

Understanding Trusts: A Comparative View of Property Rights in Europe

Stathis Banakas

University Of East Anglia

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Abstract

This paper explains the unique features and functions of the Trust in English law in the light of the structure and style of English Property law, in contrast with Continental European legal systems, where the absence of the Trust is linked with the special principles and dogmatic structures of Property rights, as developed by the Pandektenwissenschaft from original Roman law sources, and from the old droit coutumier of the French North. The division of the powers and benefits of ownership that lies at the foundation of the Trust is shown to be historically and dogmatically untenable in Civil law systems. Moreover, the different historical evolution of sources of liability in Civil law and Common law systems is shown to have prevented institutions functionally similar to that of the Trust from emerging on Continental European soil.

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1. Introduction

Despite the Hague Convention of 1985¹ on the recognition of Trusts², all Civil law jurisdictions in Europe, except Italy and the Netherlands, and, with reservations, now also Luxembourg³, still refuse not only to accept the introduction of the Trust into National law, but even to recognise it as a valid concept for the purposes of Private International Law. Nevertheless, recent work for a restatement of a harmonised European Property law reveals functionally similar needs in Common law and Civil law countries, despite their historical and dogmatic differences, and adds to the evidence of the modern utility of the Trust in the commercial and business environment⁴.

The reasons for this state of affairs must certainly be not only purely legal dogmatic reasons⁵, but also practical, such as fear of an increase in debt and tax evasion⁶, and the factor of the unknown size of funds that may be put out of circulation by being settled in trusts. This paper is mainly about the former kinds of reasons, purely legal-dogmatic, that prevent Civil law systems from accommodating the institution of Trust.

¹ *Convention on the Law Applicable to Trusts and on their Recognition*, 1 July 1985, 1-VII-1985, online: Hague Conference on Private International Law, http://hcch.e-vision.nl/index_en.php?act=conventions.text&cid=59. See also J. HARRIS (2002), *The Hague Trusts Convention: Scope, Application and Preliminary Issues*, Hart Publishing, Oxford.

² Several common law countries have ratified the Convention, including the UK, and, in Asia, Hong Kong. Civil law countries that signed are: Italy (1985), the Netherlands (1985), France (1991), Luxembourg (1985), Cyprus (1998) and Malta (1994), but the Convention has been ratified so far in Continental Europe only by Italy (1990), Malta (1994), The Netherlands (1995), and Luxembourg (2003).

³ Newcomers to the EU Cyprus and Malta have also enacted versions of the trust, but in their case things are made easier by the fact that, as erstwhile British Colonies, they have been exposed for a long period of time in the past to the influence of the common law.

⁴ See M.GRAZIADEL, U. MATTEI and L. SMITH (2005), *Commercial Trusts in European Private Law*, Cambridge University Press; HAYTON D.J. et al.(1999), *Principles of European Trust Law* (Series Law of Business and Finance, Volume 1); Kluwer Law International / W.E.J. Tjeenk Willink, Deventer; Ugo MATTEI (2001), "Basic Issues of Private Law Codification in Europe: Trust", *Global Jurist Frontiers*: Vol. 1: No. 1, Article 5; Henry HANSMANN & Ugo MATTEI (1998), "The Functions of Trust Law: A Comparative Legal and Economic Analysis", 73 N.Y.U.L. Rev. 434; John H. LANGBEIN (1995), "The Contractarian Basis of the Law of Trusts" 105 Yale L.J. 625 at 640-643; Maurizio LUPOI (2000), *Trust: A Comparative Study* (Cambridge: Cambridge University Press); George G. TRIANTIS (2004), "Organizations as Internal Capital Markets: the Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises", 117 Harv. L. Rev. 1102.

⁵ See K. W. RYAN (1961), "The Reception of the Trust", 10 I.C.L.Q. 265; Vera BOLGAR (1953), "Why No Trusts in the Civil Law?", 2 Am. J. Comp. L. 204; Antonio GAMBARO (1984), "Problemi in materia di riconoscimento degli effetti dei trusts nei paesi di civil law", in *Rivista di Diritto Civile*, Vol. 30, p. 93. But see also: F. GUILLAUME (2000), "Incompatibilité du trust avec le droit suisse? Un mythe s'effrite", *Revue suisse de droit international et de droit européen*, No 1, p. 1.

⁶ For a French analysis of the practical problems of recognising trusts, see F. TRIPET (1989), *Trusts patrimoniaux anglo-saxons et droit fiscal français*, Paris.

2. *When is a trust a real trust?*

There is an ongoing debate as to what are the core elements of the Anglo-American concept of Trust, which is both the original, and the most advanced today, Trust concept⁷. But it is clear that the irreducible core of the Anglo-American Trust includes:

- (i) assets which form an estate or patrimony separate from that of the settlor or trustee, and unreachable for the spouse, other relatives or creditors of the trustee;
- (ii) trustees to administer and manage the assets for the benefit of a beneficiary or, in the case of charitable trusts, a beneficial purpose;
- (iii) a defined purpose other than the benefit of the trustee;
- (iv) a court or administrative authority with a supervisory jurisdiction that can be called on to intervene, at least if the beneficiaries or, in the case of charitable trusts the public interest represented by an official, so wish, to ensure that the trustees do their job properly in fulfilling the purpose of the Trust;
- (v) legal title of ownership vested in the trustee⁸;
- (vi) equitable or beneficial ownership vested in the beneficiary, with the right of tracing the assets in the hands of third parties;
- (vii) intentional trusts can be oral or even secret;
- (viii) constructive trusts may be imposed ex post facto by the courts on parties without their consent, most notably in the process of tracing trust property⁹;
- (ix) as the assets settled on trust are out of circulation, trusts cannot exist in perpetuity except charitable trusts so authorised by the State;
- (x) third parties who deal with the trustee in trust property acquire property interests only if they have purchased from the trustees directly for value and without notice (ie in good faith); if trust property has been passed on by the trustees to a third party without these conditions being present, subsequent purchasers are not protected against the beneficiary's undeclared equitable interest and will be holding such assets in a (constructive) trust for the benefit of the beneficiary, unless any such purchasers can show that they purchased bona fide and for value.

3. *The dogmatic resistance of civil law to real trusts*

The core content of Trusts as summarised above is indeed a toll order to accommodate in Civil law systems, the codes of which are based on basic property law principles such as:

⁷ See David J. HAYTON (1996), "The Irreducible Core Content of Trusteeship", in A. J. Oakley (ed), *Trends in Contemporary Trust Law*, Oxford; idem (2005), "The distinctive characteristics of the Trust in Anglo-Saxon law", in *Trust & Fiducie - la Convention de La Haye et la nouvelle législation luxembourgeoise*; Ed. Montchrestien, Paris, p. 1.

⁸ See e. g. J. MOWBRAY Q.C. et al (2000), *Lewin on Trusts*, 17th ed. (London: Sweet & Maxwell) [*Lewin on Trusts*] at 38-55. American Law Institute, *Restatement (Second) of Trusts* (St. Paul: American Law Institute Publishers, 1959), §17 [*Restatement (Second) of Trusts*].

⁹ See Lionel D. SMITH (1997), *The Law of Tracing* (Oxford: Clarendon Press)

- (i) the principle of numerous clausus of property rights, and the related principle of specificity of such rights;
- (ii) the principle of publicity of property rights, with registration (generally for rights on immovables) or possession (generally for rights on movables) being a necessary both substantial and evidentiary condition of vindicating property rights as enforceable against one and all;
- (iii) a single, all-embracing legal concept of ownership that cannot be compatible with another's all-embracing beneficial property right on the same thing, but only another's limited beneficial right (e.g. usufructus). All Civil law systems accept the basic definition of ownership by the Pandektenwissenschaft as the unlimited power of the owner, who is the person with legal title of ownership acquired in an original manner or succeeds in title the previous owner, to manage, enjoy and dispense freely of the thing that he owns, subject only to limited property rights of others¹⁰. Even when there are such limited property rights of others, however, when they become extinct the powers or uses that they occupied are automatically restored to the owner.

3.1. The principle of Numerous Clausus

The existence of this principle, which includes the principle of specificity, makes it impossible for Civil law systems to accept the almost infinite variety of voluntary Trusts that one finds in the Anglo-American legal systems. In a show of endless ingenuity, lawyers have devised several different forms of voluntary Trusts in the Anglo-American legal systems in order to offer, as Tony HONORÉ has put it¹¹, a device to circumvent any undesirable effect of the law without actually breaking it!¹²

In Civil law systems, the principle of numerous clausus and the specificity principle make it necessary for all new forms of property rights to be specifically introduced and regulated by the legislator, in harmony with the originally recognised rights in Civil Codes. Parties are not allowed to create new forms of property rights. This is, indeed, a basic difference between real rights and mere obligations that can be determined by the parties in the exercise of their freedom of contract. No such freedom is allowed in the case of defining real rights in property and property relations. It is, therefore, not surprising that in Continental Europe only the Dutch have

¹⁰ For the historical-cultural origins of this overwhelming approach to ownership in Civil law systems see, e.g., T.HONORÉ (1987), "Ownership" in *Making Law Bind*, p.160; T.BETHELL (1998), *The Noblest Triumph. Property and Prosperity through the Ages*, p.23.

¹¹ A. M. HONORÉ, "On Fitting Trusts into Civil Law Jurisdictions" [unpublished], online: Tony HONORÉ, <http://users.ox.ac.uk/~alls0079/preview.htm>.

¹² There are Trusts that are made to keep property or its proceeds in a family; to protect the weaker members of society even if (like drug addicts or alcoholics) they are not legally incapable; to safeguard the interests of creditors (debenture trusts); to enable shareholders to combine so as to exercise an influence proportionate to their joint shareholdings (voting trusts); to attract investors (unit trusts); to minimise tax liability (estate planning); to assemble the necessary finance for a building or engineering project (project finance trusts); to provide for the issue of shares or bonds to the public; to guarantee payment of a debt by transferring assets to be sold in the event of non-payment (trust indentures); to hold property in a convenient form; to provide for employees on retirement (pension trusts); to promote abstract purposes, whether truly charitable or not, so long as they are not purely political and economic.

been able to introduce a limited version of the Anglo-American trust¹³ in the new Civil Code of the Netherlands¹⁴. In Italy scholars like Professor Mauro LUPOI have successfully argued that the country does not need to enact Trusts in Italian law, since it can recognise foreign Trusts under the Hague Convention and apply the law of the place of settlement (in most cases English law)¹⁵. Luxembourg has adopted a similar approach¹⁶, and in Switzerland there are calls for a more open treatment of trusts¹⁷. But in France, an attempt to change the Code Napoleon in 1991 to include a fiduciary institution (*la fiducie*) failed¹⁸.

3.2. The principle of publicity of property rights

This principle is a major obstacle to the proper functioning of the Anglo-American trust. First, it prohibits the creation of oral or secret trusts. Secondly, it does not allow the beneficiary to trace trust property thus preventing the trust from offering real protection to beneficiaries. In Civil law systems it is both dogmatically and culturally unacceptable that a remote owner of assets may still have to surrender his rights to hidden proprietary interests of others, as is the case when the beneficiary traces trust property in the hands of a remote third party, who did not purchase for value and without notice from another who had colluded with the trustee, to dispose of trust property. In such cases, Anglo-American law will, moreover, impose a constructive trust on such remote third parties to keep the property for the benefit of the beneficiary, an obligation that goes far beyond any responsibility that Civil law rules of Unjustified enrichment may create. The tracing rule is, in fact, a rule completely alien to Civil law systems that are unable to proceed further applying the rules of unjustified enrichment for tracing the value of a benefit which does no longer exist.

The principle of publicity of property rights creates a presumption of ownership, which may be more or less hard to rebut for specific reasons related to the acquisition of title, in the case of immovables by the person registered as owner, and in the case of movables primarily by the person who holds the thing or assets. Only a third party with a valid reason to question the

¹³ But see also the islands of Malta and Cyprus that are, however, linked to English common law, above, note 4

¹⁴ *The bewind*. See KOPENNOL-LAFORCE (1998), M.E. *The Institution of Trust and Dutch Law; XVth International Congress of Comparative Law Bristol*, Netherlands report to Trusts i.s.m. R.P.J. Kottenhagen, ed. E.H. Hondius, *Intersentia Rechtswetenschappen*, p. 137-153. See also Rijn VAN ALKEMADE (1998), "Yes, the Dutch can tame the trust!", in *Weekblad voor Privaatrecht, Notariaat en Registratie*, No 6317, p. 361.

¹⁵ See M.LUPOI (1984), "The domestic Trust Theory is Upheld in Italy", 4 *Trusts and Trustees* 24; idem (1998), "Effects of the Hague Convention in a Civil Law Country", 4 *Trusts and Trustees* 15; idem (1997), *Trusts: A Comparative Study* (Milan, Giuffrè), translated by S DIX, (Cambridge, Cambridge University Press, 2001). On an attempt to legislate for Trusts in Italy, see P. MATTHEWS (2001), "New Draft Italian Trust Law"; 14 *Trust Law International*, 33.

¹⁶ See PRÜM, A., REVET, T. & WITZ, C (2005), "La ratification de la Convention de La Haye par le Grand-Duché de Luxembourg", in *Trust & Fiducie - la Convention de La Haye et la nouvelle législation luxembourgeoise*; Ed. Montchrestien, Paris, p. 53.

¹⁷ See THÉVENOZ, L. (2001), "Trusts en Suisse: Adhésion à la Convention de La Haye sur les trusts et codification de la fiducie", *Trusts in Switzerland: Ratification of the Hague Convention on Trusts and Codification of Fiduciary Transfers*; Schulthess, Zurich.

¹⁸ But see now the latest attempt by the French Senator Philippe MARINI to introduce a new law: *proposition de loi instituant la fiducie*, available at www.senat.fr See Sergio CÁMARA LAPUENTE (2005), "Trust a la francesa: las doce preguntas de siempre y un reto desesperado a partir de la proposición de ley de 8 de febrero de 2005 que instituye la fiducie", InDret, 2/2005.

validity of title can challenge this presumption. Therefore, the creditors of a person cannot, in principle, be excluded from any of his assets in a Civil law system, unless these assets were wrongfully acquired by him or he does not have real title for some other reason (e.g. seller or lender reserves title), in which case the assets may be, under certain circumstances, vindicated by another. This prevents the most important in practice result of the Anglo-American Trust from coming into effect, particularly valuable in a commercial context, but with considerable value also in a family or any other context. Namely, the separation of trust property from the trustee's own personal assets, whether the trustee is inherited by his heirs, sued by his creditors or divorced by his wife! Without this result, the Trust is deprived of one of its most essential social functions.

3.3. The principle of the unlimited powers of the legal owner

This principle not only is incompatible with any parallel unlimited beneficial ownership of another, as said above, but it also prevents Civil law systems from accepting the basic rule of court or administrative supervision of the trustee's management of trust property. In Civil law it is inconceivable that a legal owner would have to account to a third party through the courts for the way he manages, uses or dispenses of his property. Guardianship and Curatorship are limited exceptions of supervision of a person with powers to manage and dispense of property, but even in these cases the Guardian or Curator administers another's property for his benefit *not* as legal owner, but as protector of the other's interests, fulfilling the public interest in protecting minors, absent or incapacitated persons. Trustees are not only legal owners of the Trust assets, but also Trust officials accountable to the courts, and can be dismissed and replaced by the courts, or indeed directly appointed by the courts themselves as judicial trustees. Civil law entities such as foundations for a purpose, show similar features as directors of such foundations are treated largely as the trustees of Anglo-American law. But Civil law foundations for a purpose are themselves the legal owners of their assets; these assets are not transferred to the individuals responsible for their administration, as is the case with the Anglo-American voluntary trust, where Trust assets must be transferred to the trustees upon the creation of the trust (unless the settlor becomes himself the trustee, as said above).

The principle of the unlimited powers of the legal owner would also be contrary to the fundamental feature of the Trust that it exists for a purpose. This has led to the emergence of important modern rules of Anglo-American Trust law about the dissolution of Trusts. There is, first, a cardinal rule against perpetual trusts, necessitated by the need to avoid a perpetual withdrawal of valuable assets from circulation. Trusts must, therefore, be only temporary (except charitable trusts) and must come to an end, either according to the settlor's instructions or through judicial intervention, when the purpose of the trust has been fulfilled. And, second, the Anglo-American Trust has developed a rule that if all beneficiaries are adults and agree they can ask for the dissolution of the trust and for legal ownership to be transferred to them¹⁹. The trustee's legal ownership will, therefore, always be limited in time even if he is not dismissed or replaced, as said above. Such a limitation clearly runs contrary to the principle of the unlimited

¹⁹ Introduced in England by *Saunders v Vautier* (1841), Cr. & Ph. 240

powers of the legal owner in Civil Law systems. Temporary ownership is not consistent with this principle and cannot fit in the structure of Property law in Civil law systems.

3.4. No room for Equity!

Despite the existence of institutions that share some of the features of the Anglo-American trust, Civil law systems never developed a practice of another's equitable or full beneficial ownership of the same thing or assets, parallel to the legal ownership of the legal owner. In Anglo-American law, this practice emerged because historically and before the two jurisdictions of Law and Equity merged, the separate jurisdiction of Equity could not restore legal title to a person that had a valid claim in Equity on a thing, as such title could only be restored by courts of Law that by definition were unable to help (hence the need to come to the Equity courts). So, Equity courts would award an equitable right or interest, parallel to the legal right and eventually superior to it. In Civil law systems, institutions that have features of Trust are the Roman *fiducia* and the German *Treuhand*²⁰, but also traditional Civil law principles of Guardianship, Curatorship or administration of legacies (*fideicommissum*). However, none of these institutions recognise a parallel ownership of the person that administers the assets and the person for whose benefit he does so.

4. Conclusions

In the light of the above, it is clear that the introduction of an unadulterated version of the Anglo-American Trust in Civil law jurisdictions²¹ is impossible without a major overhaul of the dogmatic structure of their Property laws. Only watered-down variations may be possible, as shown not only by the example of the Netherlands in Europe, but, also, jurisdictions of mixed Civil/Common law traditions, Mexico and developed countries in Asia²². The Anglo-American Trust is the product not only of the unique historical evolution of Anglo-American law, but, also, the cultural and social ethos in the Anglo-American world that historically asserted the independence of private individual will against tight State control of social and personal affairs, to an extent far greater than in Civil law countries. The Trust institution, as has been noted by a distinguished scholar, '...alters the balance of power between the state and the individual'²³. But this can only work if individuals are willing to accept the (normally non-remunerated)

²⁰ See the classic study of H.COING (1973), *Die Treuhand kraft privaten Rechtgeschäfts*.

²¹ For a collective effort to reconcile differences and introduce a minimum core Trust concept in European legal doctrine see David J. HAYTON et al ed. (1998), *Principles of European Trust Law* (The Hague; London: Kluwer Law International). Differences and similarities are explored in the latest volume in the Trento Common Core of European Private Law project, M.GRAZIADEI, U. MATTEI and L. SMITH (2005), *Commercial Trusts in European Private Law*, Cambridge University Press. See also David J. HAYTON (2002), "Trusts and their Commercial Counterparts in Continental Europe", Report for the Association of Corporate Trustees (January 2002) [unpublished, available from tact@cooden.fsbusiness.co.uk]; David HAYTON (2004), "The Trust in European Commercial Life", *The Sir Roy Goode Commercial Law Lecture Series 2004*.

²² See David J. HAYTON ed. (1999), *Modern International Developments in Trust Law* (London: Kluwer Law International); Lusina HO (2004), "The Reception of Trust in Asia: Emerging Asian Principles of Trust?" in *Singapore Journal of Legal Studies*, 287-304.

²³ A. M. HONORÉ, "On Fitting Trusts into Civil Law Jurisdictions" [unpublished], online: Tony Honoré, <http://users.ox.ac.uk/~alls0079/preview.htm>.

responsibilities of the office of the trustee, and if society as a whole is prepared to place confidence in fiduciary relationships²⁴, beyond any safety that legal formalities can offer. The social and economic rewards of doing so are beyond dispute, as the success of the institution of Trust in common law countries and, to a certain extent also in Asia, has shown.

²⁴ There are great doctrinal difficulties in any introduction of fiduciary duties in civil law jurisdictions, as the debate about developments of Trust law in Asia shows: See Katharina PISTOR & Chenggang XU (2003), "Fiduciary Duty in Transitional Civil Law Jurisdictions—Lessons from the Incomplete Law Theory" in Curtis J. Milhaupt, ed., *Global Markets, Domestic Institutions: Corporate Law and Governance in a New Era of Cross-Border Deals* (New York: Columbia University Press), c. 3; Kon-Sik KIM and Joongi KIM, "Revamping Fiduciary Duties in Korea: Does Law Matter to Corporate Governance?", in Curtis J. Milhaupt, ed., *ibid.*, c. 11; Kideki KANDA and Curtis J. MILHAUPT (2003), "Re-examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law", Columbia Law and Economics Working Paper No. 219 (24 March 2003), online: Social Science Research Network, <http://ssrn.com/abstract=391821>.