisdictions, in stark contrast with the Swiss notion that a deceased's estate vests with her successors at the point of death while *exécuteurs testamentaires* (*Willensvollstrecker*) and other administrators act in a representative capacity rather than as owners of the estate;
- for similar reasons, our *administrateurs de faillite* (*Konkursverwalter*) have a status and powers quite different from trustees in bankruptcy.

In other words, whether it is on purpose or by way of collateral effects, the use of trusts may interfere significantly with institutions and principles that, from a conflict of laws perspective, are not subject to the proper law of the trust, but to some other law applicable under a different title (inheritance, matrimonial property, transfer of property or security interest, etc.).

This type of interference is a recurring phenomenon in trust jurisdictions and is not perceived as a major challenge in legal systems where trusts naturally developed alongside and gradually transformed other institutions. To the contrary, this kind of interference was perceived as a significant threat to the integrity of other legal systems, not only because trusts are unfamiliar, but also because any situation is subject to many rules and institutions that may be dramatically affected, so it is feared, by the collision with trust law. In non-trust jurisdictions, not only is there no previous experience with that type of conflict, but there may be substantive incompatibility between the principles governing trusts and domestic institutions.

Article 15 addresses this concern by acknowledging that giving effect to foreign trusts „does not prevent the application of provisions of the law designated by the conflicts rules of the forum, in so far as those provisions cannot be derogated from by voluntary act". It includes a non-exhaustive list of matters that may be governed by some other law than the law governing the trust, namely:

> „*a)* the protection of minors and incapable parties;
>
> *b)* the personal and proprietary effects of marriage;
>
> *c)* succession rights, testate and intestate, especially the indefeasible shares of spouses and relatives;
>
> *d)* the transfer of title to property and security interests in property;

e) the protection of creditors in matters of insolvency;

f) the protection, in other respects, of third parties acting in good faith."

Given the significant overlap between trust law and other matters on the one hand, and the meagre experience acquired thus far in most non-trust jurisdictions as to these conflicts on the other, Article 15 creates significant uncertainty about the effectiveness of trust recognition under the Convention and the extent to which the effects of trusts will be recognised and enforced. The fallback rule in paragraph (2) smoothes the edges of paragraph (1) but does not remove the uncertainty:

> „If recognition of a trust is prevented by application of the preceding paragraph, the court shall try to give effect to the objects of the trust by other means."

What can be done about this, except for relying on the wisdom of the courts which will be entrusted with applying the Convention? Legal authors may certainly be of help by studying some of the conflicts envisaged by Article 15 and offering solutions that courts might find sensible and workable. Some of these conflicts could even be the object of some solution or guidance from the legislator. In my report on the ratification, I have looked in some detail at the conflicts between the tracing of trust assets under trust laws and the limits characteristic of our law on property; one possible solution would be for parliament, at the time of authorising the ratification, to adopt a distinct set of rules distinguishing the scope of trust law from the scope of other mandatory provisions in some particularly sensitive areas within the broad limits of Articles 15, 16 and 18.[26]

Parliament, courts, and legal authors may all contribute to reducing the uncertainty resulting from the collision of trust law with the laws of non-trust jurisdictions. But a measure of uncertainty is unavoidable. The Convention on Trusts strongly affirms the recognition of trusts and provides a legal and intellectual framework to accommodate the effects of trusts in other legal systems. It is a major improvement to the current situation, in respect of principles and of many concrete problems as well, but it is not and could not be

26 L. THÉVENOZ, Trusts in Switzerland: Ratification of The Hague Convention on Trusts and Codification of Fiduciary Transfers, Zurich: Schulthess 2001, 255-274; see also IDEM, Risques et responsabilités des banques et des négociants dans les opérations avec des trustees, in: Journée 2000 de droit bancaire et financier, Bern: Stämpfli 2001, 155 ff.

the end of the long and interesting process through which Swiss law is learning to deal with an institution so different from its own .

VI. Room for manoeuvre – a call for action

At the end of this summary introduction to the Hague Convention on Trusts, it is important to keep in mind all the decisions that should be considered regarding the ratification of the Hague Convention on Trusts.

The Convention allows for a limited number of declarations and reservations. Switzerland should not be interested in excluding the exceptional application of foreign *lois de police* (Article 16), since taking account of them is expressly granted in Art. 19 of the Private International Law Act.

Switzerland should probably not extend the provisions of the Convention to trusts declared by judicial decisions, in particular to constructive trusts. Constructive trusts are remedies administered by courts to enforce tracing and liability against persons who have knowingly helped in the misappropriation of someone's property. Their consequences are far-reaching and their administration often very complex. Under Swiss law, the relevant remedies are (mostly) tortious damages, unjust enrichment, and disgorgement of profits (Art. 41 ff, 62 ff, and 423 of the Code of obligations). The conflicts between our remedial principles and constructive trusts are a largely uncharted area. Not extending the provisions of the Convention to constructive trusts does not exclude any recognition thereof, as illustrated by a recent decision of the Federal Tribunal.[27] However, enforcing constructive trusts in Switzerland should remain a matter of discretion rather than the object of an international obligation.

Though the Convention is meant to apply *erga omnes*, Article 21 allows a Contracting State to reserve the right to recognise the effects only of those trusts whose validity is governed by the law of a Contracting State. Such a reservation is of no interest for Switzerland, which needs adequate rules of conflict for trusts, whatever law is finally found to apply. Whether or not the proper law is the law of another Contracting State is irrelevant. Significantly, none of the seven Contracting States for which the Convention is currently in force has made use of Article 21. The same reasoning applies to the reservation set out in

27 Decision of 19 November 2001, 5C.169/2001, accessible at www.bger.ch.

Article 22(2) which allows restricting the application of the Convention to trusts created after its entry into force.

The latitude for decisions to be taken by the Federal Assembly when authorising the ratification is not restricted to the declarations and reservations contemplated by the Convention. Some adjustments to domestic laws are necessary, some others would be useful.

In my report on the ratification, I have advocated a small number of such statutory amendments that I shall mention here and have listed below[28] while referring the reader to the report for their motivation:

- The Civil Code gives an action for abatement (*action en réduction, Herabsetzungsklage*) to spouses whose rights on matrimonial property are affected and to heirs whose undefeasible share is being infringed upon by donations performed by way of a trust. The Code should clarify whether the trustee or the beneficiaries should defend the action and whether restitution could be allowed in value. The scope of the heirs' right to information against trustees and third parties should be regulated as well.
- Debt collection and bankruptcy proceedings are crucial moments when trustees or beneficiaries want to have trust property set aside so as to escape the reach of common creditors. The Convention contains the clear principle, subject to some exceptions under the applicable trust law and to the revocation of fraudulent dispositions (*révocation, Anfechtung*) under the law governing the enforcement or bankruptcy. When trust property must be set aside, the latter must also provide the ways and means by which the substantive rule can be enforced. The Debt Enforcement and Bankruptcy Act[29] should be supplemented so as to provide the practicalities (claimant, defendant, time limits, *prima facie* evidence).
- The Private International Law Act should include a rule on international jurisdiction on trust matters when the Lugano Convention does not apply. As I have suggested above, it should also include a clear rejection of Article 13 of the Convention by stating that Swiss courts and administrative agencies will not make use of it.

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28 See also the draft statutory amendments below at page 27 ff.

29 SR/RS 281.1.

- A substantive provision should also decide how the trustee is registered in the land, aeroplane, sea-going vessel registries and the like, or how the trust relationship must otherwise be mentioned.

My report to the Federal Office of Justice also includes a full draft codification of the Swiss *fiducie* or *Treuhand* in order to give it more scope and breadth, more flexibility and protection, so that it may compare more favourably with the many advantages perceived in trusts. Improving a domestic figure to give it a better chance when competing with trusts is an important effort but it is not a pre-requisite to ratifying the Convention.

Careful planning is strongly advisable: it requires a close look at the main areas of domestic laws where improved recognition of trusts will matter, as well as a careful consideration of the experience gained by Italy, the Netherlands, and Luxembourg in preparing and implementing their ratification of the Convention.[30] The many and valuable contributions to this conference are all part of this effort. But good analysis and preparation call for action, they do not replace it. Almost 20 years after the adoption of the Hague Convention on Trusts, Switzerland should make a choice and finally become part of it.

30 At the time of writing this report, the Luxembourg Parliament had not yet acted upon the ratification proposed by the Government.

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Appendix: Draft Statutory Amendments

Excerpts reprinted from: THÉVENOZ, Trusts in Switzerland: Ratification of The Hague Convention on Trusts and Codification of Fiduciary Transfers, Zurich: Schulthess 2001, 331-338.

Amendments to the Civil Code

Art. 208, new paragraph

3 The settlement of a trust during the settlor's lifetime shall be treated as a gift if the distributions provided for in the trust deed are in the nature of gifts to the beneficiaries

Art. 527, new paragraphs

2 The settlement of a trust during the settlor's lifetime shall be treated as a gift if the distributions provided for in the trust deed are in the nature of gifts to the beneficiaries.

Art. 528*a* (new) c. Trusts

1 In the case referred to in Article 527 paragraph 2, an action in abatement may be brought against each beneficiary in respect of the distributions he has received and against the trustee in respect of the trust property which the property still holds.

2 The trustee shall be entitled to make restitution of equivalent value.

Art. 533*a* (new)

1 Where an heir to an indefeasible share provides *prima facie* evidence of facts which, if proved, would be grounds for an action in abatement against a trustee or the beneficiary of a trust, the court can compel the trustee to supply the appropriate information and produce the necessary evidence. The court may also compel beneficiaries or depositories of the relevant assets to do likewise.

2 The duty of confidentiality binding lawyers, notaries, physicians, clerics and their assistants is reserved.

Amendment of the Federal Debt Enforcement and Bankruptcy Act

Art. 108*a* (new)c. Trusts

1 Where it is alleged that the property seized is subject to a trust, Art. 108 shall apply if this legal relationship is apparent to third parties. Otherwise, Art. 107 shall apply.

2 Standing to bring the action contained in Art. 107, par. 5, is granted to all trustees, beneficiaries and others persons to whom the rules applicable to the trust grant standing to claim the property in the possession of third parties. A person who learns that an action to trace property has been commenced, which he would have had the standing to initiate, may intervene if he does so within 30 days after he learned of the proceedings.

[3] Where there are several trustees, they shall jointly defend the action to trace property provided by Art. 108, par. 1. The debtor shall notify their identity and domicile or establishment to the Debt Collection Office. Any inaccuracy in this information shall not prejudice the claimant, who may at any time rectify the defendants' identities.

[4] Where the debtor is the sole trustee, any beneficiary may intervene in the proceedings within 30 days after he learned of the proceedings.

[5] In the action provided for in Art. 107, par. 5, and Art. 108, par. 1, the creditor can object to the action where the rules applicable to the trust recognise his right to satisfy his claim by realisation of the seized property.

Art. 242*a* (new) Trusts

[1] Assets subject to a trust shall be excluded from the estate in bankruptcy and returned to the other trustees or to a new trustee, after deduction of the bankrupt's claims against such assets.

[2] Where the conditions for such exclusion do not appear to be met, the receiver in bankruptcy shall grant the trustees a period of 20 days to bring an action to trace property before the courts of the bankruptcy forum. Art. 108*a*, par. 3, shall apply by analogy.

Amendment of the Swiss Private International Law Act

Chapter 9*bis*: Trusts and Fiduciary Transfers (new)

Art. 149*a* (new) I. Jurisdiction

[1] In actions concerning the validity, interpretation, effects, administration or alteration of a voluntary trust evidenced in writing, the courts designated for that purpose in the trust deed shall have exclusive jurisdiction.

[2] If no forum has been chosen, such actions may be brought before the Swiss courts at the trust's principal place of administration.

[3] [Where a fiduciary transfer is governed by Swiss law, and in the absence of another forum in Switzerland, such actions may also be brought before any Swiss court].

Art. 149*b* (new) II. Applicable Law

[1] Trusts are governed by the Hague Convention on the law applicable to trusts and on their recognition of 1 July 1985.

[2] Swiss courts or authorities shall not refuse to recognise a trust on the sole grounds that all significant elements of the trust, with the exception of the choice of law, are more closely connected to states whose legal systems do not contain trusts or the category of trust in question.

Art. 149*c* (new)

[1] In cases covered by Article 11, par. 3.d of the Convention, the law designated by Chapter II of the Convention shall determine the conditions on which the purchaser must restore the trust

asset or give up the right over the asset created by the trustee in breach of trust. This law shall also govern the repayment of any valuable consideration supplied by the purchaser.

[2] The law designated by the present law shall determine the subject and extent of restitution of the benefits and revenues of the asset, the sale proceeds, the reinvestments or equivalent value. This law shall also govern compensation for use and enjoyment as well as reimbursement of expenditure.

Art. 149*d* (new)

[1] In relation to property he owns or a right to which he holds title, a trustee shall have the power to require any inscription in the registers that provide notice thereof. He may require his status as trustee to be mentioned, or the existence of the trust to be made apparent in some other way.

[2] In the land, ship and aircraft registers, the existence of a trust shall be entered as a mention. The mention shall refer to the trust deed, an original or notarised copy of which shall be kept by the registrar as supporting documentation.