

**Publications du Centre d'études juridiques européennes, Genève**

# **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**

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# **Trusts in Switzerland: Ratification of The Hague Convention on Trusts and Codification of the Law of Fiduciary Transfers\***

## **I. Introduction**

The Swiss legal system, courts and Swiss economic operators have increasingly frequent contacts with trusts validly constituted abroad. Owing to increased personal mobility, many citizens of Anglo-American states, although resident in Switzerland, choose their national law for succession purposes<sup>1</sup> and organise their succession wholly or partially by means of trusts constituted during the testator's lifetime (*inter vivos* trusts), or on his or her demise (testamentary trusts). Trustees acting in that capacity now control substantial assets deposited in Swiss banks. Furthermore, Swiss banks advise their foreign clients in this field and frequently offer trustee services through subsidiaries established in offshore jurisdictions.

However, the contacts between the Swiss legal system and foreign trusts are not limited to family trusts, established by wealthy individuals wishing to organise their assets, or for succession and tax planning purposes. Owing to increased capital mobility, Switzerland receives significant inflows of funds held in trust. Many foreign institutional investors (particularly pension funds) active in the Swiss capital markets are organised in the form of trusts. Numerous foreign investment funds are also organised as trusts: such funds are marketed in Switzerland and their units are purchased by Swiss private and institutional investors. In volume and in value these financial trusts far exceed family trusts.

Swiss companies and their subsidiaries, traditionally active abroad, also resort to foreign trusts in many circumstances. These include bond issues in a foreign market (indenture trusts), securitisation transactions (*e.g.*, as-

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\* Translated by Margaret Tschanz-Norton, Barrister-at-law.

<sup>1</sup> Federal Act on Private International Law of 18 December 1987 (the "SPILA"; RS 291) Art. 90 par. 2.

set-backed securities) and other financing transactions as well as staff pension plans.

The increasing importance of such trusts in international legal relationships connected to Switzerland highlights the lacunae in Swiss private international law, which does not include trusts.

Trusts are characteristic of Anglo-American property law and derive from the remedies granted over time by England's Lord Chancellor and equity courts in cases where the courts of common law did not protect certain promises, not binding in the strict legal sense. Trusts as such are unknown in Swiss law<sup>2</sup> and in the legal systems of most countries with a Romano-Germanic legal tradition<sup>3</sup>. Consequently, when a Swiss court must characterise a foreign trust according to the *lex fori*, to determine which chapter of the SPILA contains the applicable conflict rules, it must usually choose between characterising the trust as a contract<sup>4</sup> or as an organised estate (*patrimoine organisé, organisiertes Vermögen*)<sup>5</sup>, for which the legal consequences are substantially different. Nor does choosing one or the other resolve all difficulties – in particular the choice fails to define precisely the effects that Swiss law confers, within the Swiss legal system, on trusts – because the characterisation of a trust as a contract or a corporation remains an analogy and fails to take account of the trust's unique features. Although a scattering of Swiss legal texts recognise the existence of trusts<sup>6</sup>, the only rules of private international law specifically dedicated to the

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<sup>2</sup> ATF 96 II 79, *Harrison c. Crédit Suisse*, JdT 1971 I 329 obs. REYMOND, ASDI 1971 223 obs. VISCHER, *Clunet* 1976 695 obs. LALIVE: it is impossible to create a trust under Swiss law; the deed designed to ensure the maintenance over time of certain benefits to a spouse and descendants must be converted into a mixture of contract types (agency, fiduciary transfer of ownership, promise of gift and a third-party beneficiary clause).

<sup>3</sup> For historical reasons, owing to their extreme proximity (Scotland, Quebec), or their enclosure (Louisiana) within a common law geographic region, or British colonisation (South Africa), trusts infiltrated several Romano-Germanic legal systems, gradually earning a place among the civil law institutions familiar to civil lawyers. Motivated by practical considerations, mainly involving competition between legal systems, other civil law countries (Japan, Liechtenstein, Malta, various Latin American states) legislated to transplant a trust directly inspired by English law into their national legal systems.

<sup>4</sup> SPILA, Art. 112 *et seq.* See ATF 96 II 79, *Harrison*, mentioned in note 2.

<sup>5</sup> SPILA, Art. 150 *et seq.*; see SC 3.9.1999: SJ 2000 I 269.

<sup>6</sup> See, in particular, the decree of the Federal Council allowing protective measures for corporate entities, partnerships and individual businesses, of 12 April 1957 (RS 531.54), which enables Swiss companies to protect their assets from spoliation by a foreign power in time of war by establishing trusts (art. 18 *et seq.*).

concept are those contained in the Lugano Convention on Jurisdiction and the Enforcement of Judgements of 16 September 1988 (the “Lugano Convention”)<sup>7</sup>.

The absence of conflict rules specific to and adapted for trusts has created considerable legal uncertainty. This unpredictability is not new, as demonstrated by several decisions in cases dating from the nineteenth century<sup>8</sup>, which illustrate the Swiss courts’ difficulty in grasping the precise role of the trustee of an international bond issue<sup>9</sup>, identifying the nature of property rights over assets held in trust<sup>10</sup> and characterising the position of a beneficiary whose creditors wish to seize the trust income<sup>11</sup>.

But the negative consequences of this uncertainty on legal predictability have expanded with the growing number of assets in trust<sup>12</sup> deposited in Switzerland and the increasingly frequent petitions for interim relief or seizure with respect to such assets. Nowadays, the Swiss courts must entertain petitions requiring disclosure or an accounting by depository banks, and petitions to seize assets held in trust in violation of the legal rules on infeasible inheritance shares. The courts must decide whether the trust assets may be seized or attached by the trustee’s personal creditors<sup>13</sup>.

In view of the foregoing, it is striking that this considerable judicial activity rarely results in the publication of decisions in official reports or

<sup>7</sup> RS 0.275.11. See Art. 5 (6), Art. 17 par. 2 and 3, Art. 53 par. 2.

<sup>8</sup> Beginning with a decision of the Geneva courts in 1874, published in the *Clunet – Journal du droit international* 1874 p. 334, in *Pught and Weatchers v. syndic Schlesinger*.

<sup>9</sup> ATF 62 II 40, JdT 1936 I 552, *Aktiebolaget Obligationsinteressenter v. Banque des règlements internationaux* (Young bond issue).

<sup>10</sup> ATF 82 III 63, JdT 1956 II 99, *Rionda* (“Spanish Refugee Trust” case).

<sup>11</sup> ATF 89 III 12, *Saunders*.

<sup>12</sup> In the French version of this report, I have habitually used the expression “biens en trust” (assets in trust, or subject to trust) in preference to the more frequently-used phrase “biens du trust” (literally assets of the trust). Both expressions are synonymous. Although not wrong, the second expression regrettably tends to suggest that the assets in question belong to an entity known as a trust. To a lawyer trained in a civil law system, this reinforces the erroneous idea that trusts are entities with independent legal status. The institutionalist concept of a trust as an entity with no legal personality, promoted by the fundamental works of LÉPAULLE during the first half of the 20<sup>th</sup> century, is clearly perceptible in the United States. “Increasingly, modern common law and statutory concepts and terminology tacitly recognise the trust as a legal ‘entity’, consisting of the trust estate and the associated fiduciary relation between the trustee and the beneficiaries.” Restatement (Third) of Trusts, § 2 comment a (Tentative Draft No. 1, 1996).

<sup>13</sup> Decisions of Zurich courts in the bankruptcy of Werner K. Rey, ZR 1999 225 n° 52.

legal periodicals<sup>14</sup>. Quite apart from the often very private and confidential character of the disputes in question, judges and lawyers seem reluctant to publish decisions that appear to arbitrate between the various interests in a special case rather than pronounce on principles. The Swiss courts have failed to shape a body of rules. Whereas their successive decisions should shed more light and gradually help to fill legal lacunae, this judicial silence has stifled the process.

At present, the uncertainty of Swiss rules on the law applicable to foreign trusts and to the recognition of their consequences does not seem to have significantly undermined Switzerland's attractions. At most, we know that the choice of Swiss professionals as trustees of foreign trusts requires specific precautions<sup>15</sup>. However, one or two high profile legal cases would suffice to highlight the gaps in Swiss law and lead foreign trustees and their legal advisers to reconsider whether it is advisable to use certain services offered in Switzerland's financial marketplace. Therefore, it is reasonable to examine at present whether this insecurity can be reduced by the adoption of carefully chosen rules and how this should be accomplished.

In 1985, the Hague Conference on Private International Law adopted a convention on the law applicable to trusts and on their recognition (hereafter the "Convention"). It took effect on 1 January 1992 between Australia, Italy and the United Kingdom. Canada, the Netherlands and Malta have since joined the first three members. The Convention also binds China for matters concerning Hong Kong. Cyprus, the United States of America, France and Luxembourg have also signed but not yet ratified the Convention. Luxembourg is about to do so, to make its financial marketplace more attractive to leading foreign trustees.

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<sup>14</sup> The *Cortrust* case, which has been pending before the Zurich courts and the Federal Supreme Court since 1992 on the issue of the right to seize the possessions of a Liechtenstein trust in legal proceedings against the trustee, has not yet been published. Various decisions have been made in Geneva, mainly in successorial disputes, which have not been published. At its seminar of 5 May 1999 ("Trusts étrangers et ordre juridique suisse"), the Association genevoise de droit des affaires published a collection of documents including four unpublished decisions of the Geneva and Vaud courts handed down in the period from 1996 to 1998. See also LIMBURG & SUPINO (1999), who mention a number of unpublished decisions.

<sup>15</sup> See SCHULTHESS & LIMBURG (1996).

Although it has benefited from the scientific contribution of an eminent Swiss lawyer, Professor Alfred von Overbeck<sup>16</sup>, and has already been discussed in numerous scientific writings by Swiss legal writers, Switzerland has not yet signed the Convention.

The present report, drafted at the request of the Federal Office of Justice, seeks to examine whether it would be opportune to ratify the Convention and, in the affirmative, what amendments may be required to Swiss domestic law to ensure adequate recognition of the effects of foreign trusts in our country without compromising the essential values that underpin our legal system.

In the interest of brevity, Chapter II succinctly states the characteristics of trusts as developed in common law systems. Chapter III summarises the Convention's scope of application, the conflict rules it sets forth and the recognition it provides for the effects of trusts.

The decision to ratify the Convention depends on the answers to two questions. Do the rules of Swiss private international law deal adequately with foreign trusts coming before the Swiss courts and authorities and, if not, are the rules of the Convention preferable and compatible with the fundamental principles of Switzerland's legal system?

Chapter IV presents the three possible characterisations (contract, company, succession) for trusts pursuant to the Federal Act on Private International Law of 18 December 1987 and the problems which result from such characterisations. Chapters V to XII review in greater detail how the Convention governs the interaction between the consequences of a foreign trust and the other laws and rules (in questions of succession, matrimonial and other property rights, enforcement, etc.) to which Swiss private international law seeks to give effect, either as a result of specific Swiss conflict rules, of Switzerland's international public policy or as foreign mandatory provisions.

Where, according to the conflict rules, Swiss substantive law applies to international situations involving a trust, Chapters V to X contain sug-

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<sup>16</sup> A professor at the University of Fribourg and head of the Swiss Institute of Comparative Law, of Lausanne, Alfred von Overbeck drew up the Special Commission's report on the draft convention, as well as the explanatory report, which comments on the Convention as it was adopted by the Conference, see Hague Conference on Private International Law, *Proceedings of the Fifteenth Session*, vol. II pp. 167 *et seq.* and pp. 370 *et seq.*



gestions regarding certain additions to Swiss legislation that may make it easier to take into consideration the consequences of trusts while complying with mandatory rules (protection of indefeasible inheritance shares, of creditors, of third parties in good faith, etc.) enshrined in our legal system and which it would be unwise to forego.

This report examines the desirability of ratifying the Convention and the measures that should accompany it. However, the Convention does not imply the reception or creation of a new institution in Swiss domestic law. Its sole aim is to recognise the existence of voluntary trusts validly created abroad, to provide the rules enabling identification of the law applicable to them, and to ensure recognition of their consequences to an appropriate extent.

Nevertheless, greater recognition of foreign trusts by the Swiss courts and authorities will have an impact on at least one of our domestic institutions. Fiduciary transfers (*fiducie, Treuhand*) have been developed by Swiss practice and more than a hundred years of case law, almost as an aside to the codified law. Though dogmatically very different from Anglo-American trusts, a powerful analogy exists between the two institutions because, like trusts, fiduciary transfers allow the legal title to a tangible or intangible asset to be dissociated from its economic benefit. Also like trusts, a fiduciary transfer lends itself to the fiduciary administration of the asset as well as to the fiduciary holding of a security interest. Without ever codifying it in a generally applicable text, the Swiss Parliament chose fiduciary transfers as the dogmatic foundation for investment funds as well as the collective management of copyrights. Furthermore, legislation has increased the protection of beneficiaries of banks' fiduciary transactions by providing for automatic exclusion of fiduciary assets from the bankrupt estate in the event of a bank's involuntary liquidation.

Though functionally similar to trusts, fiduciary transfers are set apart from them by their history<sup>17</sup>, their dogmatic foundations – Swiss law ignores the distinction between legal and equitable ownership<sup>18</sup> –, by their near-systematic two-party (from the fiduciary transferor to the fiduciary

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<sup>17</sup> See, however, the vast historic fresco painted in *Itinera Fiduciae* (1998).

<sup>18</sup> This important difference was recognised very early and may led to overestimation of the distance separating the trust from fiduciary transfers, see, in particular GUBLER (1954) and REYMOND (1954).

owner and back) rather than three-party (settlor, trustee, beneficiary) structure and, in the case of fiduciary transfer for management purposes contracts (*fiducia cum amico*), by its inadequate emancipation from the rules of agency, which subject it to the uncertainty of termination possible at any time and to the orders and instructions of the fiduciary transferor<sup>19</sup>.

Although the Convention was mainly conceived to allow and facilitate the recognition of Anglo-American trusts in legal systems unacquainted with the concepts of common law and equity, the rather broad definition of its objects (Article 2) could extend to cover Swiss fiduciary transfers, if the latter were improved, and would consequently ensure better recognition of Swiss fiduciary transfers beyond our borders. This advantage is far from insignificant in the light of the difficulties that have arisen during disputes decided by foreign courts regarding title to and exclusion of assets subject to a Swiss fiduciary transfer<sup>20</sup>.

Therefore, the Federal Office of Justice's commission requires me to examine whether it is opportune to codify fiduciary transfers as they presently exist in Switzerland (Chapter XIV) and to formulate a legislative proposal for the threefold purpose of improving its legal predictability, extending its flexibility and potential application, and ensuring its recognition abroad with the aid of the Convention. Therefore, this report includes a briefly commented draft of legal provisions that could be inserted into a new chapter of the Swiss Code of Obligations (Chapter XV). The rules applicable by default essentially correspond to the current legal system of fiduciary transactions while opening the possibility of deviating from it to carry out transactions that cannot be accomplished within the framework of the current law, notably within the framework of the rules currently governing agency (*mandat, Auftrag*, governed by the Swiss Code of Obligations Art. 394 *et seq.*) which, according to case law, apply in general to all fiduciary transfers for management purposes (*fiducia cum amico*).

As the reader will observe, the limits set by the Swiss legal system to the recognition of trusts and fiduciary transfers are fundamentally identi-

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<sup>19</sup> For an overview of these questions and a recent synthesis, see THÉVENOZ (1995) and WATTER (1995).

<sup>20</sup> In addition to several unpublished decisions, see, in particular, the *Mebco* case before the French courts (JCP 1993 II n° 22005, summarised. RSDA 1994 47 r62; JCP 1995 II n° 22427 obs. VASSEUR).

cal. Beyond their structural and dogmatic differences, the problems which our legal system must resolve derive from their common purpose: to dissociate, for certain assets, their legal control from their economic benefit. That is why a review of the objections and difficulties connected to the recognition of foreign trusts and the discussion of necessary changes largely coincides with the question of the limits that must be assigned to fiduciary transfers. These two elements partially mirror one another and, to avoid useless repetition, the discussion of objections and limits affecting the recognition of foreign trusts within the Swiss legal system is essentially applicable to Swiss fiduciary transfers *de lege lata et ferenda*.

## II. Trusts

This second chapter presents the essential characteristics of trusts as they originated from the decisions of England's Chancellors and have since developed within the framework of equity principles in most common law countries.

Although originally trusts were a specific development of English law and form part of the legal heritage of all legal systems deriving from it, they have also entered the systems of many civil law countries. This is the case of certain states profoundly influenced by common law owing to their geographic, historic and political proximity. The courts of Scotland, South Africa, Quebec and Louisiana, assisted to varying degrees by lawmakers, gradually received, recognised and developed authentic trusts within the limits and constraints characteristic of civil law legal systems (*numerus clausus* of property rights; lack of distinction between legal title and equitable ownership, indefeasible inheritance shares, etc.). In a more decided manner and with varying success Japan (1922), Panama (1925), Liechtenstein (1926), Mexico (1932), Colombia (1971), Israel (1979) and Argentina (1995) – to name some important examples – legislated to create artificially an institution based on the Anglo-Saxon trust. Even though these “civil law trusts” sometimes differ considerably from classic trusts as illustrated, for example, by British and US case law in the nineteenth century, they nevertheless contribute to the contemporary concept of trusts<sup>21</sup>, with

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<sup>21</sup> See LUPOI (1995) and (1999).

which they share a common denominator<sup>22</sup>. That is the course adopted by the authors of the Convention of 1 July 1985 discussed in this report. It is also the aim and ambition of *Principles of European Trust Law*, published in 1999 by a select group of eminent specialists who sought to express, in nine articles and twenty-four paragraphs, the core notion of trusts<sup>23</sup>.

When regarding trusts as an institution we must bear in mind that the rules slowly built up by the courts have since been the subject of many legislative reforms in most countries familiar with trusts. For example, many legislatures have amended the rules applicable by default governing the trustee's investment powers<sup>24</sup>. In addition, a number of small island states, which operate as tax havens to promote their financial marketplaces, have amended certain rules that seem fundamental to trusts (purposes, maximum duration, protection against creditors, the settlor's power to control the future of the trust, secrecy in respect of beneficiaries, etc.) to such an extent that it is justified to ask whether such offshore creations still correspond to the notion of trusts<sup>25</sup>.

The sole aims of this chapter are to present to civil lawyers, in the simplest possible terms, the concept of trust as an institution (A), then to recapitulate their most distinctive characteristics from the viewpoint of a Swiss jurist (B–G). It is not intended to replace an educational summary<sup>26</sup>, let alone a broad comparative synthesis<sup>27</sup> or the in-depth analyses to be found in the major jurisdictions familiar with trusts<sup>28</sup>.

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<sup>22</sup> See, in particular WATERS (1995) pp. 341 *et seq.*; *Itinera Fiduciae: Trust and Treuhand in Historical Perspective* (1998).

<sup>23</sup> *Principles of European Trust Law* (1999). This work presents and comments on the Principles – drafted in eight Articles (in English and French) – then reproduces a series of national reports comparing these with the existing law of in Scotland, Germany, Switzerland, Italy, France, Spain, Denmark and the Netherlands. The Swiss report was written by Professor Alfred von Overbeck.

<sup>24</sup> See in the United States: Restatement (Third) of Trusts: Prudent Investor Rule (1990); Uniform Prudent Investor Act (1994); in the United Kingdom: [English] LAW COMMISSION & SCOTTISH LAW COMMISSION, *Trustees' Powers and Duties*, July 1999 (Joint Report No 260/172), see also [www.open.gov.uk/lawcomm](http://www.open.gov.uk/lawcomm).

<sup>25</sup> See HAYTON (1999).

<sup>26</sup> For recent summaries on the subject, see in particular in French: BÉRAUDO (1992); in English: HAYTON (1998). I do not know of a German equivalent.

<sup>27</sup> See FRATCHER (1974); WATERS (1995). See also DYER & van LOON (1982).

<sup>28</sup> See D. WATERS, "The Role of the Trust Treatise in 1990s", 59 *Missouri Law Review* pp. 121-156 (1994).

## A. Trust Concept

The trust is primarily a judicial creation of the courts of equity in which the legislator intervened at a relatively late stage, with respect to particular aspects, and without seeking to codify case law. That is why one does not generally encounter a statutory definition of trusts in England, the United States or Australia. Generally neither the legislature nor the courts have been concerned with defining trusts. Moreover, displaying their traditional reticence towards legal abstractions, Anglo-American authors have preferred to characterise trusts rather than to define them. It is nevertheless appropriate to quote here three definitions to be found in normative or normative-like instruments:

“In a trust, a person called the “trustee” owns assets segregated from his private patrimony and must deal with those assets (the “trust fund”) for the benefit of another person called the “beneficiary” or for the furtherance of a purpose.”<sup>29</sup>

“For the purposes of this Convention, the term “trust” refers to 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.”<sup>30</sup>

“A trust, as the term is used in this Restatement when not qualified by the word ‘resulting’ or ‘constructive,’ is a fiduciary relationship with respect to property, arising as a result of a manifestation of an intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee.”<sup>31</sup>

Thus, trusts are not legal entities<sup>32</sup>. They do not possess the attributes of legal personality: they are not subjects of law and do not have the legal capacity to sue and be sued. Trusts are merely a relationship between the trustee and the beneficiaries dominated by the former’s fiduciary duties to the latter. The settlor creates this relationship by declaring the intention to allocate certain assets either to the interests of one or more beneficiaries, or

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<sup>29</sup> Article I (1) des Principles of European Trust Law.

<sup>30</sup> Article 2 par. 1 of the Convention.

<sup>31</sup> Restatement (Third) of Trusts, § 1 (Tentative Draft No. 1, 1996).

<sup>32</sup> Even though usage has evolved so that trusts are often referred to as entities composed of the assets in trust and the fiduciary transfers pertaining to those assets which bind the trustee to the beneficiaries, see Restatement (Third) of Trusts, § 2, comment a (Tentative Draft No. 1, 1996) quoted above in footnote 12.

for a definite purpose, and by transferring the title to these assets to the trustee. Unless he provides otherwise, the settlor's role stops there. The settlor may appoint himself as a beneficiary, and may retain the possibility of participating or opposing certain important decisions by the trustee. However, if he has not so provided, he disappears from the legal relationship formed between the trustee and the beneficiaries, which will end only when the trustee has completely relinquished the assets in trust in compliance with his duties.

## B. The Beneficiaries' Varying Rights and Expectations

A trust has generally has the effect of creating rights, present or future (which may be vested or purely contingent), for the appointed beneficiaries<sup>33</sup>. From the viewpoint of a civil law jurist, one unusual feature is the extreme diversity of interests that the settlor can confer on the beneficiaries<sup>34</sup>.

- Diversity of subject matter: the beneficiaries may receive very varied privileges or expectations: the use of any property with or without valuable consideration therefor; enjoyment of the fruits of capital; partial or full distribution of capital; any other form of benefit assured out of the trust funds. Thus, the Americas Cup – a trophy awarded for the first time in 1851 – is the subject of a trust providing that the last winner of the Cup becomes a trustee. The beneficiaries are the future competing teams who are entitled (subject to conditions) to challenge the holder. If the challenge is valid, the trustee (*i.e.* the team currently holding the Cup) must organise a regatta for the trophy. Whoever wins it will become the next trustee<sup>35</sup>.

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<sup>33</sup> Certain trusts are not created in favour of beneficiaries, but for the pursuit of a particular purpose, the utility of which is recognised by the law applicable to the trust (purpose trusts): charitable trusts are the most widely known examples. The modern trend is to widen the purposes which can justify the creation of such trusts devoid of beneficiaries. In certain offshore jurisdictions, a purpose trust may even (inadequately) conceal a trust wholly controlled by the settlor for his own benefit. Trusts in the latter category, which probably do not correspond to the core concept of trusts, will generally violate Swiss public policy because they allow the settlor to create a separate estate by allocating it to a totally fictitious purpose. Swiss public policy is reserved by Art. 18 of the Convention.

<sup>34</sup> FRATCHER (1974) N. 1 has illustrated this aspect by imagining the clauses of a trust providing for 26 different types of interest affecting the same assets entrusted to the trustee.

<sup>35</sup> *Mercury Bay Boating Club Inc. v. San Diego Yacht Club*, 76 N.Y. 2d 256, 557 N.E. 2d 87, 557 N.Y.S. 2d 851 (C.A., 1990).

- Diversity of beneficiaries, who may exist when the trust is created and be identified, or who may be determined later according to criteria such as family relationships, membership of a group, etc.
- Diversity of terms: (at a given age, during his lifetime, on the death of, etc.), within the maximum duration determined by the rules (frequently complex, as in the case of the rules against perpetuities), and by conditions precedent or subsequent (divorce, bankruptcy of beneficiary, etc.).
- Diversity of nature: the rights of a beneficiary may be determined in advance (fixed interest) or may be left to the trustee's discretion (discretionary interest) according to terms of the settlement deed. The powers of the trustee – or of a potential third party often called the protector – may extend to excluding beneficiaries and appointing new ones.

This fourfold diversity is not in itself unknown in legal systems deriving from the Romano-Germanic tradition. It exists partially in Swiss testamentary practice, and especially in relation to foundations. Trusts differ from Swiss wills in that they often allow the trustee a (very) broad discretionary power regarding the time, amount and beneficiaries of trust distributions, a freedom which is fundamentally alien to our law of succession<sup>36</sup>. Moreover, distributions made by the trustee may sometimes extend over a period far longer than the time-limit for extended testamentary execution or the provision of a reversionary heir, known in Swiss law as *substitution fidéicommissaire* (*Nacherbeneinsetzung*)<sup>37</sup>. Ordinary trusts also differ from Swiss foundations in that they are not limited by a list of acceptable purposes, but by the existence of beneficiaries. On the other hand, trusts and foundations resemble each other significantly in allowing the settlor to stipulate the classes of persons (who do not, as a sole consequence of being members of the class, acquire vested rights against the trustee or the foundation) among whom the trustee or the foundation board may freely choose the actual beneficiaries of certain benefits at their discretion, within the parameters set by the trust or foundation deed.

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<sup>36</sup> See *infra* V.A.1 and note 40.

<sup>37</sup> CC, Art. 488 par. 2: “<sup>1</sup> A testator can in his will or pact charge the instituted heir to pass on the inheritance to another as reversionary heir. <sup>2</sup> He cannot lay a similar obligation on the reversionary heir.” PIOTET (1975) p. 96 has pointed out that although *substitution fidéicommissaire* clauses are limited to two successive beneficiaries, there is no limit on the time at which the second succession occurs, so that the testator may name the commune of Lausanne as the heir to his assets, charging it to transfer them, in the year 2222, to his descendants then living.

## C. Duties of a Trustee

The trustee's duties regarding the assets entrusted to him lie at the heart of trusts. The *Principles of European Trust Law* summarise them as follows<sup>38</sup>:

“(2) The fundamental duty of a trustee is to adhere to the terms of the trust, to take reasonable care of the trust assets and to act in the best interests of the beneficiaries or, in the case of a trust for purposes, the furtherance of those purposes.

(3) A trustee must keep separate and protect the trust assets, must maintain accurate accounts and must provide the beneficiaries and the enforcer with information requested to protect their interests.

(4) Except to the extent otherwise permitted by the terms of the trust or by law, a trustee must personally perform his functions. He must act honestly and he must avoid all conflicts of interest unless otherwise authorised.

(5) A trustee is accountable for the trust fund, must personally make good any loss occasioned to the trust fund by his breach of trust and must personally augment such fund by the amount of any profits made by him in breach of his duty.”

In Anglo-American law, these fiduciary duties<sup>39</sup> differ from contractual duties by their intensity and the high degree of diligence and loyalty expected of the trustee. As Cardozo, J. expressed it in a frequently quoted decision of the New York Court of Appeal in 1928: “Many forms of conduct permissible in a workaday world for those acting at arm's length are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honour the most sensitive, is then the standard of behaviour.”<sup>40</sup>

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<sup>38</sup> Article V.

<sup>39</sup> Which are characteristic of trusts and certainly originate therefrom, have also developed and expanded into numerous other legal relationships affected by the rules of equity including in particular the duties of an agent to his principal, of corporate management to the shareholders, of a tutor to pupil, etc. For a recent review, see McKENDRICK *et al.* (1992); Tamar FRANKEL, “Fiduciary Duties”, in *The New Palgrave Dictionary of Economics and the Law*, London (Macmillan), New York (Stockton) 1998, vol. 2 p. 127; P. PARKINSON, “Fiduciary Obligations”, in *The Principles of Equity*, ed. by P. Parkinson, Sydney (LBC Information Services) 1996, pp. 325-378.

<sup>40</sup> *Meinhard v. Salmon et al.*, 249 N.Y. 458 (at 464), 164 N.E. 545 (at 546).



What has just been said about trusts is very close to the rules of fiduciary transfers for management purposes (*fiducia cum amico*) in Swiss law. At this stage, the two most significant differences concern form rather than substance. Swiss fiduciary transfers are based on a contract between the fiduciary transferor and the fiduciary transferee whereas a declaration of trust is usually conceived as a purely unilateral act by the settlor<sup>41</sup>; if the trustee declines to act, the validity of the trust is not affected, instead, the court having jurisdiction must appoint another trustee. Furthermore, Swiss fiduciary transfers usually correspond to a relationship between the fiduciary transferee and fiduciary transferor, who is not only the initiator but almost always also the sole beneficiary of the contract<sup>42</sup>.

However, the specific nature of trusts and the degree of protection they offer to beneficiaries result from a number of specific features which essentially involve the segregation of assets in trust and their protection from the trustee's personal creditors (D), the trustee's liability for debt (Liability for Debt), the beneficiaries' right to trace assets alienated by the trustee in breach of trust, (Beneficiaries) and the possibility of judicial intervention at the request of the beneficiaries or even of the trustee himself (Judicial Intervention).

## D. Segregation of Trust Assets

The segregation of trust assets is the primary trust characteristic mentioned in the Convention, which provides that "the assets constitute a separate fund and are not a part of the trustee's own estate"<sup>43</sup>. This fund, often called the trust corpus, "consists not only of the original assets and those subsequently added, but also of those assets from time to time representing

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<sup>41</sup> In reality, the professionalisation of trustee services results in a negotiation of the trust deed in which the future trustee is generally the settlor's advisor. Moreover, a recent but controversial trend in American legal writing emphasises the contractual nature of trusts with the declared intention of reducing the scope and intensity of fiduciary duties, see notably LANGBEIN (1995). However, this is a long-standing debate dating back to F.W. Maitland.

<sup>42</sup> Fiduciary transfer for management purposes and fiduciary security contracts rarely include a provision in favour of a third party, though this may be done (CO, Art. 112 par. 2 and 3), see THÉVENOZ (1995) pp. 345-347; see ATF 96 II 79 c. 7b & 8c, JdT 1971 I 337 & 343, *Harrison*.

<sup>43</sup> Art. 2 par. 2 a of the Convention.

the original or added assets”<sup>44</sup>. It thus corresponds to the principle of subrogation in civil property law.

In all systems containing trusts, this separate fund is distinguishable from the trustee’s private assets in at least three respects:

- It cannot be seized by the trustee’s creditors except, possibly, for debts that he contracted in his capacity as trustee of the assets (this aspect will be discussed at greater length under Liability for Debt below); in the event of the trustee’s personal bankruptcy, the fund is not included in his estate;
- The fund is not included among the trustee’s matrimonial property rights, nor may the trustee’s spouse profit from the fund;
- On the trustee’s death, the fund is not included in his estate, nor may his heirs profit from the fund.

Analysed according to the concepts of civil law, the assets subject to a trust form a separate estate (*patrimoine séparé, Sondervermögen*)<sup>45</sup>.

The particular fate of the separate estate resulting from a trust burdens the trustee with onerous duties. “A trustee of several trusts must keep each trust fund not only segregated from his private patrimony but also from each of the other trust funds”<sup>46</sup>. Where the trustee fails to comply with this strict duty, as in the case where he commingles assets in trust with his personal assets or appropriates an asset in breach of trust (for example by taking a payment to which he is not entitled or conferring a gift on himself, contrary to the trust terms), he is liable on his personal assets and must either make restitution in kind or, if that is impossible, of equivalent value.

## **E. Liability for Debt**

In addition to its exclusion from the trustee’s matrimonial and successoral property rights, the recognition of a separate estate, composed of all the assets in trust, inevitably requires specific rules regarding liability for debt. The two principles underlying these rules may be summarised as follows:

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<sup>44</sup> Art. III (1) of Principles of European Trust Law.

<sup>45</sup> On separate estates in Swiss law, see THÉVENOZ (2000).

<sup>46</sup> Art. III (3) of Principles of European Trust Law.

- The trustee’s personal creditors have no recourse against the trust corpus, i.e. the assets that he holds as a trustee. In particular, the trust corpus is not included in the trustee’s estate in bankruptcy.
- When the trustee, acting in that capacity, assumes a contractual or other obligation to a third party, in principle he is liable only on his personal estate. However, he is entitled to reimbursement of his expenses, though only insofar as they were incurred in the diligent pursuit of his duties as trustee or insofar as the expenditure has benefited the trust fund<sup>47</sup>.

This is a harsh regime for the trustee, whose position is not comparable to that of a company director or foundation administrator. First, the trustee who in that capacity assumes obligations to third parties burdens his personal estate, whereas a director makes commitments on the company’s behalf. In addition, the validity of the commitments he makes in that capacity is not limited by his powers as trustee. If he binds himself to third parties beyond the extent authorised by the trust deed and the applicable law, the obligation remains valid and binding on him vis-à-vis third parties. He must satisfy it out of his personal assets and cannot reimburse himself from the trust fund.

Under certain conditions, the classic rule of English law<sup>48</sup> allows the creditors of a trustee, who makes a valid commitment in that capacity, to satisfy their claim out of the trust fund. The conditions are quite restrictive, and this seizure of the assets in trust is considered as an equitable remedy resulting from the subrogation of the creditor, who thus steps into the trustee’s shoes and exercises the latter’s right to reimbursement of expenses. The modern trend is to allow such creditors direct access to the trust fund in respect of debts assumed by a trustee acting according to his duties. This is the course suggested by the Principles of European Trust Law<sup>49</sup>; it is also the rule in several US states<sup>50</sup>. The most recent codification is even more protective of the trustee when he acts as such and within the limits of his

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<sup>47</sup> FRATCHER (1974) N. 91 p. 73; Restatement (2d) Trusts, § 245; Uniform Trust Code, s. 709 (2000 Annual Meeting Draft).

<sup>48</sup> UNDERHILL & HAYTON (1995) Art. 86 par. 5 (pp. 787, 801-803); comp. FRATCHER (1974) p. 79. See, however, the proposals of Trust Law Committee in its report *Rights of Creditors Against Trustees and Trust Funds* of June 1999, London (Butterworths Tolley).

<sup>49</sup> Art. III (2), 2nd sentence: “...the trust fund is available only for claims made by creditors dealing with the trustee in his capacity as such ...”, and commentary, p. 46.

<sup>50</sup> FRATCHER (1974) p. 79 (n. 657), and especially SCOTT & FRATCHER (1987) t. IIIA § 271 A.1.

powers: They exempt his personal assets from any liability and restrict the claims of third parties against the trust fund<sup>51</sup>.

## F. Beneficiaries' Right to Trace Assets

The second main characteristic of Anglo-American trusts is the protection of beneficiaries where the trustee has disposed of certain assets in breach of trust, i.e. in violation of the duties imposed on him by the trust deed and the law. Not only can the beneficiaries require the trustee to repair any loss caused to the trust corpus, they can also force him to contribute to it any profit he may have realised<sup>52</sup>. They may also, under certain conditions, require third parties to restore to the trust fund any assets wrongfully alienated or obtain another form of reparation. This right to trace trust assets exists in principle against every purchaser of an asset in trust unless he acquired it as a *bona fide* purchaser for value without notice<sup>53</sup>.

The right to trace assets was extremely important when, in the absence of a statute, the trustee had the power to dispose of the assets in trust only as specified by the trust deed. Legislation has evolved, however, as have the nature of assets subjected to trusts. Real property, which for a long period was the primary object of trusts, has given way to financial assets. Their careful management in the beneficiaries' interest presumes broad powers of alienation and reinvestment. As trust deeds were (and still are) often incomplete on the precise extent of the trustee's powers in this respect, they were gradually completed by the legal default rules adopted by the legislatures of many common law states. Following the Trustees Act (1925) and the Trustee Investment Act (1961) in England<sup>54</sup>, the Uniform Trustees' Powers Act (1964) and the Uniform Prudent Investor Act (1994)<sup>55</sup> in the

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<sup>51</sup> Uniform Trust Code, s. 1010 (a) (2000 Annual Meeting Draft); Trusts (Jersey) Law 1984, Art. 28; California Trust Law (1987), codified in the California Probate Code, s. 18000.

<sup>52</sup> Art. V (5) of Principles of European Trust Law; Uniform Trust Code, *et seq.* 1002 & 1003 (2000 Annual Meeting Draft).

<sup>53</sup> FRATCHER (1974) p. 80, 2<sup>nd</sup> col.; UNDERHILL & HAYTON (1995) Art. 104 pp. 916 *et seq.*; BOGERT (1987) §§ 161-165.

<sup>54</sup> Pending new and badly needed legislation, see *supra* note 24.

<sup>55</sup> This uniform act was adopted by more than 30 states. It codifies and synthesises the Restatement (Third) of Trusts: Prudent Investor Rule (1992).

United States and equivalent legislation in other Commonwealth countries<sup>56</sup>, the trustee's power to alienate assets in trust expanded considerably. This trend has in some cases been pushed to extremes in offshore jurisdictions, as illustrated by Article 20(1) of the Trusts (Jersey) Law of 1984<sup>57</sup>. Protection of beneficiaries has diminished accordingly<sup>58</sup>.

## G. Judicial Intervention

The third feature that distinguishes trusts from similar civil law institutions (fiduciary transfers, foundations, successive beneficiaries under *substitution fidéicommissaire* clauses) is the role of the courts. They are not only called on to settle disputes, to order interim relief to preserve the status quo, and to issue judgements to remedy breaches of trust. A court may also be petitioned, in the absence of a controversy, as the authority from whom the trustee, in situations of serious doubt, can seek binding instructions that will also simultaneously exempt him from potential liability for misinterpreting the trust deed. The court may also replace a trustee who no longer meets the requirements of his office, and amend the trust deed, where necessary, to further its original purpose. It is often said that “the trustee lives in the shadow of the court.”

Such a form of jurisdiction is necessary because the settlor who creates the trust does not retain any power over its existence or operation, unless he reserves such powers in the trust deed. The beneficiaries have a passive role. The trustee carries out his task alone. The duration of the trust, which can be considerable, often means that its provisions must be interpreted in profoundly changed circumstances. Faced with a doubt, where his acts could expose him to liability, the trustee has the possibility of addressing the courts, whose interpretation is binding.

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<sup>56</sup> FRATCHER (1974) N. 100 pp. 81-83.

<sup>57</sup> “Subject to the terms of the trust and subject to his duties under this Law, a trustee shall in relation to the trust property have all the same powers as a natural person acting as the beneficial owner of such property.”

<sup>58</sup> LANGBEIN (1995) pp. 640-643 views this as one of the factors supporting a more contractual basis for trusts, to the detriment of an interpretation that views trusts as pure institutions of property law.

### III. Overview of the Convention

This is not the place for a detailed commentary on the provisions of the Convention on the law applicable to trusts and on their recognition, of 1 July 1985<sup>59</sup>. This task was carried out by Professor Alfred von Overbeck, who drew up the explanatory report on the Convention with talent and authority<sup>60</sup>. The Convention has also been the subject of many shorter commentaries, in English, French, German and Italian<sup>61</sup>. The present chapter is limited to a brief presentation of the matters governed by the Convention. The Convention will be discussed in more detail in the following chapters when examining its compatibility with the fundamental principles underlying the Swiss legal system and the co-ordination between the law applicable to trusts and the other laws whose vocation is to govern other aspects of the same international situation.

In five chapters, the Convention defines its scope of application (Articles 1 – 5), determines the law applicable to trusts (Articles 6 – 10), states the consequences of their recognition (Articles 11 – 14), reserves the rules applicable on another basis and provides certain safeguards (Articles 15 – 25), ending with the usual final clauses (Articles 26 – 32).

#### A. Scope of Application

As it is especially intended for states whose laws do not include trusts, the Convention adopts an autonomous characterisation of trusts, independent of the institutions recognised by the *lex fori*. It is based on the definition contained in Article 2 par. 1:

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<sup>59</sup> The **original French and English texts** were published in *Proceedings of the Fifteenth Session*, vol. II, and on the Conference's website <hcch.net>, which also provides the status of signatures and ratification. They are reprinted hereafter at pp. 351 *et seq.* Readers can find a **German translation** in *Praxis des internationalen Privat- und Verfahrensrecht* 1987 pp. 55-58, also reprinted hereafter at pp. 350 *et seq.* and an **Italian translation** in *Trust Laws of the World* (2000) pp. 30-38.

<sup>60</sup> *Supra* note 16.

<sup>61</sup> In **French**: von OVERBECK (1985b); GAILLARD & TRAUTMAN (1986); JAUFFRET-SPINOSI (1987); KLEIN (1990); GAILLARD (1990); REYMOND (1991); PÉLICHET (1994). In **English**: GAILLARD & TRAUTMAN (1987); LUPOI (1995) and (1997); HAYTON (1996); KÖTZ (1999). In **German**: KÖTZ (1986); PIRRUNG (1987). In **Italian**: FUMAGALLI (1992); PATON & GROSSO (1994); BROGGINI (1996).

“For the purposes of this Convention, the term “trust” refers to 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.”

This definition is supplemented by three “characteristics” (Article 2 par. 2) that set trusts apart from other institutions pursuing similar aims:

“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.”

The definition is further completed by an additional precision (Article 2 par. 3):

“The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.”

The scope of application is the subject of many qualifications, which may be resumed as follows:

- the Convention “applies only to trusts created voluntarily and evidenced in writing” (Article 3); nevertheless, each contracting state may decide to extend it to trusts declared by judicial decisions (Article 20);
- the Convention does not determine the law governing the validity of the transfer to the trustee of title to the assets in trust, nor the law governing the will from which the trust may originate (Article 4); one frequently-used metaphor states that the Convention applies to the “rocket”, namely the trust, but not to the “launcher”, i.e. the deed by which the assets are transferred to the trustee<sup>62</sup>;

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<sup>62</sup> See von OVERBECK (1995a) p. 381. Used by many authors, this metaphor is subject to one reservation: it is the law applicable to the trust (designated by the Convention) that determines whether a settlor’s deed meets the requirements for constitution of a trust (*e.g.*, clear intention to constitute a trust, sufficient identification of the assets placed in trust and the beneficiaries).

- the Convention does not apply when the law that it designates as applicable to a trust “does not provide for trusts or the category of trusts involved” (Article 5);
- the Convention applies regardless of the law designated by its conflict rules; nevertheless, each contracting state may make a reservation to limit its application to trusts whose validity is governed by the law of another contracting state (Article 21);
- the Convention also applies to trusts created before it took effect; nevertheless, each contracting state may make a reservation to limit its application to trusts created after the Convention took effect in that state (Article 22).

Although Article 13 is part of another chapter of the Convention, it can also be viewed as a limitation of the Convention’s scope of application based on insufficient contacts of a given trust with the law of a state which may serve as the basis for its validity:

“No State shall be bound to recognise 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.”

The Convention does not affect the powers of contracting states in tax matters (Article 19).

## **B. Applicable Law**

Chapter II determines the law applicable to trusts governed by the Convention. The principle is that the settlor is free to choose the law (Article 6 par. 1). However, this choice is ineffective if the chosen law does not provide for trusts or the category of trusts in question (Article 6 par. 2). Where this is the case, or where the settlor did not make a valid choice of law, the Convention designates the law “with which [the trust] is most closely connected” (Article 7 par. 1). To facilitate the identification of this law, it lists four non-exhaustive criteria: the place of administration of the trust designated by the settlor, the *situs* of the assets in trust, the domicile or place of business of the trustee, and the objects of the trust and the places where they are to be fulfilled (Article 7 par. 2).



The law applicable to the trust governs “the validity of the trust, its construction, its consequences, and the administration of the trust” (Article 8 par. 1), which 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;
- “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.”

Although, in principle, the conflict rules, either based on choice (Article 6) or based on objective factors (Article 7) refer to a single law applicable to all these issues, the Convention does permit a specific aspect of the trust, in particular its administration, to be governed by a separate law (Article 9). It also recognises the later choice of a new law when the law initially applicable to the trust authorises such a change (Article 10).

### **C. Effects and Limits in Recognising Trusts**

Chapters III (under the somewhat unfortunate title of “Recognition”<sup>63</sup>) and IV (“General Clauses”) of the Convention seek to separate methodically the matters governed by the law applicable to the trust from those governed by another law referred to by the forum’s conflict rules. In particular, the Convention states the principles that allow the effects of a trust to be coordinated with the mandatory rules applicable, for example, to the trustee’s estate for inheritance purposes as well as the protection of his co-contractors and creditors.

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<sup>63</sup> See KÖTZ (1999) p. 44.

As Article 11 provides, the recognition of the effects of a trust governed by foreign law “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.” (Article 11 par. 2). Insofar as provided by the law applicable to the trust, this implies that the assets in trust are shielded from seizure by the trustee’s personal creditors and that they do not form part of his matrimonial property rights, or part of his estate for inheritance purposes. It further implies that the trustee must have the standing to sue and be sued in respect of these assets, to appear in his capacity as trustee before any public official or notary, and to record his ownership as trustee expressly in respect of assets subject to registration (Article 12).

The Convention takes particular care to identify the issues that the private international law of a court seized of a case may submit to other laws. These essentially include:

- the validity of wills creating trusts or of other acts by virtue of which assets are transferred to the trustee (Article 4);
- the rights and obligations of third party holders of the assets in trust (Article 11 par. 3 d);
- the mandatory provisions of the law designated by the forum’s conflict rules, relating in particular to the protection of minors and incapable parties; the personal and proprietary consequences of marriage; inheritance rights, especially inalienable shares; transfer of title to property and security interests in property; protection of creditors in matters of insolvency; and protection of third parties acting in good faith (Article 15);
- those provisions of the law of the forum which must be applied even to international situations, irrespective of conflict rules (Article 16 par. 1);
- in exceptional circumstances, effect may also be given to the mandatory laws of a state having “a sufficiently close connection with a case”(Article 16 par. 2).

This extensive list reflects the concern of those who drafted the Convention to guarantee to states, whose laws do not include trusts, that the recognition of foreign trusts will not compromise the fundamental principles underlying their legal systems. The same objective is further guaranteed by a general reserve in respect of the state’s public policy (Article 18) and by the

safeguard clause (Article 13) already referred to, which enables a court to refuse recognition of “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.”

Switzerland’s private international law must provide the Swiss courts and authorities with the conflict rules necessary to characterise a trust, determine the applicable law and discern the extent of that law’s effects. Does this justify Switzerland’s signature and ratification of the Convention, as most Swiss legal writers now believe<sup>64</sup>, or could we simply retain the existing rules contained in the SPILA. Three main questions appear to be decisive factors in this choice:

- Is Switzerland’s current private international law adequate?
- Do the rules proposed by the Convention guarantee sufficient respect for the essential principles and institutions of Swiss law?
- Should the ratification of the Convention be accompanied by the adoption, by the Swiss legislature, of rules of substantive law or of private international law?
- The answer to these questions is the subject of the following chapters.

## IV. Lacunae in Swiss Private International Law

Where a court seeks to identify the conflict rules that will enable it to assert jurisdiction and to determine the applicable law, it must begin by characterising the legal relationship or issue before it. This characterisation must be made the *lege fori*, i.e. according to the substantive law of the forum: the court must identify, in its own domestic law, which institution corresponds to the legal relationship in question. However, Swiss domestic law does not contain trusts. As the SPILA of 18 December 1987 does not contain rules specifically applicable to trusts, the court must characterise

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<sup>64</sup> See in particular FLATTET (1990) pp. 264 & 272; FUCHS (1998); GIOVANOLI (1994) pp. 215 s.; GUILLAUME (2000); GUTZWILLER (1985) p. 56; von OVERBECK (1997); REYMOND (1997), *id.* in *Droit et pratique des opérations fiduciaires en Suisse* (1994) p. 22; SUPINO (1994) pp. 223-226; THÉVENOZ (1995) pp. 350 s.; THÉVENOZ & DUNAND (1998) pp. 506 s.; WACH (1987); WATTER (1995) p. 252. Comp. BREITSCHMID (1995) pp. 63 s.; KÜNZLE (2000) pp. 440 s.

the trust by its resemblance to an institution existing in Swiss law (contract, corporate body, will, etc.), which will determine which chapter of the SPILA contains the rules designating the appropriate forum – insofar as the Lugano Convention does not apply<sup>65</sup> – and the relevant choice-of-law rules.

When broken down into the components of Swiss domestic law, the legal relationships binding the settlor, the trustee and the beneficiaries with regard to the assets in trust may be characterised in three fundamentally different ways. Based on the *Harrison* decision, a trust can be viewed as a contract between the settlor and the trustee, combined with a transfer of property from the first to the second and a third-party beneficiary clause. Recent cases have determined that<sup>66</sup> some trusts (though doubtless not all) may be characterised as organised estates (*patrimoines organisés, organisierte Vermögen*), which chapter 10 of the SPILA treats in the same way as organised partnerships. Lastly, a successoral characterisation may be envisaged for trusts created by a transfer that only becomes effective on the demise of the settlor.

## A. Contractual Characterisation

Though legal writers do not favour the treatment of a trust as a contractual fiduciary relationship<sup>67</sup>, that solution was adopted by the Federal Supreme Court in the only two reported decisions in which this question was at issue prior to the enactment of the SPILA. In *Aktiebolaget Obligationsinteressenter v. Banque des règlements internationaux* of 1936, the Swiss Supreme Court decided that the fiduciary duties of the Bank for International Settlements towards the German Reich and the holders of the “Young” bond issue, derived from a *sui generis* contract analogous to agency, though differing from the latter because of its irrevocable nature and the greater independence allowed to the “fiduciary agent”<sup>68</sup>. This contractual characterisation resulted in the application of Swiss law. Similarly, in the 1970 case of *Harrison v. Crédit Suisse*, the Federal Supreme Court

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<sup>65</sup> See *supra* note 7.

<sup>66</sup> SC, SJ 2000 I 269; ZR 1999 225 n° 52.

<sup>67</sup> See, however, DREYER (1981) pp. 115-129.

<sup>68</sup> ATF 62 II 40, JdT 1936 I 552.

characterised a private trust constituted during the settlor's lifetime as a combination of contracts governed by contract law<sup>69</sup>. Here also, the contractual characterisation resulted in the application of Swiss law and compelled the Court to convert a trust (unknown in Swiss substantive law) into a gift in the form of a fiduciary transfer for the benefit of a third party.

The contractual characterisation of trusts has many disadvantages. First, it requires trusts created during the settlor's lifetime to be distinguished from those resulting from a testamentary disposition: the latter, void of any contractual element, should probably be governed by the law applicable to inheritance<sup>70</sup>.

Even for trusts created during the settlor's lifetime, this characterisation remains totally at odds with the unilateral nature of the declaration of a trust, which is valid regardless of whether the trustee accepts his office<sup>71</sup>. The contractual characterisation certainly confirms the settlor's freedom to choose the applicable law ( SPILA, Art. 116). This characterisation may probably be asserted against the beneficiaries (whose rights, in this analysis, are comparable to claims resulting from a third-party beneficiary clause), but it is doubtful whether it can serve against other third parties, such as a protector and, especially, the trustee's co-contractors<sup>72</sup>.

In the absence of a choice of law, the contractual characterisation causes further problems. The trustee's duties doubtless resemble "services" within

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<sup>69</sup> ATF 96 II 79, JdT 1971 I 329, obs. REYMOND, ASDI 1971 223 obs. VISCHER, *Clunet* 1976 695 obs. LALIVE.

<sup>70</sup> DREYER (1981) p. 119. See *infra* IV.B.

<sup>71</sup> Anglo-American law views trusts as an element of property law. As such, they are governed by the unilateral principle (only the transferor is necessary to the transfer), which contrasts with most modes of transfer under Swiss law. Therefore, although it is usual to seek the trustee's prior consent, it is not a necessary condition for constituting a valid trust and transferring the assets into the trustee's hands. "Trusts do not fail for want of a trustee." UNDERHILL & HAYTON (1995) p. 60. Quite rightly, LANGBEIN (1995) pp. 650-652 points out that most trusts are discussed with the trustee who advises the settlor and often discusses certain clauses (including his remuneration) before the execution of the trust deed.

Furthermore, the settlor may declare himself a trustee of an asset, which he already owns, in favour of a third party (*self-settled trust*). This situation is incompatible with any contractual approach.

<sup>72</sup> However, we have seen, *supra* at II.E and II.F, that trust law governs certain effects of trusts relating to the trustee's creditors and those who acquire assets placed in trust.

the meaning of the SPILA Article 117 par. 3.c, which appears to require the application of the law of the trustee's domicile. The solution would be different, however, if the trust related exclusively or mainly to real property, in which case the property's location would determine the applicable law (SPILA, Art. 119 par. 1). Moreover, what is the position when, as frequently occurs, several trustees are appointed to act jointly? If they are domiciled in different states, a supplemental connecting factor must be added: namely, the core activity, or actual place of the administration of the trust. Does a change in the trustee's domicile or his replacement by another trustee domiciled in another country entail a change of the law applicable to the trust? Does the Swiss conflict rule recognise a change in the law applicable to the trust on the initiative of the trustee or the protector, a possibility often included in the trust deed or in the law applicable to the trust?

Treating a trust as analogous to a contract also completely ignores the status of the assets in trust. The rights to such assets are governed, as to their acquisition, loss, contents and exercise, by the place in which they are situated (see SPILA, Arts. 99 and 100). The existence of rights pertaining to the assets, which the trust beneficiaries can, if a breach of trust occurs, invoke directly against the trustee and even against purchasers in bad faith, is not connected at all here to the law applicable to the trust but exclusively to the law of the place in which the assets are situated. If the assets are located in a state whose domestic law does not recognise trusts, one of the most characteristic effects of Anglo-American trusts is completely ignored.

For all these reasons, a broad consensus exists today against treating trusts as contracts, on the grounds that this approach does not produce satisfactory solutions in Swiss private international law.

## **B. Successoral Characterisation**

Like foundations<sup>73</sup>, trusts may also result from a disposition effective on death by will or other similar instrument. However, such testamentary trusts are rarer than one might think, because Anglo-American laws tend to favour estate and tax planning measures that take effect before the transferor's demise. *Inter vivos* trusts are thus far more frequent than testamentary trusts,

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<sup>73</sup> CC, Art. 81 par. 1.

of which there do not appear to be any published examples in Swiss case law.

However merely to apply Chapter 6 of the SPILA (“Inheritance”), to testamentary trusts would be inadequate. Certainly, the formal and substantive validity of the will or the testamentary agreement are governed by the *lex successionis*<sup>74</sup>. The inheritance law governs the testator’s freedom to dispose of the assets on his death, and sometimes restricts it by imposing infeasible shares in favour of spouses or relatives. But the trust itself, as a lasting relationship between a trustee and one or more beneficiaries with regard to certain property, is not a successorial institution; its administration, the trustee’s duties, the beneficiaries’ rights under a validly constituted trust, and the position of third parties do not vary according to whether the trust arose from a disposition *inter vivos* or one that took effect on the settlor’s death. This proposition is confirmed by the SPILA, Article. 92, entitled “scope of the law governing inheritance and distribution of the estate”<sup>75</sup>, a category to which a validly constituted trust clearly does not belong. To re-employ a metaphor already used, the law of inheritance affects the possibility of creating a trust in respect of certain assets or a certain portion of an estate by means of a will and may thus compromise the trust’s validity (launcher). Once the trust (rocket) is launched, it is not governed by the law of inheritance.

Furthermore, the prohibition against any choice of law in matters of inheritance contained in many legal systems, and the narrow limits which surround this choice according to Swiss private international law<sup>76</sup>, are incompatible with the practice of carefully choosing the law applicable to such a trust according to its specific characteristics. From the Swiss point of view, a successorial characterisation of testamentary trusts would limit a choice to the law of the testator’s last domicile or to that of a state of which he is a citizen.

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<sup>74</sup> Art. 4 of the Convention expressly recognises this fact.

<sup>75</sup> SPILA, Art. 92 par. 1: “The law applicable to the inheritance estate determines what is included in the estate, who is entitled to inherit and for what share, who is liable for the debts of the estate, which legal institutions of inheritance law may be relied upon, and which measures may be ordered and subject to which requirements.”

<sup>76</sup> SPILA, Art. 90 par. 2 and 91 par. 2. See also the Hague Convention on the Law Applicable to Succession to the Estates of Deceased Persons of 1 August 1989, which has not yet taken effect <hcch.net>.

## C. Organised Estate

The weaknesses inherent to the contractual characterisation and a certain resemblance between trusts and an estate having a legal personality, such as a foundation, have induced legal writers, long before the SPILA was adopted, to treat trusts – or at least certain trusts – as analogous to an entity endowed with a separate legal personality and possessing its own patrimony<sup>77</sup>. Moreover, this approach reflects the influence of the “institutionalist” trust concept advanced by LEPAULLE in the 1930s<sup>78</sup>.

By treating any “organised estate” as analogous to the companies governed by Chapter 10, whether or not the organised estate possesses a legal personality or not<sup>79</sup>, the Swiss legislature has undoubtedly followed this path. The Federal Council’s message indicates, moreover, that the SPILA, Article 150 refers to “certain forms of trust”<sup>80</sup>, an idea taken up in all recent legal writings.

Though it is certainly often preferable to a contractual characterisation, the treatment of certain trusts as organised estates nevertheless poses a number of problems. The first relates to the requirement of organisation which characterises the organised estates referred to in the SPILA, Article 150. This requirement can only characterise express trusts and automatically disqualifies those imposed by a court or by law (statutory, implied, constructive and presumptive trusts)<sup>81</sup>.

There is a question of degree here, which has been appreciated to a varying extent by different legal writers. KLEIN and MAYER argue that all voluntary trusts should be governed by the rules contained in Chapter 10 the SPILA relating to companies, whether as organised estates within the

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<sup>77</sup> See the remarks of REYMOND, LALIVE and VISCHER on the *Harrison* case (note 69), which, in particular, followed up on BLOCH (1950) pp. 67-69 and SCHNITZER (1963) pp. 88 *et seq.*

<sup>78</sup> P. LEPAULLE, *Traité théorique and pratique des trusts en droit interne, en droit fiscal and en droit international*, Paris (Rousseau) 1932; see *supra* note 12 and *infra* note 83. The “institutionalist” concept clearly had a profound influence on Swiss legal writers and case law, as suggested by the following passage from a 1963 decision of the Federal Supreme Court on debt recovery: “the appellant is the beneficiary of an English alimony trust ... and lives on the proceeds of that institution” ATF 89 III 12, 13, *Saunders*.

<sup>79</sup> IPRG-VISCHER (1993) Art. 150 N. 12.

<sup>80</sup> FF 1983 I 255, n° 292.

<sup>81</sup> IPRG-VISCHER (1993) Art. 150 N. 15, approved by DUTOIT (1997), Art. 150 N. 5.



meaning of the SPILA Article 150 or by filling a *lacuna* in the law<sup>82</sup>. Limiting his analysis to US trusts<sup>83</sup>, BARTHOLD believes that any US express trust presents a sufficient degree of organisation to satisfy the SPILA, Art. 150<sup>84</sup>. VISCHER, von PLANTA and EBENROTH & MESSER rule out any answer *a priori* and argue that the degree of organisation must be verified *in concreto*<sup>85</sup>. Whereas certain trusts – such as unit or investment trusts, commercial trusts and charitable trusts in general – unmistakably display an externally recognisable organisation, that is not automatically true of all private trusts. A revocable trust probably does not meet this test: the control that the settlor may still exercise prevents it. What of an irrevocable trust where the beneficiaries' rights are fixed? Is the trust required to be discretionary in order to be sufficiently independent of the settlor and to be treated as an organised estate? These questions indicate a corresponding number of sources of legal uncertainty.

The Swiss Federal Supreme Court – the highest court in Switzerland – appears to have set a fairly low threshold by seeming to content itself with an express deed of trust which, combined with the law applicable to that trust, determines the trustee's rights and duties with sufficient precision<sup>86</sup>. In the *W.K. Rey* case, the Zurich court ruled that a trust having a similar function to a holding company and based on a written trust deed must be treated as a company within the meaning of the SPILA, Article 150<sup>87</sup>.

In principle, the characterisation of trusts (or certain trusts) as organised estates recognises the settlor's freedom to choose the law applicable to

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<sup>82</sup> F.E. KLEIN, "Die gesellschaftsrechtlichen Bestimmungen des IPRG", BJM 1989 359 *et seq.*, p. 362; MAYER (1998) pp. 103-137.

<sup>83</sup> The American concept of trusts undoubtedly tends towards a form of institutionalisation reminiscent of LEPAULLE: "Increasingly, modern common law and statutory concepts and terminology tacitly recognise the trust as a legal 'entity,' consisting of the trust estate and the associated fiduciary relation between the trustee and the beneficiaries." Restatement (Third) of Trusts, § 2, comment a (Tentative Draft No. 1, 1996).

<sup>84</sup> B. BARTHOLD, *Aussonderung von Treugut im schweizerischen Partikularkonkurs*, Zurich (Schulthess) 1997, pp. 154-158

<sup>85</sup> IPRG-VISCHER (1993) Art. 150 N. 15; IPR-von PLANTA (1996) Art. 150 NN. 12 & 13; C. EBENROTH & U. MESSER, "Das Gesellschaftsrecht im neuen schweizerischen IPRG", RDS 1989 I 49 *et seq.*, pp. 66-70.

<sup>86</sup> SC, SJ 2000 I 271 c. 2/e/bb & cc.

<sup>87</sup> Decision of 30 November 1994, ZR 1999 225 n° 52, under B.1, p. 229.

the trust (SPILA, Art. 154 par. 1)<sup>88</sup>. On the other hand, it does not provide the power – generally recognised in *common law* – to submit the administration of the trust to a law other than that governing the trust’s validity<sup>89</sup>.

When, however, the settlor has not made such a choice of law, the objective connecting factor seems inadequate, because the SPILA Article 154 par. 2 points to the law of the state in which the trust “is actually managed”. Although it is certainly one of the factors to be considered when the place of management was decided by the settlor (see Article 7 par. 2.a of the Convention), it does not have the decisive influence it possesses in company law. Moreover, it raises the problems discussed above in relation to the trustee’s domicile: change of trustee’s domicile, plurality of trustees, replacement of a trustee, submission of the trust to a different national law.

The legal questions characteristic of trusts are often difficult to relate to those, typical of company law, by which the SPILA, Art. 155 defines the “scope of the applicable law “. Thus:

- As a trust has no legal personality, only the trustee is capable of enjoying and exercising civil rights; is his ability to act in this capacity governed by the law applicable to the trust (as the SPILA, Art. 155 c suggests) or by the rules applicable to private individuals (SPILA Arts. 34 to 36)?
- Does an alienation made by the trustee in breach of trust correspond to the trustee’s lack of authority to act on behalf of the trust (SPILA, Art. 155.i), which could then be asserted against any purchaser domiciled in Switzerland provided that the latter “was or should have been aware of these restrictions” (SPILA, Art. 158)? Or is this question – and that of the beneficiaries’ right to trace assets – governed by the *lex rei sitae*<sup>90</sup> which, if Swiss law applies, views the trustee as a titleholder whose powers of disposition *erga omnes* are unfettered by his duties as a trustee?
- In the public registers that provide public notice of the registered rights and assets (real property, trademarks, patents), it is companies and foundations, not their directors, that are registered as the owners or titleholders of such rights. This method of registration informs third

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<sup>88</sup> MAYER (1998) p. 138, however, sees a problem in the fact that the private trust is not generally submitted to the registration, publication or organisation requirements necessary when applying the SPILA, Art. 154 par. 1.

<sup>89</sup> MAYER (1998) p. 139.

<sup>90</sup> Dominant opinion: IPRG-VISCHER (1993) Art. 150 N. 17;

parties, creditors and potential purchasers adequately. A trust cannot enjoy the same privilege, because it is not a legal entity holding title to the registered asset, but a legal relationship pertaining to the asset. Only the trustee can be registered: should he therefore be registered in his capacity as trustee<sup>91</sup>? Treating a trust as a company within the meaning of the SPILA Chapter 10 resolves neither this problem nor other similar issues.

- May not the assets in trust be used to satisfy the debts contracted by the trustee only to the extent permitted by the law applicable to the trust (SPILA, Art. 155.h): this restriction should protect them from seizure by the trustee's personal creditors, including enforcement against assets located in Switzerland? Or do Swiss international public policy and the law of debt enforcement and bankruptcy guarantee to the trustee's personal creditors (if the trustee is domiciled in Switzerland or regardless of his place of domicile?) that they may obtain enforcement against all assets located in Switzerland to which the trustee has title, regardless of his trustee status?

This last question is doubtless one of the most complex in law and also one of the most sensitive for the Swiss financial marketplace as the depository and management centre of substantial assets controlled by trustees. Concerning enforcement, should the trustee be treated as a fiduciary transferee within the meaning of Swiss law, which does not permit exclusion of trust assets in favour of the fiduciary transferor (or beneficiaries) other than as provided by statute (Code of Obligations, Art. 401; Federal Act on Investment Funds, Art. 16; Federal Banking Act, Art. 37b)? Regrettably, the characterisation of trusts as organised estates within the meaning of the SPILA, Article 150 par. 1 fails to answer this question with certainty, a fact that has stimulated a particularly rich and interesting scientific debate<sup>92</sup>. However,

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<sup>91</sup> Legal writers are divided, see MAYER (1998) p. 152; BREITSCHMID (1995) p. 65.

<sup>92</sup> See in particular MAYER (1998) pp. 148-153 (the trustee's personal creditors have no recourse only insofar as Swiss domestic law excludes assets in favour of the fiduciary transferor or beneficiary of a fiduciary transfer: CO, Art. 401; FAIF, Art. 16 FAIF; FBA, Arts. 16 and 37b); SUPINO (1994) pp. 236-243 (full recognition of the rules resulting from the applicable law); D. ZOBL, *Die Aussonderung von liechtensteinischem Treuhandgut in der schweizerischen Zwangsvollstreckung*, Zurich (Schulthess) 1994, *passim*, in particular pp. 85-96 (exclusion in favour of the beneficiaries of a Liechtenstein *Treuhand*); BARTHOLD (1997) pp. 162-180 (exclusion in favour of the beneficiaries of US trusts, whose position is likened to usufruct holders in Swiss law) and pp. 109-119 (no exclusion in favour of the beneficiaries of a Liechtenstein *Treuhand*, save in cases recognised by Swiss law, e.g., CO, Art. 401).

the variety of opinions expressed and the total silence of published cases on this subject does not offer any security to settlors, trustees or beneficiaries of foreign trusts, even though Swiss private international law recognises the validity of such instruments.

Though the treatment of trusts as companies or organised estates under the SPILA, Chapter 10 seems generally preferable to a contractual characterisation, it is inadequate to supply sufficiently predictable answers to some of the most important questions that arise in international trust practice. Swiss domestic legislation contains a lacuna that justifies a serious examination of the advantages of joining the 1985 Convention on the law applicable to trusts and on their recognition. Consequently, we will now examine methodically the extent to which the provisions of the Convention are compatible with the fundamental principles of the Swiss legal system.

## V. Trusts, Inheritance and Indefeasible Shares

Whether it is established during the settlor's life (*inter vivos* trust) or by a provision taking effect at his death (testamentary trust), a trust is an exceptionally useful estate planning tool for the citizens and residents of countries whose law contains this instrument. Such individuals travel, occasionally establish domicile in Switzerland or own assets located here. The Swiss legal system cannot remain indifferent to this type of situation, which in particular gave rise to the *Harrison* decision, which stirred a debate that extended well beyond Swiss borders<sup>93</sup>. Similarly, a growing number of trusts have been created by Swiss citizens who live or have lived abroad, but whose succession may be governed by Swiss law<sup>94</sup>. Whereas the nationals of states whose law comprises trusts can choose their national law to govern both the trust and their succession (*professio iuris*, SPILA,

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<sup>93</sup> See *supra*, note 2. According to the French government delegate to the Hague Conference, testamentary trusts were the basis for 90% of the decisions made by French courts in relation to trusts, see *Proceedings* (1985) p. 247.

<sup>94</sup> Because of their last domicile, SPILA, Art. 90 par. 1, or by choice of law (*professio iuris*), SPILA Arts. 87 par. 2 and 91 par. 2.

Art. 90 par. 2<sup>95</sup>), Swiss citizens cannot do likewise because trusts are unknown in Swiss domestic law.

The Convention applies not only to trusts constituted during the settlor's lifetime (*inter vivos* trusts), but also to those created on death (Article 2 par. 1)<sup>96</sup>. However, it does not affect the validity of wills (Article 4), which is governed by the law designated by the conflict rules of the court seized of the matter: If a Swiss court is seized, the question is governed by the SPILA Article 90 *et seq.* In addition, the Convention reserves the mandatory rules of this same law which, like the rules on inalienable shares, may apply even though a trust has been validly constituted, particularly during the settlor's lifetime (Article 15 par. 1.c).

The Convention consequently requires the courts to distinguish carefully between questions governed by the law applicable to the trust and those that are reserved for the law applicable to the inheritance.

Experience shows that disputes relative to a private trust created during the deceased's lifetime in the context of a succession governed by Swiss law (or by another law deriving from the Romano-Germanic tradition) are not infrequent. The most common problems relate first, to the efforts of the heirs entitled to inalienable shares to obtain information about the trust which will enable them to check whether their inalienable shares have been complied with; second, if need be, the remedies to recover the shares. However, these problems only concern family trusts. They do not occur in relation to other types of trusts (investment trusts, security trusts, etc.) whose contacts with the Swiss legal system have already been mentioned.

None of the civil law countries that have hitherto ratified or adhered to the Convention (Italy, the Netherlands, Malta) have adopted legal provisions relative to these problems.

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<sup>95</sup> Swiss case law appears to accept this on the basis of credible circumstantial evidence, even if the testator's intent in this respect is not fully expressed, ATF 125 III 35, SJ 1999 I 298.

<sup>96</sup> This precision was added by the Conference to the draft prepared by the Special Commission, see *Proceedings* (1985), pp. 167, 208, 227 (working paper n° 8), 247-248 and 313.

## A. Reconstitution of Indefeasible Shares

Trusts were created and flourished in the common law tradition, which differs historically from legal systems inspired by the Roman legal tradition by granting the testator almost unfettered freedom to make dispositions effective on death. Trusts (both *inter vivos* and testamentary) simultaneously correspond to the expression of this freedom and are a means of exercising it by organising, for long periods often extending over several generations, the devolution of a more or less large portion of the settlor's estate. The collision between trusts, created in the common law system, and indefeasible shares deriving from civil law thus seems both inevitable and difficult to resolve.

However, at least two qualifications must be made to this scenario.

First, common law systems have evolved. With the apparent exception of South Dakota, all contain rules assuring the surviving spouse and descendants a certain continuity of the deceased's maintenance obligations<sup>97</sup>. Whereas indefeasible shares are calculated as so many portions of the estate, these rules of common law systems differ from them as a result of the court's discretion to determine the payments owed by the estate to the privileged heirs. Generally speaking, this protection of the spouse and descendants comes into play if the testator has not already taken the necessary measures to provide for such persons, their education or their material well-being. Consequently, we should not contrast states that provide for indefeasible shares with those that do not protect the close relatives of the deceased. The proper distinction is between systems in which such rules are applied automatically and those that require the court to take all the circumstances into consideration to determine the shares devolving to certain privileged heirs.

Second, in some civil law systems indefeasible shares have long co-existed with trusts. Without discussing more recent developments, such as the addition of trusts to the laws of Japan, Liechtenstein and a number of Latin American states, two examples will be mentioned here<sup>98</sup>. Long be-

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<sup>97</sup> The United Kingdom's 1975 Inheritance (Provision for Family and Dependents) Act even protects certain dependants who are not legally related to the deceased.

<sup>98</sup> Quebec, though a distant heir to the Napoleonic code, renounced indefeasible shares in favour of the principle of a surviving maintenance obligation (Arts. 684 to 695 of the 1991 Civil Code), the amount of which is set by the court according to circumstances, and limited to a maximum of half the legal shares on intestacy. The protection of this maintenance obligation is in particular assured by an action in abatement (Arts. 689 *et seq.*).

fore it was joined to the United Kingdom, the law of Scotland included genuine form of trust. Its law of inheritance is still characterised by a system of indefeasible shares, known as the legal rights, including the surviving spouse's *ius relictæ* and the descendants *legit*. However, these preferential rights, which limit the freedom to make dispositions effective on death, only apply to movable property<sup>99</sup>. Given the brief discussion of this matter in the treatise that is currently the authority in the field position, the relationship between these legal rights and trusts constituted by a deceased settlor do not appear to raise major problems<sup>100</sup>. Louisiana also has a rigid system of indefeasible shares<sup>101</sup>, partially inherited from the French Civil Code, a principle enshrined in that state's constitution<sup>102</sup>. Consequently, the Louisiana legislature took particular care to ensure the effectiveness of those rules when it codified trusts<sup>103</sup>. In particular, excessive gifts are liable to abatement<sup>104</sup>.

Swiss law, like many of the legal systems represented at the Hague Conference of 1984, contains rules on matrimonial property rights (*infra* Trusts and Matrimonial Property Rights) and a generous system of indefeasible shares. Unless there are grounds for disinheritance, the testator's freedom of disposition is reduced to the available portion of the estate. The available portion varies according to who the legal heirs may be<sup>105</sup>. Articles 470 to 480 of the Civil Code protect the inheritance prospects of the testator's descendants, parents and surviving spouse. It would not be desirable to change this system; at any rate, no plan to do so is under discussion. That is why it is advisable to examine how the Convention on trusts guar-

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<sup>99</sup> For a very brief discussion: R. MACDONALD, "Scotland", in *European Succession Laws*, D. HAYTON (ed.), Bristol (Jordans) 1998, NN. 4.151-155 pp. 96 s.

<sup>100</sup> WILSON & DUNCAN (1995) NN. 9-60 to 9-63 pp. 142 s.

<sup>101</sup> The indefeasible shares of descendants (born in wedlock) are governed by Arts. 1493 to 1505 of the Louisiana Civil Code, under the heading "The disposable portion and its reduction in case of excess". The surviving spouse's share (*marital portion*) is governed by Arts. 2432 to 2437.

<sup>102</sup> Article 12 § 5 of the Louisiana State Constitution of 1974. A two-thirds legislative majority was needed to abolish, on 21 October 1995, the legal reserve in respect of descendants enjoying legal capacity who have attained their twenty-fourth year (Civil Code, Art. 1493).

<sup>103</sup> Louisiana Trust Code (1964), codified in the Louisiana Revised Statutes §§ 9:1841-1847.

<sup>104</sup> Arts. 1503 to 1505 of the Louisiana Civil Code.

<sup>105</sup> CC Arts. 477 to 480.

antees the infeasible shares imposed by the law applicable to the settlor's succession, especially when it is Swiss substantive law.

Furthermore, though CC Articles 470 to 480 are undoubtedly mandatory rules<sup>106</sup>, they apply only to international situations in which Swiss law is the *lex successionis*, i.e. the national law designated by the forum's conflict rules (Article 15 par. 1.c of the Convention). Private international law recognises the validity of a choice of law in favour of the law of a state of which the testator is a citizen<sup>107</sup>. Infeasible shares are not part of Switzerland's international public policy<sup>108</sup>.

According to Swiss law, to which we shall now limit our analysis as the *lex successionis*, failure to comply with infeasible shares does not make the disposition *inter vivos* or on death null and void or voidable. Rather, the heir whose rights are injured may bring a legal action to abate the excessive testamentary provisions and, insofar as necessary to reconstitute the reserve, to restore any benefits received by third parties during the testator's lifetime<sup>109</sup>. This action is subject to a twofold time requirement which severely limits the legal uncertainty burdening the beneficiaries of dispositions effective on death and of gifts which might turn out to be excessive<sup>110</sup>.

## 1. Testamentary Trusts

By nature, trusts created by the settlor's testamentary dispositions are dispositions effective on death: they do not affect the settlor's estate before his

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<sup>106</sup> The fact that the heir whose infeasible share is violated may waive his right to sue for abatement does not change the nature of the provisions regarding such shares, which are binding on the testator, see von OVERBECK (1985a) N. 137 p. 401.

<sup>107</sup> SPILA, Art. 90 par. 2.

<sup>108</sup> See ATF 102 II 136, JdT 1976 I 595, *Hirsch c. Cohen*; approved by S. OTHENIN-GIRARD, *La réserve d'ordre public en droit international privé suisse: Personnes – familles – successions*, Zurich (Schulthess) 1999, pp. 595-600. See, however, ATF 118 II 108 (violation of public policy by the French law of inheritance, which discriminates against children born out of wedlock and not subsequently legitimised?).

<sup>109</sup> ATF 110 II 228 c. 7c, JdT 1985 I 630.

<sup>110</sup> One year from the date on which the heir entitled to the infeasible share learns of the violation and at most ten years from the opening of the deed or the succession, CC, Art. 533 par. 1. However, the action in abatement may be opposed at any time as a defence to a claim, CC, Art. 533 par. 2.



demise<sup>111</sup>. In a testamentary trust, the Convention differentiates between wills and trusts, the former being the legal instrument that constitutes the trust. Pursuant to Article 4, 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.”

The formal and substantive validity of a will is governed by specific conflict rules which, for the Swiss judge, are found in the SPILA Articles 90 to 95 as well as in the Hague Convention on the conflicts of laws relating to the form of testamentary dispositions of 5 October 1961<sup>112</sup>. If the testamentary disposition in question is deemed valid at this first stage, the trust then falls within the scope of application of the Convention on the law applicable to trusts and on their recognition, Articles 6 and 7 of which designate the law applicable to the trust<sup>113</sup>. This second stage intervenes only after the first. The 1984 conference frequently used the image of a launcher (disposition *inter vivos* or effective on death by which the settlor transfers to the trustee the legal title to the assets) and a rocket (the trust itself)<sup>114</sup>.

Thus a testamentary trust can be validly created only if the testamentary disposition in question is formally and substantively valid under the law applicable to the inheritance. Before a Swiss court, two situations occur in this respect.

In the first hypothesis, the law applicable to the succession (designated by the SPILA, Art. 86 *et seq.*) allows the testator, by a disposition effective on death, to constitute a trust in respect of any or all of the estate’s assets. If need be, such law adapts this freedom to the mandatory rules protecting the infeasible rights of certain privileged heirs. If the testamentary disposition in question is valid under these rules, it is capable of creating a trust whose validity must be governed by the law applicable to the trust. The *lex successionis* and the law applicable to the trust do not necessarily coincide: they are designated by different conflict rules. The testamentary trust must meet the requirements as to form and substance for both laws.

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<sup>111</sup> See *supra* IV.B: Successoral Characterisation.

<sup>112</sup> RS 0.211.312.1; see also [www.hcch.net](http://www.hcch.net).

<sup>113</sup> See D.W.M. WATERS, Explanatory Report on the Convention on the Law Applicable to Succession to the Estates of Deceased Persons of 1 August 1989, in *Proceedings of the Sixteenth Session*, vol. II: *Succession to estates — applicable law*, The Hague (Permanent Bureau) 1990, N. 108 p. 586 2nd paragraph.

<sup>114</sup> See *supra* note 62.

In the second situation, Swiss law or a similar law is the national law applicable to the succession. The Swiss Civil Code, which allows the creation of a foundation by will (CC, Art. 81 par. 1), does not recognise the creation of a trust by a disposition effective on death. Furthermore, the “methods of disposition”<sup>115</sup> are limited in number (*numerus clausus*)<sup>116</sup>. A disposition of a type unknown to Swiss law is null and void from the outset<sup>117</sup>.

The conversion<sup>118</sup> of such a void disposition into a bequest or the appointment of an heir subject to a charge or lawful substitution appears difficult<sup>119</sup>. It is unlikely that the charge would be so detailed that it might determine with adequate precision the fate of the assets placed in trust. However, the Swiss law of inheritance postulates the eminently personal nature of dispositions on death: in principle it does not permit the testator to delegate to a third party the power to appoint certain beneficiaries in preference to others, or to determine their respective shares<sup>120</sup>. The attempt to establish a discretionary trust of this kind thus appears void from the outset. An attempt to constitute a trust with fixed interests might possibly be converted, within in the narrow confines of Swiss law, into a series of conditions or of substitutions of beneficiaries<sup>121</sup>. If the testamentary clause in question can be converted in this way into one or more dispositions valid under Swiss law, the protection of the indefeasible shares would easily be assured: Like all other dispositions effective on death, it would be subject to the action in abatement contained in CC Article 522.

<sup>115</sup> Title of Chapter III of the fourteenth title of the Civil Code.

<sup>116</sup> DRUEY (1997) § 4 N. 19; PIOTET (1975) pp. 77 *et seq.*

<sup>117</sup> GUINAND & STETTLER (1999) N. 136 under d), p. 76; DRUEY (1997) § 12 NN. 60 & 64; PIOTET (1975) p. 250; H.M. RIEMER, “Nichtige (unwirksame) Testamente und Erbverträge”, in *Festschrift Max Keller*, Zurich (Schulthess) 1989, pp. 245 *et seq.*, esp. pp. 252-253.

<sup>118</sup> PIOTET (1974) p. 196; DRUEY (1997) § 12 N. 23; von TUHR *et al.* (1979) t. I pp. 228 s.

<sup>119</sup> *E.g.*, conversion of a foundation for unlawful maintenance into a valid family foundation: ATF 75 II 81 c. 4, JdT 1949 I 595.

<sup>120</sup> ATF 81 II 22 c. 8, JdT 1955 I 584; ATF 68 II 155 c. 7, JdT 1942 I 626. Less strict: ATF 100 II 98 c. 3 (validity of a clause providing “the remainder of my money for the lepers”). For a more liberal view: J.Ch. SCHÄRER, *Der Grundsatz der materiellen Höchstpersönlichkeit*, doctoral dissertation presented at Berne, 1973 (which proposes a framework and conditions under which some delegation should be permitted), approved by DRUEY (1997) § 12 N. 63 and § 8 NN. 23 *et seq.*; PIOTET (1975) p. 77.

<sup>121</sup> CC, Art. 488 par. 2 limits the substitution of beneficiaries to a single step, i.e. a single party can bear the burden of transmission.

## 2. *Inter Vivos Trusts*

The protection of inalienable shares poses more complex and frequent problems in connection with trusts constituted during the settlor's lifetime (*inter vivos* trusts).

First, we must bear in mind that the constitution of a trust (or the allocation of fresh assets to an existing trust) during the settlor's lifetime does not necessarily correspond to a gift to the beneficiaries. The interests acquired by the beneficiaries may be in consideration of services or benefits granted to the settlor (*e.g.*, trusts constituted to provide security for the settlor's creditors) or for services rendered directly to the trust fund (*e.g.*, unit trusts, in which the beneficiaries' share in the collective investment is proportionate to their contributions; also pension funds organised in the form of trusts; etc.). Therefore, it is necessary to establish a criterion distinguishing trusts that constitute gifts from those that are constituted in return for advantages received by the settlor.

One can not judge whether the trust is or is not supported by valuable consideration from the trustee's standpoint. Unless he himself is one of the trust beneficiaries, the acquisition of title to the assets placed in trust confers no economic advantage on the trustee other than possible compensation for his services. His ownership is burdened by onerous duties relative to the conservation, administration and investment of the assets in trust and, especially, the duty to distribute them to the beneficiaries without receiving anything from the latter in return. Therefore, it is necessarily from the standpoint of one or more beneficiaries that one must evaluate the valuable consideration (or lack of it) given for the trust. Swiss legal writers and case law define gifts (*libéralités; Zuwendungen, unentgeltliche Zuwendungen*)<sup>122</sup> as any voluntary economic sacrifice in favour of others (wholly or partially)<sup>123</sup>. The constitution of a trust is a gift from the settlor insofar as distributions stipulated in the trust deed are, from the beneficiaries' point of view, in the nature of gifts from the settlor. A private trust set

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<sup>122</sup> The law employs this term without ever defining it, see, in particular CC Arts. 208, 225, 321, 473 *et seq.*, 520 *et seq.*, 626 *et seq.*, CO Arts. 246 and 526. Under the margin heading "Gifts", DEBA, Art. 286 includes any donation and any disposition made without consideration.

<sup>123</sup> DESCHENAUX, STEINAUER & BADDELEY (2000) N. 1426; HAUSHEER, REUSSER & GEISER (1996) Art. 238 N. 20; PIOTET (1975) pp. 277 *et seq.*, esp. p. 281.

up to ensure transmission of a personal estate over one of more generations is a gift in favour of the beneficiaries, even though the settlor is, at least partially, performing a moral obligation.

**a) *Distributions made by the Trustee to the Beneficiaries before the Settlor's Demise***

Since whether a trust was constituted with or without valuable consideration must be looked at from the beneficiaries' standpoint, the value of any distributions they may already have received must be added to the inheritance estate insofar as they are in the nature of gifts and affect the indefeasible shares to such an extent that they are liable to an action in abatement (CC, Arts. 475 and 527). Such gifts made during the settlor's lifetime, must be likened to donations<sup>124</sup> and are, in most cases liable to an action in abatement if they are made within the five years preceding the settlor's death (CC, Art. 527, sub-par. 3) or if they were made by the deceased "with the manifest intention of evading the rules on indefeasible shares" (CC, Art. 527, sub-par. 4). Moreover, beneficiaries in good faith need only restore the value of their enrichment as of the date when the succession is opened (CC, Art. 528 par. 1).

**b) *Trust Fund at the Time of the Settlor's Demise***

The restitution to the estate and abatement of distributions already received by the beneficiaries will not necessarily suffice to reconstitute the indefeasible shares. The trust corpus still existing at the settlor's death must also be taken into account because it represents gifts deferred in time. The characterisation as a gift, which is the reason why it is subject to the action in abatement, must be appreciated from the beneficiaries' viewpoint. On the other hand, the total value of the gifts made by the settlor via the trust necessarily includes the value of the assets not yet distributed, estimated at the date of death<sup>125</sup>.

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<sup>124</sup> See *infra* note 129 and V.A.2.c).

<sup>125</sup> CC Arts. 474 par. 1 and 537.

Consequently, insofar as the distributions provided for by the trust deed are in the nature of gifts to the beneficiaries, the trust fund at the time of the death represents deferred gifts. It must be added to the existing assets to calculate the indefeasible shares. To the extent necessary, it is – like the distributions already made to the beneficiaries – subject to abatement and restitution.

The conditions under which the trust fund is subject to abatement depend, however, on characterisation: is it a gift *inter vivos* or effective on death? In the first case, the action in abatement affects the trust fund only if the trust was revocable during the settlor's lifetime, if the assets were transferred to the trustee in the five years preceding death, or if they were transferred to him "with the manifest intention of evading the rules on indefeasible shares" (CC, Art. 527). In the second case, all of the assets in hands of the trustee at the date of the settlor's death would be subject to an action in abatement to the extent necessary to reconstitute the indefeasible shares (CC, Art. 522); in reality, the trust would be purely and simply ignored and the trust corpus in its entirety would be treated as part of the inheritance estate.

For the purposes of the action in abatement, transfers of property made to the trustee during the settlor's lifetime and remaining in the trust fund on the date that the succession takes effect must be treated as gifts *inter vivos* (art. 527 CC). Indirect gifts are already recognised in Swiss law, particularly in relation to foundations. The impoverishment of the donor (founder or settlor) does not necessarily coincide with the enrichment of the beneficiaries of the foundation or the trust. Swiss cases and legal writers consider that the decisive moment is when the founder makes a disposition in favour of the foundation and treat it as a gift *inter vivos*<sup>126</sup>. Unlike a disposition effective on death, which affects the deceased's estate only after his death, the creation of a foundation or a trust affects the settlor's estate immediately<sup>127</sup>. In the law of inheritance, and more particularly the rules on actions in abatement, it is the moment when the donor relinquishes the prop-

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<sup>126</sup> RIEMER (1975) ART. 82 NN. 6-7; BaK-GRÜNINGER (1998) Art. 82 ZGB NN. 1-2; ATF 90 II 365 c. 3c, JdT 1965 I 331; ATF 99 II 246 c. 9h, JdT 1974 I 252.

<sup>127</sup> In the same way as gifts *inter vivos* (CO, Art. 239), referred to in CC, Art. 527 (3).

erty that must be considered, and not the date on which the ultimate beneficiaries are enriched<sup>128</sup>.

Like the constitution of a foundation, the creation of a trust must be treated as a donation<sup>129</sup>. In particular, the heirs of indefeasible shares can seek abatement of the trust fund as of the date of death if the trust was revocable by the settlor in his lifetime, in cases where the assets were transferred to the trustee in the five years preceding the settlor's death (CC, Art. 527 sub.-par. 3) or where the settlor had "the manifest intention of evading the rules on indefeasible shares" (CC, Art. 527 sub.-par. 4). Such an intention must be found in particular where the settlor, in his lifetime, was directly or indirectly the exclusive or principal beneficiary of the trust or retained *de facto* control over the trust fund. Such trusts should be considered as purely successoral mechanisms intended to defeat the rules on indefeasible shares.

### c) *Proposed Amendments to the Civil Code*

To improve the predictability and legal security that should result from Switzerland's ratification of the Convention, it would be advisable to clarify in the Civil Code the way in which the action in abatement applies to trusts that constitute gifts to beneficiaries. Whereas the beneficiaries who received distributions before the settlor's death have standing to be sued for abatement to the extent of the value received, only the trustee can defend such an action in respect of the assets that he still holds.

For the trust fund in the hands of the trustee, it is best to allow the trustee to choose between restitution in kind or of equivalent value. Indeed, the trustee is charged with administering the assets entrusted to him in the interest of all the beneficiaries. The types of investment are determined by the nature of the assets placed in trust by the settlor, by the clauses of the

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<sup>128</sup> See the French Cour de Cassation (First Civil Chamber), decision of 20.2.1996 (*Ziesenis*), JCP 1996 II 22647, note BÉHAR-TOUCHAIS, *Rev. crit. dr. int. privé* 1996 692 obs. DROZ

<sup>129</sup> CC, Art. 82 formally expresses the analogy ("like a gift") owing to the unilateral nature of foundations, which distinguishes them from contracts (bilateral) for gifts pursuant to CO, Art. 239, see RIEMER (1975) Art. 82 N. 6. Like foundations, trusts are based on a unilateral act by the creator, and all distributions are similarly based on this unilateral act and the trustee's unilateral acts.

trust deed and the likely frequency of distributions provided for in the deed. Assets in trust are not always easy to divide or to realise. Rather than obliging the court to determine which assets should be restored to the successful plaintiffs or realised in their favour, it is better to order the trustee to pay a sum of money at the expense of the trust fund. This solution is all the more necessary where the trust corpus consists of a business and the settlor sought to ensure that it would continue its activity. Insofar as the action in abatement does not exhaust the trust fund, the interest of the beneficiaries subsists, and it would be better not to compel dismemberment of the business by allowing the trustee to find or to raise the capital necessary to indemnify the heirs whose inalienable shares have been violated.

The provisions of the Civil Code governing the abatement of gifts *inter vivos* might, therefore, be completed in the following way:

**Art. 527**, new paragraph

<sup>2</sup> 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. 528a** (new)                      c. Trusts

<sup>1</sup> 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 trustee still holds.

<sup>2</sup> The trustee shall be entitled to make restitution of equivalent value.

Whether these dispositions are inserted into the Civil Code or a specific statute on the trusts subject to the Convention<sup>130</sup>, they are in substance part of Switzerland's inheritance law and are thus applicable only insofar as that law governs the inheritance according to the forum's conflict rules.

The action in abatement against the trustee and the beneficiaries is an inheritance dispute, which as a rule falls within the jurisdiction of the courts at the testator's last domicile<sup>131</sup>. The trustee's domicile is not inevitably in Switzerland and the assets in trust are not necessarily located here. En-

<sup>130</sup> For aspects of legislative technique, see *infra* XVI.

<sup>131</sup> CC, Art. 538; SPILA, Art. 86 par. 1; Federal Act on Venue in Civil Cases (the "Federal Venue Act"; *loi fédérale sur les fors, Gerichtsstandsgesetz*) of 24 March 2000, Art. 18 (RS 272, RO 2000 2355). The Swiss court may also have jurisdiction because the deceased was a Swiss citizen and chose Swiss law, SPILA, Art. 87.

forcement of a judgement ordering a trustee to pay monies to the heir entitled to an indefeasible share could turn out to be problematic if the necessary assets are situated abroad. Indeed, some recent trust laws include provisions aimed at shielding trusts from inheritance claims by heirs entitled to indefeasible shares; they provide that the validity of the property transfer to the trustee and that of the trust itself is wholly unaffected by foreign provisions establishing indefeasible shares<sup>132</sup>.

From the point of view of Swiss private international law, such a rule pertains more to the law of inheritance than to trust law. Moreover, it tends to frustrate the application of Article 15 par. 1.f of the Convention, which prevails – according to the Swiss conception of the relationship between international and domestic law – as a norm of superior rank. A rule of this nature will simply be ignored when the law applicable to the inheritance, according to forum's conflict rules, constitutes heirs with indefeasible shares. A judgement against the trustee might result in enforcement against the assets in trust located in Switzerland. In the absence of an international convention on the subject<sup>133</sup>, recognition and enforcement of this judgement abroad could be problematic if the assets in trust are situated in a jurisdiction which does not recognise the mandatory nature of the indefeasible shares created by the *lex successionis*.

## **B. Heirs to Indefeasible Shares: Right to Information from the Trustee**

However, merely providing that heirs whose entitlement to indefeasible shares is violated have an action in abatement against a trust constituted by the settlor in his lifetime is not enough to protect the heirs if they do not possess the information they need to assert their rights. In addition, they need such information to decide if it is advisable to repudiate an inheritance

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<sup>132</sup> E.g., Trusts (Jersey) Law, Art. 8A(2)(b) of the, introduced by the Trusts (Amendment) (Jersey) Law 1989; [Bahamas] Trusts Choice of Governing Law Act 1989, Art. 8 (b); [Bermuda] Trusts (Special Provisions) Act 1989, Art. 11 (b). D. HAYTON proposed the adoption of a similar rule in English law: "Developing the law of trusts for the twenty-first century", *The Law Quarterly Review* 106 (1990) pp. 87 *et seq.*, 95-96.

<sup>133</sup> The Lugano Convention (RS 0.275.11) does not concern inheritance; nor does the future Convention on jurisdiction and foreign judgements in civil and commercial matters, currently being prepared by the Hague Conference on private international law.



where the remaining assets do not cover the liabilities. This problem is not new and is frequently the subject of judicial decisions and legal writings because the Civil Code does not explicitly lay down a general duty to provide information, except in respect of the heirs themselves (CC, Art. 607 par. 3 & 610 par. 2 ) or third parties, but only in the context of a inventory of assets for inheritance purposes (CC, Art. 581 par. 2). However, the peculiarities of trusts demand, if we wish to recognise foreign trusts without compromising a fundamental principle of the Swiss law of inheritance, that we provide an express legal basis for allowing the heirs to indefeasible shares to obtain the information necessary to exercise their rights.

At risk of over-simplification, the case law of the Federal Supreme Court may be summarised as follows. The heirs (and also the executor, and even the official administrator of the estate for inheritance purposes) have a statutory right to obtain the information necessary to assert their rights to the estate and to ensure that the estate is distributed according to law<sup>134</sup>. This right can be exercised individually by each heir<sup>135</sup>. It can be exercised, in particular, against the depository of the estate's assets; if it is a bank, it cannot refuse to comply on the grounds of banking secrecy<sup>136</sup>. The heir to an indefeasible share has a more extensive right to information, which concerns not only the assets that were the deceased's property at his death, but also transfers made in his lifetime insofar as they are liable to be returned or subject to abatement<sup>137</sup>. The recent case law of the Federal Supreme Court even seems to uphold the right to obtain banking information on the assets that the deceased transferred to a non-resident company to the extent that he remained the economic beneficiary thereof<sup>138</sup>.

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<sup>134</sup> ATF 89 II 87 c. 6; ZR 1965 190 n° 136 c. 1 & 2.

<sup>135</sup> ATF 82 II 555 c. 7, JdT 1957 I 136, confirmed *obiter* by ATF 121 III 118 c. 3, summarised in JdT 1995 I 274.

<sup>136</sup> ATF 89 II 87 c. 6. On the "facts of a strictly personal nature" that the bank may have a duty not to reveal: ATF 74 I 493.

<sup>137</sup> ATF 90 II 365 c. 2a, JdT 1965 I 330; SC, Rep. 1993 127 c. 4b (schedule of assets); see the decision of the Geneva Court of Appeal of 11.12.1998, in ASSOCIATION GENEVOISE DE DROIT DES AFFAIRES, Seminar documents, 5 May 1999 "Trusts étrangers et ordre juridique suisse", pp. 90-93; *ditto* of 6.03.1997, unpublished (ACJC /297/1997), cited by STANISLAS (2000) n. 73 p. 438.

<sup>138</sup> SC, Rep. 1996 5. See LIMBURG & SUPINO (1999) pp. 206-208, who discuss unpublished decisions.

Fundamentally, legal writings agree with case law on this issue<sup>139</sup>. Some scholars rightly point out that an heir's right to information is limited to its purpose, *i.e.* to the need to implement inheritance rights<sup>140</sup>.

By ratifying the Convention, the Swiss legislature cannot merely leave it to the courts to ensure that the heirs to indefeasible shares receive the information they need to take advantage of their rights in the context of a trust. If the heir is also a beneficiary of the trust, the law governing the trust generally guarantees him the right to demand an accounting from the trustee, which enables him to ensure that his rights to the estate are respected<sup>141</sup>. Certainly, it does not seem very difficult to extend the case law of the Federal Supreme Court, particularly regarding foundations and non-resident companies<sup>142</sup>, to cover trusts. However, we should not underestimate the significant differences existing between the law of trusts as expressed in most common law jurisdictions and Swiss law.

The law of trusts broadly imposes a general a duty of confidentiality on the trustee vis-à-vis all third parties<sup>143</sup>. The duty to account to the beneficiaries, and provide information to the court or the protector, are exceptions to this rule. To any Anglo-American trustee, judge or lawyer, it seems inconceivable to impose on the trustee a duty to provide a settlor's heir with information about the value and composition of the trust fund, on the trust's

<sup>139</sup> See, above all, M. AUBERT *et al.*, *Le secret bancaire suisse*, 3<sup>rd</sup> ed., Berne (Stämpfli) 1995, pp. 329-332; A. MEIER-HAYOZ & P. FORSTMOSER, "Die Auskunftsrechte von Erben gegenüber Banken", *Deutschland-Schweiz: Zeitschrift zur Förderung der Wirtschaftsbeziehungen* 1970 pp. 536 *et seq.*; STANISLAS (2000) pp. 333 *et seq.*; A. OSWALD, *Die Auskunftsspflicht im Erbgang*, thesis, Zurich (Juris) 1976, esp. pp. 5-7, 28, 68, 78; P. SCHWAGER, *Das schweizerischen Bankgeheimnis...*, Fribourg dissertation, Zurich (Schulthess) 1973, pp. 121-125. Regarding the executor of a will, see KÜNZLE (2000) pp. 264 *et seq.*; P. BREITSCHMID, "Die Stellung des Willensvollstreckers in der Erbteilung", in *Praktische Probleme der Erbteilung*, Berne 1997, p. 119; BaK-KARRER (1998) Art. 518 N. 18.

<sup>140</sup> B. KLEINER & R. SCHWOB, in *Kommentar zum Bankengesetz*, Zurich (Schulthess), Art. 47 N. 19 (June 1996 supplement); J.N. DRUEY, "Der Anspruch des Erben auf Information", *BJM* 1988 113-132. Thus, there is no right to information regarding a gift *inter vivos* once the action in abatement is time-barred: STANISLAS (n. 137), p. 335.

<sup>141</sup> Some jurisdictions even tend to deprive beneficiaries of their right to information, a questionable practice that may compromise the international recognition of such trusts, see D. HAYTON, "Anglo-Trusts, Euro-Trusts and Caribbo-Trusts: Whither Trusts?", in *Modern International Developments in Trust Law*, ed. by D. Hayton, The Hague etc. (Kluwer Law International) 1999, pp. 1 *et seq.*, esp. pp. 14-16.

<sup>142</sup> See *supra* notes 137 & 138.

<sup>143</sup> For a general discussion: BROWNBILL (2000).

beneficiaries and on distributions already made, unless the heir is also a beneficiary. The idea that this information is owed because it is required for the protection of indefeasible shares appears curious, because those legal systems do not have a comparable approach to these shares<sup>144</sup>.

A trustee confronted with this situation, even though he is subject to the territorial jurisdiction of the Swiss courts, is in grip of conflicting duties. The law applicable to the trust orders him to protect the interests of the beneficiaries and the efficacy of the trust by remaining silent to any third party, even the settlor's heirs, about the very existence of a trust. The law applicable to the settlor's succession orders him to give any heir to an indefeasible share the information necessary to discover whether that share has been satisfied so that, if the heir's share has not been respected, the latter may require restitution of part of the trust corpus or of distributions made to the beneficiaries. The trustee's pecuniary liability to the beneficiaries, even sanctions by the professional authority, are at stake and they are governed by the law applicable to the trust. The right of an heir to an indefeasible share to obtain such information from the trustee will certainly go unheeded if the trustee cannot rely on an express and unambiguous judicial order to supply information that the law of inheritance imposes on him.

Requirements of this nature exist in Swiss private law, such as the one found in the law governing the general effects of marriage. CC Article 170 might be used as the model for the proposed rule to be adopted on ratification of the Convention. Based on that model and according to federal case law on the information due to heirs by mere depositories of the estate assets, or of assets that must be returned to the estate, the same duty should be extended to the depositories of assets in trust. In the absence of this measure, if the assets are deposited in Switzerland but under the control of trustees resident abroad, that would be enough to frustrate the right that ought to be guaranteed in such circumstances.

Consequently, I propose to add the following provision to the Civil Code:

**Art. 533a** (new)

<sup>1</sup> Where an heir to an indefeasible share provides *prima facie* evidence of facts which, if proved, would be grounds for an action in abatement

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<sup>144</sup> When the law in question does not seek to frustrate the indefeasible share, see *supra* note 132.

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.

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

According to the case law of the Federal Supreme Court, the reservation pertaining to lawyers' and notaries' professional duty of confidentiality concerns secrets they learn in the course of their regular professional activities. Though usually protected by a contractual duty of confidentiality, portfolio management<sup>145</sup>, trust administration, and activities undertaken as trustee or trust protector<sup>146</sup> do not fall within the ambit of Art. 321 of the Swiss Penal Code providing for criminal sanctions against lawyers and notaries for breaching their duty of secrecy<sup>147</sup>. Consequently, such persons may not assert such rules to justify a refusal to testify or produce evidence pursuant to CC, Art. 170 par. 3 or Art. 533a par. 2 proposed above.

This provision will be part of Swiss inheritance law and, as such, will only apply when that law governs the succession according to the forum's conflict rules.

## VI. Trusts and Matrimonial Property Rights

The constitution of an *inter vivos* trust in respect of part of a spouse's assets can have the effect of depriving the other spouse of certain rights or expectations deriving from matrimonial property rights. The Convention unambiguously reserves the mandatory rules of the law applicable to the personal and patrimonial effects of marriage according to the forum's conflict rules (Article 15 par. 1.b).

The issue only concerns the Swiss Civil Code insofar as the SPILA designates Swiss law to apply to the settlor's matrimonial property rights

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<sup>145</sup> ATF 120 Ib 112; 115 Ia 197, JdT 1991 IV 142; 114 III 105, JdT 1990 II 98; 112 Ib 606, JdT 1987 IV 450; etc.

<sup>146</sup> See ATF 124 III 363, SJ 1999 38.

<sup>147</sup> Art. 321 of the Swiss Penal Code of 21 December 1937 (RS 311; "SPC").

when a Swiss court is seized of the matter<sup>148</sup>, or when Swiss law is designated by the conflict rules of a foreign forum. Therefore, we shall examine here whether it is necessary to supplement the sixth title of the Civil Code, “Matrimonial property rights”, in all the situations in which Swiss law may apply to this aspect of a dispute.

In each of the three matrimonial property regimes provided under the Civil Code, the creation of a trust over a spouse’s personal property does not pose any particular problem. In the ordinary marital property regime providing for the sharing of property acquired during wedlock (CC, Art. 196 *et seq.*) and in community property (CC, Art. 221 *et seq.*), the spouse is entitled to dispose of such personal property as he or she sees fit<sup>149</sup>. In consequence of a gift to a third party, the matrimonial acquisitions or common assets will certainly be deprived of the income from the alienated personal property<sup>150</sup>, but this is the result of exercising a right of disposal which the law does not wish to restrict. Under the separation of marital property regime (CC, Art. 247 *et seq.*), both spouses enjoy the same freedom in respect of all their property.

The constitution of an *inter vivos* trust by one of the spouses can cause a problem when it affects property that must be shared (1.) or community property (2.).

## 1. Sharing Property acquired during Wedlock

Pursuant to the ordinary regime of sharing of property acquired during wedlock, each spouse owns the property he or she acquired for valuable consideration during the marriage (*acquêts, Errungenschaft*, CC, Art. 197). They may administer, use and dispose of such property throughout the duration of the marital property regime<sup>151</sup>. When the regime is dissolved, each spouse is entitled to half the value of the property acquired by the other, unless another distribution has been agreed<sup>152</sup>. The extent of the

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<sup>148</sup> SPILA Arts. 52 to 57.

<sup>149</sup> Within the limits of the rules on the general effects of marriage (CC Arts. 166, 169, 178) and, for joint ownership of property acquired during wedlock, CC, Art. 201 par. 3.

<sup>150</sup> CC, Art. 197 par. 2 (4) (save where the marriage contract provides otherwise, CC, Art. 199 par. 2) and CC 223 par. 2.

<sup>151</sup> CC, Art. 201 par. 1.

<sup>152</sup> CC, Art. 215 par. 1, 216 & 217.

acquired property is calculated as the value of such acquisitions on liquidation of the marital property regime after deduction of the corresponding debts<sup>153</sup>.

CC Article 208 provides that, to the property acquired during the marriage and held by a spouse on the date that the marital property regime is dissolved, must be added the value, as of the date of alienation (CC, Art. 214 par. 2), of the acquired property of which he or she “disposed by gifts *inter vivos*, without the consent of the spouse, in the five years previous to the dissolution of the marital property regime, with the exception of customary gifts”, as well as the property transferred throughout the duration of the regime “for the purpose of preventing the spouse from sharing in it”. Inspired by the legislation of neighbouring states<sup>154</sup>, this protection of each spouse’s share in the other’s acquired property corresponds to the tracing and abatement of *inter vivos* gifts under inheritance law<sup>155</sup>.

Each spouse’s share in the property acquired by the other is a monetary claim of the former against the latter<sup>156</sup>. When certain acquired property is transferred, in the circumstances mentioned in CC, Art. 208, the remaining acquisitions and personal property belonging to the debtor may not be sufficient to satisfy this debt. In such cases, CC, Art. 220 provides that “the creditor spouse or his heirs may sue for the shortfall any third party who may have benefited from transfers subject to being returned”<sup>157</sup>. This action is subject to a twofold absolute time-bar<sup>158</sup>. “Furthermore, the provisions pertaining to the action in abatement apply by analogy.”<sup>159</sup> As a rule, the forum is the place of the debtor spouse’s domicile<sup>160</sup> or last domicile if the latter is deceased<sup>161</sup>.

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<sup>153</sup> CC, Art. 210 and 214 par. 1.

<sup>154</sup> French Civil Code, Art. 1573.; German *Bürgerliches Gesetzbuch*, § 1375 (2).

<sup>155</sup> See CC, Art. 220 par. 3.

<sup>156</sup> HAUSHEER, REUSSER & GEISER (1992) Art. 215 N. 16; DESCHENAUX, TERCIER & BADDELEY (2000) NN. 1608-1610.

<sup>157</sup> CC, Art. 220 par. 1.

<sup>158</sup> CC, Art. 220 par. 2.

<sup>159</sup> CC, Art. 220 par. 3, as amended by the annex of the Federal Venue Act (see above n. 131).

<sup>160</sup> Federal Venue Act, Art. 15 par. 1.c; in international cases: SPILA, Art. 51.b.

<sup>161</sup> Federal Venue Act, Art. 18 par. 1; in international cases: SPILA Arts. 51 and 86 to 88.

The addition of the value of certain gifts to the assets acquired for the purpose of calculating their net value and the possible grounds for an action against third parties for restitution strongly resembles the action in abatement under inheritance law. The characterisation of transfers to trustees should therefore be treated identically: such transfers cannot be characterised as gifts unless the distributions specified in the trust deed are gifts from the viewpoint of the beneficiaries. To remove all ambiguity, a new paragraph 3 should be added to CC, Art. 208:

**Art. 208**, new paragraph

<sup>3</sup> 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.

However, it is unnecessary to state in CC, Art. 220 the conditions under which an action may be brought against the trustee and beneficiaries, insofar as the reference in par. 3 to the "provisions on the action in abatement" comprises the (new) CC, Art. 528a proposed above.

Unlike the rules on inheritance, those on the general effects of marriage already include CC, Art. 170, which grants each spouse the right to obtain from the other, or from a third party pursuant to a court decision, the necessary information and evidence regarding the income, property and debts of the other spouse. This right covers the disposals mentioned in CC, Art. 208<sup>162</sup>. This article applies equally to the dissolution of the matrimonial property regime during the lifetime of the defendant spouse<sup>163</sup>. When the marriage ends on the death of a spouse, the new CC Article 533a proposed above ensures equal information for the surviving spouse regarding the liquidation of the matrimonial property regime and inheritance.

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<sup>162</sup> *Gerichts- und Verwaltungspraxis des Kantons Zug* 1991 115 (n° 92), c. 1.

<sup>163</sup> A spouse's right to information lasts as long as the marriage does, up to the date on which the divorce judgement becomes final; if necessary during the proceedings to liquidate the matrimonial property insofar as it is separate from the divorce proceedings: DESCHENAUX, STEINAUER & BADDELEY (2000) N. 306; HAUSHEER, REUSSER & GEISER (1999) Art. 170 N. 6.

## 2. Community Property

In the optional community property regime, the community property is owned in common by the spouses (*propriété commune, Gesamteigentum*)<sup>164</sup>. Unlike co-ownership (*co-propriété, Miteigentum*), owners in common (joint owners) do not possess an alienable share in the property<sup>165</sup>.

A gift such as the constitution of a family trust does not fall within the ordinary administration of community property<sup>166</sup>. Therefore, it can only be done by a joint deed of transfer executed by both spouses or with the consent of the other<sup>167</sup>. If one spouse constitutes a trust over community property without the other's consent, the transfer of title to the trustee – which is not governed by the law applicable to the trust but by the *lex rei sitae*<sup>168</sup> – is unlawful and cannot constitute a trust unless this defect is cured by the rules on acquisition in good faith<sup>169</sup>, or by the wronged spouse's presumed consent<sup>170</sup>.

The question seems rather hypothetical for the kind of assets (bank accounts, securities, real estate) usually placed in trust for gift purposes. Under the community property regime, the spouses are likely to have taken care to mention their dual title in the bank documents and public registers. Given the exceptional nature of a trust, it would doubtless be hard for a trustee to prove that he used the care required in the circumstances (CC, Art. 3 par. 2) when accepting (assuming that the bank or depository agreed to act on such instructions) a transfer to his own name, by a single spouse, of bank accounts or negotiable instruments registered in the names of both

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<sup>164</sup> See CC, Art. 652 to 654; see HAUSHEER, REUSSER & GEISER (1996) Art. 221 N. 3; DESCHENAUX, STEINAUER & BADDELEY (2000) NN. 1608-1610.

<sup>165</sup> Confirming CC, Art. 653 par. 3, CC, Art. 222 par. 3 provides that neither spouse may dispose of his or her share in community property while the matrimonial community regime is in effect.

<sup>166</sup> CC, Art. 227.

<sup>167</sup> CC, Art. 228 par. 1.

<sup>168</sup> Art. 4 of the Convention; SPILA, Art. 99 to 102.

<sup>169</sup> CC, Art. 714 par. 2, 933 and 973. The protection of a party who acquires the property in good faith, unaware of the spouse's failure to consent (CC, Art. 228 par. 2) amounts to the protection of a transferee who in good faith is unaware that the transferor does have the power to dispose of the item in question (CC, Art. 714 par. 2, 933 and 973), see HAUSHEER, REUSSER & GEISER (1996) Art. 228 N. 43; DESCHENAUX, STEINAUER & BADDELEY (2000) NN. 1723-1725

<sup>170</sup> CC, Art. 228 par. 2.



spouses. Real estate located in Switzerland can only be transferred by a notarised deed signed by both spouses. An acquisition in good faith is thus possible only if the spouses did not take care to make their ownership in common evident to third parties<sup>171</sup>.

Thus, there is no need to create special rules to protect each spouse against the creation of a trust over community property to which he or she has not consented.

## **VII. Enforcement**

In the context of enforcement proceedings in respect of assets located in Switzerland, the Swiss recognition of the effects of trusts and personal and property rights raises three points:

- Since the assets in trust should be shielded from enforcement for the benefit of the trustee’s personal creditors, proceedings to seize or attach property located in Switzerland must ensure that these assets can be realised only by creditors whose rights are recognised by the law applicable to the trust.
- Where the trust terms recognise a beneficiary’s enforceable right to future distributions, this right must be subject to enforcement by the beneficiary’s creditors.
- The settlor’s creditors should be protected against the creation of a trust designed to place assets beyond their reach. In addition to the remedies provided by the law applicable to the trust, the revocatory action in Swiss law should also apply to disposals by which the settlor places certain assets in trust by transferring them to a trustee.

### **A. Enforcement against Assets in Trust**

The Convention characterises trusts as “a separate fund” of property which is “not a part of the trustee’s own estate” (Article 2, par. 3.a). The recognition of a trust implies, in particular, that “In so far as the law applicable to

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<sup>171</sup> Or if the property is excluded from the community property regime (CC, Art. 224 & 225), in which case the spouse’s consent is not required.

the trust requires or provides ... 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 ...” (Article 11, par. 2).

However, there are notable exceptions to the principle that assets in trust escape enforcement for the benefit of the “personal creditors of the trustee”. Most legislation relative to trusts accepts that the assets in trust should be available to third parties in respect of liabilities contracted by the trustee acting pursuant to the trust deed and his duties as trustee (*supra* Liability for Debt). While allowing beneficiaries and, if need be, other trustees to intervene to ensure that the assets of the trust are not realised for the benefit of a trustee's personal creditors, the enforcement procedure must also be adjusted to allow a creditor to make a claim that may be asserted against the assets in trust under the law governing the trust in question.

Ratification of the Convention provides, pursuant to Article 11, a sufficient legal basis to assure beneficiaries that assets in trust will not be realised for the benefit of the trustee's personal creditors. However, the Federal Debt Enforcement and Bankruptcy Act<sup>172</sup> should be amended to clarify the respective roles of the debt collection authorities, the civil courts and the parties to a trust when implementing this principle. That is what we intend to do here for debt enforcement, either by individual creditors (processed by seizing assets, *infra* Seizure Proceedings directed against the Trustee) or by collective proceedings against the trustee (bankruptcy, *infra* Bankruptcy of Trustee), as well as by way of attachment (*infra* Attachment ).

## 1. Seizure Proceedings directed against the Trustee

Whether an ordinary seizure or the forfeiture of a pledge, the Statute on Debt Enforcement and Bankruptcy provides an action to trace the property (*revendication, Widerspruchsverfahren*)<sup>173</sup>. It is set in motion by the Debt Collection Office “where it is alleged that a third party has, over the goods seized, a right of ownership, pledge or other right incompatible with the seizure or which must be taken into account later in the course of the

<sup>172</sup> Of 11 April 1889, as amended on 16 December 1994 (RS 281.1; “DEBA”).

<sup>173</sup> Arts. 106 to 109, referred to by DEBA, Art. 155 par. 1.

proceedings”<sup>174</sup>. Where the petition is contested, the dispute will be heard by a civil judge, who deals with it in expedited proceedings and decides whether the seized assets may be realised for the benefit of the creditor or must be excluded from the seizure<sup>175</sup>.

The administrative and judicial procedure for tracing property should be amended in three ways to ensure implementation of the principle expressed in Article 11 paras. 3.a and 2.b of the Convention.

### *a) Parties to the Civil Action to Trace Property*

The distribution of procedural roles – i.e. the responsibility for introducing the civil action, but not the burden of the proof – is determined by the Debt Collection Office according to the *prima facie* rights resulting from actual possession of that property. When movable property is in the exclusive possession of the debtor, the petitioner who seeks to exclude it from seizure must introduce the civil action<sup>176</sup>. When the property is in the possession or co-possession of the petitioner, the creditor attempting to enforce against the property must bring the action<sup>177</sup>. When the property is in the possession of a third party such as a custodian, it must be ascertained whether the latter holds the property for the debtor’s or the petitioner’s account.

Thus, which party must bring an action in the civil courts depends on whether the debtor subject to the enforcement proceedings is the sole (direct or indirect) possessor of the disputed property. In trust matters, however, the criterion of possession is unworkable. The trustee is by definition the legal owner of the property. His direct or indirect (*e.g.*, through a custodian) possession of that property is *prima facie* evidence that it can be seized by his personal creditors.

Possession (*possession*, *Gewahrsam*) was chosen as the criterion that determines procedural roles in the action to trace movable property because it is *prima facie* evidence that the possessor is entitled to that prop-

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<sup>174</sup> DEBA, Art. 106 par. 1.

<sup>175</sup> DEBA, Art. 109.

<sup>176</sup> DEBA, Art. 108 and 242 par. 3.

<sup>177</sup> DEBA, Art. 107 and 242 par. 2.

erty, and therefore that his personal creditors should have access to it<sup>178</sup>. For immovable property, registration in the land register creates the same presumption<sup>179</sup>. These criteria do not apply to claims and intangible rights that cannot be registered<sup>180</sup>. The principle underlying the choice of possession or registration in the land registry to determine whether the creditor or the objecting third party must introduce the action to trace property is therefore the *prima facie* evidence of the petitioner's better entitlement<sup>181</sup>. If the debtor appears to have better title to the seized asset, it is up to petitioner to introduce the action to exclude the asset from enforcement. When appearances are to the contrary, the creditor attempting to seize the asset must introduce the action to subject the disputed property to enforcement.

If one applies this same rationale to the legal relationships resulting from a trust, the only applicable criterion appears to be whether it is apparent to third parties that the seized property is subject to a trust or, in other words, that the trustee holds the property in that capacity. All trust laws require the trustee to take the necessary precautions to segregate his personal estate from the trust fund<sup>182</sup>; such laws allow, but do not generally require, registration of the asset in his capacity as trustee. If the trustee has taken precautions to make third parties aware that the asset is not part of his personal estate, it is reasonable that creditors who wish to seize the property should have to initiate the civil action to determine the status of the property. Conversely, if the trustee did not take the necessary precautions, so that third parties might in good faith consider that the asset belongs to the trustee's personal estate, the appearances are in favour of the seizing

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<sup>178</sup> CC, Art. 930 par. 1: "He who has possession of property is presumed to be the owner." However, the DEBA uses the term *Gewahrsam* where the Civil Code uses *Besitz* to indicate actual direct control over the asset, though the subjective element which characterises the *Besitz* need not necessarily be present, see SchKG-STAEHELIN (1998) Art. 107 NN. 5-6; P.R. GILLIÉRON, *Poursuite pour dettes, faillite and concordat*, 3<sup>rd</sup> ed., Lausanne (Payot) 1993, p. 211.

<sup>179</sup> See CC, Art. 973 par. 1; absent from the 1889 DEBA, this criterion is now contained in DEBA Arts. 107 and 108, par. 1 (3).

<sup>180</sup> On the *grössere Wahrscheinlichkeit der Berechtigung* concerning claims and other rights, see SchKG-STAEHELIN (1998) Art. 107 NN. 12-16.

<sup>181</sup> *Besserer Rechtschein*, see SchKG-STAEHELIN (1998) Art. 108 N. 4.

<sup>182</sup> See PETL Art. III (1): "A trustee of several trusts must keep each trust fund not only segregated from his private patrimony but also from each of the other trust funds, except to the extent that the terms of the trusts otherwise permit."

creditors; those whose interest is to exclude the asset from enforcement must then bear responsibility for introducing the action.

To the Debt Collection Office or the receiver in bankruptcy, this criterion specific to trusts is no more difficult to evaluate than the possession test. In particular, where the seized asset has been recorded in a public register, the mention of the trust in the register would be decisive<sup>183</sup>. Where the asset is deposited in a warehouse, with a financial intermediary or in other hands, the criterion is met if the contractual documents and the bank statements, if any, name the trustee as such. If the asset is in the trustee's direct possession, third parties are generally unable to identify the property as assets in trust.

Like possession, the power to designate an asset as trust property may lead to certain types of manipulation by an owner aiming to make life difficult for his creditors. However, fraudulent designation of a personal asset as trust property has some significant disadvantages for the owner, because it restricts or complicates alienation of the asset and makes it harder to use it as collateral: a prudent purchaser or lender will want to make sure that the alleged trustee is not in breach of trust, for fear of an action by the beneficiaries<sup>184</sup>. Besides, the *prima facie* evidence of better entitlement resulting from possession or designation of an asset as trust property only affects the distribution of roles in the civil action to trace property, but has no impact on the burden of proof, which lies firmly on the party seeking to exclude the asset from enforcement. Finally, the burden of initiating the action is not unduly burdensome because Swiss courts of the place where the asset is located always have jurisdiction<sup>185</sup>.

The procedure to trace property allegedly subject to a trust could consequently be supplemented by a new article in the DEBA, with the following first paragraph:

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

<sup>1</sup> 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.

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<sup>183</sup> See *infra* Chapter IX: Public Registers.

<sup>184</sup> See *supra* II.F and *infra* VIII.

<sup>185</sup> DEBA, Art. 109, paras. 1 to 3.

### ***b) Definition of Standing to Sue and be Sued***

In trusts, the standing to sue or defend a suit depends on the powers and rights that the law applicable to the trust grants to the trustees, beneficiaries, protector of the trust (if any), or the public authority responsible for overseeing charitable trusts. Standing is also influenced by the fact that the trustee's office is often shared by several physical persons or corporate bodies who, as a rule, make all authorised decisions jointly.

If he is a sole trustee, a debtor who is the subject of debt recovery proceedings has a potential conflict of interest: his desire to pay off his creditors and put an end to the proceedings does not necessarily coincide with his fiduciary duty to ensure that the assets in trust are not realised for the benefit of his personal creditors. Such a conflict of interests may often justify his replacement as trustee, a replacement which he himself or any beneficiary is entitled to seek from the courts of the trust forum<sup>186</sup>. Experience shows, however, that such proceedings tend to be lengthy when the trustee – generally disinclined to be relieved of his office – opposes his replacement. Even when this replacement is not disputed, the decision of the court may be excessively slow in comparison with the short periods allowed in Swiss enforcement proceedings.

Therefore, it does not seem realistic to disqualify the seized debtor and prevent him from participating as a trustee in the action to trace property. However, owing to conflicts of interest which might compromise his loyalty, it is vital to ensure the participation of the other potential trustees and to afford the beneficiaries an opportunity to intervene to defend their interests.

The proceedings to trace property begins with the assertion that the seized asset must be excluded from enforcement in favour of the creditor. This petition can be made by the debtor-trustee or any other interested party<sup>187</sup>. If the petition is not disputed, the asset is automatically excluded from enforcement. If it is disputed, judicial proceedings are necessary, in which the parties' standing needs to be determined.

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<sup>186</sup> See the Lugano Convention, Art. 17 (2) and 53 par. 2 (RS 0.275.11).

<sup>187</sup> DEBA, Art. 106 par. 1 *in initio*: "Where it is alleged ...".

Where the law makes the petitioner responsible for instigating the judicial action to trace property, standing to sue should be widely recognised within the brief period of twenty days fixed by the Debt Collection Office<sup>188</sup>. Standing to sue can mirror on the rules of the law governing the trust regarding standing to trace assets alienated by the trustee in breach of trust.

Given the short time-limits allowed and the international nature of the dispute, it is possible that not all parties having standing to sue will be able to start the civil action within the prescribed 20 days. Moreover, DEBA Article 107 par. 5 requires the Debt Collection Office to notify the petitioner, but not all interested parties, whose identity is generally unknown to the Office. In view of the divergent interests that may arise between the trustee and the beneficiaries, or even among the beneficiaries themselves, interested parties other than the petitioner should be allowed to intervene in the proceedings after the action has commenced.

Standing to introduce the action to trace property could be determined as follows:

**Art. 108a** (continued)

<sup>2</sup> Standing to bring the action contained in Art. 107, 5th paragraph, 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.

The situation is different in the case of standing to be sued. Where it falls to the seizing creditor to initiate action to trace an asset apparently subject to a trust, the number of defendants must be limited to avoid needlessly complicating the claimant creditor's task in the brief period granted to him<sup>189</sup>. The creditor cannot be expected to identify all the beneficiaries and name all of them as defendants. Besides, in general the beneficiaries do not personally have the information necessary to establish whether an asset is part of the trust corpus; they depend on the trustees for such knowledge and documentation. The trustees are in a better position to estimate the chances

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<sup>188</sup> DEBA, Art. 107 par. 5.

<sup>189</sup> Also twenty days, Art. 108 par. 2 DEBA.

of success and costs of the action and produce the evidence needed to defend it. In addition, their identity can be established any time.

If the debtor is the sole trustee at the time of the action to trace property, he is the only defendant. The existing conflict of interest, however, justifies allowing all beneficiaries to intervene in the proceedings, within a reasonable period, to defend their interests pending the possible replacement of the trustee by courts of the trust forum.

This proposal might be worded as follows:

**Art. 108a** (continued)

<sup>3</sup> The trustees, where there are more than one, 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.

<sup>4</sup> Where the debtor is the sole trustee, any beneficiary may intervene in the proceedings within 30 days after he learned of the proceedings.

**c) *Objection to the Action to Trace Property: Debts Enforceable against Trust Property***

Though trust assets are usually shielded from enforcement for the benefit of the trustee's creditors, certain debts may nevertheless be enforced against them.

- According to the classic principles still part of English law<sup>190</sup>, a trustee who makes commitments in that capacity and in the regular course of his duties exposes only his own estate to liability, though he may be reimbursed out of the trust corpus. The creditors concerned have no direct rights against the trust fund. However, they do have a recognised derivative right if the trustee is insolvent and himself has a right to be reimbursed out of the trust corpus, *or* where a refusal to allow the creditors to seize the trust assets would result in unjust enrichment of

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<sup>190</sup> English law is at present considered unsatisfactory; trust practitioners wish to see legislative reform of the entire chapter, see TRUST LAW COMMITTEE, *Report: Rights of Creditors Against Trustees and Trust Funds*, London, June 1999.



- the trust corpus at the creditors' expense<sup>191</sup> or where the trust terms permit it<sup>192</sup>.
- The trustee who incurs liabilities in the regular performance of his duties can, however, stipulate with the co-contracting party that the debt shall burden the trust fund exclusively<sup>193</sup>. Such creditors may then be regarded as genuine “trust creditors”, where the trust is understood – as elsewhere – to refer to a specific estate and not to a legal entity or quasi-entity.
  - The current trend, initiated several years ago in some of the American states<sup>194</sup> and offshore jurisdictions<sup>195</sup>, assigns exclusive liability on the trust fund where the trustee contracts expressly in that capacity in the course of his duties. As in the previous case, these creditors can obtain enforcement against the trust assets to recover the debt.
  - In addition, in the United States, co-contractors of the trustee who extend credit believing in good faith that the trust assets are available to satisfy the debt have access to the trust property provided that the beneficiaries were aware of the situation and did not object to it (estoppel doctrine)<sup>196</sup>.

The action to trace property must allow the creditor who seizes the property to allege and prove that, according to the law applicable to the trust, he is entitled to satisfy his claim out of the trust assets. Whichever party commenced the civil action, if the third party claimant supplies proof that the property is subject to a trust (here the third party claimant bears the burden

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<sup>191</sup> UNDERHILL & HAYTON (1995) Art. 86 par. 5 (pp. 787, 801-803); BOGERT (1987) § 128; comp. FRATCHER (1974) p. 79. USA: Restatement (Second) of Trusts, §§ 266-270; SCOTT & FRATCHER (1987) §§ 268-269; BOGERT & BOGERT (1977) § 712, Part I. Australia: MEAGHER & GUMMOW (1997) N. 2112.

<sup>192</sup> SCOTT & FRATCHER (1987) § 270.

<sup>193</sup> United States: BOGERT & BOGERT (1977) § 126; Restatement (Second) of Trusts, § 271; SCOTT & FRATCHER (1987) § 271; *Jessup v. Smith*, 223 N.Y. 203, 119 N.E. 403 (C.A. 1918, per Cardozo J.). Scotland: WILSON & DUNCAN (1995) NN. 29-05 to 09. Australia: MEAGHER & GUMMOW (1997) N. 2103. The situation in English law is uncertain, see TRUST LAW COMMITTEE, *Rights of Creditors Against Trustees and Trust Funds: A Consultation Paper...*, London, April 1997, N. 2.35.

<sup>194</sup> SCOTT & FRATCHER (1987) § 271A; BOGERT & BOGERT (1977) § 712, Part 2; California Trust Law (1987), codified in the California Probate Code, s. 18000. Uniform Trust Code, § 1010 (a) (2000 Annual Meeting Draft).

<sup>195</sup> See Trusts (Jersey) Law (1984), Art. 28 (1).

<sup>196</sup> Restatement (Second) of Trusts, § 313: “If a third person extends credit to the trustee in reliance upon his apparent ownership of the trust property, and the beneficiary knew or had reason to know that the trustee was receiving credit because of his apparent ownership, the third person can obtain satisfaction of his claim out of the trust property.”

of proof), the creditor must be allowed to object that the law applicable to the trust nevertheless authorises him to realise this asset for his benefit (here it is the creditor who bears the burden of proof). This objection to the action to trace property must be expressly reserved.

**Art. 108a** (continued)

<sup>5</sup> In the action provided for in Art. 107, 5th paragraph, and 108, 1st paragraph, 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.

The success of this objection signifies that the asset in trust can be realised for the benefit of the sole creditor who benefits from it. It does not benefit other creditors participating in the same seizure<sup>197</sup>.

A final remark must be made here in connection with enforcement for the benefit of creditors who benefit from a right to seize trust assets. According to a long-standing decision of the Federal Supreme Court – concerning a *Spanish Refugee Trust*<sup>198</sup> – made in the context of an attachment, where there are several trustees and the creditor takes action against only one of the trustees, enforcement affects no more than a portion of the jointly-held property. In that case the subject of enforcement would not be the trust assets themselves, but the share pertaining to the trustee being sued<sup>199</sup>.

This decision is erroneous. Though generally the trustees' ownership of trust assets may be treated as a form of ownership in common (CC, Art. 652 *et seq.*) in which the trustees in principle jointly and unanimously dispose of the property, a "trust creditor" is the creditor of all the trustees jointly and, subject to the conditions mentioned above, he has access to the trust fund, and not a share thereof. As a rule, such actions must be brought against all the trustees simultaneously. If, for reasons such as the international jurisdiction of the Swiss authorities responsible for enforcement, that cannot be the case, enforcement cannot be reduced to a share on liquidation of a joint estate because the defendant trustee(s) do not in principle<sup>200</sup> hold

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<sup>197</sup> DEBA, Art. 110.

<sup>198</sup> ATF 82 III 63 c. 3, JdT 1956 II 99, 101-102, *Rionda*.

<sup>199</sup> Decree of the Federal Supreme Court of 17 January 1923 regarding seizure and realisation of shares in jointly-owned property (RS 281.41).

<sup>200</sup> Save where a trustee is simultaneously a beneficiary. But compulsory enforcement against his rights as a beneficiary is based on other principles, see *infra* VII.B.

any equitable interest in the trust fund; they have no personal interest at all in the trust fund, with the exception of any fees or reimbursement of expenses due to them.

## 2. Bankruptcy of Trustees

In relation to actions to trace property, bankruptcy differs from seizure (and the realisation of a pledge) by a narrower definition of rights justifying exclusion of the assets from the estate in bankruptcy<sup>201</sup>, by an additional list of cases in which exclusion is justified<sup>202</sup>, and by a very different preliminary procedure, initiated by the receiver in bankruptcy and not by the Debt Collection Office. In addition, it is the receiver in bankruptcy who has standing to dispute the action to trace property before the civil courts, and he can also offer to assign it to the creditors<sup>203</sup>.

Just as, insofar as provided by the law applicable to the trust, the assets in trust are shielded from seizure by the trustee's creditors (Article 11 par. 2.a of the Convention), the assets "shall not form part of the trustee's estate upon ... bankruptcy" (*ibid.*, 11.2.b). Therefore, it is advisable to exclude them from estates in bankruptcy in the same way that Swiss law excludes the assets of investment funds and those employed in banks' fiduciary transactions<sup>204</sup>. The receiver in bankruptcy will do so automatically (*distraktion, Absonderung*).

However, this exclusion must reserve any rights that the bankrupt trustee may have over the trust fund, particularly any expenses and fees to which he may be entitled as trustee: these "debts"<sup>205</sup> form part of the bankrupt estate against which the bankrupt's creditors have recourse. The exist-

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<sup>201</sup> J.L. TSCHUMY, *La revendication de droits de nature à soustraire un bien à l'enforcement*, doctoral dissertation, Lausanne, 1986, pp. 80-82.

<sup>202</sup> DEBA, Art. 201 to 203.

<sup>203</sup> DEBA, Art. 242 par. 3 and 260.

<sup>204</sup> Federal Act on Investment Funds of 18 March 1994 (RS 951.31; "the FAIF"), Art. 16 and 4 par. 4; Federal Banking Act of 8 November 1934 (RS 952.0; "the FBA"), Arts. 6 (2) and 37b.

<sup>205</sup> In reality, "make-up debts" because they relate to two different estates held by the bankrupt, so that his standing as creditor and debtor become confused, see THÉVENOZ (2000) pp. 353-354 & 364-366.

ence and the extent of these debts are determined by the trust deed and the law applicable to it.

The existing legislation does not expressly pronounce on the legal remedies available where the receiver in bankruptcy considers that an exclusion of property, based on Banking Act or the Investment Fund Act, is not justified<sup>206</sup>. If the exclusion is contested, it is advisable to provide that the judge of the action to trace property has jurisdiction to decide the matter. It is then up to the receiver in bankruptcy to set a time limit. Standing to sue to recover property should be similar to the rules on seizure.

The DEBA would thus need to be supplemented as follows:

**Art. 242a** (new) 3 bis. In trust matters.

<sup>1</sup> 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.

<sup>2</sup> 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. 108a, par. 3, shall apply by analogy.

Unlike seizure, which affects certain assets for the benefit of some creditors, bankruptcy proceedings are collective and concern the trustee's entire personal estate. The special estates of which the trustee is the sole titleholder, or a co-titleholder with other trustees, cannot be merged with his personal estate in bankruptcy.

In theory, the assets of the trust situated in Switzerland could be listed as such by the receiver in bankruptcy and the corresponding claims ("trust creditors") ranked with a specific and exclusive privilege in respect of these assets, like claims guaranteed by pledge<sup>207</sup>. However, the analogy with claims guaranteed by pledge is misleading: the assets of the trust are accessible to an indeterminate number of creditors designated by the trust law; any surplus on the realisation of the assets remains the property of the trust fund and cannot be made available to the bankrupt trustee's personal creditors.

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<sup>206</sup> See B. LUTZ, in *Kommentar zum Bankengesetz*, Art. 37b N. 10; D. ZOBL, "Kollisionen zwischen Sachen- und Zwangsvollstreckungsrecht: Gedanken und Bemerkungen zum Ausbau der Aussonderungsrechte im Bankenkonzurs", in *Festschrift Anton Heini*, Zurich (Schulthess) 1995, pp. 543 *et seq.*, 555-556; THÉVENOZ (2000) pp. 358-363.

<sup>207</sup> Art. 219 par. 1 DEBA.

Consequently, in a trustee's personal bankruptcy, issues involving the assets in trust and the creditors to whom they are accessible cannot be treated as they would be in the case of a pledge. To do so would be to confuse the trustee's insolvency with the solvent estate of the trust. Moreover, adjudicating both in the same proceeding would result in subjecting the trust's assets and liabilities to the trustee's bankruptcy proceedings, time limits, receiver and procedural applications, which would be incompatible with the requirement "that the trust assets shall not form part of the trustee's estate upon his insolvency or bankruptcy" (Article 11, par. 2.b of the Convention).

Therefore, the objection provided for in Art. 108*a* par. 5 DEBA above<sup>208</sup> is inappropriate in the trustee's bankruptcy, which must be completely dissociated from any enforcement against the trust fund. Assets in trust located in Switzerland may be the subject of enforcement only by seizure or forfeiture of a pledge.

In exceptional circumstances, a declaration of bankruptcy relative to the trust fund itself may be pronounced by the courts of the trust forum, pursuant to the law applicable to the trust<sup>209</sup>. This decision can be recognised in Switzerland and may result in the commencement of collective proceedings limited to the assets and claims connected to Switzerland, according to the SPILA, Chapter 11 "Bankruptcy and Composition".

### **3. Attachment of Trust Property**

Where an asset in trust is attached at the request of the trustee's creditors<sup>210</sup>, its exclusion from enforcement can be sought by two different proceedings.

Based in the reference contained in DEBA Article 275, the trustee (or the beneficiaries) may start proceedings to trace the attached property, as in

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<sup>208</sup> See *supra* VII.A.1.c).

<sup>209</sup> See TRUST LAW COMMITTEE (n. 190), chapter 5; BOGERT & BOGERT (1977) § 247-T (business trusts),

<sup>210</sup> Art. 271 *et seq.* DEBA.

cases of seizure<sup>211</sup>. Consequently, the amendments proposed above also apply to actions to trace property in cases of attachment.

Furthermore, “a party whose rights are affected by attachment”<sup>212</sup> is also allowed to contest the attachment order before the court that made the ruling. Subject to a brief time-limit of ten days from the date on which the injured party learns of the order, this procedure guarantees him a quick and adversarial re-examination of the conditions on which the order was based.

Undoubtedly, attachment of the assets in trust affects the rights of beneficiaries as much as those of the trustees, even though those rights are different in nature. The trustees’ legal title essentially corresponds to the Swiss concept of ownership (*propriété, Eigentum*). Trustees are the title-holders to the property in trust, and they can obviously assert this when contesting the order. The beneficiaries’ equitable interest – which has no counterpart in Swiss law or in other Romano-Germanic legal systems – is also a form of property right over the same assets, because it entitles the beneficiaries, on conditions determined by the law of the trust, to claim the property “when the trustee, in breach of trust, has mingled trust assets with his own property or has alienated trust assets.”<sup>213</sup> Even though Swiss law does not currently contain equivalent rights, ratification of the Convention would require it to give the beneficiaries standing to oppose an attachment order aimed at an asset in trust.

This interpretation of DEBA Article 278 par. 1 in the light of Article 11 par. 3.d of the Convention seems sufficiently evident, so that no statutory change seems necessary.

Incidentally, for a creditor to obtain attachment, there must be assets capable of being realised for his benefit. This condition is also the subject matter of the action to trace property where, as here, the existing assets may be excluded from attachment because of third parties’ rights. That is why legal writers accept that, within the necessarily limited framework of evidence that can be produced in the opposition proceedings, if the grounds

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<sup>211</sup> Art. 106 to 109 DEBA, see *supra* Enforcement against Assets. See M. OCHSNER, “De quelques aspects de l’exécution du séquestre”, in *Le séquestre dans la nouvelle DEBA*, editor V. Jeanneret, Zurich (Schulthess) 1997, p. 59; GILLIÉRON (2000) Art. 106 N. 23.

<sup>212</sup> Art. 278 par. 1 DEBA.

<sup>213</sup> Article 11 par. 3.d of the Convention; see *infra* VIII.

for excluding the attached assets from the creditor's grasp cannot be established conclusively enough, the attachment is maintained and the parties must proceed by way of an action to trace property<sup>214</sup>.

## B. Enforcement against Beneficiaries' Rights

This report mentioned earlier the wide variety of interests that the settlor can confer on the trust beneficiaries<sup>215</sup>. Whether the trust involves the payment of valuable consideration (*e.g.*, investment trusts, security trusts) by the beneficiary, or is a gift (*e.g.*, family trusts) to the latter, he is from the outset or ultimately the holder of a right to receive certain economic advantages, enforceable against the trustee. Such right (possibly subject to terms or conditions) may accrue from the creation of the trust, such as, for example, in the case of a life beneficiary of trust fund income or investors in an investment or pension fund organised as a trust (fixed interests). In contrast, this right may accrue only when the trustee of a discretionary trust decides to make a distribution based on his unfettered consideration of the circumstances. In all common law legal systems, such rights can as a rule be realised for the benefit of the beneficiary's creditors, unless the trust or the applicable law provides otherwise<sup>216</sup>.

A remark is necessary at this point: the subject matter of enforcement by the beneficiary's creditors is not the trust corpus, but the beneficiary's rights – when and insofar as they exist – to receive economic benefits from the trustee, usually in the form of money<sup>217</sup>. Enforcement does not concern the assets in trust, which are the property of the trustee as long as they have not been distributed to a beneficiary, but the beneficiary's right to obtain a benefit from the trustee in respect of the trust assets. Enforcement can also

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<sup>214</sup> SchKG-REISER (1998) Art. 278 N. 11.

<sup>215</sup> See *supra* II.B.

<sup>216</sup> FRATCHER (1974) § 73 p. 57; BOGERT (1987) § 39; Restatement (Second) of Trusts, § 147; Restatement (Third) of Trusts, § 56 (Tentative Draft No. 2, 1999); WILSON & DUNCAN (1995) NN 10-44 *et seq.* The creditors of a beneficiary have more extensive rights when the beneficiary is also the (or one of the) settlor(s) of the trust, see *infra* Creditors' Rights according to the Law Applicable to the Trust.

<sup>217</sup> But not necessarily, because the advantage received by the beneficiary may also consist in the use of a residence or pasture land, see *supra* II.B.

affect other rights that the beneficiary may obtain against the trustee, including the right to damages owed to him personally for breach of trust<sup>218</sup>.

Below we will examine the extent to which the beneficiary's rights are, in Switzerland, subject to enforcement by way of seizure ( a ), bankruptcy ( b ), and attachment ( c ).

## 1. Seizure

The beneficiary's interest can be the subject of a seizure (*saisie, Pfändung*) if it is *i*), a patrimonial right (*i.e.* having a monetary value) *ii*), that can be realised *iii*) subject to enforcement in Switzerland, and *iv*) which the DEBA does not exempt from enforcement.

(*i*) Seizure can only affect patrimonial rights vested in the beneficiary, not mere expectations<sup>219</sup>. Article 8, par. 2.g and i of the Convention provide that it is the law applicable to the trust that determines if and when the beneficiary has a genuine right against the trustee. This may be contingent on time, or subject to a contingent condition (precedent or subsequent) the realisation of which is not purely hypothetical, so that the value of the economic benefit subject to the condition may be estimated.

The interest of the beneficiary under a discretionary trust is a mere expectation as long as the trustee remains free, at his absolute discretion, to proceed or not with a distribution in favour of the aforementioned beneficiary. A patrimonial right arises only once the trustee has exercised this power and decided to make a distribution<sup>220</sup>. In the United States, however, a

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<sup>218</sup> Damages owed by a negligent or disloyal trustee to the trust fund itself should be sharply distinguished – see UNDERHILL & HAYTON (1995) pp. 826-831 – which may be sought by any beneficiary but only for the benefit of the *trust fund*, from the rarer situation in which the trustee is directly liable to the beneficiary, see BOGERT & BOGERT (1977) § 862.

<sup>219</sup> SchKG-VONDER MÜHLL (1998) Art. 92 N 2 and references.

<sup>220</sup> On the nature of the beneficiary's interest in a discretionary trust, see in particular the Restatement (Third) of Trusts, § 50 (Tentative Draft No. 2, 1999); MEAGHER & GUMMOW (1997) NN. 317 & 923; ONG (1999) pp. 246-248, and this definition by Lord Wilberforce in *Gartland v. Inland Revenue Commissioners*, [1968] AC 553 (at 617-618), [1968] 1 All ER 121: "No doubt in a certain sense a beneficiary under a discretionary trust has an 'interest': the nature of it may, sufficiently for the purpose, be spelt out by saying that he has a right to be considered as a potential recipient of benefit by the trustees and a right to have his interest protected by a court of equity. Certainly that is so, and when it is said that he has a right to have the trustees exercise their discretion 'fairly' or 'reasonably' or 'prop-



beneficiary's prospective rights are accessible to creditors, though this does not oblige the trustee to make a distribution on which he has not yet decided unless the trustee abuses his discretionary power<sup>221</sup>. Instead, it obliges the trustee to pay such a distribution, once decided, to the beneficiary's creditors<sup>222</sup>.

(ii) The beneficiary's rights against the trustee can be realised only if they are capable of being assigned or otherwise transferred *inter vivos*; this question is also governed by the law applicable to the trust<sup>223</sup>. Such limitations are frequent in family trusts; they occasionally result from the law, but most often from the trust terms.

The best known are the so-called spendthrift clauses, accepted in most US states. In a clause of this type, the settlor excludes the beneficiary's interest from voluntary alienation by the beneficiary and, simultaneously, from the reach of the latter's creditors<sup>224</sup>, with the exception of some classes of creditors (notably alimony and taxes)<sup>225</sup>. However, such clauses do not restrict a distribution's vulnerability to alienation or seizure once it has been made by the trustee<sup>226</sup>. The same rule applies to support trusts<sup>227</sup>.

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erly' that indicates clearly enough that some objective consideration (not stated explicitly in declaring the discretionary trust, but latent in it) must be applied by the trustees and that the right is more than a mere spes. But that does not mean that he has an interest which is capable of being taxed by reference to its extent in the trust fund's income: it may be a right with some degree of concreteness or solidity, one which attracts the protection of a court of equity, yet it may still lack the necessary quality of definable extent which must exist before it can be taxed."

<sup>221</sup> Uniform Trust Code, § 504 (2000 Annual Meeting Draft).

<sup>222</sup> Restatement (Third) of Trusts, § 60 (Tentative Draft No. 2, 1999); BOGERT (1987) § 41 p. 161.

<sup>223</sup> STAEHELIN (1995) p. 277 and References under nn. 243 & 244.

<sup>224</sup> Restatement (Second) of Trusts, §§ 152 ("Restraint on alienation of income") and 153 ("Restraint on alienation of principal"); Restatement (Third) of Trusts, § 58 (1) (Tentative Draft No. 2, 1999). See especially BOGERT (1987) § 40; Uniform Trust Code, § 502 (2000 Annual Meeting Draft).

<sup>225</sup> Essentially, the alimony claims of a spouse, ex-spouse and children; those corresponding to the provision of goods and services necessary to the beneficiary; those corresponding to services needed to protect his interest in the trust, as well as moneys owed to the state. Restatement (Second) of Trusts, § 157; Restatement (Third) of Trusts, § 59 (Tentative Draft No. 2, 1999). Uniform Trust Code, § 503 (2000 Annual Meeting Draft) envisages doing away with the second category.

<sup>226</sup> See Uniform Trust Code, §§ 502 (c) and 506 (2000 Annual Meeting Draft).

<sup>227</sup> BOGERT (1987) § 42: "where the trustee is directed to spend only so much of the income as is necessary for the education and maintenance of the beneficiary, and to spend

Classic English law is more restrictive but nevertheless accepts protective trusts, which confer a life interest on the beneficiary (*e.g.*, distribution of income or an annuity): if the beneficiary goes bankrupt, the protective trust is transformed into a discretionary trust in favour of the original beneficiary and his immediate family<sup>228</sup>.

Other restrictions on alienation of the beneficiary's rights may derive from the collective relationship among interests that unites the beneficiaries (blended trusts) or the strictly personal nature of the beneficiary's right (use of a residence, personal trusts)<sup>229</sup>.

However unfortunate it may be for the beneficiary's creditors, the extinction of the beneficiaries' rights under a trust, resulting from a trust clause containing a condition subsequent, is not contrary to Swiss public policy<sup>230</sup>, at least where the beneficiary acquires these rights without giving valuable consideration for them. The creditors of the beneficiary are not deprived of an asset to which they would have had access if the trust did not exist; rather, the conditional gift to the beneficiary is beyond their reach. Naturally, the situation is different when the settlor himself is a beneficiary of the clause, which is then intended to shield all or part of his estate from his creditors while retaining the benefit; this constitutes a fraud against the interests of the settlor's creditors which is sanctioned by a revocatory action in Swiss law and by various remedies provided by trust legislation<sup>231</sup>.

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the income only for those purposes". According to the Restatement (Second) of Trusts, § 154, this interest is, however, may be seized by the privileged creditors mentioned, *supra* note 225.

<sup>228</sup> UK: sec. 33 du Trustee Act 1925; UNDERHILL & HAYTON (1995) pp. 184-186. Australia: MEAGRE & GUMMOW (1997) NN. 924-930. United States: BOGERT (1987) § 44, however, the term, *protective trust* is sometimes used to refer to all forms of *spendthrift and discretionary trusts*, see *In re Shurley*, 171 B.R. 769 (at 776 n. 3) (1994).

<sup>229</sup> Restatement (Second) of Trusts, § 160.

<sup>230</sup> SPILA, Art. 17, Art. 18 of the Convention. On the enforcement in Switzerland of rights that are inalienable under the *lex causae*, see D. STAEHELIN (1995) p. 277 (1st col.). On whether contingent, future or inalienable rights may be seized, see A. STAEHELIN, *Probleme aus dem Grenzbereich zwischen Privat- und Zwangsvollstreckungsrecht : Die Pfändung und Admassierung unveräußerlicher Rechte und künftiger Vermögensstücke...*, Basle (Helbing & Lichtenhahn) 1968, esp. pp. 5-6, 15-16 & 28 *et seq.*

<sup>231</sup> See *infra* VII.C.1: Protection of the Settlor's Creditors.

(iii) The beneficiary's rights are subject to enforcement in Switzerland *if the beneficiary is domiciled here*<sup>232</sup>. Furthermore, such domicile creates an ordinary forum for debt collection proceedings<sup>233</sup>. For companies and other legal entities, the registered office or main administrative centre is the connecting factor<sup>234</sup>. The beneficiary's rights are not generally incorporated in securities<sup>235</sup>. They can be seized in the hands of the beneficiary<sup>236</sup>, who is bound to remit the assets received from the trustee to the Debt Collection Office on pain of prosecution<sup>237</sup>. In addition, the Debt Collection Office will notify the trustee (or trustees if there are more than one) of the seizure; this notice is a security measure<sup>238</sup>, not an essential formality of the seizure<sup>239</sup>. If he does not have a domicile or establishment in Switzerland, the trustee (who is a third party to the debt enforcement proceedings) has no obligation to appoint anyone here for service of process, which makes it necessary to serve notice via the authorities at the trustee's domicile if notice by mail is not permitted under a convention binding Switzerland and the state concerned<sup>240</sup>.

The rights of the beneficiary may also be subject to enforcement in Switzerland *if the trustee is domiciled in Switzerland*, while the beneficiary is either domiciled abroad<sup>241</sup> or his domicile cannot be established<sup>242</sup>. In

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<sup>232</sup> ATF 31 I 208 c. 2, recently confirmed in ATF 107 III 147 c. 4, JdT 1984 II 25; STAEHELIN (1995) p. 265.

<sup>233</sup> DEBA, Art. 46 par. 1.

<sup>234</sup> Art. 46 par. 2 DEBA.

<sup>235</sup> With the exception of unit trusts, investment trust and shares in business trusts (BOGERT & BOGERT (1977) § 247-O), which are usually issued as securities.

<sup>236</sup> DEBA, Art. 99; see ATF 89 III 12, *Saunders* (seizure from the beneficiary of monthly distributions by an English support trust).

<sup>237</sup> SPC, Art. 169 and 292.

<sup>238</sup> See marginal note to DEBA, Art. 98.

<sup>239</sup> SchKG-LEBRECHT (1998) Art. 99 N. 7.

<sup>240</sup> Art. 66 par. 3 DEBA by analogy; see SchKG-LEBRECHT (1998) Art. 69 N. 5.

<sup>241</sup> ATF 107 III 147 c. 4a, JdT 1984 II 25, and citations; ATF 114 III 31, JdT 1989 II 89; see SPILA, Art. 167 par. 3; STAEHELIN (1995) p. 265; K.I. MÖSSLE, *Internationale Forderungspfändung...*, Berlin (Duncker & Humblot) 1991, pp. 224-226.

<sup>242</sup> ATF 76 III 18, 19, JdT 1951 II 9.

the absence of any other debt enforcement forum<sup>243</sup>, one can be created by obtaining attachment of the beneficiary's rights<sup>244</sup>.

A difficulty occurs, however, where there are several trustees, not all of whom are domiciled in Switzerland. Must we consider that the beneficiary's rights are located (*localisés, belegen*) here? It would be impracticable to require the presence in Switzerland of all the trustees or even the majority of them. It would be preferable to adopt a twofold connecting factor: Swiss domicile of at least one trustee together with the presence here of all or a significant portion of the assets in trust.

(iv) One obstacle to enforcement may be found in the DEBA, which states that some assets are wholly or partially exempt from seizure. In particular, this question can arise in family trusts where certain clauses – e.g., providing for the distribution of all or part of the income from the capital to a beneficiary who enjoys a life interest – may resemble a life annuity.

DEBA Article 92 item 7 states that “life annuity rights [*droit aux rentes viagères, Stammrecht*] constituted pursuant to Articles 516 to 520 of the Code of Obligations”, are exempt from seizure, while DEBA Article 93 allows seizure of each successive right to distributions deriving from this right, “after deduction of what the Debt Collection Office considers indispensable to the debtor and his family” (the vital minimum) and only for a period of one year from the execution date of the seizure.

Exemption from seizure is the exception to the rule and must be interpreted narrowly. By making an express reference to the provisions of the Swiss Code of Obligations, the Swiss Parliament clearly expressed its intention to restrict DEBA Article 92 sub.-par. 7 to life annuities constituted according to Swiss law<sup>245</sup>. It should not be extended to trusts governed by foreign law. As we saw above, a trust allows the settlor to take measures broad enough to protect beneficiaries against insolvency or the claims of their creditors. The limitations on these clauses are set by the law applica-

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<sup>243</sup> In the absence of the debtor's Swiss domicile (DEBA, Art. 46), a forum for debt enforcement proceedings may result from an establishment or a choice of a place of performance of the debt (DEBA, Art. 50), or even from mere presence (DEBA, Art. 48) or a pledge of the beneficiary's rights in favour of a creditor in Switzerland (DEBA, Art. 51 par. 1).

<sup>244</sup> DEBA, Arts. 272 par. 1 (3) and 52.

<sup>245</sup> SchKG-VONDER MÜHLL (1998) Art. 92 N. 28 and references.

ble to the trust, and vary considerably from one jurisdiction to another. It would be inappropriate for the Swiss law on enforcement to exempt beneficiaries' rights from seizure more broadly than provided or allowed by the law applicable to the trust. As we saw earlier in relation to the other conditions for seizure, the Debt Collection Office should therefore examine the law applicable to the trust to determine the scope of the seizure<sup>246</sup>. Its decision may be reviewed by the judicial authorities by means of a complaint and an appeal to the Federal Supreme Court.

## **2. In the Bankrupt Beneficiary's Estate**

Where the beneficiary is subject to enforcement by way of bankruptcy proceedings, the estate in bankruptcy is composed of all assets not exempt from seizure<sup>247</sup>. As a result, the beneficiary's rights against the trustee become part of the estate in bankruptcy on the same conditions as those that we have just examined in relation to seizure.

## **3. Attachment**

The rights of beneficiaries can be attached in Switzerland insofar as they can they are capable of being seized.

## **4. Conclusion**

As it stands, the DEBA ensures that a beneficiary's creditors may reach his rights resulting from a validly constituted trust to the extent that, independent of the law applicable to the enforcement proceedings, the trust deed and the law applicable to the trust do not make such rights inaccessible to the beneficiary's creditors.

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<sup>246</sup> For example, the Uniform Trust Code, § 501 (2000 Annual Meeting Draft): "To the extent a beneficiary's interest is not protected by a spendthrift provision, a creditor or assignee of the beneficiary may reach the beneficiary's interest in an appropriate judicial proceeding, including a proceeding to attach present or future distributions to or for the benefit of the beneficiary. The court shall award the creditor or assignee such relief as is appropriate under the circumstances, following consideration of the beneficiary's actual needs and the needs of those legally dependent on the beneficiary for support."

<sup>247</sup> DEBA, Art. 197.

### C. Protection of the Settlor's Creditors

The constitution of a trust in respect of certain assets places them beyond the reach of the settlor's creditors. When the settlor obtains something in exchange (*e.g.*, a share in the investments realised by an investment trust or a loan guaranteed by a security trust), the creditors' position is not prejudiced: the debtor has made an investment which, like any other investment, may turn out to be profitable or unprofitable. When on the other hand the trust is constituted without valuable consideration from the beneficiaries, *e.g.*, for charitable purposes or to provide maintenance for the settlor's family or even maintenance for the settlor himself, the settlor's solvency is reduced but without counterpart. This result is not specific to trusts: the same is true of any other gift, in particular "when the debtor makes a donation *inter vivos* subject to Swiss law<sup>248</sup> or sets up a Swiss family foundation or charitable foundation during his lifetime. Swiss law protects creditors by allowing them, on certain conditions<sup>249</sup>, to sue for revocation of the donation so that its subject matter can then be realised for their benefit<sup>250</sup>.

This risk has long been known in countries where trusts exist as an institution. Common law systems provide for the possibility of setting aside trusts constituted with the intent of defrauding creditors (fraudulent conveyances), pursuant to the rules on bankruptcy and insolvency, which we will examine here in the light of Swiss legislation on enforcement (b). Furthermore, such systems contain additional safeguards to enable creditors to realise for their benefit assets in trust or rights that the settlor has reserved to himself by appointing himself as a beneficiary (a).

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<sup>248</sup> CO, Art. 239 *et seq.*

<sup>249</sup> DEBA, Art. 285 to 292.

<sup>250</sup> Revocation or a revocatory action, DEBA, Art. 285 to 292. The rules governing foundations refer to it as follows: "A foundation can be attacked, as a donation, by the heirs *or by the creditors* of the founder" (CC, Art. 82, emphasis added). The donation is expressly referred to in DEBA, Art. 286. CO, Art. 250 further allows the donor to refuse to perform a promise to make a gift because his financial position has deteriorated; CO, Art. 240 par. 3 permits the supervisory authority to void a donation where the donor is a person lacking legal capacity owing to his profligacy, or where the proceedings to deprive him of the legal capacity were pending at the time of the donation.

## 1. Creditors' Rights according to the Law Applicable to the Trust

Generally, common law considers that a trust constituted by the settlor to exclude any or all of his estate from creditors is invalid. The consequence of this breach of public policy varies considerably from one legal system to another. However, they all allow the settlor's creditors to realise for their benefit either the assets in the invalid trust, or all of the rights and interests conferred by the trust on the settlor as beneficiary, regardless of the conditions and restrictions designed to protect him.

Every system contains at least one of the following four doctrines<sup>251</sup>.

- The settlor's intention to defraud allows the creditors to petition the court to have the trust set aside. As a consequence, the trustee fails to acquire title to the assets, so that they can be seized and realised for the benefit of the creditors or included in the settlor's estate in bankruptcy. In certain US states, the mere creation of a trust in the settlor's favour raises the presumption of fraudulent intent, so that the settlor must prove the justification for the validity of the trust. Sometimes, the creditors can obtain enforcement over the assets in trust without previously having to sue to set aside the trust<sup>252</sup>.
- The creditors can satisfy their claim out of all the assets of the trust if the settlor is the sole beneficiary of the trust<sup>253</sup>, or if the trust is revocable<sup>254</sup>, or if the rights he has reserved to himself are substantially equivalent to ownership – for example, a life interest in the trust income and a discretionary power to appoint new beneficiaries<sup>255</sup>.
- When the trust created by the settlor confers on him an interest as beneficiary but this interest is either uncertain (*e.g.*, a discretionary trust, in which the beneficiary has an unvested interest), or subject to conditions or limitations on alienation which may exclude it from the

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<sup>251</sup> See *In re Baum*, 22 F.3d 1014 (US Court of Appeals 10<sup>th</sup> Circuit, 1994, applying Colorado law).

<sup>252</sup> Restatement (Second) of Trusts, § 63; Restatement (Third) of Trusts, § 28 comments a & c (Tentative Draft No. 2, 1999); BOGERT & BOGERT (1977) § 211 pp. 59 & 66.

<sup>253</sup> BOGERT & BOGERT (1977) § 223 n. 56. This "self-settlor rule" also applies where the debtor is one of settlors and simultaneously one of the beneficiaries, see *In re Shurley*, 115 F.3d 333 (US Court of Appeals 5<sup>th</sup> Circuit, applying Texas law), *cert. denied*, 552 U.S. 82 (1997).

<sup>254</sup> Uniform Trust Code, § 505(a)(1) (2000 Annual Meeting Draft)

<sup>255</sup> USA: BOGERT & BOGERT (1977) § 233. Scotland: WILSON & DUNCAN (1995) N. 8-30.

reach of the settlor's creditors (spendthrift clauses)<sup>256</sup>, the creditors can require the trustee to make a distribution corresponding to the maximum that the settlor is entitled to receive, disregarding all the limitations burdening the settlor's rights or prospective interests<sup>257</sup>. The settlor's intent to defraud is not a condition of this remedy.

- Finally, the legislation applicable to enforcement against the settlor or to the settlor's bankruptcy provides, on varying conditions, different forms of revocatory action (*i.e.* to set aside fraudulent conveyances)<sup>258</sup>, which do not concern us in the present chapter, which deals with enforcement in Switzerland against the settlor (*infra*, b).

Many aspects of these various legal constructions overlap and it is sometimes difficult to distinguish them. Some allow the settlor's creditors to reach the assets directly in the hands of the trustee, while others allow the creditors to require the trustee to make an immediate distribution corresponding to the settlor's maximum interest. All these judicial remedies may be administered (to varying degrees) by a court having *in personam* jurisdiction over the trustee and/or *in rem* jurisdiction over the assets in trust<sup>259</sup>.

This extremely brief review serves to emphasise that – independent of the revocatory action provided for by the Swiss Debt Enforcement and Bankruptcy Act – creditors can generally find, in the law applicable to the trust and before other courts, powerful legal remedies enabling them to reach assets that would otherwise be unattainable.

## 2. Creditors' Rights under the Swiss Law of Enforcement

If the settlor is subject to enforcement in Switzerland, his creditors can bring a revocatory action (*action révocatoire*, *Anfechtungsklage*) pursuant to DEBA Chapter 10.

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<sup>256</sup> Restatement (Second) of Trusts, § 156.

<sup>257</sup> USA: Uniform Trust Code, § 505(a)(2) (2000 Annual Meeting Draft); Restatement (Third) of Trusts, §§ 57, 58 (2) (Tentative Draft No. 2, 1999); see *Vanderbilt Credit Corp. v. Chase Manhattan Bank*, 473 NYS2d 544, 100 AD2d 544 (N.Y., 1984). England: UNDERHILL & HAYTON (1995) p. 184; OAKLEY (1998) p. 231; *Re Burroughs-Fowler*, [1916] 2 Ch 251.

<sup>258</sup> On the United Kingdom: UNDERHILL & HAYTON (1995) pp. 260-267; OAKLEY (1998) pp. 224-230; section 423 of the Insolvency Act 1986. Australia: MEAGHER & GUMMOW (1997) NN. 959-965.

<sup>259</sup> On the United States: BOGERT & BOGERT (1977) § 292.



A revocatory action has no effect on title and other property rights to the assets concerned<sup>260</sup>. Its “purpose is to submit to enforcement the assets excluded from it as a result of a transaction” identified in the Act (Art. 285, par. 1).

(i) For trusts in the nature of gifts to the beneficiaries (*e.g.*, family trusts), constituted by the settlor without valuable consideration from the beneficiaries<sup>261</sup>, the constitution of the trust – and consequent transfer of the assets to the trustee – is subject to a revocatory action if it takes place in the year preceding the settlor’s bankruptcy or seizure (DEBA, Art. 286).

(ii) Trusts constituted by a deeply indebted settlor to supply security to his creditors may be revoked, if made within the same period of one year, if the guaranteed debt predates the settlement and the settlor had not previously undertaken to guarantee it<sup>262</sup>. Any trust constituted during the same suspect period for the purpose of otherwise assuring payment of the settlor’s debts is also subject to revocation<sup>263</sup>.

(iii) Finally, a trust is also revocable if constituted in the five years preceding bankruptcy or seizure, by a settlor with the intention of prejudicing his creditors’ or favouring some creditors to the detriment of others. DEBA Article 288 requires that this intention be “apparent to the other party”. This condition is realised if the settlor’s intention was apparent either to the trustee himself, or to the beneficiaries without the trustee’s knowledge.

Consequently, the application of the substantive conditions to which the DEBA submits the revocatory action does not appear to create any special difficulty. In particular, the text of DEBA Article 286 par. 1 refers to “any donation or other disposal not made for valuable consideration”, and such wording includes the constitution of a trust as a gift to the beneficiar-

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<sup>260</sup> SchKG-STAEHELIN (1998) Art. 285 NN. 8-10; H.R. SCHÜPBACH, *Droit and action révocatoires: Commentaire des Articles 285 à 292 de la [DEBA]*, Basle (Helbing & Lichtenhahn) 1997, Art. 291 N. 4.

<sup>261</sup> On trusts in the nature of gifts to the beneficiaries, see *supra* Inter Vivos Trusts (protection des indefeasible share in inheritance) and Trusts and Matrimonial Property Rights (protection of spouse’s matrimonial property rights to joint ownership of property acquired during wedlock). The creation of security interests without valuable consideration from the beneficiary is a gift, see ATF 95 III 47, JdT 1970 II 78.

<sup>262</sup> DEBA, Art. 287 par. 1 (1).

<sup>263</sup> DEBA, Art. 287 par. 1 (2).

ies, so that it is not necessary to complete the Article as proposed above regarding the law of inheritance<sup>264</sup>.

The action may be brought against the trustee and, in respect of distributions already made, the beneficiaries who received them<sup>265</sup>.

The forum for a revocatory action is the defendant's Swiss domicile, or, if there is none, the forum in which the seizure or bankruptcy is to be conducted<sup>266</sup>. When at least one of the trustees is domiciled in Switzerland, the courts at his domicile have jurisdiction over the action against all the trustees<sup>267</sup>.

## VIII. Beneficiaries' Right to Trace Assets and Third-Party Liability

The beneficiaries of a trust do not only have personal rights against the trustee, whom they may hold liable if he breaches the duties resulting from the trust<sup>268</sup>. According to the English trust concept – which exists in all legal systems deriving from the laws of England – beneficiaries enjoy an equitable interest in the trust assets, which may be asserted against third parties<sup>269</sup>. When the trustee fails in his duties to the beneficiaries, the latter usually have remedies against him and, on certain conditions, claims against

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<sup>264</sup> See proposal for CC, Art. 527 par. 2 *supra* V.A.2.c). RIEMER (1975) Art. 82 N. 9 further points out that the phrase “by the founder's creditors” in CC, Art. 82 is a mere confirmation.

<sup>265</sup> DEBA, Art. 290: “persons... who have benefited from an advantage conferred on them by” the debtor; see SchKG-STAEHELIN (1998) Art. 290 N. 5. In cases of revocation for over-indebtedness, the action can only be brought against beneficiaries who knew or could not fail to be aware of the settlor's excessive debts, DEBA, Art. 287 par. 2.

<sup>266</sup> DEBA, Art. 289.

<sup>267</sup> See Federal Venue Act (n. 131), Art. 7 (the actions are not mutually exclusive) par. 1. The Lugano Convention (RS 0.275.11) does not apply because of the subject matter (art. 1 par. 2 (2)).

<sup>268</sup> This liability is governed by the law applicable to the trust, see Art. 8.g of the Convention.

<sup>269</sup> “Just as every owner of a legal interest has the right that others shall not, without lawful excuse, interfere with his possession or enjoyment of the property or adversely affect its value, so the beneficiary, as equitable owner of the trust res has the right that third persons shall not knowingly join with the trustee in a breach of trust.” BOGERT & BOGERT (1977) § 901 *in initio*.

certain third parties who participated in or benefited from the breach of trust. These rights are mutually exclusive: consequently, the beneficiaries must as a rule choose between exercising the right to trace the asset sold by the trustee in breach of his duties or requiring the trustee to hand over the profit he made on the sale. The cases show that third parties are generally sued only when the trustee can no longer meet his obligations to the beneficiaries.

If the trustee alienates an asset in trust or creates a limited property right in breach of trust, each beneficiary has the following rights against the purchaser:

- A right to trace the asset in question, the income generated by it, the sale proceeds or assets acquired with the reinvested proceeds or product;
- If a third party has acted in particular bad faith, the beneficiary may sue the third party for compensation for the full value of the asset.

a) The right to trace assets is based on the principle that, when the trustee disposes of trust assets in breach of his duties, this transfer does not in principle extinguish the beneficiary's equitable interest, so that the third party acquires the asset subject to the trust. The beneficiary may, therefore, require the third party to restore the property itself to the trust fund, as well as the income and gains thereon, and, if the property has been sold, the proceeds of sale or other assets in which such proceeds were reinvested. The right to trace thus includes an element of subrogation connected with the property right. However, this right may be extinguished in various circumstances, the most important of which are:

- Purchase for valuable consideration by a *bona fide* purchaser unaware that the trustee is in breach of his duties (*bona fide* purchaser without notice)<sup>270</sup>;
- Dissipation (in fact, consuming or spending without reinvestment, *e.g.*, gambling, vacation travel, etc.) of the asset in trust, its income, sale proceeds or other assets acquired as reinvestments<sup>271</sup>;

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<sup>270</sup> See *infra* VIII.A.1.

<sup>271</sup> *Idem*.

- A change of position, i.e., the fact that the position of the innocent defendant has changed to such an extent that it would now be inequitable to force him to make restitution<sup>272</sup>.

b) The potential personal liability of a third party for the value of the asset – particularly of interest to the beneficiary if the asset has been dissipated or has depreciated in value – treats the third party who has acted wrongfully as a trustee in terms of liability. Such a constructive trustee assumes obligations similar to those of an ordinary trustee (fiduciary duties). He is thus exposed to liability that extends beyond the mere restitution of the assets concerned. This greater liability is justified only by a particular degree of fault, which it is not always easy to define precisely. English case law distinguishes various situations and seems, generally, to use the test of dishonesty<sup>273</sup>. US law treats deliberate ignorance of circumstances suggesting a breach of the trustee's duties as actual knowledge of a breach of trust serving as a basis for third-party liability<sup>274</sup>. Mere negligence by the third party is not a sufficient basis for liability; particular bad faith must also be present<sup>275</sup>.

Unlike the right to trace, which is limited to the asset, as well as the income and reinvested proceeds thereof, the constructive trustee's liability is really a liability for damages burdening his entire estate. A constructive trust forms the theoretical basis for third-party liability in three situations in which the trustee acts in breach of his duties: where the third party delib-

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<sup>272</sup> Long recognised by the Restatement (Second) of Trusts, §§ 291 comment g and 292 (3), the objection based on a change of position was only accepted recently by the House of Lords in *Lipkin, Korman v. Karnpale*, [1991] 2 AC 548 (at 558 & 579-581), [1992] 4 All ER 512 (at 516 & 532-534); see, however, *In re Diplock*, [1948] Ch. 465 (C.A., pp. 546-548). See also OAKLEY (1998) pp. 738-740, UNDERHILL & HAYTON (1995) pp. 927-929 and *infra* Purchaser's Liability for Knowing Receipt.

<sup>273</sup> PEARCE & STEVENS (1998) pp. 722-740, who consider that the criterion adopted by the Privy Council in *Royal Brunei Airlines v. Tan*, [1995] 2 AC 378, [1995] 3 All ER 97, regarding a third party who knowingly assists in a breach of trust (knowing assistance), also applies to a third party who knowingly receives the asset in trust (knowing receipt).

<sup>274</sup> "... where facts suggesting fiduciary misconduct are compelling and obvious, it is bad faith to remain passive and not inquire further because such inaction amounts to a deliberate desire to evade knowledge." *New Jersey Title Insurance Co. v. Caputo*, 163 N.J. 143, 748 A.2d 507 (2000) and the many precedents cited; BOGERT (1987) § 167; see also the Uniform Fiduciary transferees Act of 1922.

<sup>275</sup> "The so-called dishonesty standard... [is] a way of differentiating bad faith from mere negligence in terms of purpose." *New Jersey Title Insurance Co. v. Caputo*, 163 N.J. 143 (at 156), 748 A.2d 507 (at 514).

erately assumes the functions of a trustee without having been properly appointed (trustee de son tort), where he acquires or receives a trust asset in bad faith (knowing receipt), or where, in bad faith, he participates in a breach of trust (knowing assistance)<sup>276</sup>.

Actions against third parties are brought by the beneficiaries for the benefit of the trust fund. The trustee may also do likewise<sup>277</sup>; where necessary, this will be done by the new trustee appointed by the competent court to replace the former trustee in breach of his duties.

If the trustee and the third parties concerned are domiciled within the jurisdiction of the legal system governing the trust, the position of third parties dealing with the trustee forms part of the mesh of rules and legal practice that are familiar to them. If, on the other hand, such third parties are domiciled or resident in a state in which trusts do not exist, nor the type of liability that may result from a transaction with a trustee, application of the law of the trust can produce unexpected results differing significantly from the principles of property and contract law familiar to such third parties.

Mindful of this difficulty, the authors of the Convention decided “that the trust assets may be traced when the trustee, in breach of trust, ... has alienated trust assets”<sup>278</sup>, subject to two notable restrictions:

- “The Convention 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”, relating in particular to the “the transfer of title to property and security interests in property”<sup>279</sup>.
- “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.”<sup>280</sup>

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<sup>276</sup> *Royal Brunei Airlines v. Tan* (n. 273); *Agip (Africa) Ltd v. Jackson*, [1990] 1 Ch 265, [1992] 4 All ER 385; Restatement (Second) of Trusts, §§ 321–326; see notably PEARCE & STEVENS (1998) pp. 720-740.

<sup>277</sup> Restatement (Second) of Trusts, § 294.

<sup>278</sup> Article 11 par. 3.d, first sentence.

<sup>279</sup> Article 15 par. 1.d

<sup>280</sup> Article 11 par. 3.d, second sentence.

Consequently, the Convention distinguishes the purchaser of a trust asset (or of a right over such an asset) from the mere holder of such an asset. We must examine these cases separately.

### **A. Purchasers of Assets in Trust (or of Rights Related Thereto)**

The first hypothesis concerns a large number of situations in which the trustee, in breach of trust, causes a third party to acquire title or another right (in particular a limited property right, but also a license to use an intangible asset, etc.) to the asset he holds as trustee. For example:

- The trustee of a painting, which he is to transfer to a beneficiary when the latter attains his majority, sells the painting to a collector domiciled in Switzerland;
- The trustee of real property located in Switzerland, whose trustee status is stated in the land registry<sup>281</sup>, sells three plots of land to a property developer. The power to sell them is not provided in the trust deed or in the law applicable to the trust.
- In breach of the trust deed, the contents of which were unknown to the bank, the trustee of a securities account obtains a loan from the bank in favour of one of the trust beneficiaries, pledging the portfolio as collateral.

On one hand, the Convention requires the courts to apply the rules of trust law allowing trust assets to be traced in cases where the trustee has disposed of them in breach of his duties under the trust (Article 11 par. 3.d). On the other, the Convention states that it does not stand in the way of applying mandatory provisions applicable under the forum's conflict rules on the transfer of title to property and security interests in property (Article 15 par. 1.d).

If the trustees in the foregoing three examples were “mere” owners, the property transfers would be valid, the pledges would be validly perfected, and the purchasers protected, provided that the contracts concluded for that purpose were not defective. In Swiss law, the fact that an owner breaches a duty to a third party does not affect the validity of the property

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<sup>281</sup> Regarding references to trustee status in public registers, see *infra* IX.

right that he transfers, even if the purchaser knows or should have known that the transferor was acting improperly.

Fiduciary transfers provide a good illustration of this principle. In Swiss law<sup>282</sup>, the fiduciary transferee acquires sole and full title to the assets and rights transferred to him as in this capacity (*Vollrechtstheorie*). As the titleholder, his power to dispose of the fiduciary assets is identical to that of any other owner: he is not restricted by the contractual obligations he has assumed in relation to the fiduciary transferor. Consequently, under Swiss law, the fiduciary owner can effectively alienate the fiduciary assets, even if he breaches the terms of the fiduciary transfer agreement and must therefore fully indemnify the fiduciary transferor or the beneficiary for the damage he causes<sup>283</sup>.

The fact that the fiduciary transferee is considered (not without criticism) as an owner whose power of disposal is unlimited should not lead us to overestimate the differences that appear to differentiate him from a trustee.

*I*° On one hand, although *in principle* the purchaser remains uninvolved in the fiduciary transferee's contractual breach, that is not always the case. Incitement to breach the fiduciary contract is, in some circumstances, a violation of *bonae mores* which can expose the instigator to civil liability<sup>284</sup>. In addition, the fiduciary's behaviour may attract criminal sanctions (in particular for fraudulent misappropriation), in which the purchaser may be the instigator, an accessory, or even a receiver<sup>285</sup>. The purchaser may thus be liable to pay damages jointly with the trustee. Swiss law allows the

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<sup>282</sup> German case law adopts the same solution (*Bundesgerichtshof*, NJW 1968 1471), though it is criticised H. KÖTZ, NJW 1968 1471 s.; H. SCHLOSSER, NJW 1970 681 *et seq.*, 685-686; H. COING, *Die Treuhand kraft privaten Rechtsgeschäft*, Munich (Beck) 1973, pp. 163-168. Recent review: S. GRUNDMANN, *Der Treuhandvertrag*, Munich (Beck) 1997, pp. 324-331.

<sup>283</sup> ZOBL (1982) Syst. Teil N. 1427, with references; STARK (1984) Art. 933 N. 57. *Contra* WATTER (1995) pp. 232-235; OFTINGER & BÄR (1981) Syst. Teil. N. 251. Undecided: ATF 91 III 104 c. 6, JdT 1966 II 44, 48.

<sup>284</sup> CO, Art. 41 par. 2; see in particular J.M. GROSSEN, "La responsabilité du tiers complice de la violation du contrat", in *Festgabe Wilhelm Schönenberger*, Fribourg (Ed. Universitaires) 1968, pp. 121-136, A. MÜLLER, *Die Beeinträchtigung fremder Forderungen als Delikt...*, Zurich (Schulthess) 1975.

<sup>285</sup> Art. 138 (1), 2<sup>nd</sup> case, of the Swiss Penal Code, in combination with Arts. 24 par. 1, 25 and 160 (1); THÉVENOZ (1995) pp. 336-337.

courts broad discretion to determine the form of restitution, which include ordering the return of the wrongfully-acquired asset<sup>286</sup>.

2° Moreover, Swiss law recognises situations in which the owner's power of disposal is limited by his own legal act (*e.g.*, a marriage contract), that of a third party (*e.g.*, a will) or by an administrative decision. This is not only the case of an heir burdened with the charge of passing on the inheritance to another as reversionary heir (*substitution fidéicommissaire*, *Nacherbeneinsetzung*)<sup>287</sup> – which presents a clear analogy with a rudimentary trust having only one beneficiary (the substitute) and a single distribution of the entire trust fund at the time specified by the testator – but also of heirs to an estate subject to executorship, administration by the state, or official receivership or bankruptcy<sup>288</sup>; spouses who have contractually adopted the community property regime<sup>289</sup>; and the owner of any asset subject to seizure or attachment<sup>290</sup>. In all these cases, anyone who acquires property from an owner with a limited power of disposal is protected only if he is in good faith unaware of this limitation<sup>291</sup>.

In common law, the trustee is the owner (or legal title holder) of the assets in trust<sup>292</sup>. Once burdened with a trust in favour of a third party, this

<sup>286</sup> CO, Art. 43 par. 1: “The judge shall determine the means ... of restitution...”. See THÉVENOZ (1995) p. 337; K. OFTINGER & E.W. STARK, *Schweizerisches Haftpflichtrecht*, t. I, 5th ed., Zurich (Schulthess) 1995, pp. 101-103. *E.g.*, (not a fiduciary transfer case): ATF 100 II 134 c. 6d. For a different reasoning method that reaches the same conclusion: GUBLER (1954) pp. 265a-266a; WATTER (1995) pp. 232-235.

<sup>287</sup> CC, Art. 488 to 492; see above note 37. Concerning the restriction on the owner's power of disposal, who “becomes the owner, subject to the duty to pass on the estate” (CC, Art. 491 par. 2), see C. van de SANDT, “La transmission du patrimoine et la substitution fidéicommissaire: L'obligation de rendre la succession à un tiers”, in *La transmission du patrimoine*, Fribourg (Ed. Universitaires) 1998, pp. 75 *et seq.*, esp. 81-86, and citations, as well as the authors mentioned in the following note; for a contrary opinion: PIOTET (1975) p. 100.

<sup>288</sup> CC, Art. 554, 593 *et seq.* and 517 *et seq.*; STEINAUER (1997) N. 437; STARK (1984) Art. 933 N. 59.

<sup>289</sup> CC, Art. 222 par. 3 and 228; STARK (1984) Art. 933 N. 58.

<sup>290</sup> DEBA, Art. 96 and 275; STEINAUER (1997) N. 437 p. 119; STARK (1984) Art. 933 N. 61.

<sup>291</sup> CC, Art. 933 & 935 CC on movable property; see STEINAUER AND STARK, *loc. cit.*

<sup>292</sup> See in particular Art. I (1) of the Principles of European Trust Law; Restatement (Second) of Trusts, § 2, confirmed by Restatement (Third) of Trusts, § 2 and comment f (Tentative Draft No. 1, 1996); WATERS (1995) p. 428; FRATCHER (1974) p. 28 N. 33 (which pints out that the trustee's title to the trust property may be more limited than ownership in civil law; see, *e.g.*, UNDERHILL & HAYTON (1995) p. 38). The more conservative and criti-



ownership acquires certain consequences. In principle, the Convention requires recognition of such consequences. In particular, the specific rules applicable to enforcement against the trustee and the beneficiary's right to trace assets where a breach of trust has occurred, expressly referred to by the Convention<sup>293</sup>, seem the most alien to civil law concepts.

The beneficiary's right to trace assets cannot be compromised by the objection that the Swiss legal system— if it governs the acquisition of the asset<sup>294</sup> – requires the trustee's power of disposal to be identical to that of any other owner. This objection would be contrary to the current state of Swiss law which, as we have just seen, recognises owners whose power of disposal is limited by their own legal act or by that of a third party. Furthermore, if Switzerland adheres to the Convention, this objection would be tantamount to evading Article 11 par. 3.d, first sentence.

On the other hand, by recognising the trustee as the holder of a power of disposal limited by the trust deed and the law applicable to the trust, one can compare any *ultra vires* disposals to cases of acquisition *a non domino* under Swiss law. Alienation in breach of trust and the conditions on which a *bona fide* purchaser is protected may be compared to alienation by a person in possession of something entrusted to his care – or by an owner whose power of disposal is restricted by a legal act – and to the protection of a purchaser in good faith under Article 933 of the Civil Code.

However, the remedies differ in each system.

- According to Swiss law, a purchaser who is not protected by CC Articles 933 or 935 does not acquire any property right over the asset, but holds it without any right until the acquisitive prescription period has expired<sup>295</sup>.
- The position of a person who acquires in breach of trust is different. Even if he is not a *bona fide* purchaser without notice, he acquires good title or some other property right over the asset. The acquisition is not void, but the right he acquires remains subject to the beneficiaries'

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cised phrasing of Art. 2 of the Convention (“under the control of a trustee”, “title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee”) was essentially motivated by the desire to enable institutions similar (but non-identical) to the common law trust to benefit by the Convention.

<sup>293</sup> Article 11 par. 3.a & d of the Convention.

<sup>294</sup> As the *lex rei sitae*, pursuant to SPILA, Art. 99 to 107.

<sup>295</sup> CC, Art. 728, relating to personal property.

equitable interest, and they may bring an action for restitution of the property<sup>296</sup>. Unlike the person who remains the owner under Swiss law, the trust beneficiaries must choose between tracing the assets from the third party or requiring the trustee to transfer the sale proceeds to the trust fund. In other words, the purchaser exposed to the risk of an action by the beneficiaries is not, as in Swiss law, a holder without right, but has a right that remains subject to another's interest.

In spite of this structural difference between the two systems, we shall seek to verify, in the following pages, whether the principles of trust law on this subject are really as remote as they appear to be from Swiss legal rules with a similar function: acquisition *a non domino* of property entrusted to a person and the liability of a holder without right.

## 1. The Right to Trace the Trust Property Itself

In English law, when the trustee's disposal is not authorised by the terms of the trust or by the default rules of the law governing the trust, or when the alienation otherwise breaches the trustee's duties, the purchaser of the asset – or of a limited property right, such as a pledge, on the asset – is protected, as a rule<sup>297</sup>, only insofar as he acquires the property for valuable consideration and was unaware, through no fault of his own, that the asset had been placed in trust. This *bona fide* purchaser without notice acquires the asset free of any trust and has no duty to make restitution. In contrast, an assignee who does not give valuable consideration (a donee or anyone who believes that he is a beneficiary of the trust) is not protected and must make restitution, even if he is in good faith<sup>298</sup>. Similarly, even a purchaser for valuable consideration is not protected if he knew (had actual notice) or should have known (constructive notice) that the asset was the object of a

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<sup>296</sup> *E.g.*, regarding securities pledged in breach of trust: *Schantz v. Marine Midland Bank*, 221 B.R. 653 (at 658); Uniform Commercial Code, § 8-315 (1) [1977 revision]. The 1994 amendment to Article 8 UCC (*Investment Securities*) no longer provides a basis for a distinct cause of action but reserves the actions which are (in this case) based on the trust (§ 8-502).

<sup>297</sup> The other principal exceptions are dissipation and change of position as discussed earlier.

<sup>298</sup> Innocent volunteer, see *Re Diplock*, [1948] Ch 465, [1948] 2 All ER 318 (Court of Appeal). Restatement (Second) of Trusts, § 289 (*donee*).

trust. Good faith relates to the fact that the alienated asset is subject to a trust<sup>299</sup>. If the purchaser knows of the trust, or remains ignorant of it through his own fault, the asset he acquires remains burdened by the trust and subject to the right to trace trust property. The evaluation of wrongful ignorance depends on the nature of the transaction; case law tends to exclude it from commercial transactions<sup>300</sup>.

In the United States, the Restatement Second protects the *bona fide* purchaser for value even if he does know of the trust's existence where, through no fault of his own, he is unaware that the trustee is acting in breach of his duties<sup>301</sup>. The difference between US and English law on this point is probably less significant than it seems, since knowledge of the trust's existence generally creates a duty to enquire into its terms, so that a negligent purchaser can be blamed for wrongly remaining ignorant of the breach of trust<sup>302</sup>. The Restatement Second further states that, to qualify as a *bona fide* purchaser, one must not knowingly participate in a wrongful transaction<sup>303</sup>.

Like the doctrine of notice, Swiss law protects a *bona fide* purchaser for value who acquires an asset (or a limited property right over an asset), without knowing that the transferor has no power to dispose of the prop-

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<sup>299</sup> PIERCE & STEVENS (1998) pp. 730-731 & 100-101; OAKLEY (1998) p. 738; UNDERHILL & HAYTON (1995) Art. 104(2) pp. 916 *et seq.*

<sup>300</sup> “. . . as regards the extension of the equitable doctrines of constructive notice to commercial transactions, the Courts have always set their face resolutely against it. The equitable doctrines of constructive notice are common enough in dealing with land and estates, with which the Court is familiar; but there have been repeated protests against the introduction into commercial transactions of anything like an extension of those doctrines, and the protest is founded on perfect good sense. In dealing with estates in land title is everything, and it can be leisurely investigated; in commercial transactions possession is everything and there is no time to investigate title; and if we were to extend the doctrine of constructive notice to commercial transactions we should be doing infinite mischief and paralysing the trade of the country.” *Manchester Trust v. Furness*, [1895] 2 QB 539 (at 545). Recently approved by Vinelott J in *Eagle Trust v. SBC Securities*, [1992] 4 All ER 488 (at 507-509) (Ch. D.), and par Scott LJ in *Polly Peck International v. Nadir (N° 2)*, [1992] 4 All ER 769 (at 782) (C.A.).

<sup>301</sup> Restatement (Second) of Trusts, § 296.

<sup>302</sup> *Idem*, § 297, comment f. See, however, the Uniform Trust Code, § 1012 (b) (2000 Annual Meeting Draft)

<sup>303</sup> *Ditto*, § 284 (1), 290: this exception refers, *inter alia*, to payments made by the trustee in cases of gaming debts, to pay for illegal services (in the United States, prostitution) or illegal substances (drugs). Corruption, money-laundering and some more modern offences could be added to this list.

erty<sup>304</sup>. Good faith is presumed, but it can not be invoked when it is “incompatible with the attention [required of the purchaser] by the circumstances”<sup>305</sup>.

One might think that Swiss law, unlike English or US law, would also protect assignees who acquire the property, without giving valuable consideration for it, in the same circumstances. Under CC Article 933, acquisition *a non domino* does not depend on any form of valuable consideration from the assignee. The difference is merely superficial. In reality, the Swiss legal system distinguishes between purchases for value and assignments without valuable consideration and protects the latter to a significantly lesser degree.

(i) According to CO Article 239 par. 1, a donation is any transfer in which “a person assigns all or part of his assets to another without corresponding consideration.”<sup>306</sup> Legal writers deduce from this that the contract is void if it pertains to assets which do not belong to the donor<sup>307</sup>. While CC Article 933 certainly protects a purchaser in good faith who is unaware that the seller does not have the power to dispose of the property, it does not dispense with the need for a valid obligation – contractual or other – as a requirement for the assignment of the property right in question<sup>308</sup>. The nullity of the donation contract makes the disposal in favour of the donee ineffective<sup>309</sup>.

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<sup>304</sup> CC, Art. 933: “A purchaser in good faith who obtains personal property as titleholder or receives any other property right from the person to whom the property was entrusted, shall retain title, even if the transferor did not have the authority to make the transfer.” On real estate, see CC, Art. 973.

<sup>305</sup> CC, Art. 3, par. 1 and 2 respectively.

<sup>306</sup> See also the German (“aus seinem Vermögen”) and Italian (“coi propri beni”) versions of the legal text.

<sup>307</sup> BaK-VOGT (1996) Art. 239 OR N. 42; P. CAVIN, *Traité de droit privé suisse*, t. VII/1: *La vente, l'échange, la donation*, Fribourg (Ed. Universitaires) 1978, p. 177; H. HONSELL, *Obligationenrecht Besonderer Teil*, 5<sup>th</sup> ed., Berne (Stämpfli) 1999, p. 183; P. TERCIER, *Les contrats spéciaux*, 2<sup>nd</sup> ed., Zurich (Schulthess) 1995, N. 1324; von TUHR *et al.* (1977) p. 497 n. 143 & p. 516.

<sup>308</sup> See ATF 65 II 62, 65, JdT 1939 I 424, 426; ATF 48 II 1 c. 1, JdT 1922 I 241; STARK (1984) Art. 933 N. 58.

<sup>309</sup> The requirement of a legal basis for acquisition resulting from an assignment (*principe de causalité*) is provided by statute for real property law (CC, Art. 974 par. 2) and by case law for personal property (ATF 119 II 326 c. 2c, JdT 1995 II 87, 90 s.). It remains the subject of debate for assignments of debts, but seems recently to have won favour with legal writers (see H.C. von der CRONE, “Zession: kausal oder abstrakt? RSJ 1997 249; E.

(ii) The Swiss Penal Code distinguishes assignments made with and without consideration from purchases for value in matters of criminal forfeiture. “Forfeiture shall not be pronounced when a third party acquires assets without knowledge of the facts which would have justified it, and insofar as that party provided adequate consideration...”<sup>310</sup>

(iii) In trust law, the denial of protection for the innocent volunteer (or donee) essentially applies to distributions made to beneficiaries (or apparent beneficiaries) in contravention of the terms of the trust. For example, trustees may make distributions to a charitable institution on the basis of a clause in the trust deed which is subsequently declared void by a court<sup>311</sup>. Or, they may make a mistake regarding a person’s membership of a class of beneficiaries named in the trust deed. The trustees might make an error in calculating the amount of the distribution. When faced with a party who, even in good faith, wrongly received a distribution from the trustee and a party to whom the distribution is or will be due, equity generally protects the latter<sup>312</sup>.

In the same circumstances, Swiss law yields a similar solution. The underlying legal basis (*causa*) of the disposals made by the trustee in favour of the beneficiaries (distributions) is none other than the trust itself, which in this respect is comparable to a donation with a third party beneficiary clause<sup>313</sup>. If the disposition is governed by Swiss law as the *lex rei sitae*, its validity (and, consequently, the acquisition by the beneficiary) depend on the existence of a valid underlying basis: the trust deed underlying the trustee’s duty to transfer certain assets to the beneficiary<sup>314</sup>. Thus, anyone who, even in good faith, receives a distribution from a trustee to which he is not entitled is not protected in Swiss law either, because the

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SPIRIG, [Zürcher] *Kommentar zum Schweizerischen ZGB*, t. V 1k, 3<sup>rd</sup> ed. (1993), Vorb. zu 164-174 NN. 106-107). If one accepts that the validity of an assignment does not depend on the existence of a valid underlying basis for the transfer, the assignee acquires the debt assigned, but is bound to restore it pursuant to the rules on unjust enrichment (CO, Art. 63; SPIRIG, *ibidem* N. 51).

<sup>310</sup> SPC, Art. 59 (1).

<sup>311</sup> *Re Diplock*, [1948] Ch 465, [1948] 2 All ER 318 (Court of Appeal).

<sup>312</sup> *Ibidem*, where the settlor’s heirs prevailed over charitable institutions as beneficiaries under the terms of a void trust clause.

<sup>313</sup> See ATF 96 II 79 c. 7b, JdT 1971 I 337, *Harrison*.

<sup>314</sup> See *supra* note 309.

assignment lacks an underlying legal basis<sup>315</sup>. In particular, CC Article 933 does not apply. The assignee is thus exposed to the trustee's claim to trace the property, because the trustee remains the owner. The transferee can acquire good title only after the ordinary prescription of five years, but that requires uninterrupted good faith throughout the period (CC, Art. 728)<sup>316</sup>.

Consequently, by allowing the beneficiary to trace assets in the hands of an innocent volunteer, the law applicable to the trust does not conflict with Swiss law when it applies to the disposition as the *lex rei sitae*.

## 2. The Right to Trace Income and Sale Proceeds

The right to trace allows the beneficiary (or trustee) to require restitution to the trust corpus not only of the alienated asset, which remained burdened by the trust, but also its proceeds, namely any income therefrom (interest, dividends, rents, etc.), together with sale proceeds whether kept separately or mingled with other assets), as well as any assets acquired by way of reinvestment. This process, by which the court identifies the assets that constitute the proceeds or reinvestment of the asset originally alienated in breach of trust, is known as tracing<sup>317</sup>.

The defendant who is bound to restore the property itself, or the sale proceeds or reinvestments may deduct (or be reimbursed) the price paid to the trustee insofar as the trust fund benefited from it<sup>318</sup>.

The right to trace is extinguished when the asset, its proceeds or reinvestments have been dissipated, i.e. spent or consumed without being replaced by new assets.<sup>319</sup> Dissipation is a conclusive bar to the right to trace. The innocent purchaser's liability stops there. However, anyone who

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<sup>315</sup> This is also true if one were to accept that the transfer of certain rights (claims, other intangible rights) is valid regardless of its underlying basis. In that case, the (valid) assignment enriches the purchaser, a form of unjust enrichment because it has no valid basis. Restitution by the assignee of what he wrongly received, in good or bad faith, thus depends on the trustee's personal rights rather than on a property right (CO, Art. 62 *et seq.*, 63).

<sup>316</sup> CC, Art. 728.

<sup>317</sup> *Boscawen v. Bajwa*, [1996] 1 WLR 328 (at 334), [1995] 4 All ER 769 (at 776 f), per Millet LJ, approved by OAKLEY (1998) p. 711; PEARCE & STEVENS (1998) pp. 748 *et seq.*

<sup>318</sup> Restatement (Second) of Trusts, § 291 comment o.

<sup>319</sup> PEARCE & STEVENS (1998) pp. 761-762.

wrongly acquired, dissipated or consumed the asset in trust, having meanwhile learnt that the beneficiaries were entitled to trace it, incurs a liability as a constructive trustee, a topic dealt with in the following section.

As regards income, sale proceeds and assets acquired as reinvestments, CC Article 938 treats a holder without right more favourably<sup>320</sup>. Insofar as he is in good faith, he does not owe any compensation for the use and enjoyment of the property within the limits of his presumed right<sup>321</sup>. Consequently, if he believed himself the owner of the property, the income accrues to him and he need not repay it. According to the case law of the Federal Supreme Court, this principle would extend to dispositions made by the holder: the party who could have traced and demanded restitution of an asset while it was in the defendant's estate cannot demand either the resale price of the asset, or even the gain realised by the holder without right<sup>322</sup>.

This already dated case law, rightly criticised by recent authors who have examined the question in detail<sup>323</sup>, runs contrary to the text of the law and produces inequitable results. The defendant's good faith does not justify allowing him to keep the sale proceeds to the extent that he is still unjustly enriched. This question is beyond the scope of CC Article 938, which refers only to enjoyment of the asset, its loss or deterioration, but not to disposal of it by a holder without right. Since the *lex specialis* does not settle this question, it is governed by the general rules on unjust enrichment and managing another's property without an agreement to do so (*gestion d'affaires sans mandat*) which applies<sup>324</sup>. These provisions adequately pro-

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<sup>320</sup> CC, Art. 938: “<sup>1</sup> The holder in good faith who benefited by the property in accordance with his presumptive right does not owe any compensation for such benefits to the person to whom he is bound to return the property. <sup>2</sup> He is not liable for loss or deterioration.” CC, Art. 939 deals with reimbursement of expenses incurred by the holder for the benefit of another's property.

<sup>321</sup> CC, Art. 938 par. 1.

<sup>322</sup> ATF 71 II 90 c. 5, JdT 1945 I 521; approved by STEINAUER (1997) NN. 506 s. p. 139; STARK (1984) Art. 934 NN. 8 & 18-18c. For a holder in bad faith, the special rule (CC, Art. 940: *infra* note 334) and the general rules produce the same substantive result.

<sup>323</sup> See, in particular C. CHAPPUIS, *La restitution des profits illégitimes*, Basle (Helbing & Lichtenhahn) 1991, pp. 71-83; P. HOLENSTEIN, *Wertersatz und Gewinnherausgabe*, Zurich (Schulthess) 1983, pp. 137 *et seq.* See also: H. HINDERLING, *Schweizerisches Privatrecht*, t. VI/1: *Der Besitz*, Basle (Helbing & Lichtenhahn) 1977, p. 512; A. HOMBERGER, [*Zürcher*] *Kommentar zum schweizerischen. ZGB*, 2<sup>nd</sup> ed. (1938), Art. 938 N. 12.

<sup>324</sup> CO, Art. 62 *et seq.* and 423.

tect a holder in good faith, who need only return the sale proceeds to the extent that he was and remains enriched<sup>325</sup>.

To summarise, whether in good or bad faith, a holder without right must restore the property or the proceeds thereof, if any. A holder in good faith who has consumed the asset or its proceeds need not make restitution. Swiss law coincides on these points with the principles of equity. A single aspect sets them apart: Swiss law dispenses a holder without right who is in good faith – *i.e.* who through no fault of his own is unaware of his irregular position – from returning the income received from the asset.

### 3. Purchaser's Liability for Knowing Receipt

On certain conditions, the purchaser is treated like a trustee and consequently assumes more extensive duties which, in case of breach, require him to indemnify the trust fund for damages caused to the trust corpus. Whereas the right to trace relates only to the asset, its proceeds and reinvestments, the duties and liabilities of a constructive trustee affect his entire estate. In particular, they bind the third party to render accounts like any other trustee and make him answerable for the asset's value, even if the asset has depreciated or has been consumed.

A purchaser becomes a constructive trustee of the acquired asset:

- Immediately on acquisition if he had actual knowledge that the purchase was irregular<sup>326</sup>;
- Subsequently, as soon as he learns that the asset, which he believed free of any encumbrance is burdened by an equitable interest in favour of the beneficiaries<sup>327</sup>. This situation essentially concerns innocent volunteers<sup>328</sup> – as we have seen, they do not extinguish the beneficiary's equitable interest in the asset – but does not affect a *bona fide* purchaser for value without notice, whose acquisition definitively extinguishes the beneficiary's rights.

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<sup>325</sup> CO, Art. 64.

<sup>326</sup> Restatement (Second) of Trusts, § 291 (1)(c).

<sup>327</sup> *Westdeutsche Landesbank Girozentrale v. Islington London Borough Council*, [1996] AC 669 (at 705-706), [1996] 2 All ER 961 (at 988).

<sup>328</sup> Restatement (Second) of Trusts, § 292 (3).



English case law distinguishes the degree of knowledge by the third party that excludes a purchase in good faith from the degree that triggers liability as a constructive trustee – the second is higher than the first. Such a distinction is necessary: otherwise, every purchaser for valuable consideration who is not a *bona fide* purchaser would automatically become a constructive trustee, an inequitable result systematically rejected by case law and by legal writers. On the other hand, what degree of culpable ignorance amounts to constructive notice (excluding a purchase in good faith) without resulting in liability as a constructive trustee? This is a much-debated subject at present and consequently remains uncertain. Although this classification itself has been criticised<sup>329</sup>, a 1982 decision proposed to distinguish between five different subjective states in the mind of a third party:

“knowledge can comprise any one of five different mental states [...]: (i) actual knowledge; (ii) wilfully shutting one’s eyes to the obvious; (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make; (iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man; (v) knowledge of circumstances which would put an honest and reasonable man on inquiry.”<sup>330</sup>

While all these hypotheses exclude the purchaser’s status as a *bona fide* purchaser without notice, not all will transform him into a constructive trustee: in commercial transactions, hypotheses (iv) and (v) do not seem to have this effect<sup>331</sup>.

In Swiss law the liability of a purchaser in bad faith – like that of an innocent volunteer once he has discovered his irregular position – is mainly governed by CC Article 940<sup>332</sup>. Its scope is considerable because it covers

<sup>329</sup> “I gratefully adopt the classification but would warn against over refinement or a too ready assumption that categories (iv) or (v) are necessarily cases of constructive notice only. The true distinction is between honesty and dishonesty. It is essentially a jury question.” Millet J in *Agip (Africa) Ltd v. Jackson*, [1990] 1 Ch 265, [1992] 4 All ER 385 (at 405 e-f). In agreement: PEARCE & STEVENS (1998) pp. 732-740; OAKLEY (1998) p. 341 (who points out that knowledge remains the basis for such liability).

<sup>330</sup> *Baden v. Société Générale*, [1992] 4 All ER 161 (at 235), per Gibson J. (Ch. D. 1982).

<sup>331</sup> *Eagle Trust v. SBC Securities*, [1992] 4 All ER 488 (at 509 j); *Re Montagu’s Settlement Trust*, [1987] 1 Ch 264, [1992] 4 All ER 308 (at 324 *et seq.*, esp. 330c).

<sup>332</sup> CC, Art. 940: “<sup>1</sup> A holder in bad faith must return the asset and indemnify the rightful owner for any damage caused by its improper detention, as well as the benefits or income he has received or failed to collect. <sup>2</sup> He has no claim for his expenditure unless the rightful owner would have had to incur it himself. <sup>3</sup> He is liable only for the damages caused by his own fault, as long he is unaware of the person to whom the asset must be returned.”

all damage resulting from the improper holding of the asset. This is a genuine tort liability governed by special rules<sup>333</sup>. The holder must indemnify the rightful owner for his actual use of the asset and the income, whether received or not. In principle, he is liable for the loss or deterioration of the asset. If he has legally or physically disposed of it, he is liable for the resale price or the equivalent value<sup>334</sup>.

#### 4. Conclusion: Borderline between the Trust Law and the *Lex Rei Sitae*

This broadly sketched comparison reveals that, contrary to appearances, Swiss law yields solutions substantially similar to equity in the case of alienation by a titleholder with limited powers of disposal.

The main difference between them lies in the treatment of the purchaser whose purchase, even if made in good faith, is not protected<sup>335</sup>. The principles of equitable tracing require him to restore the property itself, the income received therefrom and the proceeds of sale or the reinvestments (provided that these assets have not been dissipated while ignoring, through no fault of his own, the duty to make restitution). Swiss law does likewise, except for income received in good faith, even if it has not been consumed<sup>336</sup>.

The difference appears minimal and does not seem to affect any essential principle of the Swiss legal system. Does this mean that, in addition to the action to recover the property itself, pursuant to Article 11 par. 3.d of the Convention<sup>337</sup>, the Swiss courts should apply the tracing rules of the

<sup>333</sup> ATF 120 II 191 c. 4c.

<sup>334</sup> Case law tends to apply CC Article 940 to alienation by a holder in bad faith, see ATF 84 II 253; ATF 121 III 71 c. 3b, JdT 1995 I 576, 578; Commercial Court SG, RSJ 1985 167. Like Article 938 (*supra* The Right to Trace Income and Sale Proceeds and note 323), CC Article 940 concerns the damage caused by improper detention, but not by disposition. Here also, the general rules (CO, Art. 62 *et seq.* and 423) are preferable and produce a similar result.

<sup>335</sup> In Swiss law as in trust law, he is almost always a transferee without valuable consideration, see *supra* VIII.A.1.

<sup>336</sup> CC, Art. 938 par. 1, cited *supra* note 320.

<sup>337</sup> According to its the text, Article 11 par. 3.d of the Convention implies “that the trust assets may be recovered” where authorised by the law applicable to the trust, but does not refer to the income, sale proceeds, reinvestment etc., pertaining to such assets. The Convention suffers from a lacuna in this respect, which provides the member states with the margin for manoeuvre under discussion here.

law applicable to the trust to determine the scope of this restitution in respect of income, profit and reinvestment? One must seriously doubt it. Unlike the sparse provisions of the Swiss Civil Code and Code of Obligations, which are sometimes rather simplistic, the rules on tracing are extraordinarily complex. A reading of the chapters devoted to them in authoritative textbooks amply demonstrate this fact. For a jurist untrained in the mysterious workings of equity, the challenge would be daunting and would compromise the effective and predictable application of such rules by our courts.

One should also bear in mind that Swiss case law on the bad faith of a holder without right does not necessarily coincide with the abundant, complex and occasionally contradictory English and US decisions, mentioned earlier. Again, application by a Swiss judge of criteria defined by numerous complex rulings could not guarantee fast and predictable adjudication.

Consequently, in the search for the dividing line between the scope of application of the trust law and that of the law applicable to property rights and to possession, the Convention should be interpreted with the aim of ensuring a rational and reasonably predictable solution to disputes. The earlier finding that the principles of Swiss law on this subject are remarkably similar to those of equity guarantees that the solutions will not seem surprising in either system. It appears that this dividing line should be drawn as follows:

- The Convention Article 11 par. 3.d, 1<sup>st</sup> sentence, states that the action to trace trust assets disposed of in breach of trust will be recognised insofar as the law applicable to the trust so requires. Thus, it is the law of the trust that determines whether the trustee who acts in breach of trust transfers to the third party the asset (or a right over the asset, *e.g.*, a pledge) free of the trust which encumbered the asset. In particular, the law applicable to the trust governs:
- The protection of the *bona fide* purchaser for value without notice; in the appreciation of the circumstances that may lead to a finding of constructive notice, it is advisable to consider the perspective of the purchaser who, in a country with a civil law tradition, is not necessarily familiar with trusts and the limitations on a trustee's power of disposal;
- The existence of a right to trace the asset itself, *i.e.* the right to require the first purchaser and every subsequent purchaser to restore the asset, standing to exercise this right as well as the conditions on which the purchase price must be returned to the purchaser bound to make restitution;

- The extinction of the right to trace by the passage of time or by the beneficiaries' consent (statute of limitations, laches, estoppel)<sup>338</sup> or by the defendant's behaviour (change of position, dissipation). Swiss rules on acquisitive prescription<sup>339</sup> cannot be varied voluntarily and they concern the transfer of title and the protection of third parties in good faith. Under the Convention, Article 15 paras. 1.d and f, the Swiss rules would take precedence over any longer limitation period set forth in the law governing the trust.
- The conditions and extent of restitution of the income and sale proceeds of the asset in question, the assets acquired by way of reinvestment, the repayment of expenditure by the holder, and his potential liability for damages caused to the asset are not addressed in either the first or the second sentence of Article 11 par. 3.d of the Convention. Application of the law governing the disposal (transfer of title to an asset, creation of limited property rights, transfer or creation of another right) to these questions would ensure that, whether in good or bad faith, the purchaser of the asset in trust is subject to the rules applicable to any irregular purchase. When, as it is often case, the *lex rei sitae* is the law of the forum, its application guarantees a more efficient and predictable adjudication. Consequently, if Swiss law applies as the *lex rei sitae*<sup>340</sup>, the extent of the restitution owed by the unprotected purchaser and his potential liability to the beneficiaries should be governed by the rules applicable to the holder without right, and not by the law applicable to the trust.

Because it is based on an interpretation of the Convention faithful to the drafters' intentions, the dividing line we have just drawn can be implemented by the Swiss courts without legislative intervention. However, the reasoning is here particularly complex because, in a private international law context, this is the line of confrontation between the property laws of two legal systems and of two major legal traditions (civil law, common law) which are based on opposing principles. Therefore, it might be helpful to facilitate the task of the courts by adopting a provision that clarifies the conflict rules on a point where the Convention is incomplete. Such a provision could have the following content:

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<sup>338</sup> See BOGERT (1987) §§ 169-170.

<sup>339</sup> CC, Art. 661 *et seq.* (immovable property) and 728 (movable property).

<sup>340</sup> SPILA, Art. 99 to 107.

<sup>41</sup> 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 transferred to him in breach of trust. This law shall also govern the repayment of any valuable consideration supplied by the purchaser.

<sup>42</sup> The law designated by [the SPILA of 18 December 1987] 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.”

## B. Security Interests: a Special Case

By reserving the mandatory rules of the law designated by the forum’s conflict rules, Article 15.d of the Convention distinguishes between those concerning “the transfer of title to property” and those relating to “security interests in property”, without limiting the latter to the creation of security interests.

The intention of those who drafted the Convention is clear, and results from several interventions by the Bank for International Settlements<sup>341</sup>. The trust allows the creation of security interests without dispossession: the owner of the asset can declare himself a trustee in favour of his creditor while retaining possession; he can also transfer the property to a trustee in favour of his creditor but retain possession of it by virtue of a loan or lease. Where common law would consider that a security interest has been validly constituted<sup>342</sup>, the Swiss Civil Code (and other similar legal systems) would view this procedure as an infringement of the pledge principle (*principe du*

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<sup>341</sup> The *Proceedings of the Fifteenth Session* (1985) include a report entitled “A trustee in Continental Europe: The experience of the Bank for International Settlements” by G.K. SIMONS & L.G. RADICATI (pp. 124-130); Art. 19 of the preliminary draft Convention (p. 170) and N. 148 of the Special Commission’s report (p. 202), discussed on 13 and 15 October 1984 (pp. 294-296, 297-303) at the same time as preliminary documents (PD) n° 18 (p. 228; subsequently replaced by PD n° 53, p. 289) and PD n° 42 and 44 (p. 271), 49 (p. 282) 52, 53 and 53 (p. 289). The drafting committee took these discussions into account when preparing a new version (art. 15, PD n° 58 p. 315), which was debated and approved virtually unchanged on 18 October (pp. 332-333). The resulting text (PD n° 64, p. 342) underwent final wording changes on 19 October 1984 (p. 347).

<sup>342</sup> This is not necessarily the case, see *infra* note 346.

*nantissement, Faustpfandprinzip*), which would void the pledge<sup>343</sup> and make any other form of security incapable of being asserted against third parties<sup>344</sup>. The requirement of the pledgor's dispossession applies not only to the transfer of the security interest, but also to its continuation<sup>345</sup>. That is why the authors refer to "security interests" in Article 15 par. 3.d of the Convention, without limiting it by the words "transfer" or "constitution".

The problem here does not concern the conditions on which the trustee can create a security interest over an asset in trust. The trustee does not enjoy a privileged position compared to any other owner regarding the conditions and formalities necessary to create a security interest valid against third parties. According to Swiss private international law, this question must be governed by the law of the place in which the property is located.

The problem that the authors of the Convention sought to resolve concerns the conditions on which the trustee may acquire and retain a security interest as trustee in favour of the beneficiaries.

- Certain trusts (generally purely domestic) are substitutes for retention of title. In particular, this is the case where a purchaser for credit of building materials or commodities undertakes to retain them (or the transformed products) as a trustee for the supplier until the purchase price has been paid. Some common law countries see this practice as a potential risk to other creditors and require registration of this security interest<sup>346</sup>, just as Swiss law requires registration for a valid retention of title<sup>347</sup>.

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<sup>343</sup> CC, Art. 884 par. 3: "The right of pledge does not exist as long as the pledgor exclusively retains effective control of the property."

<sup>344</sup> CC, Art. 717 par. 1: "When a person who transfers property retains it on a specific basis, the transfer of title cannot be asserted against third parties, if the purpose of retention was to prejudice them or to circumvent the rules on pledges of personal property." This provision is aimed specifically at fiduciary transfers of title for the purpose of creating a security interest (*transfert de propriété à titre de sûreté, Sicherungsübereignung*).

<sup>345</sup> ATF 99 II 34, JdT 1974 I 42. See also CC, Art. 888: "1 The pledge is extinguished as soon as the creditor ceases to hold the pledged property and is no able to reclaim it from a third party in possession. 2 The effects of the pledge are suspended as long as the pledgor exclusively retains effective control of the property with the creditor's consent."

<sup>346</sup> UK: Section 395 of the Companies Act 1985, see HAYTON (1998) p. 65.

<sup>347</sup> CC, Art. 715; see SPILA, Art. 102 paras. 2 & 3.

- Other trusts are very similar to Swiss fiduciary transfers for security purposes. An importer who acquires a maritime bill of lading, and the goods it represents, in his name but in trust for the bank financing the purchase<sup>348</sup> is in a situation similar to the importer who acquires title to the bills of lading on a fiduciary basis<sup>349</sup>. Also, a trust encumbering claims resulting from deliveries made by the borrower to his customers is very similar to the assignment of claims on a fiduciary basis in Swiss law.
- In theory, asset-backed securitisation, which is generally accomplished by a trustee indirectly holding<sup>350</sup> the securitised claims on behalf of the bondholders secured by these assets, could in theory be achieved by a fiduciary transfer under Swiss law. However, fiduciary transfers also have certain weaknesses that make them inapt for this purpose<sup>351</sup>.
- Using indenture trusts, a bond issue can be designed to allow the bondholders to benefit from collateral (*e.g.*, mortgages on the issuer's real estate), where it would be impracticable to transfer such security interests individually to each bondholder or to grant all of them such rights collectively. The trustee acquires title to the pledged assets, which he is authorised to invoke for the benefit of the bondholders. He is also authorised to supervise the borrower and, where necessary, to declare default<sup>352</sup>.

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<sup>348</sup> HAYTON (1998) p. 66.

<sup>349</sup> See L. THÉVENOZ, "Propriété and gage sur la marchandise and son titre représentatif dans le crédit documentaire", SAS 1985 pp. 1 *et seq.*, esp. 5-7; ATF 113 III 26, JdT 1989 II 79; ATF 114 II 4, 48 c. 4c; ATF 123 III 73, 78 c. 6/b/aa.

<sup>350</sup> The claims are usually acquired by a corporation (*SPV: special purpose vehicle*) which issues the bonds. The SPV shares are held in trust so that the SPV is insulated from the risk that the originator, who created the assets and refinanced them using this mechanism, may go bankrupt.

<sup>351</sup> THÉVENOZ (1995) pp. 293-294; *idem*, "Switzerland", in *Asset-backed Securitization in Europe*, Th. Baums & E. Wymeersch (ed.), London etc. (Kluwer) 1996, pp. 241-257.

<sup>352</sup> WATERS (1995) pp. 329-330; US: Trust Indenture Act of 1939, 15 U.S.C. § 77aaa; LANDAU & KRUEGER (1998) *passim*; M.D. SKLAR, "The corporate indenture trustee: Genuine fiduciary or mere stakeholder?", 106 *Banking Law Journal* pp. 42-61 (1989).

Unlike some other civil law systems<sup>353</sup>, the Swiss legal system recognises the use of title for security purposes (*fiducia cum creditore*)<sup>354</sup>. Such fiduciary transfers for security purposes are frequently used for negotiable instruments and other securities<sup>355</sup>, and for current and future claims<sup>356</sup>. They are rarely used for real estate because of costs<sup>357</sup>. They are not generally used for machines and vehicles (where leasing is an alternative) or for merchandise<sup>358</sup>, because fiduciary transfers for security purposes are not absolved from the requirement of dispossession that applies to charges on movable property<sup>359</sup>.

As a mechanism for the creation and transfer of security interests, trusts are extremely flexible. However, certain forms of trust do not conform – either when constituted or while the security interest persists – to the fundamental notice requirements (dispossession of the pledgor, registration of

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<sup>353</sup> *E.g.*, the new Dutch Civil Code, in Art. 3:84 (al. 3): “The legal act purporting to transfer an asset as security or which is not intended to make it part of the purchaser’s estate after the transfer shall not constitute a valid transfer [of title.]”, forbids any use of the property as security. When ratifying the Convention on trusts, the legislature removed this prohibition for trusts by Article 4 of the *Wet Conflictenrecht Trusts*, which von OVERBECK (1997) p. 374 translates into French as follows: “Les dispositions du droit néerlandais en matière de transfert de propriété, de [sûretés] ou de protection des créanciers en cas d’insolvabilité n’affectent pas les conséquences juridiques de la reconnaissance d’un trust décrites à l’art. 11 de la Convention.” [“The provisions of Dutch law on transfer of title, [security interests] and protection of creditors from insolvency do not affect the legal consequences of the recognition of a trust described in Article 11 of the Convention”]. See also DYER (1999) p. 7; KOPPENOL-LAFORCE & KOTTENHAGEN (1998), as well as the contributions by HAYTON (p. 58), N.E.D. FABER (rés. p. 261), M.H.E. RONGEN (rés. pp. 300 s.) and B.J.M.A. MEESTER (rés. pp. 417 s.) in *Vertrouwd met de trust: Trust and trust-like arrangements*, Deventer (Tjeenk Willink) 1996.

<sup>354</sup> See THÉVENOZ (1995) pp. 302-310.

<sup>355</sup> *E.g.*, ATF 119 II 326, JdT 1995 II 87 and ATF 115 II 349, JdT 1992 II 34 (mortgage certificates); ATF 100 II 153, JdT 1975 I 174 (savings book); ATF 113 III 26, JdT 1989 II 79 (title documents for goods).

<sup>356</sup> *E.g.*, ATF 113 II 163 (global assignment of current and future claims); ATF 101 III 92, JdT 1976 II 109 (sale of segregated claims).

<sup>357</sup> *E.g.*, ATF 86 II 221, JdT 1961 I 203.

<sup>358</sup> *E.g.*, ATF 78 II 412, JdT 1953 I 553 (machine); ATF 71 III 80, JdT 1945 II 113 (goods warehoused with a depository).

<sup>359</sup> CC, Art. 717: “<sup>1</sup> “When a person who transfers property retains it on a specific basis, the transfer of title cannot be asserted against third parties, if the purpose of retention was to prejudice them or to circumvent the rules on pledges of personal property. <sup>2</sup> The judge shall decide.” The Federal Supreme Court applies a purely objective interpretation of this provision, without verifying an intention to evade the law: ATF 42 II 17. Chattel mortgages are unknown in Swiss law, except for cattle (CC, Art. 885), vessels and aircraft.



the retention of title) imposed by Swiss law to protect third parties dealing in movable property located in Switzerland. Like fiduciary transfers for security purposes, security trusts represent a risk. Rightly, rather than excluding them purely and simply from the Convention's scope of application, the authors reserved the mandatory rules of the law applicable to the property encumbered by the security interest. In referring to "security interests in property", the text of Article 15 par. 1.d not only indicates the requirements for perfecting the security interest<sup>360</sup> but also the mandatory rules concerning its retention, transfer, realisation and extinction.

The principle that a security interest on movable property is valid against third parties only if the debtor does not have the exclusive possession of the property is a mandatory rule of Swiss law. If the property is situated in Switzerland<sup>361</sup>, Article 15 par. 1.d of the Convention allows for the operation of CC Articles 717 and 884 par. 3, under which a security interest created by means of a trust on movable property, without the debtor relinquishing possession, is invalid against third parties.

## C. Depositories of Trust Assets

On the basis of the comments by the Bank for International Settlements, the Convention provides, in Article 11 par. 3.d, 2<sup>nd</sup> sentence, special rules on the liability of "third party holders" of the trust assets.

Unlike the purchaser of the asset in trust, who is exposed to tracing under the law applicable to the trust<sup>362</sup> subject only to the reservation regarding the mandatory rules contained in the law applicable to "the transfer of title to property"<sup>363</sup>, 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."<sup>364</sup> The application of the *lex rei sitae*, the *lex contrac-*

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<sup>360</sup> Art. 4 of the Convention would have sufficed, because it excludes from the scope of application the validity of "acts by virtue of which assets are transferred to the trustee".

<sup>361</sup> Which is the conflict criterion in Swiss movable property law, see SPILA, Art. 100.

<sup>362</sup> Art. 11 par. 3.d, first sentence, of the Convention.

<sup>363</sup> Art. 15 par. 1.d of the Convention; see *supra* Purchasers of Assets in Trust.

<sup>364</sup> Art. 11 par. 3.d, 1st sentence: "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."

*tus* or of any other law that the forum's choice-of-law rules designate is not limited here to the mandatory rules: the holder's rights and duties completely escape the law applicable to the trust.

An examination of the proceedings of the Conference indicates that this exception was indeed motivated by the position of depository banks in countries whose legal system does not include trusts<sup>365</sup>. However, its terms were deliberately drafted to encompass broader issues.

The Conference does not seem to have specifically considered the position of the third parties who are neither purchasers nor holders of assets in trust, but who may be liable as a result of their knowing participation in a breach of trust. According to the Restatement Second, this liability for knowing assistance concerns, *inter alia*, a party who transfers a sum of money or an asset knowing that the trustee will not allow the trust corpus to benefit from it, or the debtor of the trust who obtains a remission of debt without giving valuable consideration for it<sup>366</sup>. For identical reasons, these liabilities of third parties who are not holders should also benefit from the exception provided in Article 11 par. 3.d of the Convention and be made subject to the law designated by the forum's choice-of-law rules. Moreover, the *Restatement Second* treats them in the same way as the liability of a bank acting as a depository of trust assets<sup>367</sup>.

Consequently, the rights and duties of bankers, traders and other financial intermediaries as depositories of the assets in trust, as well as the other

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<sup>365</sup> Art. 11 of the Special Commission preliminary draft did not contain this reservation (p. 169 *Proceedings* (1985)). The idea appeared in a BIS proposal elaborated in Preliminary Document n°17 (p. 228), whereas the Dutch Delegation proposed excluding the action to trace property from the effects of trusts whose recognition is required by the Convention (PD n°27, p. 234). On 12 October 1984, the BIS's proposal was accepted in principle and sent to the drafting committee (pp. 279-283), together with a formulation proposed by the UK delegation (PD n 47, p. 281). The current French formulation of the Convention results from the text then prepared by the drafting committee (PD n 58, p. 315). The UK formulation was adjusted during the debate of 28 October 1984 (pp. 325-326). See von OVERBECK (1985b) p. 36 and (1997) p. 371 n. 15; PÉLICHET (1994) pp. 155 s.; JAUFFRET-SPINOSI (1987) pp. 58 s.

<sup>366</sup> Examples drawn from Restatement (Second) of Trusts, §§ 321, 322. The general rule is expressed in § 326 under the title *Other Dealings With Trustee*: "A third person who, although not a transferee of trust property, has notice that the trustee is committing a breach of trust and participates therein is liable to the beneficiary for any loss caused by the breach of trust."

<sup>367</sup> Restatement (Second) of Trusts, § 324.

depositories, are governed by the law designated by the forum's choice-of-law rules.

- A bank is generally bound to the trustee by contract: according to Swiss private international law<sup>368</sup>, this means the law chosen by the parties (choice of law)<sup>369</sup>, and if no choice was made, the law of the depository's principal place of business applies<sup>370</sup>. Swiss banks and securities brokers always include a choice of law clause in favour of Swiss law. Consequently, the contract in question and Swiss law determine in particular the subject, scope, place, time and creditor of the obligation to return the assets entrusted to the depository; the terms of consignment in the event of doubt regarding the creditor's identity<sup>371</sup>; the duties of diligence, information and loyalty imposed on the bank or securities broker; etc.
- If a director or employee of the bank commits a tort to the detriment of the trustee or the beneficiaries, his personal liability and that of the legal entity are in principle governed by the law applicable to the pre-existing legal relationship<sup>372</sup>. Therefore, the tort liability of the Swiss bank or securities broker is also governed by Swiss law<sup>373</sup>.

Thus, as intended by those who drafted the Convention, Swiss financial intermediaries, insofar as they are mere depositories (or holders on another basis) of the assets in trust, are not subjected to a system of rights and duties different from that governing the rest of their customers.

The situation differs where a bank or a broker acquires securities an asset included in a trust fund – for example by acting as the trustee's counterparty in executing a sale, CO Articles 436 to 438 – or when a bank or broker obtains such securities under a pledge. If the trustee sells or pledges

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<sup>368</sup> Which coincides with the Convention on the law applicable to contractual obligations opened for signing in Rome on June 19, 1980, as amended by the accession treaties of 1992 and 1997, consolidated version: JOCE 1998 C 27, p. 34.

<sup>369</sup> SPILA, Art. 116; Art. 3 of the Convention of 19 June 1980.

<sup>370</sup> SPILA, Art. 117 par. 1, par. 3.c & d together with SPILA, Art. 21; Art. 4 of the Convention of 19 June 1980.

<sup>371</sup> See CO, Art. 479 and 96.

<sup>372</sup> SPILA, Art. 133 par. 3.

<sup>373</sup> The solution is the same where the victim (trustee or beneficiary) has his habitual place of residence in Switzerland (SPILA, Art. 133 par. 1) or when the tort coincides with the breach of contract (SPILA, Art. 133 par. 3), which, as we have seen, is governed by Swiss law in principle.

the securities in breach of his duties to the beneficiaries, the conditions on which the purchaser is protected are governed by the law applicable to the trust, as we have seen above<sup>374</sup>; they mainly depend on the knowledge of the trust's existence and the trustee's powers that the bank had or could be deemed to have at the time of the acquisition.

## IX. Public Registers

Article 12 of the Convention states:

“Where the trustee desires to register assets, movable or immovable, or documents of title to them, he shall be entitled, in so far as this is not prohibited by or inconsistent with the law of the State where registration is sought, to do so in his capacity as trustee or in such other way that the existence of the trust is disclosed.”

In addition to rights over real property which are recorded in the land registry, many assets and rights are registered in Swiss public registers: vessels, aircraft, patents, trademarks, industrial designs and models, retention of title to movable property. Trustees may acquire and hold such assets. They can be also pledged in favour of a trustee to obtain financing from the trust fund. The activities of certain trusts can also relate to the operations of corporations or other entities registered in the commercial register.

The rules governing the maintenance of these registers might need to be supplemented to clarify how a legal relationship with the trustee should be published. This report is not the place for a detailed study, which would anyway be premature because of the relative lack of experience of the authorities concerned<sup>375</sup>. Therefore, we will examine below the principle of a

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<sup>374</sup> See *supra* VIII.A.

<sup>375</sup> See in particular the recent communication by the Land Registry (*Office du registre foncier*) to the meeting of the Swiss Society of Cantonal Land Registrars of 17 September 1999, reproduced in RNRF 1999 406-407. This uncertainty contrasts with French practice regarding mortgage registration, in which it appears that a note of the titleholder's trustee status has long been accepted, see comments by BERAUDO under Court of Justice of the European Communities, 17.5.1994, *Webb*, in *Rev. crit. dr. int. privé* 1005 pp. 123 *et seq.*, 136. Against any mention in the land registry *de lege lata*: BREITSCHMID (1995) p. 65; SUPINO (1994) pp. 128 s.

general rule (A.), capable of being supplemented *inter alia* by *ad hoc* rules for the land, ship and aircraft registers (B.).

## A. General Rule

Public registers are essential to legal security and the protection of third parties' interests, especially the interests of purchasers who buy registered assets (or rights over such assets) and the interests of the creditors of titleholders to these assets and rights. Insofar as it pertains to assets located in Switzerland, a trust created under foreign law, recognised under the Convention, affects the legal position of such third parties. Notice of the titleholder's trustee status in relation to the registered asset (or to a limited right, in particular a pledge on the asset) gives them two important pieces of information<sup>376</sup>:

- To a third party who intends to acquire an asset (or a right pertaining to an asset) to which a trustee holds title, a note of the trustee's status reveals the risk of exposure to the beneficiaries' right to trace if the trustee acts in breach of trust<sup>377</sup>. To avoid this risk, the potential purchaser will require information about the trustee's powers. In practice, this often means asking the trustee to obtain a legal opinion on whether the planned transaction complies with the trust deed and the law applicable to the trust. Because it leads to increased caution by purchasers as well as additional costs, registration of the trustee's status has an adverse effect on the asset's marketability. This obstacle, which varies in importance according to circumstances, is designed to protect trust beneficiaries against alienation against their interests.
- For the trustee's creditors, a note of the trust's existence in the public registers allows them to identify the assets unavailable to meet personal debts<sup>378</sup>. Consequently, it conveys information about the trustee's personal solvency. His personal creditors know that they cannot seize such assets. Creditors of the trustee in his official capacity (the "creditors of the trust") can ascertain the existence and legal status of the assets

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<sup>376</sup> Restatement (Second) of Trusts, § 297 comment b and § 308 comment e.

<sup>377</sup> Article 11 par. 3.d of the Convention; see *supra* II.F and VIII.

<sup>378</sup> Article 11 par. 3.a & b of the Convention, see *supra* II.E and VII.

in the trust fund, out of which they may if necessary satisfy their claims to the exclusion of the trustee's personal creditors<sup>379</sup>.

The publication of a registered asset's inclusion in a special estate held by the titleholder has not attracted much attention from legislators. The testamentary charge on the owner of some real property to pass it on to a reversionary heir (*substitution fidéicommissaire, Nacherbenenseitzung*) may be annotated in the land registry<sup>380</sup>. The law on investment funds provides for the mere mention in the land register of "the inclusion in a real estate fund" in the case of immovable property to which the fund manager holds title<sup>381</sup>. This mention does not have any effect *per se*: it merely indicates the special status of the immovable property which, if the fund manager goes bankrupt, will not be included in the estate in bankruptcy, but retained for the benefit of the investors after deduction of the fund's debts<sup>382</sup>. A similar provision was not envisaged for banks' fiduciary transactions; it would have been superfluous, because FBA, Article 16 item 2 refers only to "movable property, securities and claims which the bank holds in a fiduciary capacity"<sup>383</sup>, which are not usually recorded in public registers.

Wherever Swiss law requires that public registers give notice of the legal relationships affecting certain assets, this purpose and the interests of third parties suggest that it would be helpful to facilitate the addition of notice that the titleholder is a trustee of the registered asset or right. It is hard to see what interest protected by our law would justify using Article 12 *in fine* of the Convention to limit the cases in which a trustee can require the trust to be indicated when registering his title.

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<sup>379</sup> On this question, see *supra* VII.A1.c).

<sup>380</sup> See CC, Art. 490 par. 2, 960 par. 1 (3) and Ordinance on the Land Register of 22 February 1910 (RS 211.432.1), Art. 74. About reversionary heirs, see above note 37.

<sup>381</sup> FAIF, Art. 36 par. 2.a (1994), restating (with amendments) Article 31 par. 2.a of the Act of 1 July 1966. On the legal characterisation as a mention (in spite of the erroneous French text), see *infra* IX.B.1.

<sup>382</sup> FAIF, Art. 16 par. 1; see THÉVENOZ (2000) pp. 358-363. By not ruling out as a matter of principle the exclusion of a patent registered in the patents register without an indication of the fiduciary transfer, the Federal Supreme Court seems to hold that such an indication does not constitute an element of notice required for the application of CO Article 401, ATF 117 II 429, JdT 1994 II 2.

<sup>383</sup> FBA, Arts. 16 (2) and 37b, as amended by the DEBA of 16 December 1994.

The Italian Parliament ratified the Convention without accompanying it with domestic legal provisions to ensure its implementation. However, some legal writers have pointed out the need for such rules in respect of registration<sup>384</sup>. In contrast, the Dutch parliament, mindful of the importance of this question, dealt with it in a manner that might prove inspirational to Swiss legislators. To underline the fact that the law of the Netherlands neither prohibits nor limits the mention of a trustee's status in public registers, the *Wet conflictenrecht trusts* of 1995 confirmed the trustee's right to enter his status in Dutch registers by repeating the first part of Article 12 of the Convention and omitting the second ("in so far as this is not prohibited by or inconsistent with the law of the State where registration is sought")<sup>385</sup>.

The public registers provided for under Swiss law are subject to varying degrees of regulation. While the land, aircraft and shipping registers benefit from detailed regulations, a few sparse paragraphs cover the rules for patent and trademark registers.

The approach proposed here, inspired by the Dutch choice, is to adopt a general legal basis giving any trustee the possibility of being identified as such in any register, public or otherwise<sup>386</sup>. It could be drafted as follows:

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.

The word "right" refers equally to intangible rights such as intellectual or industrial property rights (*e.g.*, trademarks, designs and models, patents) and to limited property rights or personal rights (*e.g.*, real property mortgage, patent license).

Article 12 of the Convention and the rule proposed above seek to confer a power, but not to impose a duty on the trustee to identify himself as such or to make the trust's existence apparent. The trust deed and, alternatively, the law applicable to the trust, do not necessarily require the trustee

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<sup>384</sup> PATON & GROSSO (1994) p. 661.

<sup>385</sup> Act of 4 October 1995, Art. 3, reproduced in *Trust Laws of the World* (2000) p. 40. See DYER (1999) p. 1005; von OVERBECK (1997) p. 375.

<sup>386</sup> Art. 12 of the Convention is not limited to public registers. It also applies to the shareholders' registers maintained by limited companies, etc. See DYER (1999) p. 1005.

to notify the existence of the trust to third parties. Subject to the law governing the trust, the trust deed can make this form of notice a duty, or a mere power, or forbid it. By making such a choice, the settlor can significantly reduce the beneficiaries' right to trace assets in the hands of a purchaser. However, it is not for Swiss law to transform the power provided by the Convention into a duty.

Certainly, the protection of the trustee's personal creditors is a legitimate concern, as they could be misled by the apparent solvency of their debtor if his trustee status is not revealed in the public registers. This fear is unfounded. Where a debtor's solvency is based on assets such as real estate, aircraft, vessels or industrial or intellectual property rights, a lender who is anxious about the debtor's worth will not be content to verify his assets at the time the loan is made, but will seek collateral, which alone guarantees the possibility of realising it for his benefit in the event of the debtor's default. The validity of the security interest on real estate not identified in the land register as subject to a trust will then depend entirely on the lender's good faith (as a *bona fide* purchaser). If the register is silent about the trust, it may prejudice the beneficiaries' interests, but not those of the secured creditor.

The mention of the trust in the register cannot be a condition for the separation of estates in the trustee's bankruptcy<sup>387</sup>. FAIF Article 16 does not make mention in the land register a condition for exclusion of the real property belonging to a real estate investment fund. Besides, nobody would argue<sup>388</sup> that the application of CO Article 401 to registered trademarks or patents turns on the mention in the register of the holder's status as an agent or fiduciary transferee of the titleholder<sup>389</sup>.

Statutes (*e.g.*, legislation on the purchase of immovable property by persons residing abroad or against money laundering) or by-laws (*e.g.*, statutory clause requiring shareholders to declare whether they act on behalf of

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<sup>387</sup> See KOPPENOL-LAFORCE (1998) p. 39.

<sup>388</sup> U. RÜEDE-BUGNON, *Fiduziarische Rechtsgeschäfte, die ein Markenrecht zum Gegenstand haben ...*, Berne (Stämpfli) 1978, pp. 92 *et seq.* & 288 *et seq.*; W. FELLMANN, *Berner Kommentar*, t. VI/2/4, 4<sup>th</sup> ed. (1992), Art. 394 N. 78, Art. 401 NN. 29 & 63 s.; G. GAUTSCHI, *Berner Kommentar*, t. VI/2/4, 3<sup>rd</sup> ed. (1971), Art. 401 N. 12; J. HOFSTETTER, *Traité de droit privé suisse*, t. VII/II/1: *Le mandat et la gestion d'affaires*, Fribourg (Ed. Universitaires) 1994, pp. 124 *et seq.*

<sup>389</sup> ATF 117 II 429, JdT 1994 II 2.



third parties) that demand identification of the economic beneficiary naturally apply equally to trustees, fiduciary transferees and other persons acting on behalf of third parties. The existence and terms of such requirements are based on rules that do not concern us here, when discussing the maintenance of registers.

## **B. Land, Ship and Aircraft Registers**

It would be advisable to supplement the general rule proposed above regarding notice of real property interests. In the Swiss land registry system, it is up to the legislature to determine what form should be followed to indicate that a titleholder of a real property right holds it as a trustee, *i.e.*, that the asset in question is subject to foreign law trust.

### **1. Sole trustee**

Swiss real estate – the transfer of which, as well as the property rights relating to it are exclusively governed by Swiss law<sup>390</sup> – may be the object of a trust in two different situations:

- the settlor constitutes a trust on real property belonging to him by transferring title to the trustee;
- the trustee acquires the real estate by investing assets belonging to the trust fund and/or creating a security interest in the real property or any other asset belonging to the trust fund.

*I*<sup>o</sup> In the first hypothesis, the basis for the trustee's acquisition – on which the validity of the title transfer depends<sup>391</sup> – is the trust deed itself. Swiss private international law on contracts recognises the possibility of dissociating the law applicable to the basis for the acquisition (the contract, for which a choice of law is permitted)<sup>392</sup> from the law governing the transfer and contents of the real property right transferred<sup>393</sup>. However, it requires that the contract, even if governed by foreign law, must comply with the

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<sup>390</sup> SPILA, Art. 99 par. 1.

<sup>391</sup> CC, Art. 974 par. 2.

<sup>392</sup> SPILA, Art. 119 par. 2.

<sup>393</sup> SPILA, Art. 99 par. 1.

requirements of Swiss law as to form<sup>394</sup>, which in principle rules that private deeds purporting to transfer real property must be witnessed in writing by a notary (*acte authentique, öffentliche Urkunde*)<sup>395</sup>. The same principle could be applied to trusts recognised in Switzerland pursuant to the Convention: a trust deed governed by foreign law may stipulate the transfer of title to real property situated in Switzerland to a trustee, provided that the deed is witnessed in writing by a Swiss public official authorised to perform such duties. It is conceivable that a deed witnessed by a Swiss public official could simultaneously contain the clauses of a trust governed by foreign law and the settlor's undertaking to transfer to the trustee title to real property in Switzerland, a matter exclusively governed by Swiss law. As a rule, legal systems providing for trusts do not require a deed witnessed by a public official for their creation: they are satisfied with a private agreement, even with a simple verbal statement<sup>396</sup>. Therefore, there seems to be no obstacle to a deed witnessed by a Swiss public official constituting a trust deed valid in the foreign law designated as applicable to the trust provided that the substantive requirements of that law are satisfied. Practice will show, however, whether and to what extent this procedure answers the needs of the interested parties.

Alternatively, it is conceivable that a Swiss notarised deed may stipulate an obligation to transfer, together with its conditions, to the trustee of the settlor's real estate located in Switzerland pursuant to a separately documented trust deed. Cantonal law determines the extent to which the trust deed must be attached to or reproduced in the Swiss notarised deed<sup>397</sup>. In either case, the acquisition of the real property by the trustee acting as such is recorded by the public official and apparent to the clerk of the Land Registry.

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<sup>394</sup> SPILA, Art. 119 par. 3.

<sup>395</sup> CC, Art. 657 par. 1, subject to the legal form specifically required for dispositions on death and for marriage contracts, CC, Art. 657 par. 2. In Switzerland, a notarised deed is necessarily witnessed by a public official. The exact formalities are determined by the cantonal legislation within the framework of the minimal requirements laid down by the case law interpreting the federal law.

<sup>396</sup> Pursuant to Article 3, the Convention concerns only trusts "evidenced in writing."

<sup>397</sup> Art. 55 of the Final Title of the Civil Code. See, however, ATF 125 III 131 (compliance with the notarised deed requirement where standard general terms and conditions are attached).

2° In the second hypothesis, the acquisition of Swiss real estate by a trustee does not *per se* indicate that the property forms part of the trustee's personal estate or is subject to a trust. The deed may certainly identify the transferee as a trustee acting in that capacity, but this is not a condition for validity in private law. However, notarial practice resulting from the legislation on the acquisition of real property by foreign residents requires the purchaser to identify the persons on whose behalf he acts, at least when they are domiciled abroad so that, in this case also, the trustee must state the capacity in which he is acting<sup>398</sup>.

Thus, where a trustee acquires title to Swiss real estate, whether from the settlor or a third party using the trust corpus, his status as trustee will generally be recorded in the notarised deed on which his registration as titleholder in the land register is based. How should this status be indicated in the land register?

The Civil Code and the Ordinance on the Land Register distinguish between registrations (*inscriptions, Eintragungen, iscrizioni*), annotations (*annotations, Vormerkungen, annotazioni*) and mentions (*mentions, Anmerkungen, mention*). They differ in their objects (real or personal rights, limitation on the right of alienation, other legal relationship), in their consequences (particularly, whether they create or merely declare a pre-existing right) and by the way in which they are entered in the register<sup>399</sup>.

To determine how the titleholder's trustee status should appear in the land register, one should compare the ownership of real estate as a trustee to the two situations most closely resembling it in Swiss law, namely ownership of real estate via an investment fund and the charge in favour of a reversionary heir.

The heir to real estate encumbered by a substitution clause is bound to pass it on to the reversionary heir at the time stipulated in the will. The Civil Code authorises an annotation in the land register "of the obligation to make restitution"<sup>400</sup> so that it may be asserted against any subsequent

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<sup>398</sup> Federal statute on the acquisition of immovable property by foreign residents of 16 December 1983 (RS 211.412.41).

<sup>399</sup> See in particular STEINAUER (1997) pp. 193-231; DESCHENAUX (1983) pp. 84-108, 213-298, 335-362 & 486 *et seq.*; D. ZOBL, *Grundbuchrecht*, Zurich (Schulthess) 1999, pp. 115-137.

<sup>400</sup> CC, Art. 490 par. 2.

purchaser of rights over the same real property. Rather than viewing it as a personal right belonging to the substitute beneficiary, the majority of legal writers analyse this annotation as a having as its object a condition subsequent affecting the first beneficiary's ownership, so that the condition can be asserted against third parties<sup>401</sup>.

Real property belonging to a real estate investment fund is registered in the name of the fund manager, who is the titleholder, but accompanied by a mention of its status as the fund's property<sup>402</sup>. This results clearly from the German (*Anmerkung*) and Italian (*menzione*) texts of Article 36 par. 2.a of the Act of 18 March 1994<sup>403</sup>. The Act of 1 July 1966 referred to an annotation (*annotation, Vormerkung, annotazione*). However, legal writers had pointed out that this was an error<sup>404</sup>, which the Federal Council and Parliament decided to rectify<sup>405</sup>, but unfortunately overlooked the correction of the French text.

When real estate is part of a trust corpus, this fact has a broader impact than its inclusion in a real estate investment fund. In both cases it is excluded from seizure by the personal creditors of the trustee and the fund manager, except for claims relating to the trust or the fund. However, the consequences of the trust do not stop there. The beneficiaries may, on conditions determined by the law of the trust, trace trust assets alienated by a trustee in breach of trust. This right to trace is unknown in the legislation governing investment funds. It presents a number of analogies with personal rights and restrictions on the power of disposal in Swiss law that can be entered as annotations in the land register.

In spite of this analogy with personal rights and limitations on the power to alienate that can be annotated under Swiss private law, the inclusion of

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<sup>401</sup> STEINAUER (1997) N. 784a and references.

<sup>402</sup> A. BUTTSCHARDT, in *Kommentar zum schweizerischen Anlagefondsgesetz*, Zurich (Schulthess) 1997, Art. 36 N. 3; M. KROLL & J. KOEFERLI, in *Kommentar zum schweizerischen Kapitalmarktrecht*, Basle (Helbing & Lichtenhahn) 1999, Art. 36 AFG N. 9; M. DEN OTTER, *AFG: Anlagefondsgesetz...*, 3<sup>rd</sup> ed., Zurich (Orell Füssli) 1996, Art. 36 Abs. 2.a) N. 5.

<sup>403</sup> RS 951.31.

<sup>404</sup> STEINAUER (1997) N. 780a; DESCHENAUX (1983) p. 279 and p. 319 n. 18; RNRF 49 (1968) 267.

<sup>405</sup> Message of 14 December 1992, FF 1993 I 189, 246.

real estate in a trust calls for a mention in the land register, not an annotation.

Annotation is used for a personal right, which it strengthens so that it can be asserted against any subsequent purchaser. It assumes that the content of the annotated right and the creditor thereof are adequately identified. The same applies to the annotation of a charge in favour of a reversionary heir<sup>406</sup>, which might be compared to an extremely limited form of trust: when the registration is requested, the reversionary heir is irrevocably identified by the will, as is the time when the reversion will take place. These requirements cannot be met by most trusts. On one hand, the number of beneficiaries may vary over time, if the trust identifies classes of beneficiaries (the settlor's grandchildren, bondholders, etc.), and their identity can only be identified on a temporary basis. On the other hand, the tracing right that would be the subject of the mention is governed by conditions wholly determined by the law applicable to the trust, which cannot be summarised in the trust deed, still less in indications entered in the land register.

The right to trace assets, considered in Anglo-American law as a right *in rem* rather than *in personam* is very different from the personal rights which, under Swiss law, are the subject of annotation in the land registry. Its existence is independent of any entry in the land register. The purpose and effect of such an entry is to inform third parties (particularly subsequent purchasers) that a trust exists. However, actual or constructive knowledge of this fact through an entry in the land register is not a sufficient basis for the right to trace, since it further requires that the purchaser knew or should have known that the trustee acted in breach of trust. It is true that there is a connection between knowing that the asset is subject to a trust and knowing that its alienation would breach the trustee's duties. The purchaser of such an asset must take steps to ascertain whether the trustee can effectively transfer the asset to him. However, public notice that real property is included in the corpus of a trust is neither a required nor a sufficient basis for the right to trace assets. Instead, it affects the purchaser's state of mind, and thus the evaluation of his good faith.

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<sup>406</sup> See CC, Art. 490 par. 2, 960 par. 1 (3) and the Ordinance on the land registry of 22 February 1910 (RS 211.432.1), Art. 74.

To sum up, the immunity of the trust fund from the trustee's personal creditors as well as the beneficiaries' right to trace trust assets are the consequences of a legal relationship governed by foreign law. These consequences will be recognised in Switzerland when the Convention is ratified. They occur regardless of a corresponding entry in the land register. Therefore, the sole purpose of the entry is to inform third parties about the trust's existence, thus drawing their attention to the possible legal consequences of this relationship<sup>407</sup>. Consequently, the trust should not be entered as a registration (*inscription*) or an annotation, but as a mention<sup>408</sup>, according to the definition provided by Federal Supreme Court based on the best legal writings: "The effect of a mention in the land register as a rule neither creates nor confirms a right; it merely informs the public of the existence of the legal relationship in question; in consequence, the existence and content of the relationship are independent of the mention."<sup>409</sup>

The conclusion reached by this reasoning can be extended to the ship and aircraft registers, which are based on the land registry model and maintain the same distinctions among registrations, annotations and mentions<sup>410</sup>.

It would thus be appropriate to complete the legal basis proposed above by a paragraph with the following content:

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.

## 2. Co-trustees as titleholders

A settlor frequently appoints several trustees, who must then act jointly and severally and together become the titleholders of the assets included in the trust corpus. If this joint ownership by the trustees were characterised *lege fori* according to Swiss law, it could not be seen as a form of co-ownership

<sup>407</sup> SC, SJ 1998 725 c. 1a.

<sup>408</sup> In agreement: MAYER (1998) p. 152.

<sup>409</sup> SC, SJ 1998 725.

<sup>410</sup> See in particular Art. 1 *et seq.*, 26, 27 and 28 of the Federal Ship Register Act (*loi fédérale sur le registre des bateaux*) of 28 September 1932 (RS 747.11) and Art. 4 to 7 of the Federal Aircraft Register Act (*loi fédérale sur le registre des aéronefs*) of 7 October 1959 (RS 748.217.1).

within the meaning of CC Article 646 *et seq.* No trustee possesses a portion that he is entitled to alienate separately, and the co-ownership cannot be dissolved by an action for partition<sup>411</sup>. The trustees may only alienate jointly.

In reality, the position of co-trustees is comparable to that owners in common within the meaning of CC Articles 652 to 654. The community that they form together has the specific feature of being based on a foreign law, which consequently determines their rights and duties<sup>412</sup>. This conclusion is not inconsistent with the principle of a *numerus clausus* of the communities giving rise to ownership in common<sup>413</sup>: By authorising ratification of the Convention, the Swiss legislature will recognise the special community that the law applicable to the trust creates between co-trustees.

Where there are two or more trustees, the Ordinance on the Land Register, Art. 33 par. 3<sup>414</sup> requires the registration to identify the community existing between the trustees of real estate situated in Switzerland. This exception to the principle that the trustee's status need not be revealed is justified here by the necessity of informing third parties, in particular, about the way in which the joint owners of the asset are entitled to dispose of it. This is a mandatory rule of Swiss law, which applies as the *lex rei sitae*, and the Convention does not create an obstacle to it<sup>415</sup>.

### 3. Trusts on Real Property Located in Switzerland: Conclusion

This brief chapter proposes a solution to the current uncertainty as to how the existence of a trust can be indicated in the land register. No-one questions the principle that Swiss real estate can be placed in trust<sup>416</sup>. However,

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<sup>411</sup> It can only be dissolved by the distribution of the assets to the beneficiaries or by the dismissal or replacement of the trustees by the court competent to hear disputes relating to the administration of the trust, see *supra* II.G: Judicial Intervention.

<sup>412</sup> CC, Art. 653 par. 1: "The rights and duties of the joint holders shall be determined by the rules governing the statutory or contractual community existing among them."

<sup>413</sup> ATF 84 I 126 c. 2, JdT 1959 I 36.

<sup>414</sup> Ordinance on the land registry of 22 February 1910 (RS 211.432.1), Art. 33 par. 3: "For joint property, it is necessary to add ... a mention of the legal relationship on which the community (community property, joint heirs, joint tenancy, etc.) is based."

<sup>415</sup> See Article 15 par. 1.d & f of the Convention.

<sup>416</sup> See in particular the circular issued by the Office of the Land Registry (note 375) and others previously cited.

the transfer and creation of property rights over real estate located in Switzerland is necessarily governed by Swiss law<sup>417</sup>.

Referring to Article 4 of the Convention, Professor von Overbeck has suggested that it would be advisable to confirm, in a statutory provision, the possibility of constituting a trust on an asset situated in Switzerland<sup>418</sup>. However, this precaution seems redundant. Swiss law is already familiar with fiduciary transferees, who exercise full ownership in the eyes of the law while contractually bound to the fiduciary transferor. Although based on simple contractual claims, the fiduciary transferor's personal rights against the fiduciary transferee do also include some extra-contractual effects<sup>419</sup>. By virtue of the Convention, particularly Article 11 par. 3.d, the trust beneficiary's legal position vis-à-vis third parties is more favourable than the fiduciary transferor's<sup>420</sup>. This preferential treatment of an institution unknown to Swiss domestic law but recognised by Swiss private international law is one of the reasons for strengthening our law on fiduciary transfers<sup>421</sup>.

Our legal system treats the transfer to the fiduciary transferee as the acquisition of full and complete title (*Vollrechtstheorie*)<sup>422</sup>. Transposed into our own categories of property rights, the trustee must, like the fiduciary transferee, be regarded as the owner of the assets transferred to him. This concept, clearly adopted by the Swiss legal system, does not prohibit recognition that the trust beneficiaries, like the fiduciary transferor, enjoy certain rights that may be asserted against third parties. Consequently, Switzerland does not need to legislate to characterise the trustee's position in comparison to an outright owner. Insisting on the obvious can undermine its true import.

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<sup>417</sup> SPILA, Art. 99 par. 1.

<sup>418</sup> Von OVERBECK (1997) p. 379; KOPPENOL-LAFORCE (1997) § 2.6.3, summary p. 266. The Netherlands chose this solution to ensure that the validity of a security trust is not affected by the total prohibition of fiduciary transfers for security purposes introduced by the new 1992 Civil Code Art. 3:84 par. 3.

<sup>419</sup> Essentially on the fiduciary transferee's bankruptcy, see CO, Art. 401, FAIF, Art. 16 and FBA, Arts. 16 (2) and 37b.

<sup>420</sup> See *supra* VIII: Beneficiaries' Right to Trace Assets and Third-Party Liability.

<sup>421</sup> See *infra* XIV: Swiss Fiduciary Transfers: Ripe for Codification.

<sup>422</sup> See THÉVENOZ (1995) pp. 274 *et seq.*, with references to judicial decisions.



Therefore, Switzerland need not confirm, in an express statutory provision, that a trust may be constituted on assets (including real property) located in Switzerland or, in other words, that the settlor can transfer to the trustee title to assets situated in Switzerland. If any doubt remains regarding the intentions of the legislator, the two proposed paragraphs in the present chapter suffice to confirm that a trust can exist over real estate and, *a fortiori*, any other assets whose transfer is governed by Swiss law.

## X. Jurisdiction

The relationships between a trustee (or a beneficiary or settlor) and third parties do not create any particular problem regarding jurisdiction. The trustee is an owner. He can enter into contracts. He has the capacity to commit torts. The fact that his activities relate (or not) to a trust does not change the legal forum that has jurisdiction over disputes with third parties<sup>423</sup>. On the other hand, rules on international jurisdiction are necessary for disputes concerning the trust's "internal relationships", *e.g.*, disputes among trustees, between trustees and beneficiaries, or between such parties and the settlor<sup>424</sup>. Such disputes essentially relate to the validity, interpretation, consequences, administration and purposes of the trust as well amendment of the trust deed<sup>425</sup>.

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<sup>423</sup> See D. SCHLOSSER, "Rapport sur les Traités....", JOCE 1979 C 59, p. 106 N. 110. The SCHLOSSER report examines and comments on the provisions of the treaties governing the United Kingdom and the Republic of Ireland's membership of the European Community, which amended the Convention on Jurisdiction and the Enforcement of Judgements in Civil and Commercial Matters (known as the Brussels Convention of 27 September 1968; current consolidated version: JOCE 1998 C 27, pp. 1-27). This treaty introduced, in particular, jurisdictional rules for trusts: their need for such rules was not apparent until the United Kingdom and the Republic of Ireland became Community members.

<sup>424</sup> *Ibidem*, N. 111.

<sup>425</sup> The validity or effects of a trust may also constitute a preliminary issue in many disputes among trustees or between trustees and beneficiaries or third parties. These preliminary issues must be decided by the legal forum competent to handle the dispute with the third parties, see the five decisions of the Zurich courts (*Einzelrichter, Obergericht and Kassationsgericht*) which ultimately found void the trust, constituted under Guernsey law, by Werner K. Rey to protect from his creditors the shares of the holding companies he used to control his group, ZR 1999 pp. 225-259 n° 52.

Switzerland's private international law does not deal with trusts as such. We have already seen that certain trusts can be compared to organised estates within the meaning of the SPILA Article 150 par. 1, which entails the application of the jurisdictional rules on companies<sup>426</sup>. Trusts created by a will or by another disposition effective on death are undoubtedly within the jurisdiction of the legal forum handling the succession<sup>427</sup>. However, other trusts escape these characterisations, and it is difficult to apply to trusts, as triangular relationships based on a settlor's unilateral legal declaration, the jurisdictional rules for contracts or property rights.

Nevertheless, Switzerland is bound by the Convention on jurisdiction and enforcement of judgements in civil and commercial matters, made at Lugano on 16 September 1988, which mentions trusts in Article 5 item 6 (alternative forum at the "trust domicile") and Article 17 item 2 (forum designated in the deed constituting the trust)<sup>428</sup>. The concept of "trust domicile" is not defined in the Convention; Article 53 par. 2 refers to the forum's conflict rules, which do not exist in Switzerland at present<sup>429</sup>. However, these rules do not apply unless the defendant (trustee, settlor or beneficiary) *and* the trust itself are domiciled in a member state<sup>430</sup>. They do not affect jurisdiction relating to persons domiciled beyond the borders of the European Community, Norway, Iceland and Switzerland. In particular, residents of offshore jurisdictions<sup>431</sup>, whose laws govern numerous trusts, are not affected. In this respect, Swiss private international law contains a significant lacuna.

This situation should be dramatically improved if the convention on jurisdiction and foreign judgements in civil and commercial matters, which is currently being prepared under the aegis of the Hague Conference on Private International Law, is adopted by a diplomatic conference and subsequently enters into force. Its current draft as adopted by the special Com-

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<sup>426</sup> SPILA, Art. 151 to 153.

<sup>427</sup> SPILA, Art. 86 to 89.

<sup>428</sup> RS 0.275.11. See in particular KAUFMANN-KOHLER (1995) pp. 67-72; BERTI (1994) and STIEGER (1992).

<sup>429</sup> KAUFMANN-KOHLER (1995) pp. 70-71.

<sup>430</sup> KAUFMANN-KOHLER (1995) p. 67.

<sup>431</sup> Including the Channel Islands (Jersey, Guernsey and the Isle of Man), which are not part of the United Kingdom of Great Britain and Northern Ireland and are not affected by the ratification.

mittee on 30 October 1999<sup>432</sup> includes, in Chapter II, jurisdictional rules applicable to all international disputes, even if the parties are not domiciled in the contracting states.

The proposals formulated by the special Committee on trusts appear, essentially, in Article 11 of the draft:

“Article 11

1. Trusts

“1. In proceedings concerning the validity, construction, effects, administration or variation of a trust created voluntarily and evidenced in writing, the courts of a Contracting State designated in the trust instrument for this purpose shall have exclusive jurisdiction. Where the trust instrument designates a court or courts of a non-Contracting State, courts in Contracting States shall decline jurisdiction or suspend proceedings unless the court or courts chosen have themselves declined jurisdiction.

“2. In the absence of such designation, proceedings may be brought before the courts of a State –

- a) in which is situated the principal place of administration of the trust;
- b) whose law is applicable to the trust;
- c) with which the trust has the closest connection for the purpose of the proceedings.”

As it stands at present, this convention would limit, but not totally prohibit, the adoption by contracting states of additional bases for international jurisdiction<sup>433</sup>. However, only judgements pronounced by a court having jurisdiction according to the convention will benefit from the provisions guaranteeing recognition and enforcement in the other contracting states<sup>434</sup>.

From the point of view of Swiss private international law, which lack rules on jurisdiction specific to trusts, the solution proposed in the draft convention seems fundamentally appropriate, even though the conflict factor under (c) (jurisdiction of the courts of the state “with which the trust has the closest connection for the purpose of the proceedings”) is uncertain in its application<sup>435</sup>. Moreover, the new convention would determine international jurisdiction in trust matters whenever the Lugano Convention is in-

<sup>432</sup> Published on the Conference’s website at [www.hcch.net](http://www.hcch.net). See K.M. CLERMONT “Jurisdictional salvation and the Hague treaty” 85 *Cornell Law Review* pp 89 *et seq.* (1999).

<sup>433</sup> This possibility, provided by Article 17 of the preliminary draft convention, is limited by the “prohibited grounds of jurisdiction” listed in Article 18.

<sup>434</sup> Chapter III of the preliminary draft convention.

<sup>435</sup> BUCHER (2000) p. 96.

applicable. In addition, Article 11 par. 2 of the draft would provide the Swiss courts with a useful concept for determining the “trust domicile” within the meaning of the Lugano Convention.

However, the adoption and entry into force of that convention is not yet certain. It is thus advisable to supplement Swiss law with a rule on international jurisdiction, as the rules contained in the Lugano Convention do not apply universally. As there is no Swiss trust, such disputes relating to trusts necessarily have an international element. Therefore, this matter should be governed by the SPILA, not the Federal Act on Venue in Civil Cases of 24 March 2000. Independent of the convention’s success and its acceptability in Switzerland, Article 11 of the current preliminary draft could inspire the addition of a new rule on jurisdiction to Swiss private international law. The adoption of such a rule would permit localisation of the “trust domicile” within the meaning of the Lugano Convention. On the other hand, paragraph 2.c could be discarded, because the SPILA, Article 3<sup>436</sup> provides a potential forum in Switzerland in cases of necessity.

Such a provision could be worded as follows:

<sup>1</sup> 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.

<sup>2</sup> If no forum has been chosen, such actions may be brought before the Swiss courts at the trust’s principal place of administration.

## **XI. Article 13**

Article 13 of the Convention provides:

“No State shall be bound to recognise 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 con-

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<sup>436</sup> SPILA, Art. 3: “Where the present law does not provide any legal forum in Switzerland and proceedings in foreign courts are impossible or cannot reasonably be required, the Swiss judicial or administrative authorities at the place presenting adequate links to the case shall have jurisdiction.”

nected with States which do not have the institution of the trust or the category of trust involved.”

It was introduced at the request of states whose domestic laws do not include trusts and responds to the fear that “foreign” trusts may be used fraudulently in purely internal circumstances<sup>437</sup>. Common law countries and other states whose internal legislation includes trusts do not share this fear and the Article is of no use to them. The United Kingdom illustrated this fact when, in complying with its constitutional obligation to reproduce in a statute adopted by Parliament the text of provisions of international treaties binding on its subjects, it deliberately omitted to reproduce Article 13<sup>438</sup>. Malta did likewise<sup>439</sup>.

The Convention is not limited to “international” or “foreign” trusts. As in company law, such a requirement would be inappropriate for trusts, which often are created in a purely domestic context and subsequently acquire foreign elements (investments abroad, change of beneficiary’s domicile, etc.)<sup>440</sup>.

As we have seen earlier, recognition in the Swiss legal system of the effects of trusts governed by foreign law does not present insuperable difficulties. In particular, the reservation of the mandatory rules of Swiss law, or of another law designated by Swiss conflict rules (Art. 15) is enough to forestall, in inheritance and property law, the consequences of a trust incompatible with essential principles that may not be evaded by means of a trust. Like the SPILA<sup>441</sup>, the Convention also contains reservations for the forum’s international public policy (Art. 18) and for the forum’s mandatory legal provisions or those of another state with close links to the subject-matter of the dispute (Art. 16).

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<sup>437</sup> See von OVERBECK (1985a) pp. 397-400.

<sup>438</sup> The Recognition of Trusts Act 1987, reproduced in *Trust Laws of the World* (2000) pp. 1955 *et seq.*

<sup>439</sup> The Recognition of Trusts Act 1994 Art. 3, reproduced in *Trust Laws of the World* (2000) pp. 1315 *et seq.*

<sup>440</sup> See GAILLARD & TRAUTMAN (1986) p. 11.

<sup>441</sup> SPILA, Art. 17 to 19.

Article 13 of the Convention bears a certain resemblance to the SPILA Article 15<sup>442</sup>. Nevertheless, their purposes differ. Article 13 aims to render a legal transaction governed by foreign law ineffective, while the latter serves only to correct the consequences of a choice-of-law rule where its application seems undesirable in the circumstances (*Anknüpfungsgerechtigkeit*). The former primarily protects the law of the forum<sup>443</sup> against an abusive application of foreign law; that is why it also (and mainly) applies in choice-of-law cases, whereas the SPILA Article 15 is superseded by such a choice<sup>444</sup>.

Does Swiss law need this type of protection, in addition to the safeguards already mentioned<sup>445</sup>? There are at least two reasons for doubting it.

First, Swiss law contains other institutions that tend to dissociate legal title to certain assets from the economic benefit thereof: they primarily include fiduciary transfers and their specific forms in relation to investment funds and banking transactions, as well as foundations. The traditional instruments of Swiss private law – and in particular the prohibition against fraud on the laws<sup>446</sup>, which in private international law translates into the public policy reservation and internationally mandatory provisions (*lois d'application immédiate* or *lois de police*, *Eingriffsgesetze*) – suffice to guarantee compliance with the fundamental principles of Swiss law. The decisions of the Zurich courts pertaining to the W.K. Rey case show, in particular, that while employing the existing instruments of Swiss private international law and without resorting to grounds similar to Article 13 of the Convention, the Swiss courts are capable of sanctioning the use of foreign trusts to defraud interests recognised and protected by our law<sup>447</sup>.

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<sup>442</sup> SPILA, Art. 15: “<sup>1</sup> ... any law referred to by this Act is not applicable if, considering all the circumstances, it is apparent that the case has only a very loose connection with such law and that the case has a much closer connection with another law. <sup>2</sup> This provision does not apply where a choice of law has been made.”

<sup>443</sup> Von OVERBECK (1995a) N. 123 p. 397.

<sup>444</sup> SPILA, Art. 15 par. 2 cited above.

<sup>445</sup> Art. 15, 16 and 18 of the Convention.

<sup>446</sup> In fiduciary matters, see in particular ATF 117 II 290 and ATF 81 II 534, JdT 1956 I 269 (no fraud on company law); *Commercial Court* ZH, ZR 1999 103 n° 29, comp. ATF 87 II 203, JdT 1962 I 92 (fraud on the regulations governing the legal profession); SC, SJ 1993 373 n° 13 (fraud on procedural law); SC, RDAF 1991 126 (fraud on foreign tax law); ATF 72 II 235, JdT 1947 I 134 (in application of CC, Art. 717); ATF 58 II 162, summarised. SJ 1932 627 (fraud on an international treaty).

<sup>447</sup> ZR 1999 225 n° 52, especially pp. 229-236.

Moreover, Switzerland's private international law is very liberal. This is particularly true of company law, to which organised estates are assimilated<sup>448</sup>. According to case law the incorporation theory enshrined by the legislature in the SPILA Article 154 ensures almost total freedom to the founders to choose a foreign law, regardless of its substantive content and the absence of any other connection to that law. The theory of the fictitious registered office, derived from the prohibition of fraud on the laws, has been categorically rejected by the Federal Supreme Court, which, however, reserves public policy but has not had the occasion to apply it so far<sup>449</sup>.

Article 13 of the Convention resembles the reservation regarding a fictitious registered office. Both sanction the application of foreign law where there are insufficient substantive elements to justify it. They sanction the artificial creation of an international situation by choosing a foreign law, regardless of the legal consequences of that choice. The clear rejection of the theory of the fictitious registered office, the possible application of internationally mandatory provisions and the public policy reservation mean that, in matters of company law and separate estates, the internationalisation of an essentially or exclusively domestic situation is not, without something further, a reason for refusing to recognise its consequences. It is necessary to examine on a case-by-case basis whether Swiss public policy is violated: a substantive evaluation of the consequences of applying the foreign law is required.

Nevertheless, Article 13 of the Convention is a source of legal uncertainty. Such uncertainty is particularly harmful in long-term legal relationships, where the issue may not be examined until many years after the settlor, the first trustees and/or the first beneficiaries have died. Such uncertainty is undesirable<sup>450</sup>. Like the United Kingdom and Malta, Switzerland should avoid it, by adopting a rule of private international law along these lines:

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<sup>448</sup> Cf. *supra* IV.C: Organised Estate.

<sup>449</sup> ATF 117 II 494 c. 6-7; Geneva Court of Appeal, SJ 1999 167 c. 2; criticism: J.A. REYMOND and J.F. PERRIN, in *Études de droit international en l'honneur de Pierre Lalive*, Basle 1993, pp. 141 *et seq.* and 173 *et seq.*

<sup>450</sup> "... the preliminary drafts [of the SPILA] attached primary importance to the certainty and predictability of company law" (ATF 117 II 500 c. 6c, with citations), which also includes most trusts (see *supra* IV.C: Organised Estate) as long as Switzerland has not ratified the Convention.

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.

## **XII. Reservations and Other Declarations Permitted by the Convention**

### **A. Internationally Mandatory Rules (Article 16)**

Article 16 of the Convention authorises the application of provisions “which must be applied” (par. 1) or “policy laws” of the forum and, “in exceptional circumstances”, allows the mandatory provisions of “another State [which] has a sufficiently close connection with a case” (par. 2) to be given effect<sup>451</sup>.

Not all legal systems take foreign mandatory provisions into consideration. That is why paragraph 3 allows contracting states to make a reservation to paragraph 2. At present, only the United Kingdom and China, its successor for the special administrative region of Hong Kong, have formulated such reservation.

The application of Article 16 par. 2 of the Convention does not create any problem for Switzerland. SPILA Article 19 already allows the Swiss courts to take into account mandatory foreign provisions in similar conditions, so that it would not be appropriate to adopt the reservation provided in Article 16 par. 3 of the Convention.

### **B. Trusts Created by Judicial Decision (Article 20)**

The specific subject of the Convention is “trusts created voluntarily and evidenced in writing” (Art. 3). In common law countries, trusts have proved extraordinarily fertile, so that they have expanded to cover circumstances that are not based on a legal deed by a settlor for the purpose of creating a trust.

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<sup>451</sup> See von OVERBECK (1985a) pp. 403-407.



Consequently, numerous laws make an executor or a receiver in bankruptcy a trustee. These are termed legal trusts. In addition, case law has identified trusts which, though not based on the express intention of a party, are declared by judicial decisions. These resulting and constructive trusts<sup>452</sup> are imposed in situations where the fiduciary duties and remedies developed in the trust context enable the courts to resolve problems which, in the civil law tradition, are mainly dealt with by the rules of unjust enrichment and intervention in another's affairs by a volunteer (*gestion d'affaire sans mandat, Geschäftsführung ohne Auftrag*)<sup>453</sup>.

For resulting and constructive trusts, common law jurisdictions share a considerable amount of ground, even though case law reveals some surprising, and at times disconcerting, developments. However, it was only natural to give contracting states the opportunity to extend the Convention's scope of application to trusts declared by judicial decision: Article 20 allows them to formulate a declaration to that effect.

In characterising *lege fori* the factual situations typically covered by trusts declared by judicial decision, it is evident that they include situations covered in the Swiss legal system by the SPILA Articles 127 *et seq.* ("unjust enrichment") and 129 *et seq.* ("torts"). Therefore, it seems inappropriate for Switzerland to extend the consequences of the Convention to trusts declared by judicial decision<sup>454</sup>. Furthermore, those civil law states that have already ratified the Convention (Italy, the Netherlands and Malta) have not made any such declaration.

Article 20 does not concern itself with trusts created directly by law. That would be superfluous<sup>455</sup>. In Switzerland, they are taken into consideration within the framework of the conflict rules applied to inheritance

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<sup>452</sup> There is extensive literature on this topic. For a preliminary approach, see, in particular, WATERS (1995) pp. 210-213; PEARCE & STEVENS (1998) pp. 224 *et seq.*

<sup>453</sup> See D. SCHLOSSER (*supra* note 423), JOCE 1979 C 59, p. 107 N. 117. The Lugano and Brussels Conventions on jurisdiction apply to legal trusts, but not to trusts declared by judicial decisions. See Art. 5 (6) of the Lugano Convention (RS 0.275.11): "a trust created by the operation of a statute ...".

<sup>454</sup> KOPPENOL-LAFORCE (1997) § 2.4.2.5 points out that the recognition of trusts declared by judicial decisions removes the limits imposed by Article 11 par. 3.d on the beneficiaries' right to trace assets and the liability of third parties, in particular the depositories of trust funds.

<sup>455</sup> *Contra* REYMOND (1991) p. 19.

(regarding executors) and to international bankruptcies (regarding receivers in bankruptcy)<sup>456</sup>.

### **C. Reciprocity (Article 21)**

The Convention was designed to operate *erga omnes*. However, after debate the contracting states were authorised to make a reservation limiting the benefit of the Convention to trusts governed by the law of another contracting state (Article 21). This option has turned out to be superfluous. None of the states that have ratified the Convention to date have employed it. A reservation of this kind would be inappropriate for Switzerland because, if it decides to be bound by the Convention, it does so to obtain conflict rules more suited to trusts than those found in our existing legislation. There is no question here of extending a favour to a third-party state, the real issue being the need to fill a lacuna in our own law. To limit the application of the Convention to certain trusts would be a source of increased confusion regarding the others.

### **D. Application Date (Article 22)**

The same reasoning applies *mutatis mutandis* to the date as of which the Convention applies. Insofar as the Convention represents an improvement on the existing situation without restricting the freedom of the parties, there would be no justification for refusing to apply it to situations that arose before Switzerland became bound by the Convention.

## **XIII. Reservation of Fiscal Sovereignty**

Pursuant to Article 19 thereof, “Nothing in the Convention shall prejudice the powers of States in fiscal matters.” The tax treatment of trusts in Switzerland is the subject of a flourishing administrative practice. More and more frequently, the issue arises when a foreign citizen – or a Swiss

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<sup>456</sup> SPILA Chapters 6 and 11.

citizen formerly domiciled abroad – comes or returns to reside in Switzerland having previously constituted a trust. The cantons seem to have varying tax practices, a natural though somewhat unfortunate consequence of the substantial powers they retain, particularly with regard to income tax (together with the Confederation), as well as wealth, gift and inheritance tax.

Switzerland's ratification of the Convention would not remove any tax powers from the cantons or the Confederation. It would not require any amendment of existing rules, but would probably increase the frequency with which these questions are submitted to the tax authorities. This new situation might well incite our tax authorities to co-ordinate their practice to a greater extent. However, it would be neither conceivable nor desirable to adopt legislative measures to harmonise these practices on ratification of the Convention.

#### **XIV. Swiss Fiduciary Transfers: Ripe for Codification?**

Fiduciary transfers (*fiducie, Treuhand, fiduzia*), which are not codified in Swiss law, originated as a business practice gradually recognised and developed by the Swiss courts, has received abundant attention from legal writers<sup>457</sup>. Swiss legislators have adopted and frequently consolidated it in three specific sectors. Since the 1996 Act, Swiss investment funds are based on a fiduciary structure: the fund manager holds title as a fiduciary transferee to the fund's assets on behalf of the investors, *i.e.*, at their potential gain or loss<sup>458</sup>. In 1992, copyright law confirmed the monopoly over authors' rights of collective management companies, whose activity is to acquire as a fiduciary transferee the copyrights of the authors, which they exercise for

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<sup>457</sup> The reports presented at the 1995 Congress of the Swiss Society of Jurists by WATTER (1995) and THÉVENOZ (1995) form, with the dissertation published by DUNAND (2000), an up-to-date synthesis of the developments in the fields of legislation, case law and legal writings on fiduciary transfers.

<sup>458</sup> Federal Act on Investment Funds (FAIF) of 1 July 1966 (RO 1967 125, 1971 808, 1974 1857), replaced by the Act of 18 March 1994 (RS 951.31).

the latter's benefit<sup>459</sup>. Finally, Swiss banks successfully engage in various types of fiduciary transactions (monetary deposits in the Euromarket for clients, obtaining fiduciary transfers for security purposes from clients, etc.), for which legislators have provided special protection in the event of bankruptcy<sup>460</sup>.

Fiduciary transfers as a non-legislative institution, together with its special forms, fulfil functions similar to those of a trust, though to a limited extent<sup>461</sup>. Like trusts, Swiss fiduciary transfers are based on the fiduciary transferor's intent which, however, is expressed in a contract, rather than a unilateral legal act. Like trusts, they dissociate legal title to the fiduciary assets (which is acquired by the fiduciary transferee) from the economic benefit of such assets, which is due exclusively to the fiduciary transferor or other beneficiaries<sup>462</sup>. Contrary to trusts, it is not based on the distinction between legal title and equitable ownership. The fiduciary transferee is an owner in the full sense of the word, with comprehensive powers vis-à-vis third parties, and is merely bound by duties to the fiduciary transferor (or other beneficiary, if any). As long as the fiduciary transfer lasts, the fiduciary transferor (or the beneficiary) has over the fiduciary assets no property right that can be asserted against third parties. Unlike a trustee, the fiduciary transferee remains subject to the fiduciary transferor's instructions during the duration of the fiduciary transfer, which one or the other party can terminate any time<sup>463</sup>.

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<sup>459</sup> Federal Act on Copyright and Similar Rights of 9 October 1992 (RS 231.1), which replaced, in particular, the Federal Act of 25 September 1940 concerning the collection of copyrights (RS 2 824).

<sup>460</sup> FBA, Art. 16 (2) and 37b, introduced by the Act of 16 December 1994, which amended the DEBA (RO 1995 II 1227).

<sup>461</sup> On their similarities and differences, see in particular REYMOND (2000) pp. 686-687, FLATTET (1990), WATTER (1995) pp. 199-203.

<sup>462</sup> In a fiduciary security contract, the fiduciary transferee is simultaneously the owner of the asset and the beneficiary of the security, so that the economic benefit is shared between the fiduciary transferee (if the secured debt remains unpaid) and the fiduciary transferor (who regains the asset once the creditor has been satisfied). In the current practice of fiduciary transactions, a fiduciary transfer for management purposes rarely has beneficiaries other than the fiduciary transferor himself. Whereas a trust is basically a triangular relationship among three parties (settlor, trustee and beneficiaries), a fiduciary transfer in Swiss law is still almost always a bilateral relationship (between fiduciary transferor and fiduciary transferee).

<sup>463</sup> Here also, the fiduciary security contract differs from fiduciary transfers for management purposes: the fiduciary is not bound to return the subject of the security interest until the guaranteed debt has been paid.

Having long been suspected of being a form of simulation, or fraud on the laws<sup>464</sup>, fiduciary transfers are now fully accepted in Switzerland and widely practised for certain relatively well defined transactions<sup>465</sup>. However, it seems unlikely to undergo further substantial development. In particular, many transactions for which a trust can be used (asset-backed securities; defeasance) do not appear to be feasible within the framework of fiduciary transfers for management purposes<sup>466</sup>, which is severely limited by the application of the rules on agency contracts (termination possible at any time, primacy of principal's instructions, lack of an adequate framework for beneficiaries other than the fiduciary transferor) and insufficient recognition of a fiduciary estate separate from the fiduciary transferee's personal estate. Whereas trust are essential to the creation and management of collective security interests (for the benefit of several creditors), fiduciary transfers for security purposes seem to be completely ignored in the same contexts.

As in France – where the defeat of the bill on fiduciary transfers<sup>467</sup> has delayed the ratification of the Convention *sine die* – and Luxembourg – where the ratification of the Convention recently initiated by the government provides an opportunity to revise the Grand-duchy's 1983 decree on banks' fiduciary transactions<sup>468</sup> –, for Switzerland the signature and ratification of the Convention on trusts represents an opportunity to review whether fiduciary transfers should be codified to fill the lacunae in our laws, improve legal predictability and strengthen the protection available to the parties, while taking care not to compromise either the public interest or those of third parties acting in good faith.

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<sup>464</sup> REYMOND (1989); THÉVENOZ (1995) pp. 271-274.

<sup>465</sup> THÉVENOZ (1995) pp. 284-310; WATTER (1995) pp. 35-50; *Droit and pratique des opérations fiduciaires en Suisse* (1994).

<sup>466</sup> See esp. THÉVENOZ (1995) *loc. cit.*

<sup>467</sup> *Projet de loi instituant la fiducie* (n° 2853) of 19 February 1992. Because it was not adopted by the National Assembly during the 1992 session, the bill became void. Since then, the ministries of Justice and Finance have been working on new texts which, to the best of my knowledge, have never been forwarded to the government.

<sup>468</sup> *Règlement grand-ducal relatif aux contrats fiduciaires des établissements de crédit* of 19 July 1983, reproduced in *Trust Laws of the World* (2000) pp. 1207-1208.

## A. Why is Legislation Necessary?

As currently recognised by the Swiss legal system, fiduciary transfers present numerous weaknesses, which have been examined in a detailed and critical manner by legal writers<sup>469</sup>. These weaknesses seem today to mark a borderline beyond which fiduciary transfers are unlikely to develop, unless certain obstacles are removed by legislation. These limits are now sufficiently well identified and described, so that we need only outline them here.

*a) Ordinary fiduciary transfers* (resulting from the Code of Obligations, Civil Code and case law without benefiting from additions via the legislation on banks and investment funds) offer insufficient protection to the fiduciary transferor. Case law has not recognised a fiduciary estate separate from the fiduciary transferee's personal estate. Because they become the fiduciary transferee's property, the fiduciary assets are commingled with his general estate and are essentially governed by the same regime of enforcement. The fiduciary transferor is a general, unsecured creditor; on insolvency, he has access to the fiduciary assets only in competition with the fiduciary transferee's other creditors. CO Article 401, conceived originally for cases of "simple" indirect representation (*e.g.*, commissions to act as a purchaser or seller), is certainly applied by the courts in favour of the fiduciary transferor<sup>470</sup>. The legal text limits its application, however, so that its consequences are illogical: it concerns only movable property and claims, but not real estate; it applies only to assets acquired by the fiduciary transferee from a third party, but not those that the fiduciary transferor originally transferred to him; its application to bank and postal accounts (the most common way of holding liquid assets) depends on conditions which are almost never met in practice<sup>471</sup>.

The origin of this first weakness lies in the impossibility of basing the existence of a separate fiduciary estate (*patrimoine séparé, Sondervermögen*)

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<sup>469</sup> See in particular GIOVANOLI (1994); REYMOND (2000); THÉVENOZ (1995) and (2000); WATTER (1995).

<sup>470</sup> ATF 99 II 393, JdT 1974 I 588, *Feras Anstalt c. Banque Vallugano*; ATF 124 III 350, JdT 1999 I 362; Cour de cassation, GE, SJ 1999 I 461 c. 6-8.

<sup>471</sup> ATF 102 III 103, *Zurich*; ATF 102 II 297 c. 3, JdT 1978 II 72, *Cevitch*; Federal Supreme Court, SJ 1990 637. See U. BERTSCHINGER, "Für eine Neuorientierung bei der Aussonderung im Konkurs des Beauftragten", PJA 1993 1440 *et seq.*

on the existing texts<sup>472</sup>. This results in another important lacuna: if the fiduciary transferee is the exclusive owner of the fiduciary assets, limited by the terms of a contract with the fiduciary transferor which cannot be asserted against third parties, then his disposals are fully valid, even when they result from a breach of duty that is apparent to the purchasers<sup>473</sup>.

The second weakness in ordinary fiduciary transfers is that the rules of agency apply to fiduciary transfers, or at least to fiduciary transfers for management purposes. Whereas they really concern all services supplied independently without promising a result, agency contracts under CO Articles 394 *et seq.* still include rules originating in the classic *mandatum*, i.e. the mandate of a person performing legal acts as the disclosed agent of his principal<sup>474</sup>. Pursuant to CO Article 404, ceaselessly reaffirmed by the Federal Supreme Court as being a mandatory rule<sup>475</sup>, each party can effectively terminate it at any time, with no other consequence than compensation for the damage caused to the other party if termination is ill-timed. CO Article 397 allows the principal, at any time, to give instructions concerning the execution of the agency contract, and those instructions are binding on the agent. As the debate now stands, it seems doubtful whether the principal may waive this right<sup>476</sup>. When applied to fiduciary transfers for management purposes contract, the fiduciary transferor's power to terminate the agreement at any time and to give binding orders prevent any fiduciary transfer for the purpose of ensuring management of the transferred assets during the whole agreed period and, within the framework initially agreed, regardless of any subsequent changes of opinion by the fiduciary transferor. Therefore, fiduciary transfers do not lend themselves to the many cases where the fiduciary transferee's independence and impartiality are the reason or condition for the transaction (fiduciary holding of secured interests in favour of third parties, blind trust for the duration of a term of office<sup>477</sup>, etc.).

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<sup>472</sup> THÉVENOZ (2000).

<sup>473</sup> THÉVENOZ (1995) pp. 334-338.

<sup>474</sup> F. WERRO, *Le mandat and ses effets: Une étude sur le contrat d'activité indépendante en droit suisse; analyse critique and comparative*, Fribourg (Ed. Universitaires) 1993, NN. 29-32.

<sup>475</sup> Recently: Federal Supreme Court, SJ 1998 617; *idem*, RJB 1997 333; ATF 115 II 464, JdT 1990 I 312.

<sup>476</sup> THÉVENOZ (1995) pp. 342-345 and references.

<sup>477</sup> See ROUNDS (2000) § 9.19.

For fiduciary transfers governed by the Federal Act on Investment Funds or the Federal Banking Act, legislation remedies some of these weaknesses, but not all.

*b)* There are no exceptions to the general rule in the case of collective copyright management. If a collective management company were to go bankrupt (which, fortunately, appears unlikely), the rights transferred to it by the authors for collective management do not benefit from the exclusion contained in CO Article 401: they would be included in the estate in bankruptcy, and the authors' claims would have the same rank as those of all other unsecured creditors<sup>478</sup>.

*c)* Banking legislation is considerably better in this respect because, on the involuntary liquidation of a bank, it provides for automatic exclusion (*dis-traction, Absonderung*) of movable property, securities and claims "that the bank holds as a fiduciary transferee on behalf of its depositors."<sup>479</sup> It thus confers a privilege on bankruptcy to fiduciary transferors, the statutory wording of which gives cause for hesitation regarding whether it extends to fiduciary transfers for security purposes<sup>480</sup>. On the other hand, the other weaknesses were not considered and banks remain excluded, inter alia, from transactions where a fiduciary transferee intervenes for the purpose of guaranteeing the impartial holding and administration of an estate, independent of changes in the fiduciary transferor's intentions. Even when this is not the dominant reason, fiduciary transfers are not used in Switzerland – as they seem to be used currently in Luxembourg – to implement financial transactions that originated in legal systems possessing trusts and which require an independent and impartial fiduciary transferee. Fiduciary transfers do not seem to be ideal instruments for asset-backed securitisation or balance-sheet transactions such as defeasance. Moreover, banks have been slow to offer escrow agency services and escrow accounts, another indication of the weaknesses characterising all fiduciary transactions under the existing rules.

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<sup>478</sup> See ATF 117 II 429, JdT 1994 II 2 concerning patents.

<sup>479</sup> Art. 16 (2), together with FBA Article 37*b*.

<sup>480</sup> The Act, which refers to "client depositors" can be interpreted restrictively, see B. FOËX, "Les actes de disposition sur les cédulas hypothécaires", in *Les gages immobiliers*, Basle (Helbing & Lichtenhahn) 1999, pp. 128-129, with citations.



d) The Federal Act on Investment Funds (FAIF) includes elaborate and adequate regulations on fiduciary transactions in which investors contribute capital to a fund manager who acquires, administers and realises financial or real estate investments for their account<sup>481</sup>. The segregation of each fund's assets from the corporate assets of the fund manager is achieved by recourse to a depository bank<sup>482</sup> and strict accounting rules<sup>483</sup>; furthermore, segregation is guaranteed in the event of bankruptcy by the automatic exclusion of the net assets for the investors' benefit<sup>484</sup>. In addition, the regulations of each fund alone determine the investment policy, which the fund manager can then execute, immune from the individual or collective instructions of the investors<sup>485</sup>. In exchange, the investors obtain the right to withdraw from the fund at almost any time<sup>486</sup>.

The satisfactory solution achieved for investment funds and the very partial solutions enacted by banking legislation cannot, however, conceal the relative inadequacy of the ordinary rules on fiduciary transfers. They are limited, both in the guarantees they provide to the parties and in their capacity to develop fresh applications to meet new needs. It can be said that Swiss fiduciary transfers serve relatively well the functions they are called upon to perform at present, but they do not lend themselves to transactions requiring greater durability or independence than permitted by the rules governing agency contracts, or a more complex structure of beneficiaries' rights.

The inherent weakness of these ordinary rules also compromises the security of fiduciary relations which, though less significant than those we have just described, are nevertheless extremely important to the general public. In particular, when pursuing their traditional activities<sup>487</sup>, notaries and lawyers receive and hold funds, for varying periods, on behalf of their clients: liquidation of inheritance and matrimonial estates, debt collection,

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<sup>481</sup> Collective investment agreement, see FAIF Art. 6 par. 1.

<sup>482</sup> FAIF Art. 6 par. 2 and 17 *et seq.*

<sup>483</sup> FAIF Art. 47 par. 1; OFP Art. 3 par. 4 and 62 par. 2.

<sup>484</sup> FAIF, Art. 16 par. 1.

<sup>485</sup> FAIF, Art. 7.

<sup>486</sup> FAIF, Art. 24.

<sup>487</sup> Without entering into a discussion here on the forms of asset management practised by certain attorneys and notaries, which are not part of their characteristic activities covered by professional secrecy pursuant to SPC, Art. 321.

monetary payments for settlements in or out of court, etc. Even though ethical codes require the segregation of third parties' funds<sup>488</sup>, their exclusion in the event of civil or criminal seizure or of bankruptcy is not entirely assured<sup>489</sup>.

Lastly, business practice and the decisions of the Swiss courts show that fiduciary transfers occur in numerous non-standardised patrimonial relationships and that it is not infrequent in a wholly unprofessional context, among friends or relatives. These forms of fiduciary transfer, though less visible, nonetheless merit protection by the law and improved legal certainty.

Many writers have pointed out that it would be unwise to make a decisive improvement in the legal certainty of relationships relating to trusts governed by a foreign law, without at the same time improving the legal regime of Switzerland's own fiduciary transfers<sup>490</sup>. It seems awkward to deny purely domestic transactions the guarantees we propose to offer comparable international relationships. Moreover, there is a substantial risk that the transactions for which Switzerland's existing fiduciary transfers do not seem sufficiently reliable may be legitimately carried out by means of a trust governed by better-adapted and more modern foreign legislation. Undeniably, some competition exists between trusts and Swiss fiduciary transfers, even though these distant cousins are based on very different theoretical foundations.

Improving the normative environment of Switzerland's fiduciary transfers could ultimately be rewarded by greater recognition abroad, by means of the Convention on the law applicable to trusts and to their recognition. Indeed, the authors of the Convention deliberately characterised trusts flexibly enough to extend the Convention's scope of application to cover equiva-

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<sup>488</sup> For attorneys, see in particular the directives of the Swiss Bar Association on funds belonging to third parties of 8 June 1990 and section 3.8 (Clients' Funds) of the Code of Conduct of the Lawyers Federation of the European Community, of 28 October 1988.

<sup>489</sup> Federal Supreme Court, SJ 1990 637; see *supra* note 471.

<sup>490</sup> See in particular DUNAND (2000) pp. 489-492; GIOVANOLI (1994) p. 216; GUILLAUME (2000) pp. 30-35; von OVERBECK (1997) pp. 378-378; REYMOND (2000) p. 688; THÉVENOZ (1995) pp. 350 s.; THÉVENOZ & DUNAND (1998) pp. 503 s.; WATTER (1995) p. 252; etc.

lent legal institutions existing in non-common law systems<sup>491</sup>. Article 2 of the Convention states:

“For the purposes of this Convention, the term “trust” refers to 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.

“A trust has the following characteristics:

“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.

“The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.”

Some writers believe that investment funds and fiduciary transfers already fulfil this definition<sup>492</sup>. Be that as it may, the improvements recommended by legal writers to remedy the weaknesses of Swiss fiduciary transfers would simultaneously endow them with attributes – including the recognition of fiduciary estates separate from the fiduciary transferee’s own estate – that would place them within the scope of the Convention, with its corresponding consequences on matters of inheritance, matrimonial property rights and enforcement (see the Convention, Art. 11 par. 3.a, b and c). The same concerns appear to underlie Luxembourg’s desire to ratify the Convention.

## **B. Systematic Insertion and Scope of Application**

Should legislation on fiduciary transfers be enacted in a code or specific statute? This question begs another: what should the scope of such legislation be? Like any other contract governed by the Code of Obligations, should

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<sup>491</sup> Von OVERBECK (1985a) N. 26 p. 375; DYER (1999) pp. 1002-1003 & 1013-1015; HAYTON (1996) p. 127; KOPPENOL-LAFORCE (1997) § 2.4.5; KÖTZ (1999) pp. 39-40; LUPOI (1995) *passim* and (1997) pp. 227 *et seq.*; UNDERHILL & HAYTON (1995) p. 943.

<sup>492</sup> GUILLAUME (2000) pp. 34-35; THÉVENOZ & DUNAND (1998) p. 509.

such improved fiduciary transfers be available to all co-contractors who enjoy legal capacity? Or should it be limited to specific categories of fiduciary transferees, such as certain financial intermediaries, for example?

This second option has often been chosen in civil law countries that created fiduciary transfers by statute: it was done in Luxembourg, where under the 1983 legislation only banks may act as fiduciary transferees<sup>493</sup>; in Lebanon, the 1996 act limits fiduciary transactions to banks, financial institutions and other institutions approved by the Banque du Liban<sup>494</sup>. Professor Giovanoli has put forward the same idea in Switzerland<sup>495</sup>.

However, restricting the application of codified fiduciary transfers to financial intermediaries (or certain members of that category) would create more problems than it would resolve.

On one hand, because of their history, Swiss fiduciary transfers exist in practice as an institution that extends far beyond financial transactions alone, even though the latter dominate in terms of frequency and worth. Fiduciary ownership of clients' assets is inherent to certain activities (lawyers, notaries, agents, property management, etc.), but does not necessarily make its practitioners financial intermediaries. Private individuals, merchants and entrepreneurs occasionally enter into fiduciary transfers. If a statute on fiduciary transfers were to limit its scope of application as described above, new legal uncertainties would arise regarding any fiduciary transfers not covered by the statute. What rules would apply to fiduciary transfers outside the scope of the statute? Would such agreements still be lawful? If not, would they be purely and simply null and void or could they be converted into another valid legal institution?

In fact, a limitation of the scope of application of codified fiduciary transfers as they exist would, in purely domestic relationships, create problems entirely similar to those that the Federal Supreme Court highlighted and sought to resolve in its ruling in the *Harrison* case<sup>496</sup>. It is not a feasible

<sup>493</sup> Grand-ducal Decree of 19 July 1983 cited *supra*, note 468. Though it does not prohibit fiduciary transfers that are beyond its scope of application *ration personae*, the legislation currently being prepared to replace and consolidate the Grand-ducal Decree does not provide for any extension of its scope of application.

<sup>494</sup> Act n° 520 on the development of the financial market and fiduciary transfers of 6 June 1996.

<sup>495</sup> GIOVANOLI (1994) pp. 214, 215 & 224.

<sup>496</sup> ATF 96 II 79, JdT 1971 I 329, see *supra* note 2.

option in a legal system where fiduciary transfers already exist as an institution developed by judicial decisions within the framework of existing codes and where anyone can hold assets or rights as fiduciary transferee. The approach adopted by Luxembourg and Lebanon is possible in a legal system in which fiduciary transfers are created by statute; it is impracticable where fiduciary transfers exist already. If one of the grounds for the codification of Swiss law on fiduciary transfers is the need to remedy the dispersion of fiduciary rules (ordinary fiduciary transfers, investment funds, bank fiduciary transferees), such codification must apply to the institution in general, or else it would merely create a fourth type of fiduciary transfer.

Obviously, according to the nature and the purpose of the transaction, certain service providers who offer their services professionally, particularly some financial intermediaries, provide better guarantees: solvency, audits, administrative supervision, etc. Moreover, in each category, a client must choose between service providers with differing capacities and abilities. In the current situation, where the capacity to act as a fiduciary transferee is not limited to certain occupations, this is a market reality which does not seem to cause any particular problem. There is there no dysfunction or abuse which the legislature would need to remedy other than by administrative rules already governing certain occupations (banks, traders, financial intermediaries subject to the rules against money laundering<sup>497</sup>, attorneys, notaries, etc.).

Furthermore, the mere fact of offering certain fiduciary services professionally can make the offeror subject to licensing and supervision requirements. Anyone who “deals” in fiduciary services for negotiable securities is a trader within the meaning of the law on stock exchanges and negotiable securities: he must obtain a license, for which he must satisfy very burdensome requirements regarding organisation, shareholders’ equity and competence<sup>498</sup>. Even when the agreement concerns other “patrimonial assets”, any party who offers fiduciary services “professionally” becomes subject to the legislation on money laundering<sup>499</sup>.

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<sup>497</sup> Federal Act on combating money laundering in the financial sector of 10 October 1997 (RS 955.0).

<sup>498</sup> Swiss Federal Banking Commission (www.ebk.admin.ch), Circular 98/2 of 1 July 1998 items 50 & 51; see JB. ZUFFEREY, A. BIZZOZERO & L. PIAGET, *Qui est négociant en valeurs mobilières?*, Lausanne (AMC) 1997, pp. 44-45.

<sup>499</sup> See *supra* note 497.

In fact, due to the quality of the supervision imposed on the majority of those who currently act as professional fiduciary transferees, it is useless, and would also be expensive and counterproductive, to create a new category of fiduciary service providers. There is no reason to deprive the non-professional parties to occasional fiduciary transfers of the improvements suggested below. The prevention of abuse by the existing regulations governing financial intermediaries and other professionals whose activity involves holding clients' assets, combined with Swiss legislation on money laundering, is already in place and provides guarantees that the codification of fiduciary transfers, which is part of private law, cannot offer.

### C. Project Outline

The following draft amendments to the Swiss Code of Obligations are based on five guiding principles:

- The new rules are based on fiduciary transfers such as they exist at present in Switzerland as an institution created by business practice, recognised by case law, analysed by scholars and adopted by Parliament in legislation concerning investment funds and banks. They are consistent with the full ownership theory (*Vollrechtstheorie*) developed in case law and legal writings: a fiduciary transferee is an owner within the meaning of the Civil Code, who assumes contractual obligations to others. It is suggested that these obligations be reinforced.
- The draft amendments strengthen fiduciary transfers by, in particular, permitting the creation of genuine fiduciary estates separate from the fiduciary transferee's personal estate. This assertion is not limited to the exclusion of the fiduciary assets in the event of enforcement against the fiduciary transferee. It further implies the principle of property-linked subrogation and contributions between estates. It results in specific rules on debt liability affecting, in particular, the right of set-off and the retention of fiduciary assets. On disposal by the fiduciary transferee in breach of his duties, fiduciary assets may be subjected to a genuine right to trace, though third parties in good faith will be offered adequate protection.
- Generally, the rules of the new regime, which apply unless otherwise agreed, correspond to the current regime, *de lege lata*. Consequently, in the absence of a contrary clause in the fiduciary contract, the fiduciary

transferor is the sole beneficiary of the fiduciary transfer, so that, in particular, the fiduciary assets revert to him on expiration of the agreed term or when he terminates the fiduciary transfer.

- The proposed rules would allow fiduciary practice to expand into hitherto untried areas. Notably, they would permit the appointment of beneficiaries other than the fiduciary transferor, and the legal position of those beneficiaries is guaranteed by express rules. They enable (but do not require) the fiduciary transferor to strengthen the fiduciary transferee's independence by waiving the power to give instructions or to terminate the agreement before the stipulated term. The duration of a fiduciary transfer is, however, limited by a legal maximum. Fiduciary transfers can begin or persevere after the death of the fiduciary transferor. That is why the terms of the fiduciary transfer can provide the name of a third party whose task is to act as a private supervisor of the fiduciary transferee (like the protector of a trust) while the court's powers are clarified.
- This new form of fiduciary transfer meets the definition of trusts contained in Article 2 of the Hague Convention on the law applicable to trusts and on their recognition of 1 July 1985. This definition was deliberately designed so that it would not restrict the benefit of the Convention to trusts originating in common law countries and deriving from English law, but could also apply to institutions not based on the split (unknown in civil law countries) between legal and beneficial ownership.

The draft amendments were inspired by the most recent comparative works and, in particular, the *Principles of European Trust Law* (1999), while retaining for Swiss fiduciary transfers the dogmatic structure that history, case law and scholars have conferred on it and remaining faithful to the fundamental principles of our legal system.

## **XV. Draft Codification of Fiduciary Transfers**

### **Article 1** Definition

<sup>1</sup> A fiduciary transfer results from a contract or a disposition effective on death (the fiduciary deed) by which the fiduciary transferor causes the fiduciary transferee to acquire title to certain assets for the benefit of one or more identified or identifiable beneficiaries.

<sup>2</sup> If the fiduciary deed does not appoint any beneficiary, the fiduciary transferor is deemed to be the only beneficiary.

<sup>3</sup> The fiduciary transferee cannot be the sole beneficiary.

<sup>4</sup> The fiduciary transfer can be challenged, as a donation, by the heirs, the spouse or the creditors of the fiduciary transferor.

*Paragraph 1:* Fiduciary transfers constitute lasting legal relationships between one (or more) fiduciary transferors, one (or more) fiduciary transferees and, possibly, one (or more) beneficiaries. According to the current practice in Switzerland, fiduciary transfers can be created by a contract between the fiduciary transferor and the fiduciary transferee. The contract is the underlying basis (*causa*) for the transfer to the fiduciary transferee of the assets that compose the fiduciary estate. Within the general limits of Swiss inheritance law (formal requirements, compliance with indefeasible shares, etc.), a fiduciary transfer may also be the subject of a disposition effective on death, as permitted by statute in the case of foundations (CC, Art. 81 par. 2). The fiduciary relationship then lies between the fiduciary transferee and the beneficiary as of the fiduciary transferor's death.

Although generally the fiduciary transferor transfers the assets concerned directly to the fiduciary transferee, the fiduciary transferee may receive them from a third party for the benefit of the fiduciary transferor or the beneficiary. This is in particular the case of assets that notaries, attorneys, agents, etc. may receive on behalf of a client. These hypotheses are covered by the expression "causes the fiduciary transferee to acquire".

*Paragraph 2:* A fiduciary transfer in favour of one or more identified or identifiable beneficiaries represents an extension of the current practice. It is already possible by means of a third-party beneficiary clause, but remains quite exceptional. The rule by default corresponds, however, to the current fiduciary transfers for management purposes: unless the fiduciary transferor has specified otherwise, he is deemed to be the only beneficiary.

*Paragraph 3:* Fiduciary transfers for the (non-exclusive) benefit of the fiduciary transferee are widely practised in Switzerland in the form of fiduciary transfers for security purposes (*fiducia cum creditore*, which concerns in particular claims, mortgage certificates, or other negotiable instruments) in which the first-ranking beneficiary is generally the fiduciary transferee himself. He can satisfy his claim on the fiduciary assets if it remains unpaid on maturity. Once the claim has been satisfied, the fiduciary assets or the remainder thereof shall revert to the fiduciary transferor, who is the residual beneficiary. For collective securities, a fiduciary transfer for security purposes is generally a fiduciary transfer



for the benefit of a third party, in which the fiduciary transferor who constitutes the security also ranks as a residual beneficiary.

*Paragraph 4:* Based on CC Article 82, this provision specifies that heirs entitled to indefeasible shares have standing to bring an action in abatement (CC, Art. 522 par. 1, 523, 527 item 3 and 4). This is also the case for a spouse under the matrimonial regime in which the spouses share in acquisitions made during wedlock (participation aux acquêts, CC, Art. 220)<sup>500</sup>. This provision also confirms that creditors may bring an action to set aside the transfer (DEBA, Art. 286 to 288).

## Art. 2 Fiduciary estate

<sup>1</sup> The fiduciary assets and debts encumbering them form an estate separate from the fiduciary transferee's personal estate. The fiduciary estate does not form part of the fiduciary transferee's matrimonial property rights or estate on succession.

<sup>2</sup> The fiduciary assets include movable and immovable property, claims and other rights transferred for this purpose to the fiduciary transferee by the fiduciary transferor, the income thereon, any gains in the value thereof and all assets acquired by the reinvestment of other fiduciary assets.

<sup>3</sup> The fiduciary assets shall be liable only for obligations stipulated in the terms of the fiduciary transfer and those assumed by the fiduciary transferee in the performance of his duties. They are excluded from the enforcement of any other obligation.

<sup>4</sup> The fiduciary transferee shall also be liable on all his assets for the obligations he assumes in his fiduciary capacity. His liability to third parties on his personal estate can be excluded by a special agreement for any debt for which the fiduciary assets are liable, unless the fiduciary transferee acted intentionally or with gross negligence.

*Paragraph 1* expresses the principle that every fiduciary estate (assets and liabilities) constitutes an estate separate from the fiduciary transferee's general estate. *Paragraph 2* delimits the assets of this estate and confirms the application of the principle of patrimonial subrogation ("assets acquired by reinvestment"). *Paragraphs 3 and 4* determine the rules governing liability for debt.

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<sup>500</sup> Omitted in CC, Article 82, this possibility is also recognised in relation to foundations, see RIEMER (1975) Art. 82 N. 13; DESCHENAUX, STEINAUER & BADDELEY (2000) NN. 1413, 1516 *et seq.*

*Paragraph 3:* By determining the debts for which the fiduciary assets are liable, this paragraph expresses the substantive rule which authorities responsible for enforcement (debt collection office, administration of bankruptcy, judge of the claim to trace property, etc.) must implement within the framework of the existing procedures. This procedural implementation of the right to exclude assets for the benefit of the beneficiaries of the fiduciary transfer can be ensured by DEBA new Articles 108a (seizure) and 242a (bankruptcy) proposed above in relation to trusts<sup>501</sup>. The wording of these provisions should be expressly extended to cover fiduciary transfers.

*Paragraph 4: De lege lata,* the fiduciary transferee is also liable on his private property for all debts he incurs as fiduciary transferee; this is so even if he contracts the debts in the diligent exercise of his fiduciary duties in such a way that these debts also encumber the fiduciary assets (par. 3). Insofar as the personal estate of the fiduciary transferee bears or settles debts for the fiduciary estate, the fiduciary transferee's right to reimbursement of expenses and advances made represents a contribution owed to the personal estate by the fiduciary estate (*infra* Art. 4.a). It is not necessary to modify this basic principle. But neither is there any reason to forbid agreements to the contrary with third parties insofar as the latter have access to the fiduciary assets (paragraph 3) and the fiduciary transferee is not guilty of an intentional or grossly negligent breach.

### **Art. 3** The Fiduciary Transferee's Obligations

<sup>1</sup> A fiduciary transferee shall act diligently and loyally in the exclusive interest of the beneficiaries.

<sup>2</sup> In particular, within the limits defined by the terms of the fiduciary transfer and the law, he must:

- a) promptly execute the obligations resulting from the law and the fiduciary transfer;
- b) unless otherwise provided in the fiduciary deed, act in full independence from the fiduciary transferor;
- c) where there are several beneficiaries, act impartially;
- d) keep the fiduciary assets segregated from his private property; the assets pertaining to different fiduciary estates may be commingled only if permitted by the terms of the fiduciary deed or where collective management is in the interest of all the beneficiaries and the accounts

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<sup>501</sup> See *supra* VII.A.1 and VII.A.2.

- maintained by the fiduciary transferee allow these estates to be reconstituted at any time;
- e) administer and invest the fiduciary assets in the interest of beneficiaries and according to the purposes of the fiduciary transfer;
  - f) at the request of the fiduciary transferor or of any beneficiary, render an accounting of his management at any time;
  - g) unless otherwise provided in the fiduciary deed, cause the fiduciary nature of his title to be mentioned in any public register in which the fiduciary asset is registered;
  - h) restore to the fiduciary estate any asset or benefit that he may have acquired or received or procured for a third party in breach of his duties;
  - i) compensate any damage intentionally or negligently caused to the fiduciary estate in breach of his duties.

<sup>3</sup> Unless otherwise provided in the fiduciary deed, the fiduciary transferee can delegate to a third party decisions relating to the investment and management of the fiduciary assets within the guidelines determined by the fiduciary transferee. A fiduciary transferee who does not act in a professional capacity is liable only in respect of the care he used in choosing the third party and giving his instructions.

*Paragraph 1:* The list of obligations is not exhaustive. It broadly corresponds to the duties that case law and legal writings have derived from the rules of agency. It is dominated by the interest of the beneficiaries within the framework of the law and the terms of the fiduciary deed.

*b)* codifies the rule that, unless otherwise agreed, the fiduciary transferee is not bound by the fiduciary transferor's instructions. This rule differs from the current situation regarding fiduciary transfers for management purposes (CO, Art. 397 par. 1), which is questionable<sup>502</sup> in order to match the fiduciary transfers for security purposes. The development of fiduciary transfers requires in general that the fiduciary transferee's activity be faithful to the fiduciary transferor's intentions expressed in the fiduciary deed, but independent of the latter's subsequent intentions. The fiduciary deed may, however, change this rule and grant to the fiduciary transferor (or to a third party, see Article 11 par. 2 *infra*) a more or less extensive power to give instructions.

*f)* and *h)* correspond to CO Article 400 par. 1 and the resulting case law.

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<sup>502</sup> See THÉVENOZ (1995) 342-344.

g) corresponds to FAIF Article 36 par. 1 item 2 but allows the fiduciary transferor to abandon this publication, which reduces the protection resulting from the right to trace (condition that third party purchasers be in good faith). To impose this measure of notice would have the effect of subjecting Swiss fiduciary transfers to a stricter regime than that applicable to foreign trusts benefiting from the Convention<sup>503</sup>. The rule by default concerns only public registers. The terms of the fiduciary deed can widen it to include private registers (shareholders' registers, etc.).

i) repeats the principle of contractual liability (CO, Art. 97 par. 1 and 398 par. 2) without deciding the controversial question of which party bears the burden of proof of the contractual fault in respect of a duty care (*obligations de moyens, Sorgfaltspflichten*)<sup>504</sup>.

*Paragraph 3:* The strict liability of a professional fiduciary transferee for his delegate corresponds to that of an investment fund manager (FAIF, Art. 11 par. 2). The reduced liability of a non-professional fiduciary transferee is identical to the rules regarding the authorised substitution of an agent (CO, Art. 399 par. 2).

#### **Art. 4** The Fiduciary Transferee's Rights

Every fiduciary transferee shall have the following rights, for which the fiduciary estate is liable:

- a) reimbursement, in principal and interest of advances made, expenses incurred, and the release from obligations assumed in the performance of his duties;
- b) remuneration if provided for in the fiduciary deed or customary;
- c) compensation for the damage suffered without his fault in the performance of his duties, taking into account the professional risk he assumes.

*a* corresponds to CO Article 402 par. 1 and FAIF Article 14 par. 1.

*b* corresponds to CO Article 394 par. 3.

*c:* While the principal's liability to the agent varies according to whether the agent is being compensated (CO, Art. 402 par. 2) or not (CO, Art. 422 par. 1<sup>505</sup>), this cannot apply to a fiduciary transferee, who is usually acting totally independently of the fiduciary transferor and the beneficiaries. The criterion of the professional risk seems the most suited to

<sup>503</sup> See *supra* IX: Public Registers.

<sup>504</sup> F. WERRO, *Die Sorgfaltspflichtenverletzung als Haftungsgrund nach Art. 41 OR*, RDS 1997 I pp. 377-380; BaK-WIEGAND (1996) Art. 97 N. 62.

<sup>505</sup> ATF 61 II 95, JdT 1935 I 615.

differentiate the damages that the fiduciary transferee must bear from those for which he must be indemnified by the fiduciary estate.

## Art. 5 Distributions

<sup>1</sup> The fiduciary transferee shall distribute the fiduciary estate according to the terms of the fiduciary deed.

<sup>2</sup> When the terms of the fiduciary deed make a distribution subject to conditions which do not involve discretion, any beneficiary shall be entitled to demand execution by the fiduciary transferee.

*Paragraph 1:* The word restitution, usually employed to indicate the return to the fiduciary transferor of the fiduciary assets on expiration of the fiduciary transfer, inadequately describes situations in which the assets are transferred to other beneficiaries and those in which the fiduciary transferee realises fiduciary assets to distribute sums of money.

*Paragraph 2:* This criterion already exists in the Swiss law of foundations, where a civil action seeking a benefit is possible only when the beneficiary has a subjective right that does not depend completely on the discretion of the foundation's officers<sup>506</sup>.

## Art. 6 Multiple Fiduciary Transferees

When there are several fiduciary transferees, they:

- a) are the joint owners of the fiduciary assets;
- b) are liable jointly and severally for the obligations resulting from the fiduciary deed and the law;
- c) shall make all decisions unanimously unless provided otherwise in the terms of the fiduciary deed; the fiduciary transferees may, however, delegate to one of their number the decisions on investment and management of the fiduciary assets within the guidelines unanimously agreed.

The co-fiduciary transferees form a legal community which is characterised by ownership in common, joint liability to fulfil their duties, and the principle of unanimity in making decisions and exercising their powers (CC, Art. 652 and 653). In particular, the death of a co-fiduciary trans-

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<sup>506</sup> ATF 112 II 97 c. 3, JdT 1987 I 692; ATF 61 II 695 c. 1b. See RIEMER (1975) Art. 84 N. 138.

feree reduces their number without transmission of the late fiduciary transferee's capacity to his heirs, provided at least one fiduciary transferee remains<sup>507</sup>.

### **Art. 7** Set-off and Retention of Fiduciary Assets

<sup>1</sup> In his relations with the fiduciary transferor and the beneficiaries, the fiduciary transferee may exercise a right of retention or set-off only for a claim resulting from his duties.

<sup>2</sup> The depository or holder of a fiduciary asset may exercise a right of retention or set-off in respect of such assets only for a claim in relation to its purchase, custody, management or any other service for which the asset was entrusted to him, unless he is in good faith unaware of the fiduciary nature of the asset. Any agreement to the contrary shall be null and void.

This provision was largely inspired by the proposal put forward by Prof. Giovanoli<sup>508</sup>.

*Paragraph 1* extends the rule contained in CO, Art. 125 (1) to property entrusted to another as a fiduciary transferee.

*Paragraph 2* expresses and clarifies the principle upheld rightly but *praeter legem* by the Federal Supreme Court (SAS 1981 67), the Geneva Court of Appeal (20.3.1992, n.p.), the Paris Court of Appeal (22.9.1994, JCP 1995 II n° 22427 obs. Vasseur) and, more recently, by the Zurich Commercial Court (16.1.1997, cantonal and federal appeals pending).

### **Art. 8** Right to Trace Assets

<sup>1</sup> When, in breach of duty, a fiduciary transferee alienates a fiduciary asset or constitutes a right on such asset, the fiduciary transferor, another fiduciary transferee or any beneficiary shall be entitled to demand, against any purchaser, restitution of the fiduciary asset to the fiduciary estate or the cancellation of the right.

<sup>2</sup> The right to trace shall be extinguished vis-à-vis a purchaser who was in good faith unaware of the improper alienation by the fiduciary transferee

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<sup>507</sup> Compare ATF 78 II 445, JdT 1953 I 523, which holds that a fiduciary's demise causes the other fiduciary's share to increase.

<sup>508</sup> GIOVANOLI (1994) p. 226.

and has provided adequate consideration, as well as vis-à-vis every subsequent purchaser.

<sup>3</sup> Acquisitive prescription is reserved.

<sup>4</sup> The rules on the liability of a holder without right, unjust enrichment and management by a volunteer also apply.

*Paragraph 1:* Here, the fiduciary transferee is treated as an owner whose power of disposal is limited by the terms of the fiduciary deed and the law. This paragraph consequently decides a doctrinal controversy, in which both opinions found support, and on which the Federal Supreme Court has so far had no occasion to take a position<sup>509</sup>.

*Paragraph 2:* According to the principle on which CC Article 933 and 973 are based, a *bona fide* purchaser (who is unaware that his acquisition was improper in a way that is not incompatible with the care that he should have taken in the circumstances, CC, Art. 3 par. 2) is protected. This protection is only available to purchasers who “have provided adequate consideration” (SPC, Art. 59 (1)). According to the weighing of interests made by Parliament in the other contexts<sup>510</sup>, the interests of the fiduciary transferor (or of the trust beneficiary) prevail over those of a party who does not provide such consideration.

*Paragraph 3:* A purchaser who does not provide adequate consideration and is not protected by paragraph 2, can gain protection through the passage of time, provided that he remains unaware of his position throughout the acquisitive prescription (CC, Art. 728 for movable property; CC, Art. 661 *et seq.* and 771 par. 3).

*Paragraph 4:* On the relationship between the rules of the Civil Code regarding holders without right (CC, Art. 938 to 940) and the general rules contained in the Code of Obligations (CO, Art. 62 *et seq.* and 423), see *supra* The Right to Trace Income and Sale Proceeds, in particular notes 322 and 323.

## Art. 9 Duration

<sup>1</sup> The fiduciary transfer shall end as stipulated in the terms of the fiduciary deed or as determined by its purpose, but at the latest sixty years after the transfer.

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<sup>509</sup> See *supra* note 283.

<sup>510</sup> CO, Art. 239 par. 1; SPC, Art. 59 (1); see *supra* VIII.A.1.

<sup>2</sup> If the fiduciary transfer does not set a term or if it reserves this possibility, the fiduciary transfer may be terminated by the fiduciary transferor at any time. The fiduciary transfer shall terminate automatically sixty years after the transfer.

<sup>3</sup> Where all the beneficiaries are identified, they shall be entitled to terminate the fiduciary transfer, prior to its expiration date, by unanimous agreement. The fiduciary deed may reserve the consent of the fiduciary transferor.

<sup>4</sup> On termination of a fiduciary transfer, the remaining assets shall be distributed without delay according to the terms of the fiduciary deed. If there is no such clause, they shall revert to the fiduciary transferor or his heirs.

*Paragraph 1:* A fiduciary transfer can be stipulated for a definite term, subject to a maximum corresponding to approximately two demographic generations. This rather low limit (see CC, Art. 749 par. 2: 100 years for usufruct of legal entities <sup>511</sup>) is designed to avoid the creation of assets without owners and family *fideicommissi* (see CC, Art. 335 par. 2)<sup>512</sup>.

*Paragraph 2* expresses the rule by default – termination at any time at the fiduciary transferor’s discretion – which corresponds to the current situation. Where a fixed term is stipulated (par. 1) the power to terminate at any time is deemed to have been waived, but the terms of the fiduciary deed may nevertheless reserve it. Termination is automatic on expiration of the maximum period of sixty years.

*Paragraph 3:* When all the beneficiaries are identified and known, there is no reason to impose on them the preservation of the fiduciary deed if it is not in their interest. Under the terms of the fiduciary transfer, however, the consent of the fiduciary transferor or the third party referred to in Article 11 par. 2 may be required.

*Paragraph 4:* The rule by default (reversion of assets to fiduciary transferor) corresponds to the current rules on fiduciary transfers. See Article 1 paragraph 2.

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<sup>511</sup> Legislation has limited reversionary heirs to one degree (only one heir may be charged with transmitting the inheritance to another designated heir, CC, Art. 488 par. 2 ), but has not set a maximum duration for them (see CC, Art. 489 par. 1 & 2). PIOTET (1975) p. 96 proposes remedying this lacuna in the law governing substitutions of beneficiaries (CC, Art. 1 par. 2) by fixing a maximum duration of one hundred years.

<sup>512</sup> See THÉVENOZ (1995) pp. 300-302.



**Art. 10** Replacement of the Fiduciary Transferee

<sup>1</sup> Unless provided otherwise by the terms of the fiduciary deed, the fiduciary transferor may at any time revoke the fiduciary transferee and appoint a successor.

<sup>2</sup> A fiduciary transferee must be replaced:

if he declines his appointment or asks to be relieved from his duties;  
on his demise;

if he becomes insolvent, in particular if he is declared bankrupt, seeks protection from creditors, makes a composition with his creditors or is the subject of a certificate of insufficient assets to be seized;

if he is incapacitated or is unable to perform his duties for any other reason;  
if he commits a grave breach of his duties.

<sup>3</sup> The new fiduciary transferee shall be seized of the fiduciary estate on acceptance of his appointment. However, his personal estate is liable to third parties only for obligations incurred after acceptance of his appointment.

The possible termination of the fiduciary transfer (Article 9) must be distinguished from the revocation of the fiduciary transferee (Article 10).

*Paragraph 1:* The revocation and replacement of the fiduciary transferee at the fiduciary transferor's discretion correspond to the current position (CO, Art. 404 par. 1). A fiduciary transferor may waive this power in the fiduciary deed, in particular when the fiduciary transferee's independence vis-à-vis the fiduciary transferor is necessary for the purpose at hand. The terms of the fiduciary deed may also confer on a third party the power to revoke and appoint fiduciary transferees (Article 11 par. 2).

*Paragraph 2:* The revocation and replacement of the fiduciary transferee are necessary when certain circumstances occur which prevent the fiduciary transferee from performing his duties properly. When these conditions are realised but the fiduciary transferor fails to act, this power shall be exercised by the third party appointed under the terms of the fiduciary transfer (Article 11 par. 2) or by the court (Article 12 par. 1).

*Paragraph 3:* While the transfer of the fiduciary assets to the first fiduciary transferee(s) requires as many conveyances by the fiduciary transferor, as the fiduciary estate is not yet formed, such estate is transferable by universal succession from one fiduciary transferee to another. The time of these subsequent transfers is determined by the new fiduciary transferee(s)' acceptance of his (their) task.

**Art. 11** The Fiduciary Transferee's Powers

<sup>1</sup> The fiduciary transferee shall personally exercise the powers reserved to him by law and the terms of the fiduciary deed.

<sup>2</sup> The fiduciary deed may appoint or provide for the appointment of one or more third parties and grant them all or part of the powers that the law reserves or allows to be reserved to the fiduciary transferor.

<sup>3</sup> The powers referred to in the first two paragraphs are personal, non-assignable and non-transferable.

On the model of the protector developed in trust practice, *paragraph 2* allows the fiduciary deed to confer on one (or more ) third parties powers that would otherwise be reserved to the fiduciary transferor by law or by the fiduciary deed (*paragraph 1*).

**Art. 12** Judicial Intervention

<sup>1</sup> At the request of any interested party and insofar as necessary to protect the beneficiaries' interests, the courts shall exercise any power that the law or the fiduciary deed reserves to the fiduciary transferor or to a third party where the former has failed to use such power in a timely fashion, is incapable of using it or uses it contrary to the terms of the fiduciary deed or the law.

<sup>2</sup> At the request of any interested party, the courts shall determine the fiduciary transferee's remuneration insofar as the terms thereof do not result from the fiduciary deed or when the scope of the fiduciary transferee's activity has changed significantly relative to the circumstances envisaged by the parties to the fiduciary deed.

<sup>3</sup> When there is a legitimate doubt regarding the extent of the fiduciary transferee's duties, rights or powers, the latter shall be entitled to seize the courts of the matter. The decision shall bind the fiduciary transferor and the beneficiaries, who shall be heard before judgement is given.

<sup>4</sup> Where the terms of the fiduciary deed do not designate a legal forum in Switzerland, the court of the place where the fiduciary transferee or one of the fiduciary transferees maintains his establishment or domicile shall have jurisdiction.

The fiduciary transfer proposed here is likely to be of longer duration than practised at present (Article 9 par. 1 and Article 11.c). The fiduciary transferee can be also authorised by the fiduciary transfer to act in an

essentially or totally independent manner in relation to the fiduciary transferor (Article 11.a). Such fiduciary transfers can survive the fiduciary transferor's death.

For all these reasons, the usual private law actions (action for damages, to cease and desist), which need not be repeated here, must be supplemented by three specific judicial powers.

*Paragraph 1:* Where necessary, the judge can act in lieu of the fiduciary transferor (or for the third party, Article 11) and exercise his powers. However, whereas the powers of the fiduciary transferor or the third party may be discretionary (*e.g.*, termination at any time, opposition to termination or to amendments to the fiduciary deed on the beneficiaries' initiative, discretionary revocation of the fiduciary transferee), those of the judge are limited by the twofold condition that the holder of the powers must fail to exercise them properly and timely *and* their exercise must be necessary for the protection of the beneficiaries' interests.

*Paragraph 2:* Unlike an agency contract, which can usually be revoked any time (CO, Art. 404), fiduciary transfers can be stipulated to last for a long term (but no longer than the maximum sixty years, see Articles 8 and 11.c) and may survive the fiduciary transferor or the (first) fiduciary transferee (see Article 10.b). Therefore, it is possible that the original parties to the fiduciary deed are no longer capable of clarifying or of adjusting the fiduciary transferee's remuneration (Article 4.b), so that this power must be conferred on the judge.

*Paragraph 3:* In the performance of a long-term relationship such as a fiduciary transfer, which is not in principle subject to amendment by common agreement between the parties (see Article 9 par. 2), a dispute should not be a condition for referral to a judge (litigation). The fiduciary transferee must be entitled to petition the court in the absence of a dispute when a justifiable doubt exists regarding the content or extent of his duties or powers.

*Paragraph 4:* This paragraph could be the subject of an Article to be added to the Federal Act on Venue in Civil Matters of 24 March 2000<sup>513</sup>.

## **XVI. Summary of Legislative Proposals**

To give an overview of the proposals formulated and supported by reasoning in this report, they are recapitulated here, together with the adaptations of

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<sup>513</sup> RS 272, RO 2000 2355.

domestic law that must result from ratification of the Convention and codification of fiduciary transfers.

The signature and the ratification of the Convention are the province of the government (Federal Council). Ratification requires the prior approval of Parliament (Federal Assembly)<sup>514</sup>, in the form of a federal decree, the text of which need not be proposed here. Because it relates to an international treaty entailing a multilateral unification of the law, this decree would be subject to an optional referendum<sup>515</sup>.

All the proposals formulated above are ordered according to the systematic presentation adopted by Swiss federal legislation. Certain proposals, already identified as such<sup>516</sup>, belong to the Civil Code or the Debt Enforcement and Bankruptcy Act.

Others are private international law norms because they settle jurisdictional conflicts<sup>517</sup> or conflicts of laws<sup>518</sup>. Rather than making them the subject of a special statute on trusts, on the Dutch<sup>519</sup> or British<sup>520</sup> model, I suggest introducing them into the Swiss Private International Law Act. This insertion ensures greater clarity for the public and respects Switzerland's concern to preserve the exhaustive nature of that codification. Some hesitation is justified in relation to the systematic position of the two paragraphs, proposed above, regarding the mention of trusts in public registers<sup>521</sup>. Essentially, this is a matter for domestic substantive law. But the legislation on this subject is scattered and in the interest of clarity it would be preferable to insert it in the new chapter of the SPILA devoted to trusts.

The position this chapter should occupy poses a problem of itself because the original (Anglo-American) trust concept is an institution distinct

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<sup>514</sup> Constitution of the Swiss Confederation of 18 April 1999 (RS 101) Art. 166 par. 2 and 184 par. 2.

<sup>515</sup> Swiss Federal Constitution, Art. 141 par. 1.d (3).

<sup>516</sup> See *supra* chap. V, VI and VII.

<sup>517</sup> See *supra* chap. X.

<sup>518</sup> See *supra* chap. XI and VIII.

<sup>519</sup> *Wet Conflictenrecht Trust* of 4 October 1995, reproduced in *Trust Laws of the World* (2000) pp. 40-41.

<sup>520</sup> *Recognition of Trusts Act 1987* du 9 April 1987, *ibidem*, pp. 22-27.

<sup>521</sup> See *supra* chap. IX.

from those that correspond to the headings of the SPILA chapters, but one that remains particularly close to the law of the property from which it derives. As we have observed throughout this report, recognition by Swiss private international law considerably differentiates trusts from property rights. The trustee is treated as an owner within the meaning of Swiss civil law. The beneficiaries are not recognised as enjoying a position comparable to a limited property right over the trust corpus. Their right to trace assets is limited and can be likened to a type of obligation *prompter rem*. In fact, in the categories of Swiss private international law, trusts are situated between contract law and the law of companies and organised estates. That is why I suggest inserting the corresponding chapter between Chapters 9, “Contract Law”, and 10, “Company Law”, of the Act.

The reasons for a codification of fiduciary transfers that does not limit the scope of application to certain specified intermediaries have already been discussed above<sup>522</sup>. To preserve the fiduciary transfer’s character as a general institution in Swiss private law, it would be advisable to include it in one of our codes. Fiduciary transfers could be viewed as being based on a new limited property right pertaining to the fiduciary transferee and/or the beneficiary. That is not the historic trend in the development of fiduciary transfers in our case law and legal writing. As codified here, fiduciary transfers are a relationship essentially derived from the law of obligations, which can arise from a contractual agreement (though such a transfer is not merely a contract) or even from a testamentary disposition. They thus have a natural position in the Swiss Code of Obligations.

For the reasons given above concerning the systematic insertion of trusts in the SPILA, it would seem appropriate to insert fiduciary transfers between parts two (“Various Contracts”) and three (“Trading Companies and Co-operatives”) of the Swiss Code of Obligations. Unfortunately, the current systematic arrangement of the Code is not completely satisfactory. To add a second part would have the unfortunate effect of detaching commercial companies (titles twenty-four *et seq.*) from basic partnerships (*société simple*, title twenty-three), although there are close links between the two. Practical considerations, which do not entirely satisfy the meaning of the system, suggest that it would be appropriate to insert a title twenty-

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<sup>522</sup> See *supra* chap. XIV.B: Systematic Insertion and Scope of Application.

two<sup>bis</sup> on fiduciary transfers just before the title dedicated to basic partnerships.

Square brackets indicate the adaptations required for fiduciary transfers to the amendments to the Civil Code and the Debt Enforcement and Bankruptcy Act formulated in relation to trusts.

## A. Amendments to the Civil Code

### Art. 208, new paragraph<sup>523</sup>

<sup>3</sup>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 paragraph<sup>524</sup>

<sup>2</sup>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. 528a (new)

#### c. [Fiduciary transfers and] Trusts

<sup>1</sup> 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.

<sup>2</sup> The trustee shall be entitled to make restitution of equivalent value.

### Art. 533a (new)<sup>525</sup>

<sup>1</sup> 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

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<sup>523</sup> See *supra* chap. VI: Trusts and Matrimonial Property Rights.

<sup>524</sup> See *supra* chap. V.A: Reconstitution of Indefeasible Shares.

<sup>525</sup> See *supra* chap. V.B: Heirs to Indefeasible Shares: Right to Information from the Trustee.

evidence. The court may also compel beneficiaries or depositories of the relevant assets to do likewise.

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

## B. Amendments to the Code of Obligations

### **Title Twenty-two<sup>526</sup>: Fiduciary Transfers** (new)<sup>526</sup>

#### **Art. 529a** Definition

<sup>1</sup> A fiduciary transfer results from a contract or a disposition effective on death (the fiduciary deed) by which the fiduciary transferor causes the fiduciary transferee to acquire title to certain assets for the benefit of one or more identified or identifiable beneficiaries.

<sup>2</sup> If the fiduciary deed does not appoint any beneficiary, the fiduciary transferor is deemed to be the only beneficiary.

<sup>3</sup> The fiduciary transferee cannot be the sole beneficiary.

<sup>4</sup> The fiduciary transfer can be challenged, as a donation, by the heirs, the spouse or the creditors of the fiduciary transferor.

#### **Art. 529b** Fiduciary estate

<sup>1</sup> The fiduciary assets and debts encumbering them form an estate separate from the fiduciary transferee's personal estate. The fiduciary estate does not form part of the fiduciary transferee's matrimonial property rights or estate on succession.

<sup>2</sup> The fiduciary assets include movable and immovable property, claims and other rights transferred for this purpose to the fiduciary transferee by the fiduciary transferor, the income thereon, any gains in the value thereof and all assets acquired by the reinvestment of other fiduciary assets.

<sup>3</sup> The fiduciary assets shall be liable only for obligations stipulated in the terms of the fiduciary transfer and those assumed by the fiduciary transferee in the performance of his duties. They are excluded from the enforcement of any other obligation.

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<sup>526</sup> See *supra* chap. XV: Draft Codification of Fiduciary Transfers.

<sup>4</sup> The fiduciary transferee shall also be liable on all his assets for the obligations he assumes in his fiduciary capacity. His liability to third parties on his personal estate can be excluded by a special agreement for any debt for which the fiduciary assets are liable, unless the fiduciary transferee acted intentionally or with gross negligence.

**Art. 529c**      Fiduciary Transferee's Obligations

<sup>1</sup> A fiduciary transferee shall act diligently and loyally in the exclusive interest of the beneficiaries.

<sup>2</sup> In particular, within the limits defined by the terms of the fiduciary transfer and the law, he must:

- a) promptly execute the obligations resulting from the law and the fiduciary transfer;
- b) unless otherwise provided in the fiduciary deed, act in full independence from the fiduciary transferor;
- c) where there are several beneficiaries, act impartially;
- d) keep the fiduciary assets segregated from his private property; the assets pertaining to different fiduciary estates may be commingled only if permitted by the terms of the fiduciary deed or where collective management is in the interest of all the beneficiaries and the accounts maintained by the fiduciary transferee allow these estates to be reconstituted at any time;
- e) administer and invest the fiduciary assets in the interest of beneficiaries and according to the purposes of the fiduciary transfer;
- f) at the request of the fiduciary transferor or of any beneficiary, render an accounting of his management at any time;
- g) unless otherwise provided in the fiduciary deed, cause the fiduciary nature of his title to be mentioned in any public register in which the fiduciary asset is registered;
- h) restore to the fiduciary estate any asset or benefit that he may have acquired or received or procured for a third party in breach of his duties;
- i) compensate any damage intentionally or negligently caused to the fiduciary estate in breach of his duties.

<sup>3</sup> Unless otherwise provided in the fiduciary deed, the fiduciary transferee can delegate to a third party decisions relating to the investment and management of the fiduciary assets within the guidelines determined by the fiduciary transferee. A fiduciary transferee who does not act in a professional capacity is liable only in respect of the care he used in choosing the third party and giving his instructions.



**Art. 529d** The Fiduciary Transferee's Rights

Every fiduciary transferee shall have the following rights, for which the fiduciary estate is liable:

- a) reimbursement, in principal and interest of advances made, expenses incurred, and the release from obligations assumed in the performance of his duties;
- b) remuneration if provided for in the fiduciary deed or customary;
- c) compensation for the damage suffered without his fault in the performance of his duties, taking into account the professional risk he assumes.

**Art. 529e** Distributions

<sup>1</sup> The fiduciary transferee shall distribute the fiduciary estate according to the terms of the fiduciary deed.

<sup>2</sup> When the terms of the fiduciary deed make a distribution subject to conditions which do not involve discretion, any beneficiary shall be entitled to demand execution by the fiduciary transferee.

**Art. 529f** Multiple Fiduciary transferees

When there are several fiduciary transferees, they:

- a) are the joint owners of the fiduciary assets;
- b) are liable jointly and severally for the obligations resulting from the fiduciary deed and the law;
- c) shall make all decisions unanimously unless provided otherwise in the terms of the fiduciary deed; the fiduciary transferees may, however, delegate to one of their number the decisions on investment and management of the fiduciary assets within the guidelines unanimously agreed.

**Art. 529g** Set-off and Retention of Fiduciary Assets

<sup>1</sup> In his relations with the fiduciary transferor and the beneficiaries, the fiduciary transferee may exercise a right of retention or set-off only for a claim resulting from his duties.

<sup>2</sup> The depository or holder of a fiduciary asset may exercise a right of retention or set-off in respect of such assets only for a claim in relation to its purchase, custody, management or any other service for which the asset was entrusted to him, unless he is in good faith unaware of the fiduciary nature of the asset. Any agreement to the contrary shall be null and void.

**Art. 529h** Right to Trace Assets

<sup>1</sup> When, in breach of duty, a fiduciary transferee alienates a fiduciary asset or constitutes a right on such asset, the fiduciary transferor, another fiduciary transferee or any beneficiary shall be entitled to demand, against any purchaser, restitution of the fiduciary asset to the fiduciary estate or the cancellation of the right.

<sup>2</sup> The right to trace shall be extinguished vis-à-vis a purchaser who was in good faith unaware of the improper alienation by the fiduciary transferee and has provided adequate consideration, as well as vis-à-vis every subsequent purchaser.

<sup>3</sup> Acquisitive prescription is reserved.

<sup>4</sup> The rules on the liability of a holder without right, unjust enrichment and management by a volunteer also apply.

**Art. 529i** Duration

<sup>1</sup> The fiduciary transfer shall end as stipulated in the terms of the fiduciary deed or as determined by its purpose, but at the latest sixty years after the transfer.

<sup>2</sup> If the fiduciary transfer does not set a term or if it reserves this possibility, the fiduciary transfer may be terminated by the fiduciary transferor at any time. The fiduciary transfer shall terminate automatically sixty years after the transfer.

<sup>3</sup> Where all the beneficiaries are identified, they shall be entitled to terminate the fiduciary transfer, prior to its expiration date, by unanimous agreement. The fiduciary deed may reserve the consent of the fiduciary transferor.

<sup>4</sup> On termination of a fiduciary transfer, the remaining assets shall be distributed without delay according to the terms of the fiduciary deed. If there is no such clause, they shall revert to the fiduciary transferor or his heirs.

**Art. 529j** Replacement of the Fiduciary Transferee

<sup>1</sup> Unless provided otherwise by the terms of the fiduciary deed, the fiduciary transferor may at any time revoke the fiduciary transferee and appoint a successor.

<sup>2</sup> A fiduciary transferee must be replaced:

- a) if he declines his appointment or asks to be relieved from his duties;
- b) on his demise;

- c) if he becomes insolvent, in particular if he is declared bankrupt, seeks protection from creditors, makes a composition with his creditors or is the subject of a certificate of insufficient assets to be seized;
- d) if he is incapacitated or is unable to perform his duties for any other reason;
- e) if he commits a grave breach of his duties.

<sup>3</sup> The new fiduciary transferee shall be seized of the fiduciary estate on acceptance of his appointment. However, his personal estate is liable to third parties only for obligations incurred after acceptance of his appointment.

#### **Art. 529k** The Fiduciary Transferee's Powers

<sup>1</sup> The fiduciary transferee shall personally exercise the powers reserved to him by law and the terms of the fiduciary deed.

<sup>2</sup> The fiduciary deed may appoint or provide for the appointment of one or more third parties and grant them all or part of the powers that the law reserves or allows to be reserved to the fiduciary transferor.

<sup>3</sup> The powers referred to in the first two paragraphs are personal, non-assignable and non-transferable.

#### **Art. 529l** Judicial Intervention

<sup>1</sup> At the request of any interested party and insofar as necessary to protect the beneficiaries' interests, the courts shall exercise any power that the law or the fiduciary deed reserves to the fiduciary transferor or to a third party where the former has failed to use such power in a timely fashion, is incapable of using it or uses it contrary to the terms of the fiduciary deed or the law.

<sup>2</sup> At the request of any interested party, the courts shall determine the fiduciary transferee's remuneration insofar as the terms thereof do not result from the fiduciary deed or when the scope of the fiduciary transferee's activity has changed significantly relative to the circumstances envisaged by the parties to the fiduciary deed.

<sup>3</sup> When there is a legitimate doubt regarding the extent of the fiduciary transferee's duties, rights or powers, the latter shall be entitled to seize the courts of the matter. The decision shall bind the fiduciary transferor and the beneficiaries, who shall be heard before judgement is given.

<sup>4</sup> Where the terms of the fiduciary deed do not designate a legal forum in Switzerland, the court of the place where the fiduciary transferee or one of the fiduciary transferees maintains his establishment or domicile shall have jurisdiction.

## C. Amendment of the Federal Debt Enforcement and Bankruptcy Act

### Art. 108a (new)<sup>527</sup> c. [Fiduciary transfers and] Trusts

<sup>1</sup> 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.

<sup>2</sup> Standing to bring the action contained in Art. 107, par. 5, is granted to all [fiduciary transferees,] trustees, beneficiaries and others persons to whom the rules applicable [to the fiduciary transfer or] 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.

<sup>3</sup> Where there are several trustees [or fiduciary transferees], 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.

<sup>4</sup> Where the debtor is the sole [fiduciary transferee or] trustee, any beneficiary may intervene in the proceedings within 30 days after he learned of the proceedings.

<sup>5</sup> 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. 242a (new)<sup>528</sup> [Fiduciary Transfers and] Trusts

<sup>1</sup> The assets subject to [a fiduciary transfer] shall be excluded from the estate in bankruptcy and returned to the other [fiduciary transferees] or to a new [fiduciary transferee], after deduction of the bankrupt's claims against such assets. [The same shall apply to trusts.]

<sup>2</sup> Where the conditions for such exclusion do not appear to be met, the receiver in bankruptcy shall grant the [fiduciary transferees or] trustees

<sup>527</sup> See *supra* chap. VII.A.1: Seizure proceedings directed against the trustee.

<sup>528</sup> See *supra* chap. VII.A.2: Bankruptcy of Trustees. The text has been amended slightly to mention fiduciary transfers first, as an legal institution deriving under domestic law (par. 1, 1<sup>st</sup> sentence), and the rule is then extended to trusts (2<sup>nd</sup> sentence).

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.

## D. Amendment of the Swiss Private International Law Act

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

#### Art. 149*a* (new)<sup>529</sup> I. Jurisdiction

<sup>1</sup> 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.

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

<sup>3</sup> [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

<sup>1</sup> Trusts are governed by the Hague Convention on the law applicable to trusts and on their recognition of 1 July 1985.

<sup>2</sup> 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..<sup>530</sup>

#### Art. 149*c* (new)<sup>531</sup>

<sup>1</sup> 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

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<sup>529</sup> See *supra* chap. See *supra*, chap. X: Jurisdiction: This provision will become redundant if the Hague Convention Convention Jurisdiction and Foreign Judgments in Civil and Commercial Matters is adopted and becomes mandatory in Switzerland.

<sup>530</sup> See *supra* chap. XI: Article 13.

<sup>531</sup> See *supra* chap. VIII: Beneficiaries' Right to Trace Assets and Third-Party Liability.

shall also govern the repayment of any valuable consideration supplied by the purchaser.

<sup>2</sup> 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. 149d** (new)<sup>532</sup>

<sup>1</sup> 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.

<sup>2</sup> 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.

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<sup>532</sup> See *supra* chap. IX: Public Registers.

## Abréviations – Abbreviations

La législation suisse peut être consultée sur le site de la Confédération:  
*Swiss legislation is available on the Swiss Confederation's website:*  
[www.admin.ch](http://www.admin.ch).

AC	<i>Law Reports: Appeal Cases</i> (London, 1875–)
All ER	<i>The All England Law Reports</i> (London, 1948–)
ASDI	<i>Annuaire suisse de droit international</i> (Zurich, 1944–1990)
ATF	<i>Arrêts du Tribunal fédéral suisse: Recueil Officiel = Entscheidungen des schweizerischen Bundesgerichts: Amtliche Sammlung</i> (Lausanne, 1875–)
B.R.	<i>Bankruptcy Reporter</i> (St-Paul., Minn., 1979–)
BaK–...	Voir BaK–...: <i>Kommentar zum Schweizerischen Privatrecht</i> dans la bibliographie
BGB	[Deutsches] Bürgerliches Gesetzbuch
BJM	<i>Basler Juristische Mitteilungen</i> (Bâle, 1954–)
CC	Code civil [suisse] du 10 décembre 1907 (RS 210)
CCfr.	Code civil français
Ch	<i>Law Reports: Chancery</i> (London, 1891–)
ch.	chiffre
<i>Clunet</i>	<i>Clunet : Journal du droit international</i> (Paris, 1874–)
CO	Code [suisse] des obligations (Loi fédérale complétant le code civil suisse du 30 mars 1911: Livre cinquième: Droit des obligations)
Convention	Convention relative à la loi applicable au trust et à sa reconnaissance conclue à La Haye le 1 <sup>er</sup> juillet 1985 / Convention on the Law Applicable to Trusts and on their Recognition made in The Hague on 1 <sup>st</sup> July 1985 (reproduite en annexe I / see appendix I)
CP	Code pénal suisse du 21 décembre 1937 (RS 311)
DEBA	Federal Debt Enforcement and Bankruptcy Act ( <i>loi fédérale sur la poursuite pour dettes et la faillite, Bundesgesetz über Schuldbetreibung und Konkurs</i> ) of 11 April 1999 (RS 281.1)
DT	Document de travail
FAIF	Federal Act on Investment Funds of 18 March 1994 (RS 951.31)
FBA	Federal Banking Act of 8 Novembre 1934 (RS 952.0)
FF	<i>Feuille fédérale</i> (Berne)
IPR–...	Voir IPR–...: <i>Kommentar zum Schweizerischen Privatrecht: Internationale Privatrecht</i> dans la bibliographie
IPRG–...	Voir IPRG–...: <i>IPRG Kommentar</i> dans la bibliographie
JCP	<i>Juris-Classeur Périodique: La Semaine juridique: doctrine, jurisprudence, textes</i> , édition générale (Paris, 1927–)
JdT	<i>Journal des Tribunaux</i> (Lausanne, 1853–)
JOCE	<i>Journal officiel des Communautés européennes</i> (Bruxelles, 1958–)

LB	Loi fédérale sur les banques et les caisses d'épargne du 8 novembre 1934 (RS 952.0)
LDIP	Loi fédérale sur le droit international privé du 18 décembre 1987 (RS 291)
LFors	Loi fédérale sur les fors en matière civile du 24 mars 2000 (RS 272, RO 2000 2355)
LFP	Loi fédérale sur les fonds de placement du 18 mars 1994 (RS 951.31)
LP	Loi fédérale sur la poursuite pour dettes et la faillite du 11 avril 1889 (RS 281.1.)
N. (NN.)	numéro(s) marginal(aux)
NJW	<i>Neue Juristische Wochenschrift</i> (Munich etc., 1947–)
OFP	Ordonnance sur les fonds de placement du 19 octobre 1994 (RS 951.311)
ORF	Ordonnance sur le registre foncier du 22 février 1910 (RS 211.432.1)
PDET	Principes de Droit Européen du Trust (reproduits en annexe II)
PETL	Principles of European Trust Law (see appendix II)
PJA	<i>Pratique juridique actuelle</i> = <i>Aktuelle Juristische Praxis</i> (St-Gall, 1992–)
RDS	<i>Revue de droit suisse</i> = <i>Zeitschrift für Schweizerisches Recht</i> (Bâle, 1852–)
RJB	<i>Revue de la Société des juristes bernois</i> = <i>Zeitschrift des Bernischen Juristenvereins</i> (Berne, 1884–)
RNRF	<i>Revue suisse du notariat et du Registre foncier</i> = <i>Schweizerische Zeitschrift für Beurkundungs- und Grundbuchrecht</i> (Wädenswil, 1920)
RSDA	<i>Revue suisse de droit des affaires</i> = <i>Zeitschrift für Schweizerisches Wirtschaftsrecht</i> = <i>Swiss Business Law Review</i> (Zurich, 1990–)
RSJ	<i>Revue suisse de jurisprudence</i> = <i>Schweizerische Juristenzeitung</i> (Zurich, 1904–)
s.	et suivant ( <i>and following page</i> )
SAS	<i>La Société anonyme suisse</i> = <i>Die Schweizerische Aktiengesellschaft</i> (Zurich, 1929–1989 ; devient : <i>Revue suisse de droit des affaires</i> = <i>Swiss Business Law Review</i> )
SC	Federal Supreme Court ( <i>Tribunal fédéral suisse, Schweizerisches Bundesgericht</i> )
SchKG–...	Voir <i>Kommentar zum Bundesgesetz über Schuldbetreibung und Konkurs</i> dans la bibliographie
SJ	<i>La Semaine judiciaire</i> (Genève, 1878–)
SPC	Swiss Penal Code of 21 December 1937 (RS 311)
SPILA	Swiss Private International Law Act ( <i>loi fédérale sur le droit international privé, Bundesgesetz über das Internationale Privatrecht</i> ) of 18 December 1987 (RS 291)
ss	et suivantes ( <i>and following pages</i> )
WLR	<i>Weekly Law Reports</i> (London, 1953–)
ZR	<i>Blätter für Zürcherische Rechtsprechung</i> (Zurich, 1902–)



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*Though not in any way exhaustive, the following list simultaneously includes representative basic treatises concerning trusts in the main common law jurisdictions (mainly England, the United States and Australia), in other legal systems where trusts have developed on a non-common law basis, and contributions showing the recent development of this law.*

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