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THE COMMON CORE OF EUROPEAN PRIVATE LAW

Commercial Trusts in European Private Law

EDITED BY

MICHELE GRAZIADEI, UGO MATTEI AND LIONEL SMITH

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Commercial Trusts in European Private Law

This book examines how fifteen legal systems of the European Union regulate relationships of trust, focusing in particular on asset management. Following the Common Core approach, national reporters examine their Member State's trusts laws primarily through the discussion of a series of hypothetical cases on, amongst other topics, the establishment and termination of management relationships, obligations of loyalty and of professionalism, and the choice of law. There is a special focus on commercial applications such as collective investment, collective secured lending, pension funds and securitisation. In addition to a much-needed comparative treatment of the subject, the book discusses the scholarly setting for the issues and gives guidance on the terminology in the evolving European scene.

MICHELE GRAZIADEI is Professor of Comparative Private Law, Facolta di giurisprudenza, Università del Piemonte orientale.

UGO MATTEI is Professore Ordinario di Diritto Civile at the University of Turin; Alfred and Hanna Fromm Professor of International and Comparative Law at the University of California, Hastings College of Law.

LIONEL SMITH is James McGill Professor of Law, Faculty of Law and Institute of Comparative Law, McGill University.

CONTRIBUTORS TO THE VOLUME:
Benoit Allemeersch, François Barrière, Sergio Cámara Lapuente, Merete Clausen, Antonio Gambaro, Cristina González Beilfuss, Georg Graf, Michele Graziadei, George Gretton, Stefan Grundmann, Torgny Håstad, Monika Hinteregger, Steve Jacoby, Marielle Koppenol-Laforce, George Lekkas, Ugo Mattei, Niamh Moloney, Eoin O'Dell, Pedro Pais de Vasconcelos, Lionel Smith, Jarmo Tuomisto, Alain Verbeke, Christian Vogel, Donovan Waters, Manuela Weissenbacher

CONTRIBUTORS TO THE CASE STUDIES:

Austria: Georg Graf, Monika Hinteregger and Manuela Weissenbacher
Belgium: Benoit Allemeersch, Alain Verbeke
Denmark: Merete Clausen
England and Wales: Lionel Smith
Finland: Jarmo Tuomisto
France: François Barrière
Germany: Stefan Grundmann
Greece: George K. Lekkas
Ireland: Niamh Moloney and Eoin O'Dell
Italy: Antonio Gambaro and Michele Graziadei
Luxembourg: Steve Jacoby
The Netherlands: Marielle Koppenol-Laforce
Portugal: Pedro Pais de Vasconcelos
Scotland: George L. Gretton
Spain: Sergio Cámara Lapuente and Cristina González Beilfuss
Sweden: Torgny Håstad

The Common Core of European Private Law

General Editors
Mauro Bussani, University of Trieste
Ugo Mattei, University of Turin and University of California, Hastings College of Law

Honorary Editor
Rodolfo Sacco, University of Turin

Late Honorary Editor
Rudolf B. Schlesinger, Cornell University and University of California, Hastings College of Law

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James Gordley, Cecil Turner Professor of Law, University of California, Berkeley; Editor in Chief of the American Journal of Comparative Law
Antonio Gambaro, Professor of Law, University of Milan; President of the Italian Society of Comparative Law
Franz Werro, University of Freiburg and Georgetown University Law Center
Rodolfo Sacco, President of the International Association of Legal Science (UNESCO)

For the transnational lawyer the present European situation is equivalent to that of a traveller compelled to cross legal Europe using a number of different local maps. To assist lawyers in the journey beyond their own locality *The Common Core of European Private Law Project* was launched in 1993 at the University of Trento under the auspices of the late Professor Rudolf B. Schlesinger. This is its sixth book published by Cambridge University Press.

The aim of this collective scholarly enterprise is to unearth what is already common to the legal systems of European Union member states. Case studies widely circulated and discussed between lawyers of different traditions are employed to draw at least the main lines of a reliable map of the law of Europe.

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To the memory of Professor Peter Birks
in different ways, a mentor to all of us

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General editors' preface

This book brings 'The Common Core of European Private Law' over the threshold of a half dozen published results. The project was launched in 1993 at the University of Trento under the auspices of the late Professor Rudolf B. Schlesinger. The methodology used in the Trento project is novel. By making use of case studies it goes beyond mere description to detailed inquiry into how most European Union legal systems resolve specific legal questions in practice, and to thorough comparison between those systems. It is our hope that these volumes will provide scholars with a valuable tool for research in comparative law and in their own national legal systems. The collection of materials that the Common Core Project is offering to the scholarly community is already quite extensive and will become even more so when more volumes are published. The availability of materials attempting a genuine analysis of how things are is, in our opinion, a prerequisite for an intelligent and critical discussion on how they should be. Perhaps in the future European private law will be authoritatively restated or even codified. The analytical work carried on today by the nearly 200 scholars involved in the Common Core Project is a precious asset of knowledge and legitimization for any such normative enterprise.

We must thank not only the editors and contributors to these first published results but also all the participants who continue to contribute to The Common Core of European Private Law project. With a sense of deep gratitude we also wish to recall our late Honorary Editor, Professor Rudolf B. Schlesinger. We are sad that we have not been able to present him with the results of a project in which he believed so firmly. No scholarly project can survive without committed sponsors. The Dipartimento di Scienze Giuridiche of the University of Trento and its excellent staff must first be thanked. The European Commission has partially sponsored some of our past general meetings, having included them in their High Level Conferences Program. The Italian Ministry of Scientific Research is now also funding the project, having recognized it as a 'research of national interest'. The Istituto Subalpino per l'Analisi e l'Insegnamento del Diritto delle Attività Transnazionali, the University of Torino, the University of Trieste, the Fromm Chair in International and Comparative Law at the University of California and the Hastings College of Law have all contributed to the funding of this project. Last but not least, we must thank all those involved in our ongoing Trento projects in contract law, property, tort and other areas whose results will be the subject of future published volumes. Our home page on the internet is at http://www.jus.unitn.it/dsg/common-core. There you can follow our progress in mapping the common core of European private law.

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Antonio Gambaro, Professor of Law, University of Milano; President of the Italian Society of Comparative Law
Franz Werro, University of Freiburg and Georgetown University Law Center
Rodolfo Sacco, President of the International Association of Legal Science (UNESCO)

Preface

This book is the result of a genuinely collective enterprise. As a project, it was conceived at a preliminary meeting of one and a half days in March 1998 at the University of Trento, within a small group made up of two of the editors (Graziadei and Mattei), the chairman of the property group of the Common Core project, Professor Antonio Gambaro, and leading trust scholars Professor John Langbein from Yale, Professor Hein Kötz from Hamburg and Professor Shael Herman from Tulane. At that meeting general issues of applicability of common core methodology to the domain of trust were discussed, and a clear sense emerged that the focus should be on trust law in the commercial setting.

The trust project was officially launched in July of the same year at the general meeting of the Common Core project, in Trento, where a rudimentary first draft questionnaire was discussed in depth under the leadership of Professor Antonio Gambaro, at the property session. At that meeting Lionel Smith (at that time of Oxford University) joined the editorial team and the first participants joined in. In June 1999 all the participants to the project met in Como for a three-day conference sponsored by the University of Insubria. At that meeting draft responses to the new version of the questionnaire were discussed together with Professor John Langbein, who also gave a speech on institutional investors and the law of trusts. Professor Paul Matthews of King's College London participated in our work and addressed the group on the law of trusts in offshore jurisdictions. Professor Jonathan Macey from Cornell intervened on the economic aspects of fiduciary relationships. More work with most of the participants was devoted to the finalisation of the questionnaire at the 1999 meeting in Trento, and in January 2000 the editors met for ten days of joint work on the draft responses at

Oxford University. Feedback and changes in the reports and in the questionnaire happened through the following year and a half, with another joint two days of work in Trento in July 2000. Finalised answers were prepared in the course of the following year, and at the July 2001 meeting the editors met for some more planning and for the final editorial organisation of the volume. The very last meeting with all the participants was organised at Stresa, Italy and sponsored by the Facoltà di giurisprudenza of the Università del Piemonte orientale, whose faculty was meanwhile joined by Professor Graziadei. At that meeting, Professor Donovan Waters, Dr Joshua Getzler of St Hugh's College, Oxford, and Mr Stuart Willey, of the UK Financial Services Authority, participated in the discussion of the country reports and delivered papers on the Hague Convention of 1985 on the law applicable to trusts and on their recognition, on the Trustee Act 2000, and on fiduciary duties in financial services law.

This long and thorough joint effort can be seen as a truly collective authorship of the questionnaire and of the semantics of the answers, and should be reflected in a relatively high level of homogeneity between the national reports. What is most important to point out, however, is that in this process comparison has been carried on as a matter of learning by doing, and a high level of communication between lawyers of so many different traditions has certainly been reached. The very existence of this book shows that when comparative work is done (even in traditionally very tricky areas like property and trust), it looks less problematic than when one limits oneself to discussing how it should be done.

Like everyone else, the editors were shocked and saddened by the news of the death of Professor Peter Birks, as this book was going to press. He was an intellectual leader in the field of comparative private law, as in so many other fields, and he was a great friend and supporter of the Trento enterprise. In different ways, each of the editors is intellectually indebted to Peter Birks, to whose memory this book is dedicated.

The authors jointly wish to thank all the aforementioned participants to the conception of this volume who might or might not appear as authors but who have all helped us tremendously in carrying out our task. Thank you to the brilliant Managing Editor of The Common Core of European Private Law, Mrs Carla Boninsegna, for kindness, softness and efficiency. We wish to thank Finola O'Sullivan and Professor David Ibbetson at Cambridge University Press, together with the anonymous referee of this volume, who have all, in different ways, greatly helped to improve our final artefact. We are grateful to Professor Martijn Hesselink and to Professor Rick Verhagen who joined in our discussions in Trento at an early stage of the project and who kindly corresponded with us. We thank Dr avv. Edoardo Andreaoli for his early contribution to the Italian report. We are also indebted to Professor Silvia Ferreri and to Dr Bianca Gardella Tedeschi for their effective support in the organisation of the Stresa meeting of our group. Finally, we wish to thank Mauro Bussani, General Editor of the Common Core Project, Andrea Pradi, President of the Associazione R. B. Schlesinger per lo Studio del Diritto Europeo, and Luisa Antoniolli, Professor of Comparative Law at the University of Trento, for their tremendous organisational efforts during and in between the Trento meetings.

Michele Graziadei gratefully acknowledges the support of Dr Mara Zilio, Daniela Gentili and Nadia Bovone of the Dipartimento di Scienze giuridiche ed economiche dell'Università del Piemonte orientale for their brilliant and enthusiastic administrative support of the research work. He is also indebted to Dr Cesare Tibaldeschi of the same Department for his exceptional contribution to preparation of the electronic copy of the typescript.

Lionel Smith acknowledges with gratitude the financial support of the Social Sciences and Humanities Research Council of Canada, and the assistance of a number of students of McGill University's Faculty of Law during the period 2001–2004: Edward Bridge, Tal Srulovic, Robert Peterson, Hugo Maureira and, most recently, Luisa Cetina. He also thanks the Swiss Institute of Comparative Law for its generous hospitality during 2004–2005.

Michele Graziadei and Ugo Mattei wish to thank Arianna Pretto at Brasenose College, Oxford for the lovely hospitality and intelligent reading of parts of this book, Amedeo Rosboch and Alberto Gallarati in Turin, Filippo Sartori at Trento, Andrea Ortolani in Turin and Tokyo, and Sabrina Praduroux in Alessandria for helping with energy and enthusiasm whenever involved in this project. They acknowledge with gratitude the financial support of the ISAIDAT in Turin, and of the Ministry of Scientific Research in Italy.

Ugo Mattei gratefully acknowledges the financial support of the Department of Economics of the University of Turin, and of the Fromm Chair in International and Comparative Law at Hastings College of Law.

Contributors to the volume

BENOIT ALLEMEERSCH, Doctoral researcher, Catholic University of Leuven, Belgium, and Attorney-at-Law at the bar of Brussels, Belgium

FRANÇOIS BARRIÈRE, Junior Professor (*maître de conférences*), University of Paris II (Panthéon-Assas), France

SERGIO CÁMARA LAPUENTE, Professor of Civil Law, University of La Rioja, Spain

MERETE CLAUSEN, Attorney-at-Law, Denmark

ANTONIO GAMBARO, Professor of Comparative Private Law, State University of Milan, Italy

CRISTINA GONZÁLEZ BEILFUSS, Professor of Private International Law, University of Barcelona, Spain

GEORG GRAF, Professor of Private Law, University of Salzburg, Austria

MICHELE GRAZIADEI, Professor of Comparative Private Law, University of Eastern Piedmont, Italy

GEORGE L. GRETTON, Lord President Reid Professor of Law, University of Edinburgh, Scotland

STEFAN GRUNDMANN, Professor of Private Law, European and International Private and Business Law, Humboldt University, Berlin, Germany

TORGNY HÅSTAD, Justice of the Swedish Supreme Court and formerly Professor of Private Law, Uppsala University, Sweden

MONIKA HINTEREGGER, Professor of Civil Law, University of Graz, Austria

STEVE JACOBY, Partner, Kremer Associés & Clifford Chance and Lecturer, University of Luxembourg

MARIELLE KOPPENOL-LAFORCE, Attorney-at-Law, Houthoff Buruma NV, Amsterdam, the Netherlands

GEORGE K. LEKKAS, Dr. jur., Attorney-at-Law, Athens, Greece

UGO MATTEI, Professor of Civil Law, State University of Turin, Italy, and Alfred and Hanna Fromm Professor of International and Comparative Law, University of California, Hastings College of Law, USA

NIAMH MOLONEY, Professor of Capital Markets Law, University of Nottingham, England

EOIN O'DELL, Fellow, Trinity College, Dublin, Ireland

PEDRO PAIS DE VASCONCELOS, Professor, University of Lisbon, Portugal

LIONEL SMITH, James McGill Professor of Law, McGill University, Montreal, Canada

JARMO TUOMISTO, Professor of Civil Law, University of Turku, Finland

ALAIN VERBEKE, Professor of Private and Comparative Law, Catholic University of Leuven, Belgium, and Tilburg University, the Netherlands and Attorney-at-Law at the bar of Brussels, Belgium

CHRISTIAN VOGEL, Researcher, Bielefeld University, Germany

DONOVAN W. M. WATERS, QC, FRSC, Emeritus Professor of Law, University of Victoria, Canada and Counsel to Horne Coupar (Barristers and Solicitors), Victoria, Canada

MANUELA WEISSENBACHER, Assistant to the Chair of Civil Law, University of Graz, Austria

Contributors to the case studies

Austria: Georg Graf, Monika Hinteregger and Manuela Weissenbacher

Belgium: Benoit Allemeersch and Alain Verbeke

Denmark: Merete Clausen

England and Wales: Lionel Smith

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Scotland: George L. Gretton

Spain: Sergio Cámara Lapuente and Cristina González Beilfuss

Sweden: Torgny Håstad

Abbreviations

A.2d	Atlantic Reporter (2d series) (US)
AAMN	Anales de la Academia Matritense del Notariado
ABGB	Allgemeines bürgerliches Gesetzbuch
Abs	Absatz
AC	Appeal Cases
act. juris. [in French report, with D.]	Recueil Dalloz actualités jurisprudentielles
Act. proc. coll.	Actualité des procédures collectives
ADC	Anuario de Derecho Civil
AFM	Autoriteit Financiele Martken
AG	Die Aktiengesellschaft – Zeitschrift für das gesamte Aktienwesen
AJCL	American Journal of Comparative Law
AktG	Aktiengesetz of 6 September 1965, 1965 Bundesgesetzblatt part I, 1089
All ER	All England Reports
ALR	Australian Law Reports
AMF	Autorité des marchés financiers
Annales Droit lux.	Annales du droit luxembourgeois
ANVR	Algemeen Nederlands Verbond van Reisondernemingen
AP [in French report]	Assemblée plenière (de la Cour de cassation)
AP [in German report]	Hueck/Nipperdey/Dietz, *Nachschlagewerk des Bundesarbeitsgerichts – Arbeitsrechtliche Praxis*
AP [in Greek report]	Greek Supreme Court in Civil and Criminal Matters

App.	Corte di Appello
App. Cas.	Appeal Cases (1875–90)
Arch. Civ.	Archivio civile
Arch. locazioni	Archivio delle locazioni
Arch. N.	Archeion Nomologias
art.	article
ASCI	Act on the Supervision of Credit Institutions (*Wet Toezicht kredietinstellingen*)
ASCIS	Act on the Supervision of Collective Investment Schemes
ASCS	Act on the Supervision of the Credit System (*Wet Toezicht kredietwezen*)
ASII	Act on the Supervision of Investment Institutions (*Wet Toezicht beleggingsinstellingen*)
ASST 1995	1995 Act on the Supervision of the Securities Trade (*Wet Toezicht Effectenverkeer* 1995)
ATF	Arrêts du Tribunal fédéral suisse
Az.	Aktenzeichen
B & C	Barnewall & Cresswell's Reports (reprinted in ER)
BAG	Bundesarbeitsgericht
BAO	Bundesabgabenordnung
BB	Der Betriebs-Berater
BCC [in Belgian report]	Belgian Civil Code
BCC [in English report]	British Company Law Cases
BCLC	Butterworths Company Law Cases
Beav.	Beaven's Reports (reprinted in ER)
Betr AVG	Gesetz zur Verbesserung der betrieblichen Altersversorgung of 19 December 1974
BG	Bundesgesetz
BGB	Bürgerliches Gesetzbuch of 18 August 1896
BGBl.	Bundesgesetzblatt
BGHZ	Entscheidungen des Bundesgerichtshofs in Zivilsachen
BMJ	Boletim do Ministério da Justiça
BPG	Betriebspensionsgesetz
Bull. civ.	Bulletin civil de la Cour de cassation

Bull. Droit et Banque	Bulletin Droit et Banque
Bull. Joly	Bulletin Joly
Bus. Law.	Business Lawyer
BV	Besloten Vennootschap
B-VG	Bundes-Verfassungsgesetz 1920 idF von 1929
BWG	Bankwesengesetz
CA	Cour d'Appel, Court of Appeal
Cal. L. Rev.	California Law Review
Cass. [in French report]	Cour de Cassation
Cass. [in Italian report]	Corte di Cassazione
Cass. Fr. Com.	French Cour de Cassation, Commercial Chamber
Cass. Fr. Req.	French Cour de Cassation, Chambre des Requêtes
CBFSAI	Central Bank and Financial Services Authority of Ireland
CC	Civil Code
C. civ.	Code civil
C. com. [in French report]	Code de commerce
C. com. [in Spanish report]	Código de comercio
CC Proc.	Greek Code of Civil Procedure
CCSM	Continuing Consolidation of the Statutes of Manitoba
cf.	compare
Ch. [in English report]	Chancery Division Reports
Ch. [in French report, with D.]	Recueil Dalloz Chroniques
Ch. D.	Chancery Division Reports (1875–90)
Civ.	French Cour de Cassation, Civil Chamber (First, Second or Third)
CJ	Colectânea de Jurisprudência
CLJ	Cambridge Law Journal
CMLR	Common Market Law Review
C. mon. et fin.	Code monétaire et financier
CMVM	Código do Mercado dos Valores Mobiliários
CNMV	Comisión nacional del mercado de valores
Col. J. Eur. L.	Columbia Journal of European Law
Com. C.	Commercial Code

Contrats, conc., consom.	Contrats, concurrence, consommation (journal)
Contr. e impr.	Contratto e impresa
Conv.	Conveyancer and Property Lawyer (legal periodical)
Cornell LQ	Cornell Law Quarterly
Corr. giur.	Il corriere giuridico
CPEREF	Código dos Processo especiais de Recuperação da Empresa e da Falência
Cr. & Ph.	Craig and Phillips' Reports (reprinted in ER)
Crim. LR	Criminal Law Review
CSSF	Commission de Surveillance du Secteur Financier
CVM	Código dos Valores Mobiliários
D. [in French report]	Recueil Dalloz
D. [in Greek report]	Diki
D [in Scottish report]	Dunlop's Session Cases
D. [year] Ch. [in French report]	Recueil Dalloz Chroniques
D. Aff.	Dalloz affaires
DB	Das Betrieb
DCB	Dutch Central Bank (*De Nederlandse Bank*)
Def.	Répertoire du notariat Defrénois
DepG	Depotgesetz
Dir. comm. int.	Il diritto del commercio internazionale
Dir. fall.	Il diritto fallimentare
Diss.	dissertation
DJT	Deutscher Juristentag
DKK	Danish kroner
d. lgs.	decreto legislativo (legislative enactment)
DLR	Dominion Law Reports (Canada)
DNotZ	Deutsche Notar-Zeitschrift Verkündungsblatt der Bundesnotarkammer
Doc. Parl.	Parliamentary Documents
DP	Dalloz Périodique
DSII	Decree on the Supervision of Investment Institutions (*Besluit Toezicht Beleggingsinstellingen*)
DSST 1995	1995 Decree on the Supervision of the Securities Trade (*Besluit Toezicht Effectenverkeer* 1995)

DULJ (ns)	Dublin University Law Journal (new series)
ECOJ	European Community Official Journal, two parts (L and C)
ecolex	Fachzeitschrift für Wirtschaftsrecht
Edin. LR	Edinburgh Law Review
EEA	European Economic Area
E. Emp. D.	Epitheorisis tou Emporikou Dikaiou
EEN	Epitheorisis Hellinon Nomikon
Ef.A	Efetio Athinon
EGBGB	Einführungsgesetz zum Bürgerlichen Gesetzbuch
Ef.	Greek Court of Appeal
Enc. dir.	Enciclopedia del diritto
EPEY	Company Providing Investment Services (Greece)
Eq. Cas. Abr.	Equity Cases Abridged (reprinted in ER)
ER	English Reports
ERPL	European Review of Private Law
EU	European Union
Europa e dir. priv.	Europa e diritto privato
EvBl	Evidenzblatt der Rechtsmittelentscheidungen in Österreichische Juristen-Zeitung
EWHC	England and Wales High Court Cases
EzA	Entscheidungssammlung zum Arbeitsrecht
F	Fraser's Session Cases
F.2d	Federal Reporter, Second series (US)
Fallimento	Il fallimento
FCP	fonds commun de placement
FEfA	Athens Court of Appeal for Tax Litigation
FFFS	Finansinspektionens författnings samling
FLR	Family Law Reports
Foro it.	Il foro italiano
FRMSST 2002	Further Regulations on Market Conduct Supervision of the Securities Trade 2002 (*Nadere regeling gedragstoezicht effectenverkeer* 2002)
FRSST 1999	Further Regulations on the Supervision of the Securities Trade (*Nadere regeling toezicht effectenverkeer* 1999)

FRST 2002	Further Regulations on Prudential Supervision of the Securities Trade 2002 (*Nadere regelgeving prudentieel toezicht effectenverkeer* 2002)
FSA	Financial Services Authority
FSMA	Financial Services and Markets Act 2000
FSR	Fleet Street Reports
FTH	Fondos de Titulización Hipotecaria
Gaz. pal.	La gazette du palais
Ges RZ	Der Gesellschafter
Giur. comm.	Giurisprudenza commerciale
Giur. it.	La giurisprudenza italiana
Giust. civ.	La giustizia civile
Gmb. H.	Gesellschaft mit beschränkter Haftung
GRAMF	General Regulation of the AMF
GWD	Green's Weekly Digest
Harm.	Harmenopoulos
HC	High Court (Ireland)
Hellin.Dni	Helliniki Dikaiosini
HGB	Handelsgesetzbuch
HKC	Hong Kong Cases
HL	Judicial Committee of the House of Lords
HR	Hoge Raad
Hrsg.	Herausgeber
HS	Handelsrechtliche Entscheidungen
IATA	International Air Transport Association
ICLQ	International and Comparative Law Quarterly
I. d. F.	in der Fassung
IIA	Investment Intermediaries Act
ILRM	Irish Law Reports Monthly
ILTR	Irish Law Times Reports
InvFG	Investmentfondsgesetz
IR [in French report, with D.]	Recueil Dalloz Informations Rapides
IR [in Irish report]	Irish Reports
ISP	Instituto dos Seguros de Portugal
JBl	Juristische Blätter
J.comp. Leg. and Int.L.	Journal of Comparative Legislation and International Law

JCP éd. E	La Semaine Juridique édition entreprise et affaires
JDI	Journal du droit international
Jdt	Journal des Tribunaux
JherJB	Jherings Jahrbücher für die Dogmatik des bürgerlichen Rechts
J. Int'l Tr. Corp. Plan.	Journal of International Trusts and Corporate Planning
JO	Journal Officiel du Grand-Duché de Luxembourg
JOR	Jurisprudentie ondernemingsrecht
JTCP	Journal of International Trust and Corporate Planning
JW	Juristiche Wochenschrift
JZ	Juristen-Zeitung
KAGG	Gesetz über Kapitalanlagegesellschaften of 14 January 1970
KB	King's Bench Division Reports
KKO	Korkein oikeus
KO	Konkursordnung
KSchG	Konsumentenschutzgesetz
KWG	Gesetz über das Kreditwesen of 11 July 1985
LC	Lord Chancellor
Ld. Raym.	Lord Raymond's Reports (reprinted in ER)
lett.	letter
Lit.	litera
Lloyd's Rep.	Lloyd's Law Reports
Lloyd's Rep. Banking	Lloyd's Law Reports (Banking Cases)
LMV	Ley del Mercado de Valores
LQR	Law Quarterly Review
LRI	Law Reports (Ireland)
LSA	Ley de Sociedades Anónimas
M	Macpherson's Session Cases
Mass. giur. lav.	Massimario di giurisprudenza del lavoro
MDR	Monatsschrift für Deutsches Recht
MFPA	Athens Court of First Degree for Tax Litigation
MietSlg	Mietrechtliche Entscheidungen
MPA	Athens Court of First Degree

mwN	mit weiteren Nachweisen
NCL Rev.	North Carolina Law Review
NCPC	Nouveau code de procédure civile
Necigef	Nederlands Centraal Instituut voor Giraal Effectenverkeer BV
NJ	Nederlandse jurisprudentie
NJA	Nytt Juridiskt Arkiv
NJW	Neue Juristische Wochenschrift
NJW-RR	NJW-Rechtsprechungs-Report Zivilrecht
NoB	Nomikon Vima
Non-UCITS	collective investment schemes other than UCITS
NotC	Código do Notariado
NSWLR	New South Wales Law Reports (Australia)
NV	Naamloze Vennootschap
Nw. U. L. Rev.	Northwestern University Law Review
NYU L. Rev.	New York University Law Review
NZ	Österreichische Notariats-Zeitung
NZA	Neue Zeitschrift für Arbeits- und Sozialrecht – Zweiwochenschrift für die betriebliche Praxis
ÖBA	Österreichisches Bankarchiv
obs.	observations
OGH	Oberster Gerichtshof
Oxford J. Leg. Stud.	Oxford Journal of Legal Studies
Pas.	Pasicrisie luxembourgeoise
PC	Judicial Committee of the Privy Council
PIF	Pensionsinvestmentfonds
PPR	Plano de Poupança-Reforma
Prop.	Proposition (a government's bill presented to the Swedish parliament)
PSW	Pensioen- en Spaarfondsenwet
QB	Queen's Bench Division Reports
QBD	Queen's Bench Division
Quot. jur.	Quotidien juridique
R	Rettie's Session Cases
RAO	Rechtsanwaltsordnung
Rass. dir. civ.	Rassegna di diritto civile
RCDIP	Revue critique de droit international privé
r.d.	regio decreto

RD	Real Decreto
r.d.l	Regio decreto legge
Req	Chambre des Requêtes (Cour de Cassation)
Resp. civ. prev.	Responsabilità civile e previdenza
Rev. proc. coll.	Revue des procédures collectives
RG	Reichsgericht
RGBL	Reichsgesetzblatt
RGICSF	Regime General das Instituições de Crédito e das Sociedades Financeiras
RGZ	Entscheidungen des Reichsgerichts in Zivilsachen
Riv. dir. civ.	Rivista di diritto civile
Riv. dir. impresa	Rivista di diritto dell'impresa
Riv. dir. int. priv. proc.	Rivista di diritto internazionale privato e processuale
Riv. giur. sarda	Rivista giuridica sarda
Riv. soc.	Rivista delle società
RTD civ.	Revue trimestrielle de droit civil
RTD com.	Revue trimestrielle de droit commercial
Rz	Rundzahl
S	Sirey
SB	Securities Board of the Netherlands (*Stichting Toezicht Effectenverkeer*)
SC [in Irish report]	Supreme Court
SC [in Scottish report]	Session Cases
SCC	Supreme Court of Canada
Sch. & Lef.	Scholes & Lefroy Law Reports
SchVG	Gesetz betreffend die gemeinsamen Rechte der Besitzer von Schuldverschreibungen of 4 December 1899
SCR	Supreme Court Reports (Canada)
Sel. Cas. T. King	Select Cases in the Time of Lord Chancellor King (reprinted in ER)
SGTA 1977	1977 Securities Giro Administration and Transfer Act (*Wet Giraal Effectenverkeer* 1977)
SI	Statutory Instrument
SICAV [in French and Luxembourg reports]	société d'investissement à capital variable

SICAV [in Italian report]	società di investimento a capitale variabile
SICAV [in Portuguese report]	sociedade de investimento de capital variável
SLT	Scots Law Times
SMEs	small and medium-sized enterprises
Soc	French Cour de Cassation, Social Chamber
Società	Le società
Somm.	Sommaires (part of Revue Dalloz)
SPV	special purpose vehicle
Stan. L. Rev.	Stanford Law Review
Stbl.	Staatsblad
Stcr.	Staatscourant
STJ	Supremo Tribunal de Justiça
STS	Sentencia del Tribunal Supremo
STSJ	Sentencia del Tribunal Supremo de Justicia
SZ	Entscheidungen des österreichischen Obersten Gerichtshofes in Zivil- (und Justizverwaltungs-) sachen
T.	Tribunale
T & AT	Trusts e attività fiduciarie
TA	Tribunal d'Arrondissement
Tex. L. Rev.	Texas Law Review
TR Évora	Tribunal da Relação de Évora
Trib.	Tribunale
Trib. Arb.	Tribunal Arbitral
Tr/Trs	Trustee/Trustees
Trust L. Int.	Trust Law International
UCITS	Undertakings for Collective Investment in Transferable Securities
VABEF	Vereenvoudigde Administrative en Bewaring Effecten
Vand. J. Trans. L.	Vanderbilt Journal of Transnational Law
VersR	Versicherungsrecht, Juristische Rundschau für die Individualversicherung
Ves.	Vesey's Reports (reprinted in ER)
Vita not.	Vita notarile
WLR	Weekly Law Reports
WM	Zeitschrift für Wirtschafts- und Bankrecht, Wertpapier-Mitteilungen

WTLR	Wills and Trusts Law Reports
Z	Zahl, Ziffer
ZBB	Zeitschrift für Bankrecht und Bankwirtschaft
ZPO	Zivilprocessordnung
Zeup	Zeitschrift für Europäisches Privatrecht

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PART I · SETTING THE SCENE

1 Commercial trusts in European private law: the interest and scope of the enquiry

MICHELE GRAZIADEI, UGO MATTEI
AND LIONEL SMITH

1 The interest and scope of the enquiry

The topic to which this book is dedicated is of great interest for anybody concerned with the expanding field of European private law. In several European countries business transactions commonly require the use of trusts. The litigation of trust law issues in a business context is becoming more frequent than in the past. At the European level, legal instruments enacted by the European Community make explicit reference to trusts,[1] or regulate transactions involving both trusts and other investment vehicles.[2] Principles of European Trust Law,[3] drafted by a distinguished group of scholars, are now available to provide guidance on the development of trust law in European jurisdictions. At the international level, the Hague Convention of 1 July 1985 on the Law Applicable to Trusts and on their Recognition

[1] Council Regulation (EC) No. 44/2001 of 22 December 2000, on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, arts. 5(6), 23(4), 23(5), 60(3); *Webb* v. *Webb* [1994] ECR I-1717 (ECJ); see also: Regulation (EC) No. 805/2004 of 21 April 2004, creating a European enforcement order for uncontested claims; Communication from the Commission on the transfer of small and medium-sized enterprises (98/C 93/02). On Community measures to combat criminal activities which may deploy a number of legal institutions, including trusts, for money laundering purposes, see especially the Council Directive of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering (91/308/EEC), as amended.

[2] See Cases 5 and 9 below, which involve the implementation at the national level of Council Directive 85/611/EEC of 20 December 1985, as amended, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

[3] D. J. Hayton, S. C. J. J. Kortmann, H. L. E. Verhagen, eds., *Principles of European Trust Law* (The Hague, Deventer, 1999).

has entered into force in several countries,[4] providing much-needed solutions to conflicts problems raised by trusts, but also posing fresh questions on its impact and its implementation.

The great practical importance of the subject closely matches its burning academic interest. Trusts straddle the law of property and the law of personal obligations. Located at the intersection of core categories of private law, they pose problems that turn on the proper understanding of fundamental notions of private law. From the academic point of view, trusts also raise essential questions about competing claims to property, as well as about the management of property in the broadest sense. Both sets of questions involve hotly debated subjects.

Last, but not least, trusts are familiar features of the legal landscape of the English-speaking world but, on the other hand, they are less than familiar in most civilian jurisdictions. Today it would be wrong to consider trusts a distinctive feature of the common law world, because mixed legal systems have trusts[5] and several civilian jurisdictions show important developments in this regard.[6] Nonetheless, it is still true that one can hardly imagine how to deal with, for example, English law, without running sooner or later into an issue of trust law. The same is not necessarily true in many other countries, including several major European jurisdictions. This is why, far from being a neglected field among comparative law scholars, the law of trusts has been frequently investigated in comparative perspective.

Within the comparative law field, the present book adopts a new approach to the subject, in terms both of method and of scope of enquiry. The scope of enquiry is limited to trusts operating in the business context. This means that the use of trusts in fields like the

[4] For a full status report on the Convention see the Hague Conference website: http://www.hcch.net. The states which have most recently ratified or acceded to the Convention are Luxembourg (2003), Liechtenstein (2004) and San Marino (2005).

[5] Cf. Tony Honoré, 'Trusts: The Inessentials', in Joshua Getzler, ed., *Rationalising Property, Equity and Trusts. Essays in Honour of Edward Burn* (London, 2003), 7 ff.; J. M. Milo and Joan M. Smits, eds., *Trusts in Mixed Legal Systems* (Nijmegen, 2001). Vernon V. Palmer, ed., *Mixed Jurisdictions Worldwide. The Third Legal Family* (Cambridge, New York, 2001), provides a broad view of the field.

[6] For a comprehensive collection of texts: Maurizio Lupoi, ed., *Trusts Laws of the world*, 3rd edn (Rome, 2000). After the publication of this collection, Luxembourg amended its law on *la fiducie* in 2003: see Paul Matthews, 'Fiducie and the Hague Trusts Convention: The New Luxembourg Law', (2003) Trust L. Int. 188. Several recent developments in civil law or mixed legal systems are discussed in Maurizio Lupoi, *Trusts: A Comparative Study* (Cambridge, 2000), 267 ff.; see also Alon Kaplan, ed., *Trusts in Prime Jurisdictions* (The Hague, 2000); John Glasson, ed., *International Trust Laws* (London, New York, 1992).

law of non-profit organisations, matrimonial property and succession is not covered in this book. Here the focus is on inter vivos transactions that in many European legal systems are the province of contract law, or that require the use of investment vehicles usually established under company law, but that would be characterised as trusts in other European countries like England, Wales, Ireland or Scotland.[7] The decision to investigate trusts in the setting of inter vivos transactions conducted for commercial purposes reflects the current state of the European private law debate and its concentration on the role of party autonomy in market integration.[8] This is also the reason why the subject is, for the first time, covered for fifteen Member States of the European Community.

This volume does not offer a general comparative treatment of the law of trusts as that subject is commonly understood in anglophone countries. Yet, our terminological choice is less arbitrary than it may appear at first sight, considering also that the English term has no special status in a work covering the laws of several European countries.[9]

In setting the scene for the comparative discussion of the national laws, part I of the volume introduces the reader to the subject by providing a critical overview of the comparative literature on trusts, and by expanding on common core methodology as applied to this field. The main issues of traditional divergence among legal systems about trusts are thus surveyed with the intent of examining the state of the art about trusts in comparative perspective, thereby providing the general background of the present work.

[7] In this volume, even where Wales is not separately mentioned, references to 'England' and 'English law' refer to England and Wales and the law of England and Wales.

[8] Wills and succession rules, just like matrimonial property regimes, on the other hand, pose problems related to the free circulation of persons in Europe. On the first topic see the study prepared in 2002 by the Deutsche Notarinstitut for the European Commission, *Étude de droit comparé sur les règles de conflits de juridictions et de conflits de lois relatives aux testaments et aux successions dans les Etats membres de l'Union Européenne* (scientific coordination by Paul Lagarde and Heinrich Dörner). The document is available at the following website: http://europa.eu.int/comm/justice_home/news/events/document/rapport_synthese_etude_fr.pdf.

[9] Even under English law, 'trust' is a protean word: *Tito* v. *Waddell (No. 2)* [1977] Ch. 106, at 227, per Megarry VC: 'the first question is the sense in which that protean word has been used. The word, indeed, is one that may be found by the unwary to invite the comment Qui haeret in litera haeret in cortice.'

2 A brief survey of comparative literature and problems

2.1 History, concepts and functional analysis

Comparative law literature on trusts is about a century old. Its focus has changed over time. This section will provide a short account of the transformation. The following survey breaks down into four parts. The first explores the beginnings of academic interest in the topic and the development of functional approaches to the comparative study of trust law; the second covers comparative work conducted to solve conflict of laws issues before national courts; the third deals with comparisons of trust laws to advance unification projects; and the fourth deals with the emergence of a comparative literature dedicated to trusts in the financial context.

Academic interest in the comparative treatment of trusts developed a little more than a century ago, when the history of English law was for the first time investigated by scholars who, at about the same time, established legal history as an academic discipline. In that intellectual climate, while the historical origins of English law were investigated on both sides of the Channel by the first generation of professional legal historians, trusts became a test case to appraise the originality of English law vis-à-vis both the Roman law legacy and the Germanic roots of continental legal systems. The story has been told in more detail elsewhere:[10] whereas previous accounts of the history of trusts in England advanced the thesis that English law was largely indebted to ideas and institutions of Roman origins, like *fideicommissa*, or to the Germanic world, being in substance a local variety of Germanic institutions, like the *Salman*, no less a scholar than Frederic William Maitland chose trusts as one of the best examples of the need to study English law and legal history on their own terms. Maitland collected the English sources available at that time on the history of uses and trusts and concluded that they did not univocally point in one direction, namely the European continent. He observed that in continental Europe no legal institution possessed quite the same features as English trusts.[11]

We do not know what conclusions Maitland would have reached if he had known the law of *confidentia* and *fiducia* of several areas of

[10] Michele Graziadei, ‘Changing Images of the Law in Nineteenth Century English Legal Thought (the Continental Impulse)’, in Matthias Reimann, ed., *The Reception of Continental Ideas in the Common Law World* (Berlin, 1993), 115, esp. at 159 ff.

[11] Frederic William Maitland, *The Origin of Uses*; Maitland, *Moral Personality and Legal Personality*; Maitland, *The Unincorporate Body*, all reprinted in H. A. L. Fisher, ed., *The Collected Papers of Frederic William Maitland* (Cambridge, 1911), vol. II, 403 ff.; vol. III, 304 ff., 271 ff.

continental Europe flourishing from the sixteenth century to the eighteenth century, as well as its earlier manifestations.[12] By now it is clear, however, that much of the actual historical experience in this neglected field, and its relevance to the comparative study of the English law of trusts, eluded his attention. In any case, Maitland's research on trusts quickly became the twentieth-century cornerstone of influential comparative work. That work assumed that the English law of trusts was unique. Hence, the correct way to address the topic from a comparative stance was to look for institutions that on continental Europe performed some of the tasks which under English law were performed by trusts. In this context, the focus was mostly on trusts created by valid expressions of the settlor's will, as opposed to trusts serving the purposes of an emerging law of restitution and unjust enrichment.

Looking back to the early days of the comparative study of trusts, it is easy to underestimate the task facing comparative lawyers approaching trusts for the first time. In common law jurisdictions, the topic is vast. The sheer number of precedents on trusts constitutes a formidable challenge even for many dedicated researchers. The language of those precedents and of the relevant legislation is less than familiar to scholars trained in the general jurisprudence of continental legal systems, where the distinction between law and equity plays an altogether different role and is not rooted in the jurisdictional divide between courts of law and courts of equity.[13] Furthermore, the lively doctrinal controversy over the

[12] For analysis of several of the relevant *jus commune* sources: Michele Graziadei, 'The Development of Fiducia in Italian and French Law from the 14th Century to the End of the Ancien Régime', in Richard Helmholz and Reinhard Zimmermann, eds., *Itinera Fiduciae. Trust and Treuhand in Historical Perspective* (Berlin, 1998), 237; Maurizio Lupoi, 'The Civil Law Trust', 32 Vand. J. Trans. L. 967 (1998); Ferdinando Treggiari, *Minister ultimae voluntatis*, I (Naples, 2002), devotes to the examination of these sources an entire book (in Italian) from the standpoint of the legal historian. Sergio Cámara Lapuente, *La fiducia sucesoria secreta* (Madrid, 1996), covers several important sources related to the topic as well. Maurizio Lupoi, *I trust nel diritto civile* (Turin, 2004), devotes over 200 pages to the comparative study of English and continental sources, which shed yet more light on the history of trusts on both sides of the Channel. The essays by George Gretton, Richard Helmholz, Shael Herman and Michael McNair in the volume edited by Helmholz and Zimmermann greatly undermine as well any insular view of the history of the subject. In the same vein, see Patrick Glenn, 'The Historical Origins of the Trust', in Mordechai Rabello, ed., *Aequitas and Equity: Equity in Civil Law and Mixed Jurisdictions* (Jerusalem, 1997), 749 ff.

[13] For a rich set of studies on equity and the law in several legal systems: Rabello, ed., *Aequitas and Equity*; with specific regard to France: Vernon V. Palmer, 'From Embrace to Banishment: A Study of Judicial Equity in France', 47 AJCL 227 (1999).

nature of the beneficiary's interest,[14] which engaged some of the most brilliant common law minds while comparative research on trusts was taking off, inevitably stimulated some conceptual responses to basic questions such as: what is a trust? who owns trust property? In the light of that controversy, it is hardly surprising that the first wave of comparative literature on trusts looked for order and clarity by proceeding first to answer the conceptual question concerning the nature of trusts and of the beneficiary's interest, then to research the functional equivalents and the mechanics of trusts. The search for conceptual clarity was, however, often frustrated by the poor quality of the tools deployed in the analysis. In the trust context, basic jurisprudential notions like 'ownership' or 'obligation' have unexpected meanings. Working on trusts, comparative lawyers have learned that familiar words can easily become traps for the unwary. Refined conceptual analysis of trusts requires a thorough search for the complex denotation of each notion employed to describe trust relationships – it is no coincidence that analytical thinkers like Hohfeld first tested their skills on trusts.[15] But such analysis was never developed by the first comparative lawyers who approached the subject. Instead, they relied on the analysis of the nature of the beneficiary's interest in terms of property or obligation, hardly questioning the meaning of those concepts in the context of the law of trusts,[16] or they proposed to fit the notion within the framework of other general concepts (like legal personality) familiar to lawyers based in continental Europe as well. The first trend of comparative thought thus spread the idea that trusts were a special form of ownership, whereby the same asset was owned by two or more owners.[17] On the other hand, the possibility to resort to 'obligation' as the best category to analyse the trust concept did not receive wide acceptance in comparative

[14] Of lasting value on that controversy: Donovan M. Waters, 'The Nature of the Trust Beneficiary's Interest', 45 Canadian Bar Rev. 217 (1967).

[15] Wesley N. Hohfeld, 'The Relations Between Equity and Law', 9 Michigan L. Rev. 537 (1913); Hohfeld, 'The Conflict of Law and Equity', 26 Yale LJ 767 (1917).

[16] For critical reactions to the limitations of that approach see now: Antonio Gambaro, 'I trusts e l'evoluzione del diritto di proprietà', in Ilaria Beneventi, ed., *I trusts in Italia oggi* (Milan, 1996), 57 ff.; Lupoi, *Trusts: A Comparative Study*, fn. 6, pp. 187 ff.

[17] See, e.g., Remo Franceschelli, *Il 'trust' nel diritto inglese* (Padua, 1935). Some proposals to introduce trusts in civilian jurisdiction argue that this special form of ownership could become a new type of real right: Matthias E. Storme, 'La confiance est bonne, mais un dual ownership est préférable', in Jacques Herbots and Denise Philippe, eds., *Le trust et la fiducie. Implications pratiques* (Brussels, 1997), 267 ff. Countless works by common law authors provide prima facie support for a view of trusts which relies on double ownership as a key feature of trusts. See, e.g., Kevin J. Grey and Susan Grey, *Elements of Land Law*, 3rd edn (London, 2001), 81 ff.

literature on trusts, possibly because it ran contrary to the (by then) prevailing common sense among leading trust law scholars in England and in the US.[18] The second main trend of thought considered trusts as an example of 'segregation of assets from the patrimonium of individuals, and a devotion of such assets to a certain function, a certain end'.[19] This analysis ultimately evolved into the idea that trusts were legal persons,[20] though, of course, the prevailing view of the institution in common law jurisdictions avoids collapsing trusts into legal personality. Meanwhile, on the European continent, the perception that trusts posed intractable conceptual problems slowly shifted academic interest in the subject from jurisprudential debates over the proper doctrinal definition of trust

[18] Like Geoffrey Cavalier Cheshire and Austin Wakemann Scott. See now, however, Lupoi, *Trusts: A Comparative Study*, fn. 6, pp. 2–3, 187 ff., and Stefan Grundmann, 'Trust and Treuhand at the End of the 20th Century. Key Problems and Shift of Interests', 47 AJCL 401 (1999). Both comparative studies advance the obligational approach to trusts. Note that academics, from James Bar Ames, 'Purchase for Value without Notice', 1 Harvard L. Rev. 1 (1887–8) at 9, to David J. Hayton, *Underhill and Hayton: Law of Trusts and Trustees*, 16th edn (London, 2003), 3 ff., 36 ff. have either argued that the obligational approach is to be preferred, or that it cannot be marginalised. What if continental lawyers approaching trusts considered them as examples of split ownership for no other reason than the desire to 'exoticise' the object of their study?

[19] Pierre Lepaulle, 'An Outsider's View Point of the Nature of Trusts', 14 Cornell LQ 52 (1928), 55. Donovan M. Waters, 'Unification or Harmonization? Experience with the Trust Concept', in *Conflits et Harmonisation – Mélanges en l'Honneur d'Alfred E. von Overbeck* (Fribourg, 1990), 591, 600–601, notes that Lepaulle's opinion inspired the drafters of the Civil Code of Québec arts. 1261–1262, on *la fiducie* / the trust. Under those articles *la fiducie / the trust* is 'un patrimoine d'affectation autonome et distinct', that is made up of 'biens qu'il [le constituant] affecte à un fin particulière' / 'a patrimony by appropriation, autonomous and distinct', that is made up of 'property ... which he [the settlor] appropriates to a particular purpose'.

[20] Pierre Lepaulle, 'La notion de trust et ses applications dans les divers systèmes juridiques', in *Actes du Congrès international de droit privé, II, L'unification du droit*, Unidroit (Rome, 1951), 197, 206 ff.; Lepaulle, 'Débats', in J.-D. Bredin, 'L'évolution du trust dans la jurisprudence française', in *Travaux du comité français de droit international privé, 1973–1975* (Paris, 1977), 137, at 153. This conception lurks behind the notion of 'domicile of a trust', first introduced into English law in 1978, upon the accession of the UK to the Brussels Convention on Jurisdiction and Enforcement of Judgments of 1968. Interestingly, making trusts into legal persons was one of the possibilities considered during the works for the new Québec Civil Code: Waters, 'Unification or Harmonization?', 600–601; see now Madeleine Cantin Cumyn, 'La fiducie, un nouveau sujet de droit?', in Jacques Beaulne, ed., *Mélanges Ernest Caparros* (Montreal, 2002), 131. The same idea is now discussed in common law circles: cf. Sara Worthington, 'The Commercial Utility of the Trust Vehicle', in David J. Hayton, ed., *Extending the Boundaries of Trusts and Similar Ring-Fenced Funds* (The Hague, London, New York, 2002), 135 ff., 152 ff.; for critical observations on this point: Donovan M. Waters, 'The Institution of the Trust in Civil and Common Law', in *Collected Courses of the Hague Academy of International Law*, 252 (1995), 113 ff., 421 ff.

relationships to public policy and functional analysis. The roots of these approaches were already present in Maitland's essays on trusts,[21] which examined, inter alia, the relationship between trusts and legal personality. Others looked in this direction as well. Lepaulle provided a rich illustration of the various functions performed by trusts in different contexts.[22] He compared the role played by civilian institutions in similar settings, pointing to the shortcomings of the civilian solutions. The list of civil law substitutes of trusts analysed by Lepaulle is by now familiar to all comparative lawyers who take an interest in trusts. It comprises general powers of attorney, foundations, associations, gifts *sub modo*, etc.[23] The discussion of functional substitutes of trusts became prominent in the second half of the twentieth century with Hein Kötz's *Trust und Treuhand*.[24] After that, a number of publications explored the same theme, which now features also in very recent contributions on trusts in comparative perspective.[25] Mentioning these developments, one could incidentally note that reflections on the common law experience with trusts did at times inspire solutions which were incorporated into the law of civilian jurisdiction without much trouble, thanks to the role played by legal authors as hidden legislators.[26] In any case, functional analysis of trusts called for open discussion of the policy issues involved in recognising the legal form. These discussions, however, quickly bifurcated into conflicting views of the policy considerations in favour or against trusts. On one side, the

[21] Maitland was the first to note that trusts had historically provided an alternative to incorporation in England (above, note 11). For an in-depth study of an important chapter of that history: Bernard Rudden, *The New River: A Legal History* (Oxford, 1985). Note that trusts can be treated as subjects for fiscal purposes.

[22] Pierre Lepaulle, *Traité théorique et pratique des trusts en droit interne, en droit fiscal et en droit international* (Paris, 1932), ch. 2.

[23] See Jeffrey A. Schoenblum, *Multistate and Multinational Estate Planning*, I, 2nd edn (Gaithersburg, NY, 1999), 1247 ff., paras. 18.03 ff.; Rudolf B. Schlesinger et al., *Comparative Law*, 6th edn (Mineola, New York, 1998), 868 ff. William F. Fratcher, 'Trust', in *International Encyclopedia of Comparative Law*, VI (Tübingen, The Hague, Paris, 1973) ch. 11, paras. 124 ff.; see also W. A. Wilson, ed., *Trusts and Trustlike Devices* (London, 1981).

[24] Hein Kötz, *Trust und Treuhand: Eine Rechtsvergleichende Darstellung des anglo-amerikanischen Trust und funktionsverwandter Institute des deutschen Rechts* (Göttingen, 1964).

[25] See e.g. the contributions collected in Hayton et al., *Principles of European Trust Law*; Madeleine Cantin Cumyn, ed., *La fiducie face au trust dans les rapports d'affaires* (Brussels, 1999).

[26] Thus, for example, both German and Italian authors studied the English law of trusts to develop their own law on *Treuhand* and *fiducia*. Among the influential works of the twentieth century see, e.g., Wolfgang Siebert, *Das rechtegeschaftliche Treuhandverhältnis: ein dogmatischer und rechtsvergleichender Beitrag zum allgemeinen Treuhandproblem* (Marburg, 1933); Piergiusto Jaeger, *La separazione del patrimonio fiduciario nel fallimento* (Milan, 1968).

compatibility of trusts with basic rules enacted by the civil codes was defended on the basis of the existence of various civil law substitutes for trusts. Surely trusts – like contracts – could be contrary to mandatory provisions of law in some cases, but the number of trust substitutes existing in civil law countries abundantly proved that the trust form *per se* did not violate fundamental principles of law of those systems.[27] On the other side, it was argued that the trust form *per se* contravened those principles.[28] Trusts were thus held to be contrary to principles like the unitary nature of ownership, the unity of the patrimony, the *numerus clausus* of real rights, etc. The policy arguments backing these principles were essentially the necessity of preserving marketability of titles and safeguarding creditors from the effects of conveyances upon trusts.

With hindsight, it is all too easy to spot the blind corner of these different approaches. Is it correct to assume that common law jurisdictions have not developed a policy in favour of marketability of titles? Is the *numerus clausus* of real rights unknown in England, or in other common law jurisdictions? Are creditors liable to be defeated by hidden dispositions of property in England, or in other common law jurisdictions? Is it correct to assume that creditors are not protected under English law, or in other common law jurisdictions? Quite obviously, the answer to these questions is a plain 'no'! True, the answer often comes with explanations framed in terms that are alien to civilian minds. The source of the trouble does not lie here, however. The problem is that the comparative literature on trusts has rarely addressed these simple questions. If the same passion that was spent on studying technical aspects of trust law had been devoted to questions like these we would have a more reliable overall comparative picture of the field of enquiry. We could then more easily concentrate on statutory innovations that in the offshore world, as well as in some other jurisdictions, pose some serious policy problems.[29]

[27] This was basically the point first advanced by Lepaulle in his various writings.

[28] See e.g. Henri Batiffol, 'Trusts – The Trust Problem as Seen by a French Lawyer', (1951) 33 J. Comp. Leg. and Int. L., parts III and IV, 18.

[29] Several offshore jurisdictions (starting with the Cook Islands in 1989), and some jurisdictions not belonging to the offshore world, severely restrict the possibility of reaching assets transferred to trustees. Trustees (and, possibly, beneficiaries) based in those jurisdictions are thus effectively shielded from the claims of the transferor's creditors. On the risks involved in such transfers, see Duncan E. Osborne and Elisabeth M. Schurig, eds., *Asset Protection: Domestic and International Law Tactics* (St. Paul, Minn., 1993). For other concerns regarding more generally the transparency of activities based

2.2 Conflict of laws in the field of trusts, and the impact of the 1985 Hague Trusts Convention

Of course, courts based in continental Europe never refused to decide cases on trusts simply because such a reliable overall picture was lacking. Trusts in continental Europe were never solely a matter of pure academic speculation. Part of the literature on trusts (inspired by comparative preoccupations) is thus linked to the litigation of trust issues before the courts of various civil law jurisdictions.[30] Decisions rendered on those issues show that civil law courts by no means regularly denied effect to trusts governed by English law, or the law of other common law countries. For civilian courts, as well as for conflicts scholars based in continental Europe, the challenge posed by trusts was essentially how to handle concepts ignored by the lex fori, and how to govern the resulting uncertainty. Though the outcome of litigated cases often shows willingness to give effect to trust provisions, the tendency to assimilate trusts to other institutions of the lex fori frequently led to ad hoc reasoning. Inter vivos trusts were thus often considered as contractual hybrids, coupling aspects of several contracts. Trustees of trusts operating upon the testator's death were assimilated to testamentary executors, or to fiduciary administrators. On some occasions, civilian courts located title to trust assets in the trustee, but they also asserted that the trustee was not really the owner of the trust assets. On other occasions, they held that the beneficiaries were the owners of trust assets and the trustee was a mere agent. This variety of approaches does not reflect the obvious fact that different trust instruments set up different trusts; it rather shows the risks inherent in the temptation of looking at trusts through the lenses provided by the local law.

From a common law perspective, this distorted approach to trusts is clearly unsatisfactory. Of course, the situation is worst where the local law simply fails to provide the rules that in a common law jurisdiction would govern the case. But even where such mishap is avoided, thanks

in offshore financial centres: Peter Hay, 'Information Exchange and the Offshore Financial Centres', in Hayton, *Extending the Boundaries of Trusts*, 373 ff.

[30] On this litigation see in general: Jonathan Harris, *The Hague Trusts Convention: Scope, Application and Preliminary Issues* (Oxford, 2002), 330 ff.; David J. Hayton, 'Trusts under Civil Law Jurisdictions', in Charles G. Stephenson, K. Bruce Friedman, Nicholas J. Freud, eds., *International Estate Planning* (New York, 1997); Kurt Lipstein, 'Trusts', in *International Encyclopedia of Comparative Law*, III (Tübingen, Dordrecht, Boston, Lancaster, 1994), ch. 23, 18 ff., paras. 23 ff.; Adair Dyer and Hans Van Loon, 'Report on Trusts and Analogous Institutions', in Hague Conference on Private International Law, *Proceedings of the Fifteenth Session (1984)*, II, 77 ff., paras. 148 ff.

to the richness and the adaptability of the local law, problems remain. The very fact that trusts are transposed into different conceptual moulds hinders cross-border operations because – to say the least – it hampers effective cross-border communication. For this reason, the Hague Conference on Private International Law took a crucial step when it convened its fifteenth session to draft a convention on the law applicable to trusts and on their recognition. The aim of that session was to provide common conflicts and recognition rules on trusts as such.[31] The step in that direction raised two problems: first, how to write a bilingual text accessible to common lawyers and civilians alike; second, what type of institutions counted as 'trust' under the Convention. The first problem involved choices about the Convention's language; the second presented an issue of law. Both problems located the discussion of the Convention within the evolving scenario of trust laws inside and outside common law jurisdictions. To this scenario we now turn, because the debates on the interpretation of the Convention need to be clarified by exploring their broader context.

We have mentioned some functional substitutes of trusts, such as gifts and testamentary dispositions sub modo. During the twentieth century, the list of transactions producing some effects that are regularly associated with trusts constantly expanded. It soon included inter vivos fiduciary contracts, conceived thanks to the study of old Roman and Germanic sources, which combine agency and trust aspects.[32] Within this expanding framework, the knowledge of the English experience with trusts was a source of inspiration for some innovation. To be sure, developments in civilian countries at first did not threaten the conventional wisdom, which considered trusts to be peculiar to the common law world. It became harder to defend the same point of view, however, when the comparative study of trusts became a worldwide enterprise, reaching beyond the laws of continental Europe. Jurisdictions like Scotland, Jersey, South Africa, Mexico, Quebec,

[31] See the Preamble to the Convention.

[32] This study was first conducted by nineteenth-century German scholars committed to different views of the sources of German law. On this episode, in the light of recent research on the subject, see Richard Helmholz and Reinhard Zimmermann, 'Views of Trust and Treuhand: an Introduction', in Helmholz and Zimmermann, *Itinera Fiduciae*, 27 ff. The present state of German law is discussed by Hein Kötz, 'National Report for Germany', in Hayton et al., *Principles of European Trust Law*, 89 ff. German legal thinking on *fiducia* and *Treuhand* soon influenced authors and courts based in other countries, like Austria, Italy, Spain and Switzerland.

Louisiana and many others have trust laws which show a functioning set of trust rules, not based on the distinction between common law and equity. The experience of these countries undermined the claim that trusts are incompatible with the civilian heritage. All these laws showed that it was possible to draft rules on trusts which could be intelligible in London and in Paris, in Rome and in New York. Indeed, the drafters of the Hague Convention could not have proposed a description of the trust relationship which would have been meaningful in civilian terms without extending the application of the Convention to trusts governed by the law of jurisdictions outside the common law tradition.[33] Trespassing the common law boundaries in the search for a workable description of trusts did not provoke a revolt among the Hague delegates from common law countries, however, for many good reasons, including the circumstance that strict adherence to the law/equity distinction did not seem essential at The Hague.

The notion of trust emerging from the works of the Hague Conference is, accordingly, an autonomous one, i.e. independent from local conceptions of what trusts are.[34] The notion of 'trust' adopted in art. 2 of the Convention denotes any relationship possessing the elements that make up a trust for the purposes of the same Convention. That notion, as well as the text of the Convention (but not the Preamble!), purposely avoids any reference to the law/equity distinction, or to other concepts which would have impressed on that text the indelible mark of the common law heritage.

The adoption of the Convention by the Hague Conference and its entry into force in a significant number of countries (including, in Europe, the United Kingdom, Luxembourg, Italy, the Netherlands, Liechtenstein and

[33] See on this point Alfred von Overbeck, 'Explanatory Report', in Hague Conference on Private International Law, *Proceedings of the Fifteenth Session*, II, 370 ff., paras. 12–14, 25–26. Hence Lupoi's claim that art. 2 of the Convention introduces a 'shapeless trust': Maurizio Lupoi, 'The Shapeless Trust', (1995) 1 *Trusts and Trustees* 15; Lupoi, 'Effects of the Hague Convention in a Civil Law Country', in Paul Jackson and David C. Wilde, eds., *The Reform of Property Law* (Aldershot, 1997), 222, para. 3; for a full discussion: Lupoi, *Trusts: A Comparative Study*, 327–346. The wide subsequent debate on the mixed blessing of the compromise that gave birth to article 2 is presented by Harris, *Hague Trusts Convention*, 105 ff.

[34] Lupoi, *Trusts: A Comparative Study*, 338. Harris, *Hague Trusts Convention*, 116–117, disagrees because art. 2 of the Convention mentions certain characteristics of a trust but does not contain an exhaustive definition of it. To the contrary, one could argue that if no autonomous interpretation of the Convention emerges, its *raison d'être* is effectively undermined.

San Marino), marked a watershed in the comparative literature on trusts. First, the entry into force of the Convention in civil law countries like Italy and the Netherlands showed that trusts could not *per se* be considered contrary to any fundamental principle of law of some of the major civil law jurisdictions. Second, the circumstance that trusts under art. 2 of the Convention included institutions outside the common law orbit invited civilians to examine their laws in search – once more – of institutions redolent of trusts, belonging to the field of application of the Convention. Third, the provisions of the Convention aimed at safeguarding the application of the lex fori in certain cases sharpened the focus on points of resistance to trusts in jurisdictions where they should be recognised. Last, but not least, in countries like Belgium, France, Italy, Luxembourg and Switzerland, the Convention created the occasion to discuss the opportunity to amend the local law with a view to making local institutions more responsive to needs that are taken care of by the law of trusts.[35] In this intellectual atmosphere, the elaboration of the Principles of European Trust Law drafted by a distinguished group of scholars provided yet another occasion to explore the idea that trusts can be part of the law of civilian jurisdictions. So far, these initiatives have not produced wide-ranging legislative innovations in Europe. The Convention itself has been criticised because it produces too little certainty and predictability of results, due to the high number of escape clauses it contains.[36] Nevertheless, it is only fair to acknowledge that the Convention has produced a wave of comparative contributions on trusts that would have been unthinkable twenty years earlier. Most of them, far from being hostile to the institution, recognise that there is

[35] Luxembourg seized the opportunity recently by enacting the *Loi du 27 juillet 2003 portant approbation de la Convention de La Haye du 1er juillet 1985 relative à la loi applicable au trust et à sa reconnaissance; portant nouvelle réglementation des contrats fiduciaires, et modifiant la loi du 25 septembre 1905 sur la transcription des droits réels immobiliers* (JO, A- No. 124, 3 September 2003). For an overview of the situation in Switzerland, France and Germany: Luc Thévenoz, 'Civil Law Jurisdictions on their Way to Trusts? A Swiss Viewpoint', in Hayton, *Extending the Boundaries of Trusts*, 115 ff.; with specific regard to Switzerland: Luc Thévenoz, *Trusts en Suisse/Trusts in Switzerland* (Zurich, 2001); Alexander R. Markus, Andreas Kellerhals, Monique Greiner Jametti, eds., *Das Haager Trust-Übereinkommen und die Schweiz* (Zurich, 2003). On 20 October 2004 the Swiss government announced its intention to ratify the Convention. In Italy academic contributions and judicial decisions on the Convention have had a substantial impact on general attitudes towards trust issues. The issue is back on the table in France: see note 52 below.

[36] Jeffrey A. Schoenblum, 'The Hague Convention on Trusts: Much Ado About Very Little', (1994) 3 J. Int'l Tr. Corp. Plan. 5; see the replies by David J. Hayton, 'The Hague Convention on Trusts: A Little is Better than Nothing but Why so Little?', (1994) 3 J. Int'l Tr. Corp. Plan. 23 and by Harris, *Hague Trusts Convention*, 421 ff.

nothing wrong with trusts, that they are perfectly 'clean and moral'.[37] Without the Hague Convention, the spreading of this conviction outside the circle of connoisseurs would have come at a much slower pace. Indeed, as mentioned above, in some countries the Hague Convention paved the way for proposals aimed at reforming the law to introduce institutions which could compete on equal footing with trusts governed by the foreign law. Though so far these proposals have made little progress, there is a series of more successful legislative measures which is introducing all over Europe rules designed to produce effects that in the common law world would normally be linked to trusts (or some of their aspects). This legislation is mostly related to the functioning of the financial markets. Quite interestingly, it tells us a different story from the usual civilian account of resistance to trusts.[38]

2.3 Divergence among legal systems about trusts: some traditional issues

Why is it that certain legal systems do not possess a full-fledged law of trusts like that familiar to common lawyers all over the world? Every comparative enquiry about trusts sooner or later runs into this thorny question. In analytical terms, the question invites discussion of the traditional points of friction between trusts and the laws of countries outside the boundaries of the common law tradition.[39] Students of trust law know that this query raises several complex issues because a full-fledged law of trusts – let us take that expression at face value – does not exist in the abstract. Trusts laws of common law jurisdictions vary significantly, not only in points of detail, to the delight of the international estate planner. Furthermore, there is abundant evidence that trusts are by no means altogether foreign to the contemporary civil law world. In a number of countries, which are not on the map of the common law jurisdictions, there are institutions replicating effects that common lawyers would associate with trusts of one kind or another. In the case of the so-called mixed jurisdictions, those institutions are even known by the very name 'trusts'. In other countries the names may be

[37] Cf. Antonio Gambaro, in Hague Conference on Private International Law, *Proceedings of the Fifteenth Session*, II, 287–8 (with respect to 'purely internal trusts').

[38] For helpful remarks on this point, see H. L. E. Verhagen, 'Trusts in the Civil Law: Making Use of the Experience of "Mixed" Jurisdictions', in Milo and Smits, eds., *Trusts in Mixed Legal Systems*, 93 ff.

[39] For an excellent general examination of these aspects: Tony Honoré, 'Obstacles to the Reception of Trust Law? The Examples of South Africa and Scotland', in Rabello, *Aequitas and Equity*, 793 ff., 807 ff.; Honoré, 'Trusts: The Inessentials', above, note 5.

different, but the substance of the law in force leaves no doubt about the fact that the relevant institutions often partake of the same genus to which, for example, English express trusts belong.

These remarks show that our initial question has sensible answers only if one is prepared to distinguish between doctrinal arguments or dogmatic statements on one side, and operative rules and policy factors on the other side. In drawing the distinction, we will keep in mind that all these ingredients make up the law. None of them should be ignored in discussing points of friction between trusts and the legal order of jurisdictions that allegedly know nothing of trusts.

Until very recently, doctrinal or dogmatic arguments played a major role in the debate over the compatibility of trusts with basic principles of the law of legal systems outside the orbit of the common law tradition.

A first set of arguments was based on the distinction between common law and equity, as a unique feature of English law (and of the legal systems historically related to the English experience). The point advanced by linking trusts to the law/equity dichotomy was that there could be no law of trusts absent that crucial distinction.[40] This argument fails to distinguish between the language used in common law countries to frame or solve issues of trust law and the rules applicable to certain sets of facts commonly grouped under the label 'trust'. Almost a century ago, Maitland[41] and Hohfeld[42] warned that the language used to discuss trust law issues was apt to mislead. More recently, Bernard Rudden brilliantly argued that equity has been simply an alibi in the development of the English law of trusts.[43] Rudden shows that the time is ripe to call a spade a spade. We do not know whether his sensible plea will ultimately gain the day, but experience has already shown that trusts prosper also in jurisdictions where the law/equity terminology has no real counterpart or, indeed, appeal.

The different structure of property law on the two sides of the Channel is a second recurrent theme in the debate over the friction between trusts and the civilian systems of law. Conventional wisdom

[40] On this point: George Gretton, 'Trusts without Equity', (2000) 49 ICLQ 599; Honoré, 'Trusts: The Inessentials', above, note 5.

[41] Frederic William Maitland, *Equity: A Course of Lectures*, Chaytor and Whittaker, eds., rev. Brunyate, 2nd rev. edn (Cambridge, 1936).

[42] Hohfeld, 'Relations Between Equity and Law' and 'Conflict of Law and Equity', above, note 15.

[43] Bernard Rudden, 'Equity as an Alibi', in Stephen Goldstein, ed., *Equity and Contemporary Legal Developments* (Jerusalem, 1992), 30 ff. See also his golden book: F. H. Lawson and Bernard Rudden, *The Law of Property*, 3rd edn (Oxford, 2002), 82 ff.

holds that the structure of property law enacted by the civil codes is incompatible with the fragmentation of ownership that many consider the hallmark of common law trusts. More precisely, trusts would be contrary to the basic structure of property rights of civilian countries because they are contrary to the *numerus clausus* of real rights.[44] Similar arguments rest on assumptions that are well worth a closer look. The idea that trusts violate the *numerus clausus* of real rights is questionable. All systems of rights over corporeal things provide that only a certain number of rights, endowed with certain qualities, bind the whole world – to put it in standard real rights phraseology. This statement is true for the law of property of common law countries, just as it is for jurisdictions where the Roman law has left its permanent mark.[45] Trusts introduce no exception in this picture: the list of rights that bind the whole world is still there.[46] It is therefore wrong to assume that the principle of *numerus clausus* of real rights is the cornerstone of the law of property in civilian jurisdictions, while common law systems ignore it. To this quick diagnosis one may add two brief remarks. First, in most contemporary legal systems the list of real rights is no longer a reliable guide when the question is what rights bind third parties. The potential for legal innovation underlying this point can be taken to the following extreme: the English trust arose not out of a reconceptualisation of property law, but out of modifications to the law of obligations.[47] Second, the fact that trusts are frequently presented as instances of split ownership leads to a common failure of analytical discourse

[44] Recent papers retrieve the point: Philippe Rémy, ‘National Report for France’, in Hayton et al., *Principles of European Trust Law*, 131; Sebastianus Costantinus Johannes Josephus Kortmann and H. L. E. Verhagen, ‘National Report for the Netherlands’, in ibid., 195; Alegria Borrás and Cristina González Beilfuss, ‘National Report for Spain’, in ibid., 159. But the same point is made in countless contributions on the subject over the years.

[45] Bernard Rudden, ‘Economic Theory versus Property Law: The Numerus Clausus Problem’, in John Eekelaar and John Bell, eds., *Oxford Essays in Jurisprudence*, 3rd series (Oxford, 1987), 239 ff.; Michael Heller, ‘The Tragedy of Anticommons: Property in Transition from Marx to Markets’, 111 Harvard L. Rev. 621 (1998); Heller, ‘The Boundaries of Private Property’, 108 Yale LJ 1163 (1999); Andrea Fusaro, ‘The Numerus Clausus of Property Rights’, in Elizabeth Cooke, ed., *Modern Studies in Property Law* (Oxford, 2000), 309.

[46] Cf. Kenneth Reid, ‘National Report for Scotland’, in Hayton et al., *Principles of European Trust Law*, 67. The law of Scotland has no place for the distinction between law and equity, as it is known in English law, and strictly observes the distinction between real rights and personal rights.

[47] See for the full argument: Lionel Smith, ‘Transfers’, in Peter Birks and Arianna Pretto, eds., *Breach of Trust* (Oxford, 2002), 111.

on real rights and trusts in cross-border comparisons. In these comparisons too little attention is paid to how trusts help to overcome the fragmentation of property rights by concentrating the power of alienation in the hands of trustees.[48] Arguably, at least some civil law systems allow greater scope for the fragmentation of property rights than one would expect. Here we find outcomes that are clearly inefficient, like co-ownership of a house by a large number of family descendants. While paying lip service to the idea that ownership should be compact, these forms of co-ownership contrast with the policy in favour of alienability of ownership. Despite all indications to the contrary, looming large behind the diffidence towards trusts, there is often the untutored assumption that the notion of ownership prevailing in common law jurisdictions simply coincides with that enshrined in the civil codes. Hence the stumbling block represented by the tacit preconception that if trust beneficiaries are 'owners' of the trust property they must have the same degree of control over trust property that a civil law owner would have over her or his assets under the civil code provisions on property, which is clearly indefensible.[49]

In some civilian jurisdictions, like France, trusts are also thought to be contrary to the principle that each person has only one patrimony.[50] This principle evolved out of the notion that individuals hold wealth because they are recognised as subjects by the law. Contemporary legal systems do not break civil capacity into a variety of status. Hence, the argument goes, all the assets of a person form part of a notional unitary mass that can be divided into separate masses only by establishing new subjects as the owners of the separate assets. In this perspective, the move that is required to separate an asset, or several assets, from the rest of a person's wealth is the creation of a new entity. In law, the new entity is the owner of the assets formerly belonging to the individual(s) who created it. Absent the creation of a new entity, individual willpower cannot operate to segregate assets in trust (like trust settlors do every

[48] Richard Posner, *Economic Analysis of Law*, 4th edn (Boston, 1992), 73.

[49] On this point: Paul Matthews, 'From Obligation to Property, and Back Again? The Future of the Non-Charitable Purpose Trust', in Hayton, *Extending the Boundaries of Trusts*, 203 ff., 210 ff.

[50] See e.g. Rémy, 'National Report for France', 131; Michel Grimaldi and François Barrière, 'La fiducie en droit français', in Cantin Cumyn, *La fiducie face au trusts dans les rapports d'affaires*, 237. For a critical approach to this classic doctrine and an investigation of its origins, see David Hiez, *Etude critique de la notion de patrimoine en droit privé actuel* (Paris, 2003). In one form or another, the same doctrine is often invoked in other civilian jurisdictions as well as a possible obstacle to the operation of trusts.

day in other jurisdictions) because such an exercise would run contrary to the civil code rules on property, which establish who owns what.[51] This approach, however, does not exclude the possibility of legislative inroads in the above-mentioned principle of the 'unité du patrimoine'.[52] Having conceded this last possibility, it would be interesting to know on what basis and for what reasons Parliament is willing to derogate from the principle.[53] In any case, this theory, just like the notion of ownership enacted in art. 544 of the French Civil Code, and in the parallel provisions of other civil codes of continental Europe, is only the first chapter of the story about trusts in continental Europe, not the end of it. Even in France, there are recurrent arguments about the need to give more leeway to fiduciary operations.[54] In other European countries, as will be shown, there is a deep tension between the traditional picture of property rights under the civil codes' general provisions on property (or the related general theories of ownership, like that affirming the principle of the unity of patrimony) and the more mundane and flexible approach emerging in various codal provisions, in legislation enacted in blissful disregard of the architecture of the civil codes, or in judicial decisions and learned commentaries that innovate the traditional legal landscape.

After the Hague Convention was signed, the ongoing debate over the compatibility of trusts with modern civilian systems underwent a gradual change of perspective. The work of the delegates to the Hague Conference proceeded on the basis that the trust form that is familiar in common law jurisdictions is compatible with fundamental principles of law of the countries where the same form did not evolve. For this reason, where it is in force, the Convention imposes an obligation to

[51] See on this point the debate on the proposal advanced by working document 44bis at the Hague Conference on Private International Law, *Proceedings of the Fifteenth Session* II, 301–302.

[52] There are abundant examples of such legislation across Europe. See e.g. Cases 5, 8, 9 and 11 below. A Bill (No. 178) was introduced into the French Senate in February 2005, proposing modifications to the *Code civil* to create a new *fiducie*. Note that inroads into the principle are sometimes brought about by court decisions and academic writings as well, as the answers to the questionnaire abundantly show.

[53] As Matthews brilliantly argues, upon closer examination there are reasons to think that the whole issue about the 'unité du patrimoine' is a red herring: Matthews, 'From Obligation to Property, and Back Again?', 203 ff.; for an essential clarification: Maurizio Lupoi, 'The Development of Protected Trust Structures in Italy', in Hayton, ed., *Extending the Boundaries of Trusts*, 85 ff. (the trustee does not own two patrimonies but one patrimony with segregated assets).

[54] See especially the Bill mentioned in note 52.

recognise the trust form as such. At the same time, the delegates to the Convention recognised the possible clash between trusts and some traditional features of the law of many of those jurisdictions. To tackle this problem, the Convention enacts provisions that can be invoked to block the recognition of trusts or, more precisely, to limit the reach of the applicable foreign law, beyond the customary reference to *ordre public* (art. 18) and to the laws of immediate application (art. 17).

The principal provision to be mentioned in this respect is art. 15 of the Convention, which lists the following topics: (a) the protection of minors and incapable parties; (b) the personal and proprietary effects of marriage; (c) succession rights testate and intestate, especially the indefeasible shares of spouses and relatives; (d) the transfer of title to property and security interests in property; (e) the protection of creditors in matters of insolvency; (f) the protection, in other respects, of third parties acting in good faith. The list is not meant to be exhaustive. It simply sets forth specific examples of provisions of law designated by the conflicts rules of the forum, which cannot be derogated from by voluntary act (art. 15, first paragraph).

The list contained in art. 15 is interesting first and foremost because it gives voice to some deep-seated fears about trusts in many quarters of the civil law world. Within the framework of art. 15, trusts appear as institutions that could potentially unravel basic tenets of civilian legal orders. But the disruptive effects implicitly associated by art. 15 with trusts are produced by a variety of other institutions familiar to both practitioners and courts working in civilian jurisdictions. In the light of this observation, the reasons to single out trusts for the cautionary tale of art. 15 are rather meagre, though, of course, the fact that the Convention is of universal application (ch. III)[55] justifies some prudence. One further remark is that at least some of the policies backing the choice of topics mentioned in art. 15 of the Convention inform also the law of common law jurisdictions. The validity of certain trusts, or of certain uses of trusts, may therefore come under scrutiny for policy reasons, quite apart from the operation of the Convention. The common law, to take one example, is not favourable to schemes to defraud creditors. The simple transfer of property by a debtor, to another person who holds in trust for the debtor, will not harm creditors, so long as the

[55] That is, there is no principle of reciprocity; a Convention state must apply the law selected by the Convention even if that is the law of a non-Convention state. There is the possibility of a reservation on this point: art. 21.

facts can be found; the debtor's beneficial interest is part of his property and available to his creditors. If a trust is created in which the beneficial interest passes to someone else, then the debtor has divested himself, but such a trust is liable to be attacked (as might be an ordinary gift) under fraudulent conveyance rules which are often more effective than the corresponding civilian provisions.[56] Turning to another example of policy concerns, non-charitable purpose trusts are void in a large number of common law jurisdictions; among the reasons given for their invalidity there is the fact that assets held by trustees of a private purpose trust would be beneficially ownerless and yet not devoted to public interest.[57] Furthermore, trust beneficiaries are shielded from personal liability vis-à-vis trustees' creditors only if they do not exercise control over the trustees. In the opposite case, they may incur liability on the basis of agency or partnership law, and this is part of the story of why the business corporation filled such an important need and became the dominant mode of business organisation in the twentieth century. All these solutions tend to cure externality problems that are best analysed by taking a closer look at what goes under the generic label 'trusts', just like the generic label 'secured debt' must give way to narrower categories to discuss the vexed question whether secured debt is efficient.[58]

The different structure of the laws compared, therefore, does not necessarily reflect opposite policy choices. Indeed, in some of the countries which face obstacles to the recognition of trusts, there are established legal rules which themselves seem to clash with the policies protected by art. 15.

A first graphical example of this divergence between policy and practice is provided by retention of title clauses extended over products and proceeds generated out of the items sold by the seller to the buyer. In Germany these clauses are valid though they operate to create a latent security interest. In England, on the contrary, they are largely ineffective for lack of registration in the company charges register.[59]

The literature on trusts regularly mentions, as foundational for entire sectors of the law of civilian jurisdictions, policies which in reality are

[56] E.g. fraudulent conveyance provisions in a civil law country may have periods of limitation, which severely restrict the reach of the remedy.

[57] Matthews, 'From Obligation to Property, and Back Again?', above, note 53, 204 ff.

[58] Claire A. Hill, 'Is Secured Debt Efficient?', 80 Tex. L. Rev. 1117 (2002).

[59] The theme is explored in depth in another volume of this series: Eva-Maria Kieninger, ed., *Security Rights in Movable Property in European Private Law* (Cambridge, 2004).

often more vigorously and consistently pursued in some common law countries. This is the case with the policy against restraints on alienation. Alienability of land, for example, is more effectively safeguarded in England than, for example, in Italy. This is so despite the contrast between the feudal matrix of the English land law and the simpler civil code notion of property, ultimately indebted to the reading of the Roman law legacy which inspired the civil code drafters.

A last example of variation between policy and practice, though outside the scope of the present research, is provided by the legal regime of the indefeasible share of spouses and certain relatives, or, in the language of the French text of the Convention, *la reserve* (art. 15, lett c).[60]

The drafting of art. 15 of the Convention is a reminder of some traditional arguments about the incompatibility of trusts with the laws of civilian jurisdictions. Nonetheless, the compatibility issue has never been addressed solely by giving full weight to those traditional arguments. There have also been more sober and cautious assessments of the reasons why most civilian jurisdictions do not have a well-developed law of trusts, and in several cases do not look to it as an opportunity not to be missed. One of these diagnoses is that, far from being completely alien to, or totally incompatible with, the local law, trusts are simply not in great demand in several civilian jurisdictions. Many needs which in common law jurisdictions are routinely satisfied by trusts are elsewhere largely taken care of by other institutions. In civilian jurisdictions general powers of attorney, foundations and associations, contractual arrangements of various kind, etc., meet everyday demands routinely channelled into the trust laws of anglophone countries. What is left outside this framework may not be in strong demand, possibly because of an insufficient supply of trust capital, or because of the different role of the state in the economy.[61]

[60] An examination of this topic is beyond the scope of our work but in some contexts indefeasible shares may produce inequality, instead of equality, among descendants. For an instructive assessment of what portions (fixed and discretionary) and maintenance provisions achieve today, in an epoch marked by the decline of traditional family models, divorce, cohabitation and remarriage, see Donovan M. Waters, ‘Invading the Succession on Behalf of the Family – Europe, and Common Law Canada and Quebec’, in Rosalind Atherthon, ed., *The International Academy of Estate and Trust Law. Select Papers 1997–1999* (London, The Hague, Boston, 2001), 651 ff.

[61] Kötz, ‘National Report for Germany’, 97; Fratcher, ‘Trust’ in *International Encyclopedia of Comparative Law*, VI, ch. 11, para. 110.

This analysis, of course, implies an informed evaluation of the opportunities which are missed where a full-fledged law of trusts is not in place. A general assumption of informed choice goes too far in our case, however. More realistically, such an informed evaluation actually takes place only where strong players are at work. The prime example in this respect is institutional actors on the world's financial markets. Their ability to collect the relevant specific information and to propose legal change is beyond serious doubt. Not surprisingly, this is an area where we witness significant legal changes in the legal landscape of continental Europe to boost competitiveness of schemes governed by the local law with trust-based investment schemes operating under the laws of common law jurisdictions. This leaves us with the following observation. The first difficulty civilians face when confronted with the law of trusts familiar to the common law world may simply be the lack of diffuse knowledge about the institution. The anecdotal evidence on this point is not missing. In this context, arguments against trusts in civilian jurisdictions come close to a self-fulfilling prophecy.[62]

2.4 *Trusts as investment vehicles and the rethinking of traditional approaches*

Modern banking and financial operations often require the holding of assets by a manager and the segregation of those assets from other assets belonging to the manager in its personal capacity, or to other persons. The trust form is an ideal tool to organise such a structure and to produce the segregation effect. Frequent contacts between the anglophone world and the banking and the financial communities of continental Europe during the twentieth century rendered the use of trust to segregate assets familiar to money managers throughout Europe. Apparently, early experiments with the idea of replicating the model originated from the necessity to set up a vehicle to hold German

[62] See on this point the study of the Conseil d'Etat, *L'influence internationale du droit français* (Paris, 2001), 66–67: 'En définitive on peut, s'agissant du *trust*, reprocher au droit français d'être resté au milieu du gué. Sous la pression des acteurs économiques et faute d'instruments juridiques répondant à leurs préoccupations, des éléments fiduciaires ont été introduits dans notre droit. Mais celui-ci ne s'est pas enrichi d'un véritable régime juridique de la fiducie qui aurait pu véritablement répondre aux critiques internes.' On the evolution of the French scenario after the withdrawal of the Government's original bill on *la fiducie*: Coralie Raffenne, 'Why (Still) No Trust in French Law?', in Andrew Harding and Esin Orücü, *Comparative Law in the 21st Century* (London, 2002), 75. A new Bill (No. 178) was introduced into the French Senate in February 2005, proposing modifications to the *code civil* to create a new fiducie.

investments on the New York Stock Exchange in the late nineteenth century.[63] In Italy, a royal decree of 1926, probably inspired by the German precedent, introduced a rudimentary set of provisions on *società fiduciarie*.[64] This first wave of legislation did not have a great impact on the market because of its limited target, focused on specific solutions for a select number of investors, who did not look for active asset management. After the second world war, however, the need to diversify investments – the key to the success of unit trusts – spurred legislative change in several European countries. In 1957 France passed the first legislation on *fonds commun de placement*,[65] while Germany in the same year adopted the *Gesetz über die Kapitalanlagesellschaften*,[66] which introduced a similar legal form as well as a *Treuhand*-based solution. Spain followed suit in 1964, while Italy was a latecomer, putting *fondi comuni di investimento* on its statute book only in 1977 (though Luxembourg-based *fonds commum de placement* had been marketed in Italy for years).

These investment vehicles provided both diversification *and* active asset management on a collective basis, while individual portfolio management was still offered only by banks, stockbrokers and commission agents. Here too, however, there was space for innovation. With the evolution of Community law, both collective investment schemes and investment services were firmly placed within the framework of directives aimed at creating a level playing field throughout the Community space.[67] In this transition from national markets to the

[63] Helmut Coing, *Treuhand kraft privaten Rechtsgeschäfts* (Munich, 1973), 62.

[64] R.d.l. 16 December 1926, n. 2214, *disciplina delle società che esercitano funzioni fiduciarie e revisionali*.

[65] Décret 57–1342 of 28 December 1957.

[66] BGBl. I 1957, 378.

[67] For an overall illustration and critical evaluation of these developments: Niamh Moloney, *EC Securities Regulation* (Cambridge, 2002). The EC Commission's *Financial Action Plan*, which was launched in 1999, COM (1999) 232, set the framework for a complete revision of securities regulation in the EC. The periodical *Progress Report on the Action Plan* provides helpful updates on the implementation of the plan (available at: http://europa.eu.int/comm/internal_market/en/finances/actionplan/progress10-% 20annex_ en.pdf). For the list of the implementation instruments (as to June 2004) see the Annex to the 10th Progress Report. The single most important measure intervening in the field of our research is the Directive 2004/39/EC of 21 April 2004 on markets in financial instruments (amending Directives 85/611/EEC, 93/6/EEC and 2000/12/EC and repealing Council Directive 93/22/EEC), [2004] OJ L 145/1. This directive is to be transposed into the law of the Member States by the end of May 2006. The directive is a level 1 measure under the so-called 'Lamfalussy process'. More detailed regulation is in the pipeline in accordance with that process: cf. Walter Van Gerven, 'Harmonization of Private

single European market there was tension over the model which should prevail. The alternative was whether the internal market was to develop along the lines reflecting the structure of the German financial markets, which asserted the centrality of banking institutions in the field of asset management, or along the lines of the United Kingdom experience, which left a considerable role for other market actors as well.[68] The solution eventually received at the Community level was largely based on the idea that high capital ratios for providers of asset management services did not necessarily lead to better performances. On the other hand, high capital ratios certainly restricted competition among market actors.

Community law, therefore, opted for an efficient market of asset management services by protecting clients' assets from the risk of the manager's insolvency through their segregation from those belonging to the manager in its personal capacity.[69] The creation of a single market for financial services in Europe was thus linked to the explicit recognition of the multiplicity of legal forms available in Europe to conduct investment business. Investment vehicles that in England are organised as trusts were regulated at the European level together with other legal forms (such as investment companies with variable capital) to provide the same access to the European market and the same level of investor protection throughout Europe. This side of the story of financial intermediaries reflects a movement embracing other sectors of the market too. Pension funds, just like other collective investment schemes, are organised in a multiplicity of legal forms, including trusts, foundations and associations.[70] Segregation of managed assets is a key feature of several of these institutions as well. Community law in this field is quickly moving ahead, to ensure the portability of supplementary pension rights throughout the European space. Outside the reach of Community law, the triumphal march of investment techniques based on asset segregation is also noteworthy. Asset securitisation

Law: Do We Need It?', [2004] CMLR 505, at 510 ff. Note also the upgrading of the UCITS directive by Directives 2001/107/EC and 2001/108/EC on undertakings in transferable securities and Directive 2003/41/EC on the activities and supervision of institutions for occupational pensions. On the philosophy of these developments: Niamh Moloney, 'New Frontiers in Capital Markets Law: From Market Construction to Market Regulation', [2003] CMLR 809 ff.

[68] Cf. Pauline Ashall, 'The Investment Services Directive: What Was the Conflict All About?', in Mads Andenas and Stephen Kenyon-Slade, eds., *EC Financial Market Regulation and Company Law* (London, 1993), 91.

[69] See Moloney, *EC Securities Regulation*, 466 ff., 469–470.

[70] See Case 8.

schemes are the most recent addition to the list of financial techniques designed to raise money in the financial markets by segregating certain assets from the general business of the operator of the scheme. Once more, this innovation challenged civilian jurisdictions to generate legal forms which could compete with trust structures on the international financial markets. Throughout Europe we have thus witnessed since the mid-1980s the development of schemes established to further asset securitisation operations under the umbrella of more or less recent national provisions.[71]

The impact of these developments on legal thinking about trusts in comparative perspective is significant. There is a new awareness of the current role played by the institution outside the traditional context of property law, as highlighted by Professor Langbein.[72] This new awareness goes hand in hand with the impressive growth of fiduciary law, which is moving beyond the embryonic status in the European continent as well.[73] An immense mass of wealth is managed thanks to the above-mentioned investment vehicles. In financial terms, the most important role trusts play in today's world is related to the holding of incorporeal wealth. This new role of trust law invited scholars to rethink, once more, general notions of the law like property, or contract, in the context of trust law.[74] Professor Rudden conceptualised this new dimension of trust law by distinguishing the legal regime applicable to things considered as investments from that applicable to things considered as portions of the physical world.[75] Both authors are outstanding comparativists, but the role played by trusts in the business

[71] Case 11.

[72] John Langbein, 'The Secret Life of the Trust: The Trust as an Instrument of Commerce', 107 Yale LJ 165 (1997), repr. in David J. Hayton, ed., *Modern International Developments in Trust Law* (The Hague, 1999); see also Steven L. Schwarcz, 'Commercial Trusts as Business Organizations: Unravelling the Mystery', 58 Bus. Law. 559 (2003).

[73] Cf. Peter Birks, 'The Content of Fiduciary Obligation', (2000) 34 Israel L. Rev. 3, 4: 'fiduciary obligations have achieved a new prominence in the common law world: They have become, as the saying goes, all the rage.' The progress of fiduciary law in the European continent is most evident in the area of directors' duties under company law: Klaus J. Hopt, 'Trusteeship and Conflicts of Interest in Corporate, Banking and Agency Law: Toward Common Legal Principles for Intermediaries in the Modern Services-oriented Society', in Guido Ferrarini, Klaus J. Hopt, Japp Winter, Eddy Wymeersch, eds., *Reforming Company and Takeover Law in Europe* (Oxford 2004), 51 ff.; Holger Fleischer, 'The Responsibility of the Management and of the Board and its Enforcement', in ibid., 373 ff.

[74] See Robert H. Sitkoff, 'An Agency Costs Theory of Trust Law', 89 Cornell L. Rev. (2004).

[75] Bernard Rudden, 'Things as Thing and Things as Wealth', (1994) 14 Oxford J. Leg. Stud. 81.

context attracts fresh attention beyond the circle of comparative law scholars.[76]

3 The common core approach

3.1 *Trust law and common core methodology*

As should appear from the previous discussion, the literature on trust available at the beginning of our project already offered a remarkably complex picture. A sense of dissatisfaction nevertheless stimulated our enterprise, together with the conviction that applying common core methodology could move the literature beyond what we felt was a merely 'taxonomic' phase.

What is the interest of using common core methodology in the domain of trust law? What are the fundamental questions that our methodology can answer within the rich environment that we have outlined? The following section attempts to convey the sense of some of the most relevant discussion about these two fundamental questions, carried on in the collective process of production of this book.

Trust law has long been considered as a traditional point of divergence between common law and civil law jurisdictions. In a way it has been considered, together with the principle *stare decisis* or the different attitude towards the Code, as a classic *locus differentiae*.[77] Trust law is indeed an intimate part of the law of property, a domain where most of the strongest comparative differences in private law are traditionally located.[78] Even the fact of considering the trust relationship as a matter of property (common law) as opposed to a matter of obligation (civil law) reinforces this stereotype. Nevertheless, in comparative law, as in any other scholarly domain, proceeding by stereotypes does not seem to be a productive idea. Stereotypical visions of trust law, in fact, make false problems appear to be real, so that the comparative law community ends up wasting considerable intellectual resources in exercises whose destiny is to remain sterile. In what sense can we be considered better

[76] Steven L. Schwarcz, 'Commercial Trusts as Business Organizations: An Invitation to Comparatists', 13 Duke J. Comp. Int'l L. 321 (2003); Schwarcz, 'Commercial Trusts as Business Organizations: Unravelling the Mystery', 58 Bus. Law. 559 (2003).

[77] E.g. René David, *Major Legal Systems in the World Today*, 3rd edn, with John E. C. Brierley (London, 1985), 347 ff.; Konrad Zweigert and Hein Kötz, *Introduction to Comparative Law*, I, 1st edn, tr. by Tony Weir (Amsterdam, New York, Oxford, 1977), 274 ff.

[78] Ugo Mattei, *Basic Principles of Property Law. A Comparative Legal and Economic Introduction* (Westport, Conn., London, 2000).

off (even from the limited perspective of increasing comparative knowledge) once we know that fiduciary relationships can be classified in one or another legal family as a matter of property rather than as a matter of obligation? By now it is clear that there are aspects of contract law in the Anglo-American institution of trust,[79] and aspects of property law in the way civil law countries attempt to solve the problems of third party protection, which are inherent in any relationship involving management of someone else's assets.[80]

From these brief notes, the interest of using common core methodology in the domain of trust can already be detected. Common core methodology does not assume ex ante the existence of a comparative divergence,[81] and therefore the traditional comparative approach to trust law, focusing on taxonomic notions of property or of obligation, is overcome. An interesting methodology allows us to ask interesting questions, if not to give answers. To be sure, the common core methodology should not be understood as assuming ex ante the lack of difference.[82] Rather it is an enquiry into the factual dimensions of analogies and differences so that the mistake of making ex ante assumptions can also be avoided.

Traditional comparative scholarship on trust law not only tends to be merely taxonomic, it also relies heavily on the idea that 'comparison involves history', so that historical explanations of the assumed differences are usually offered. But there is a risk of tautology in concluding that things are as they are because historical developments make them so. Everything that has a history can be explained by using history as an explanation. But explanation is not justification. Much scholarship on trusts is merely backward looking. This is unsatisfactory when we are called upon to build new legal models for our future as European lawyers.

This again should not be taken to imply that the common core methodology skips the historical context in an attempt to make law

[79] John Langbein, 'The Contractarian Basis of the Law of Trusts', 105 Yale LJ 625 (1995); but see for an analysis of trust that sets it apart from contract: Tamar Frankel, 'Trusting and Non-Trusting: Comparing Benefits, Cost and Risk', 25 (Boston University School of Law Working Paper No. 99–12, 1999), available at: http://www.bu.edu/law/faculty/papers.

[80] See e.g. Cases 3 and 4.

[81] Rudolf B. Schlesinger, gen. ed., *Formation of Contracts. An Inquiry in the Common Core of Legal Systems*, I (Dobbs Ferry, NY, 1968), Introduction.

[82] This view of the common core has been expressed by Pierre Legrand Jr, *Fragments on Law as Culture* (Deventer, 1999), 83–84.

for the future. This wrong implication was once rebutted by saying that the common core methodology is not a normative enterprise, but rather a positive one.[83] Critics have challenged this rebuttal by pointing out that the difference between the positive and the normative is itself an intellectual construction, perhaps in need of being deconstructed.[84] Indeed the positivistic bias, the belief in the possibility of a relatively neat separation between the *is* and the *ought* in the law, has been successfully challenged by many post-modern approaches to legal theory in general and to comparative law in particular. But the belief that discourse about the law can actually influence the law can also be seen as a modernist faith in the possibility of modifying the landscape of our actions. Again, scepticism is in order. Some normative agenda may well be consciously pursued by some of the common core participants, or may lie behind the European Commission's decision to provide financial support to our project. Perhaps some unconscious bias in favour of convergence is unavoidable in anybody's use of our methodology, just like other approaches may be driven by other biases. But the perception of the law by a section of the legal profession broad enough to represent a pluralist sample of it is in itself valuable, particularly when the canons of research are discussed and shared by several authors instead of being simply the product of an individual intellectual venture. The aim of the common core methodology is to observe and to know something about the law in its present state (and the perception of the law by professionals is itself a crucial part of the law). This present state, by definition, relies on the past and is projected in the future. By applying common core methodology we avoid both the mistakes of deterministic, backward-looking approaches and unsupported forward-looking statements.

Within an exceedingly complex and fast-changing area of the law like commercial trust, academic enterprises engaged in these thorough factual enquiries can benefit from cross-fertilisation. For instance, our group benefited greatly from personal and methodological overlaps with the work of the group directed by Professor Eva-Maria Kieninger on security interests over corporeal movables.[85] We nourish the hope that our data can help efforts that are presently underway within the

[83] Mauro Bussani and Ugo Mattei, 'The Common Core Approach to European Private Law', 3 Col. J. Eur. L. 339 (1997).

[84] David Kennedy, 'New Approaches to Comparative Law: Comparativism and International Governance', [1997] Utah L. Rev. 545.

[85] Kieninger, *Security Rights in Movable Property*.

Study Group on Codification of Private Law, directed by Professor Christian von Bar and, for the relevant area, by Professor Ulrich Drobnig. Similarly, the overall impact of the *Principles of European Trust Law*[86] could well benefit from factual enquiry, such as that provided by the use of common core methodology.

Before proposing Restatements in whatever domain of private law, be it contracts or *a fortiori* trusts, we must pose the fundamental question: Is there something called European private law to be restated? The existence of a common European private law of contracts might well be accepted as an informed guess even without a thorough bottom up attempt to know how questions are actually solved by the different national legal systems; but in the domain of trust, things are different. Indeed, we hope that after study of the materials offered to the legal community by the present volume, the guess will at least be informed. At the present stage of the literature, most of what is available on trust justifies the opposite informed guess.

Let us offer an easy example that should immediately clarify the kind of problems that we were facing in the preparation of the questionnaire around which this volume has taken shape and that eventually allowed our group to unearth at least a limited 'common core' in European trust law.

Suppose that A, after acquiring 51 per cent of the shares in a corporation, does not wish his control to be apparent. Suppose that in order to conceal his majority position, he transfers 10 per cent of the shares to another individual B. In order to retain control of the 51 per cent, A asks B to sign a document stating that the real 'owner' of his 10 per cent is A, and declaring that B will always vote at the shareholders' meetings in accordance with the decisions of A. B does so.

How would a civil lawyer approach this factual pattern? He would probably think in terms of *simulatio* and of fiduciary transfer of ownership, notions that would be obscure for a common law lawyer. The civil law lawyer would also face major problems of communication with his English colleague if he attempted to explain himself by resorting to the idea of a divergence between intent and declaration in a *jural act* (*Rechtsgeschäft*). Common law terminology would make it difficult to translate in a meaningful way the opposition between will and declaration that is so familiar in civilian private law theory, also because in the common law there is no widely accepted theory of jural acts. The closest

[86] Hayton et al., *Principles of European Trust Law*.

analogue in the common law is the underdeveloped doctrine of the 'sham'.[87] In turn, the common law lawyer, trying to explain the very same problem to his civilian colleague, would immediately find similar problems. He would naturally ask who has a 'legal right' and who has an 'equitable interest'. By speaking this language he would turn the whole transaction into a riddle for lawyers trained in civil law countries.[88]

The problem of the lack of a legal lingua franca in this matter had to be approached in the very choice of the title of this book. Would the typically common law idea of trusts be able to convey the set of problems that we were to approach? After thorough discussion (of the terminological kind that allows one to focus on methodological problems in comparative law), we decided to keep the notion of trust in the title. Trust is not only a legal notion but is also a moral notion, used in everyday life. I trust my friend, in God we trust, I trust my travel agent, are all ideas that live outside of legal meaning. In commercial settings, such as those explored in this volume, trust is one of the key social and moral notions that make transactions happen. We felt moreover that the idea of trust (but not those of *fiducia*, *simulatio*, etc.) has been able to gain common currency in the Western legal tradition because trusts have attracted so much comparative attention that even non-professional comparativists are today aware at least of the kind of legal problems that are conveyed by this notion. A number of episodes have introduced the idea of trust into the legal vocabulary of a large number of civil law countries. Among those, one would have to mention the Hague Convention on Trusts and its impact on the law of several countries; the attempt, in France, to legislate on the 'fiducie inspiré du trust', as well as the provisions of the Civil Code of Québec on *la fiducie*/the trust (arts. 1260–1298 CCQ). Such episodes, together with the notable interest that the law of trusts of anglophone countries has been able to generate

[87] Cf. *Midland Bank plc* v. *Wyatt* [1995] 1 FLR 696; [1997] 1 BCLC 242.

[88] This example is taken from Ugo Mattei and Pier Giuseppe Monateri, *Introduzione breve al diritto comparato* (Padua, 1997), 9–10. A remarkable English case provides a graphical illustration of the problem discussed in text: *Dubai Aluminium Company Limited* v. *Deloitte Haskins & Sells* (QBD (Comm. Ct), 6 July 2001). Here English solicitors acting for a Dubai client drafted a trust instrument setting up a nominee shareholding governed by the law of the Emirate. Contrary to what the drafters of the trust instrument assumed, Dubai law has no provisions on trusts and codifies property on the basis of the model provided by the French Civil Code. The English court had to decide whether, under the law of the Emirate of Dubai, a company incorporated in Dubai had the two shareholders required by law, where one of the two shareholders was a nominee.

in the international legal community, were believed by the participants in our group to be enough to keep the word in the title of our book.

To be sure, the success of the institution of trust has been explained in a variety of ways, notably as a successful episode of competition in the arena of legal ideas due to a fundamental 'advantage' of the trust linked to efficiency reasons.[89] Trusts attract attention because they are considered (and advertised) as institutional arrangements that can provide solutions for a variety of legal problems that are either insoluble, or soluble only in more complicated ways, by the use of civil law techniques. But what are such techniques?

This volume, unlike much traditional comparative law scholarship on trust, does not offer a list of civil law instruments, invariably concluding that, however numerous and heterogeneous such instruments may be, they are not enough to cover the ground of the extraordinary creature of the Chancellor. Instead, it poses some simple questions: How is it possible that many countries, despite the lack of the trust as an institution of general application, can nevertheless compete in the international market? What alternative institutional backgrounds allow major market transactions to occur and capitalistic economies to develop? What are the alternatives to trust law that allow a market to work? How is it possible that such alternatives develop despite the (allegedly) obsolete categories that civilians still use in their (supposedly) formalistic private laws? If there is a secret life of trusts in common law countries, what institutions can have similarly exciting secret lives elsewhere?[90] One approach to these questions, which will be developed further below, is through an analysis of the balance between those legal rules which are mandatory and those which are only default rules that can be varied by those affected.

3.2 Framing the questionnaire

The method adopted to treat our subject is thus new in its application to trusts. The contributions collected in the second part of this volume focus on fact situations as a starting point for comparative enquiry. The

[89] See Antonio Gambaro, 'Il Trust in Italia e in Francia', in *Studi in onore di Rodolfo Sacco*, I (Milan, 1994); Henry Hansmann and Ugo Mattei, 'The Functions of Trust Law: A Comparative Legal and Economic Analysis', 73 NYU L. Rev. 434 (1998).

[90] The amount of wealth held through asset management techniques in OECD countries is enormous. The pension fund sector alone in the OECD area held nearly 30 per cent of OECD financial assets in 2000, for a total of US $8985.4 billion (source: OECD website: www.oecd.org/dataoecd/20/41/2768608.pdf).

factual patterns featuring as cases in this book were designed to bring on stage the various legal techniques employed across Europe in our field of study, as well as to obtain answers about the probable outcomes of the cases in each national jurisdiction. This approach was utilised to overcome some well-known traps of comparative research in the field of trust law: i.e., the circumstance that several legal systems allegedly know nothing of 'trusts', or that acoustic agreement between different laws often masks disagreement about operative rules applicable to the facts. This methodological choice also set the boundaries for attributing meaning to the label 'trusts' in relation to the topics discussed in the following pages. That label is here used to refer generically to the factual patterns in the cases proposed for comparative treatment. In many European countries the legal issues raised by the facts of the cases are not brought under the legal category 'trust' at all, as was soon found out. In other countries, though, the opposite was true. Confronted with this situation, we adopted the general label 'trust' in the title of the volume to denote all the relevant facts of each case, thus leaving to the contributors to the project the task of establishing the proper categorisation of the facts at the national level. By adopting this approach, which is a feature of all the volumes published so far in the series 'The Common Core of European Private Law', we have developed a first set of comparisons starting from the analysis of the same factual patterns across sixteen European legal systems.

The attempt to answer fundamental questions has from one perspective limited the scope of our questionnaire but, at the same time it has broadened it beyond the traditional expertise of private law scholars. Indeed, the decision to tackle the kind of problems that Professor Langbein has successfully labelled under the idea of a 'secret life of the trust'[91] has allowed us to skip, as already mentioned, the very domain in which trust law is more commonly located. No attention has been given to trust law in the context of the law of family property or succession and more generally to charitable trusts. The kinds of problem that we were interested in approaching were only those connected to the use of this institution in investment settings, i.e. in the kind of relationship that develops between investors and managers of the invested assets.[92]

[91] Langbein, 'Secret Life of the Trust', above, note 72.

[92] The setting was described *faute de mieux* as 'commercial' in choosing the title for our project. We were comforted to learn that our choice was not isolated: David J. Hayton,

As a consequence, attention in the general part (Cases 1–7) has been given to issues of conflicts of interests; of unfaithful managers transferring the invested assets to third parties against the will of the investors; of conflicts between innocent third parties and innocent investors 'betrayed' by the managers; of conflicts between the will of the investor and that of the manager in situations in which the manager might have different, perhaps more risk-taking, attitudes as to the potential returns of a given investment form; of situations in which the manager's expertise can be frustrated by excessive worries or unstable preferences of the investor; of situations in which professional managers, as is often the case, have more than one client and the consequent problem of the way in which the law attempts to keep the different investors' positions separate from each other; of situations in which the manager becomes bankrupt and the consequent problem of keeping the investments 'bankruptcy remote' in order to safeguard the assets against the creditors of the manager; of situations in which the invested assets change their nature in the course of the trust relationship, with the consequent problem of tracing such changes in order to make the investments safe without frustrating the interests of innocent third parties.

As the reader will appreciate, these are central problems that any legal system has to solve in setting the legal framework for investments. Nevertheless, common core methodology does not allow us to be either formalistic or too abstract. In real life, investments are carried on by people who act as individuals, or as organisations. While in principle nothing precludes an individual investor from seeking the help of an individual manager, professional managers set up in more or less complicated organisations. Investors too can be institutionalised, and indeed in modern capitalistic systems 'institutional investors' such as mutual funds or pension funds are crucial actors in the market. Invariably the law regulates such organisational forms with multiple legal regimes so that, in order to grasp at least a sense of these complexities, the questionnaire has been enriched by a special part (Cases 8–11). In the special part we were forced to give up, at least in part, the case approach typical of the common core methodology and we have substituted it with more descriptive, perhaps sometimes doctrinal discussions. There are a variety of reasons for this difficult choice, including the relatively embryonic stage at which, in many European jurisdictions, private law

'English Trusts and Commercial Counterparts in Continental Europe', in Hayton, *Extending the Boundaries of Trusts*, 23 ff.

schemes are beginning to compete with public law ones (this is particularly true in the domain of retirement plans). The main reason has been, however, the difficulty and perhaps even the unsoundness of trying to describe such devices within an adversarial hypothetical. The truth of the matter is that many organisational devices that make markets work do not develop as an outcome of litigation. Rather, they constitute organisational options, growing out of institutional structures that are already in place. The common core methodology attempts to reflect such organisational devices at the 'third level' of our legal formants analysis.[93] This level involves the discussion of those factors which influence the approach to a legal issue without being either the actual solution of the case, or the taxonomy used to explain it. An effort to understand the law in its local economic and social context, which certainly varies from Germany to Greece and that will vary even more with the accessions of 2004, is certainly most needed in the highly path-dependent environment of trust law. In other words, many relevant differences between legal systems are not located in the domain of substantive rules of private law. They rather dwell in the procedural devices available, in the constitution and ways of a given business community, and in other 'third level' broader political matters such as, for example, the amount of state intervention in the economy and social security sphere.

As has been pointed out,[94] in the domain of trust law, while substantive and taxonomic differences matter a great deal, procedure might matter even more. Devices of judicial supervision (such as audits, etc.) that might be available for the beneficiary in jurisdictions where trust is an institute of general application might simply be absent in other jurisdictions, and in terms of the effectiveness of the protection available, that might be all that matters. In the replies to the questionnaire, and in our comparative discussions, we point out the most relevant of such differences.

3.3 *Common core research and the economic structure of the trust relationship*

For a variety of reasons, trust seemed a promising topic for the application of common core methodology. To begin with, some critics have challenged the common core project as biased in favour of uniformity. The very fact of approaching an area of the law traditionally seen as a

[93] See Bussani and Mattei, 'Common Core Approach to European Private Law', above, note 83.
[94] Schlesinger et al., *Comparative Law*, 869.

major point of departure between the civil law and the common law tradition is a reply to such critics. Secondly, the trust project allows us to test the common law vs. civil law opposition on a ground over which one would expect to see it confirmed. Should the factual analysis point at phenomena of convergence in this area of the law, or should it point at divergences that cannot be traced to any fundamental distinction between common law and civil law, the outcome of the research would be very significant. Thirdly, the application of common core methodology to trust relationships should shed light on the major features of property rights in the systems that we are considering. Property rights, in turn, are a fundamental aspect of any market and hence of the European market as well. Finally, the treatment of trust law offers the opportunity to examine some hypotheses on the economics of the trust relationship, which is attracting growing scholarly interest. All such considerations have driven the choice of the matters included in the questionnaire.

From an economic perspective, one could argue that a divided property rights structure as opposed to a strong unitary and monistic theory of property rights makes a more flexible and efficient market institution.[95] We have seen that in several civil law countries the very possibility of such flexibility is opposed or strongly questioned, but is it true that property rights in civil law countries are unitary, and what does this mean?

For the sake of clarity, let us reason in stylised terms for a moment, focusing on the desirable sticks which make up property in the bundle metaphor of it.[96] Let us also borrow a notion of property from the economist's view of the cathedral, a meta-notion that is not necessarily part of the positive law in any one legal system, but that can work as a yardstick to compare positive laws.[97] In this scenario, let us assume that a property relationship is the only one that grants full decision-making power over certain resources. Let us also assume that only proprietary remedies fully protect entitlements to certain assets.[98] If this were

[95] Cf. Harold Demsetz, *The Trend Favouring Private Ownership* (unpublished ms, on file).

[96] The genesis and the contemporary relevance of this metaphor is explored by James Penner, 'The Bundle of Rights Picture of Property', 43 Univ. Cal. at Los Angeles L. Rev. 713 (1996); Gregory S. Alexander, *Commodity and Propriety: Competing Visions of Property in American Legal Thought, 1976–1970* (Chicago, 1997), 319.

[97] This is a classic comparative law and economics methodological step. See Ugo Mattei, *Comparative Law and Economics*, (Ann Arbor, 1997), 58–67.

[98] Guido Calabresi and A. Douglas Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral', 85 Harvard L. Rev. 1089 (1972).

true, property would be the most desirable entitlement over the invested assets for both the manager and the investor (albeit for different reasons). Let us now moreover assume that the relationship between the investor and the manager is governed by a contract that conforms to a full privity principle, which strictly limits the contractual effects to the contracting parties. Seen as a market institution, and as a typical arrangement between an investor and a manager of the invested assets, the trust relationship inevitably shows some features of contracts and some of property. From the first perspective, the seminal paper by Professor Langbein devoted to the Anglo-American trust has pointed out that trust law, like contract law, is mostly an aggregate of default rules aimed at gap-filling in certain recurrent transactions, so that the parties, by using the label trust, can incorporate in their contracts a highly developed body of law on the trustee's fiduciary duties.[99]

As to the relationship of trust with property, two fundamental aspects can be pointed out. First, the trustee, as the owner of property, should have full decision-making power over the trust property. This is particularly important in the business world where quick, reliable and unimpaired decision-making is *per se* an important asset that an agent, in principle, does not enjoy, but that the trustee does.[100] This decision-making power is one of the essential features of ownership. In the case of full ownership,it is extended all the way to many irrational behaviours that the legal system simply has no power to preclude or to sanction. From the decision-making perspective, therefore, the entitlement of the beneficiary is protected only by a *liability rule*; he will not be able to interfere with the trustee's decision-making power when it is exercised, though violation of the rules governing trustees' decision-making will attract trustees' liability.[101] The property right, here, is

[99] Langbein, 'Contractarian Basis of the Law of the Trusts', above, note 79; John Langbein, 'Mandatory Rules in the Law of Trusts', 98 Nw. U. L. Rev. 1105 (2004) further elaborates the point by distinguishing between mandatory rules which actually serve the settlor's autonomy, and mandatory rules that restrict that autonomy to implement an anti-dead-hand policy.

[100] The pressure to develop efficient decision-making rules is in fact so high that agency law itself has developed doctrines to enhance an agent's power to bind the principal beyond the limits of actual authority, not to mention statutory rules that have been specifically designed to that effect.

[101] But even under the property rule/liability rule approach we should be mindful that liability may be sanctioned by restitutionary remedies: Saul Levmore, 'Unifying Remedies: Property Rules, Liability Rules, and Startling Rules', 106 Yale LJ 2149 (1997).

vested in the trustee.[102] But does this theory reflect the practice in those jurisdictions where trust law flourishes? Can the manager be considered as an owner in this respect? Is the manager so considered in the laws of the countries surveyed in the following pages? These are some of the questions that should be enlightened by this volume. Second, the large transfer of decision-making authority over the trust property that the creation of a trust brings about can only be afforded by a legal system that grants significant and effective powers to the beneficiary. Such protection brings in another fundamental analogy between the structure of the trust relationship and that of property rights. The proprietary protection of the trust fund in favour of the beneficiary becomes apparent in case of bankruptcy of the trustee.[103] The personal creditors of the bankrupt trustee cannot satisfy themselves out of the trust property, which remains 'bankruptcy remote' at the disposal of the beneficiary. If the property is owned by the investor, the creditors of the manager cannot satisfy themselves any more on the trust property than they could do on a bicycle belonging to the investor and parked in the manager's garage. Observed from this angle, the trust property simply does not belong to the manager: it belongs to the investor. In common law trust theory a number of remedial devices, of which 'tracing' is only the most interesting for a civil law observer,[104] reinforce this analogy between the remedial devices of the owner (who can chase his property wherever he finds it, i.e. in the manager's garage) and those of the beneficiary. One could say that the entitlement of the beneficiary is here protected by a *property rule*.[105] No wonder, then, that in common law jurisdictions one can see ownership vested simultaneously in the manager and in the investor, as we have just noticed.

If one observes this picture from the perspective of a system that is unable simultaneously to grant property both to the manager and to the investor things change quite dramatically.

[102] Calabresi and Melamed, 'Property Rules, Liability Rules', above, note 98. Strong cases in favour of the general desirability of property rules in a variety of contexts have been made by Richard A. Epstein, 'A Clear View of the Cathedral: The Dominance of Property Rules', 106 Yale LJ 2091 (1997) and by James E. Krier and Stevard Schwab, 'Property Rules and Liability Rules: The Cathedral in Another Light', 70 NYU L. Rev. 440 (1995).

[103] Hansmann and Mattei, 'Functions of Trust Law', above, note 89.

[104] Lionel Smith, *The Law of Tracing* (New York, Oxford, 1997). In comparative perspective: Peter Schlechtriem, ' Unjust Enrichment by Interference with Property Rights', in *International Encyclopedia of Comparative Law*, X, ch. 8, paras. 92–96.

[105] Mattei, *Comparative Law and Economics*.

Let us imagine, for a moment, that the traditional story about a typical civil law jurisdiction were true. In that jurisdiction, trust law for inter vivos transactions between competent adults as a body of default, gap-filling rules could be almost perfectly substituted by the provisions on the contract of mandate, which are well developed in many civilian countries. However contracts, ex hypothesi, are ill situated to take care of third party effects, so that property has to enter into the picture. The proprietary aspects involved in the idea of allocating some sticks in the bundle to the manager (decision-making power) and some to the investor (protection) cannot be accommodated in that jurisdiction, however. We have seen above that in civilian jurisdictions there is resistance to conceive of property rights vested simultaneously in the trustee (managing powers) and in the beneficiary (protection as against third parties). Therefore, the story goes, only the following alternatives are available. If the trust relationship is established by means of contract, without transfer of ownership, the trustee will find himself in a subordinate position before the beneficiary who, being the owner, will maintain a significant amount of decision-making power that can interfere with the free decision-making of the manager. To be sure, the beneficiary can be stripped of some decision-making power (and in fact he frequently is) in various ways, or simply by de facto informational asymmetry between the parties. Nevertheless, it is arguable that the tension between the needs of effective decision-making power for efficient management and the power-sharing outcome of the contractual arrangement creates a distorted incentive scheme. If the trust relationship were to be created by transfer of ownership, on the other hand, the manager becomes the sole owner of the trust assets and can decide as he likes. The investor's protection will be very limited, because he will not be able to pursue remedies against third parties. At most, he is protected by a *liability rule* as against the unfaithful trustee, who is 'the owner' as against the whole world. Having parted with ownership, the beneficiary will have to suffer the effective competition of the personal creditors of the trustee. In bankruptcy cases, this makes up the crucial difference between the common law trust and the civilian alternatives, according to the conventional wisdom.

As we will see, this prima facie picture generated by reasoning with the categories of property and contract (or, more familiar to the civilian reader, of ownership and obligation) might not precisely reflect the law in action. We believe that in the present volume this, at least, has been verified. The institutional structure created by the Anglo-American trust does allow a plain division of labour between the trustee and the beneficiary, which civilian taxonomy finds difficult to grasp. By using common core methodology, we attempt to go beyond current taxonomy, to uncover the law in action and thus to contribute to a better understanding of the present European legal landscape.

It must be recognised, however, that from an economic perspective, such a division of labour is efficient. By granting proprietary protection to the beneficiary the law reduces agency costs.[106] By granting proprietary powers to the trustee the law facilitates transfers to more efficient uses. In general, transaction costs are significantly reduced because the manager (trustee) can devote his resources to grasping business opportunities instead of working on obtaining the consent of the investor (beneficiary) to the transaction. The investor (beneficiary) will be able to devote his resources to his principal activity (e.g. teaching law, or farming), and rather than devoting his own time to searching for business opportunities he may consider hiring a professional, who will be better equipped to do the job. The division of labour that follows from this arrangement is a crucial aspect of economic development.[107] We might conclude that the stylised structure of trust law that we have sketched above constitutes an institutional arrangement that should be widely recognised. The intention to examine to what extent this arrangement is already available in Europe has been a basic motivation for launching a common core project on commercial trust.

3.4 *Some fundamental questions approached*

How do civil law jurisdictions tackle these basic problems of labour division? As often happens, it is easier to see what would not work as an institutional solution rather than what would work. In other terms, the first step to approach the problem is to get rid of at least some of the most useless questions that are usually asked in the comparative law literature on trust.

From the contractarian perspective, the main aspect of trust law is its gap-filling role, i.e. the role played by a system of default rules.[108] Is this body of law present or absent in civilian jurisdictions? If it is present, how can it be located? If it is not present, can it be borrowed from

[106] Robert H. Sitkoff, ‘An Agency Costs Theory of Trust Law’, (2004) 89 Cornell L. Rev. 621.

[107] Douglass C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge, New York, 1990).

[108] Langbein,‘Contractarian Basis of the Law of Trusts’, above, note 79.

another jurisdiction? How? The basic problem is, then, whether some of the local rules governing trust in the commercial setting should be considered mandatory (either because of paternalism or because of externalities problems)[109] and how to distinguish mandatory from default rules across the legal systems. It is not easy to approach this topic with the common core methodology, but this issue is certainly a central and most promising one. The last case of the general part of our questionnaire (Case 7) explores it by provoking answers that focus on the role of party autonomy in the choice of the applicable law when all the connecting factors point to the forum law but for the express choice of the foreign law.

If the focus is on the contract aspects or if trust is to be approached as ‘a matter of obligation’, as one would say in the traditional comparative law jargon, the relationship between the parties involved in the trust deal occupies the centre of the stage. But such relationship does not develop in a vacuum. As invariably happens when the parties contract for managerial services involving transfers of property rights, it will affect third parties. The question then becomes how the law takes care of third parties, or how, in other words, it is possible to avoid externalities and to send clear signals to third parties that will prevent them from being unwillingly affected by externalities. This is the traditional function of property law, or at least, to use Professor Carol Rose’s convincing reconstruction, of the ‘crystal’ characteristic of property law.[110] Contract law needs to be supplemented by property law when it allows deals affecting third parties, because the contracting parties might opportunistically shift some of their costs to third parties.[111] Property law strives to remain simple to offer relatively uniform signals to a wide variety of individuals who do not share the particular knowledge generated by the bargaining amongst themselves. Whether or not simplicity in property necessarily carries ‘mud’ (i.e. potentially tragic commons problems, which courts consequently mess up in a clumsy attempt to take care of them),[112] it remains true that property law is ill equipped to take care of the flexibility needs of complex transacting. There is a clear tension between the need for simplicity in signalling to a collectivity of uninformed third parties, and the need of flexible

[109] Ian Ayres and Robert Gertner, ‘Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules’, 99 Yale LJ 87 (1989).

[110] Carol Rose, ‘Crystals and Mud in Property Law’, 40 Stan. L. Rev. 577 (1988).

[111] Michael J. Trebilcock, *The Limits of Freedom of Contract* (Cambridge, Mass., 1993), 58 ff.

[112] This theory is advanced in Rose, ‘Crystals and Mud in Property Law’, above, note 110.

instruments to give legal form to the nuances of the meeting point between supply and demand. While, for example, it is technically possible to register and signal to third parties certain limitations of property rights, but not the whole variety of contingencies that might affect them, the reciprocal obligations of the contracting parties can be described in great detail by resorting to a written document. As a consequence, some aspects of a deal live their whole life in the domain of contract law and will not affect unknowing third parties, while others enter the domain of property and can be opposed to third parties who should have known them. It would simply be too costly to make every possible detail of a deal among parties known to everybody. And of course it might not even be desirable. Legal systems have to strike a balance here. Accordingly, the productive question is not whether trust is a matter of property or of obligation, but which aspects of the trust relationship should become known (at least in theory) to everybody and which should not. This is why the questionnaire tries to assess the impact of the relationship on innocent third parties from different angles. While the property structure is well equipped to take care of the former need and poorly equipped for the latter, the contract structure works the other way around. The complex institution called trust needs both, and indeed legal systems have used both of these stylised forms, as our research shows. The goal is to see, in the law in action, the actual ratio between them.

The obligation vs. property issue all too often turns out to be a red herring also because it precludes the correct appreciation of institutional alternatives to trusts in a business setting. It is interesting to observe that lawyers from major civilian jurisdictions, if asked to inform colleagues from a common law jurisdiction on 'alternatives' to trust law available in their countries, would invariably expand on the niceties of the venerable notion of the 'fiducia cum amico', or the like, which has very little application in the commercial context, but would invariably omit any discussion of corporations. Several of the prima facie replies to the questionnaire offered by leading experts in civil law jurisdictions involved as reporters in this project showed this attitude. Interestingly, it almost exactly parallels the phenomenon pointed out by Professor Langbein in his article on 'The Secret Life of the Trust',[113] as well as in the remarks he gave to the authors of this volume at the Como meeting of our group. Common lawyers nurture a vision of trust

[113] Langbein, 'Secret Life of the Trust', above, note 72.

determined by its role in domains (like succession, or family law) that in economic terms are relatively trivial especially when compared to the role that trusts play in the business sector. In the domain of business law, the area in which most of the stakes of European legal integration are at play, the relationship between trust and corporation as competitive alternatives had to be tackled. This is an area in which very substantial transaction costs may be saved by offering a simple legal form, able to take care of both the needs of flexibility and of abating externalities, through a proper mix of contractual and property structures.

2 A short note on terminology

MICHELE GRAZIADEI, UGO MATTEI AND LIONEL SMITH

1 The purpose and the scope of this note

As previous works in the Common Core of European Private Law series show, the treatment in the English language of the law of the Member States of the European Union is fraught with terminological problems.[1] At first sight, these problems seem to originate essentially from the desire to express in English a number of legal concepts that do not have their roots in English law. The truth of the matter is that the same problems arise whatever natural language is employed to frame and present cross-border research on the law of several European jurisdictions. To be sure, a book on the English law of trusts written in French would have to make some shrewd terminological bets to render in that language key concepts of English law.[2]

In any case, considering the use of English for the purposes of comparative legal research, the language obstacle would pose a tremendous challenge only if we were to ignore the fact that English as a legal language has a life of its own, not necessarily related to English law. Happily, nobody requires us to ignore that fact. In Europe, the law of Scotland is a monumental example of how the English language can express legal concepts unknown in England. Outside Europe, there are civil codes largely indebted to the civilian tradition which are in force in English. And, of course, Roman law has been translated and commented upon in English, just like in other contemporary European languages.

[1] Nicholas Kasirer, 'The Common Core of European Private Law in Boxes and Bundles', (2002) 3 *European Review of Private Law* 417, provides an instructive discussion of these problems.

[2] See e.g. François Barrière, *La reception du* trust *au travers de la fiducie* (Paris, 2004); Jean-Paul Béraudo, *Les trusts anglo-saxon et le droit français* (Paris, 1992).

There is a rich repository of terms of art and expression in English that can alleviate some of the linguistic problems of the present study. But this treasure box must be used with some caution: erudition is hardly the same as the ability to communicate.

This first general observation must be supplemented with some remarks on the impact of multilingual legislation which is in force in Europe. European Community legislation has the same meaning in all the official versions. The advantage provided by the existence of such a corpus of multilingual texts is, however, still only a minor gain for our purposes.[3] Though in the Member States the language of the law is being transformed by the impact of Community legislation (and of other non-national multilingual sources), it is still fair to say that the multilingual corpus thus available does not yet generally bridge the linguistic gap existing between national legal experiences. Hence the necessity of finding a means of bridging that gap in the course of our study. The discussion of this issue among contributors to this volume quickly came to the conclusion that the questionnaire had to be framed in terms that did not point to the law of any specific jurisdiction and that could at the same time be understood throughout Europe. Aiming at this result, the language of the questionnaire had to be neutral as far as the usage of legal terms was concerned; in no case should these terms be allowed to pre-empt the answers. Finding this language proved to be a relatively simple task, as will be seen. The more complex part of the job came with the answers to the questionnaire. They showed a bewildering usage of a variety of English terms and expressions that did not have a stable denotation because they referred at the same time to many distinct concepts existing in each jurisdiction. Even more disturbing, the same notion was sometimes referred to by different English expressions. This created the impression of difference where no difference in fact existed. On the other hand, it emerged that where the laws of England and Wales, Ireland and Scotland were dealt with by English native speakers, their language had to take into consideration the needs of an international audience. That audience would not necessarily read a text as native speakers would.

[3] Rodolfo Sacco and Luca Castellani, eds., *Les multiples langues du droit européen uniforme* (Turin, 1999). In this volume, Olivier Moréteau, ‘L’anglaise: pourrait-il devenir la langue juridique commune en Europe?’, 143 ff., notes that English could serve as a means of communication for European lawyers if it evolves into a language that is detached from common law models.

In the face of this situation, it did not seem sufficient or appropriate to provide a standard glossary of terms as an appendix to the study. Instead, a note addressing the most pressing terminological issues raised by the reports was prepared to encourage the use of a vocabulary that would be more stable and transparent. The role of this vocabulary was not to superimpose English legal concepts on different realities because the focus of the research was on the present state of law of each jurisdiction, including its conceptual apparatus. In the opinion of the contributors to this project, the language had to be adapted to the different realities, not vice versa.[4] Therefore, in this study some English legal terms do not necessarily have the same denotation(s) that they would have in English law. Furthermore, some words that an English lawyer would not consider as part of the usual stock in trade of his profession feature here to describe concepts in use in other European jurisdictions. The substance of that terminological note is reproduced here to provide some guidance on the terminology used in this book. Considering the purpose of this note, reference to the current literature on the topics covered in the next two paragraphs has been limited to the essential.

In our experience, serious problems of terminology were mostly related to two topics. The first was the description of the various notions employed in Europe to express the relationships which exist where one person agrees that another person should act on his behalf when entering into legal relations with a third party. The second related to the problems raised by the need to name and discuss in English a number of legal transactions or institutions that are redolent of trust (e.g. 'fiducia', 'Treuhand'), but are governed by Austrian, Italian, German, Spanish law, etc. Could these transactions be described as 'trusts', even though the concepts employed to analyse them had nothing or little in common with the building blocks of the law of trusts in common law jurisdictions? Could this choice be justified also in light of the fact that in many of our cases it appeared, after all, that the proper characterisation of the relationship between the parties under English law, Irish law and Scottish law *was* 'trust'? Hereafter the first problem is dealt under the

[4] Kasirer, 'Common Core', above, note 1, rightly notes that this approach relies on the idea that law has no necessary relationship with the words or the language ordinarily used to give it expression. See also on the translation of terminology: Susan Šarčevic, *New Approaches to Legal Translation* (The Hague, Boston, 1997), 229 ff.

title ‘the agency problem’; the second is considered under the heading ‘the trust problem’.

2 The agency problem: civilian approaches

The terminology that is employed today in continental Europe to describe legal transactions whereby one person agrees that another person should act on his behalf vis-à-vis a third person is the historical product of the interaction of three principal factors: the Roman law and its tradition as received by the civil codes; the law merchant and in legacy in the epoch of the commercial codes; and the theories of representation developed by nineteenth-century German legal writers and their impact on subsequent doctrinal treatment of the topic. More recent additions to these roots were introduced by Community law in the investment services and collective investment schemes fields.[5] However, for the reasons explained above, i.e. the multilingual character of European legislation, this more recent source of innovations posed problems which need not be covered here.

The Roman law of contracts labelled as ‘mandate’ (*mandatum*) the contract which authorised and obliged one party – the mandatary – to act on behalf of another party – the mandator. The contract was gratuitous and the services rendered by the mandatary could be various, but in any case the acts of the mandatary never established a direct legal relationship between the third party and the mandator, for whom the mandatary acted. To be sure, the Roman law in some stages of its development admitted a number of institutions – like slavery – which reversed the rule established with respect to mandate. There were devices that produced results which can be described in terms of ‘direct effects’. Nevertheless, with respect to acts performed by free persons, the general principle of the Roman law – honoured in theory, if not always in practice – was that no direct effect in favour of the person for whom the act was accomplished could follow from the acts of a free man. The subsequent history of the Roman law is the story of the

[5] On the other hand, it should be clear from the outset that commercial agency law as defined by Directive 86/653/EEC on the coordination of the laws of the Member States relating to self-employed commercial agents and the corresponding national legislation has nothing to do with our study.

reversal of the principle against direct representation which dominated the classical Roman law.[6]

All the civil codes now in force in Europe admit that a person can act in a representative capacity, thereby establishing direct juridical effects between the third party and the party who granted the power so to act. However, the civil codes currently in force were enacted in different periods and they still reflect a variety of approaches to the matter.

The French Civil Code does not distinguish between mandate as a contract and the granting of the power to act as a representative. Pursuant to art. 1984 of that code: 'Le mandat ou procuration est un acte par lequel une personne donne à une autre le pouvoir de faire quelque chose pour le mandant et en son nom. Le contrat ne se forme que par l'acceptation du mandataire.' The contract of mandate of the French Civil Code is, at the same time, the source of the power of representation: the mandatary establishes direct legal relationships between the third party and the mandator, by communicating to the third party that he is acting in a representative capacity, or, to express the same concept in other words, in the mandator's name. A similar approach to mandate and representation is adopted by the Austrian Civil Code (ss. 1002 ff. ABGB). The French Civil Code, while conveying the idea that mandate is not only a contractual arrangement, but also the source of a power of representation, omits to clarify what legal relationship is established when the intermediary is not authorised to create direct legal relations between the mandator and the third party. With regard to this case, several interpreters of the French Civil Code speak of mandate without representation (*mandat sans représentation*).[7] The same situation, however, can be also considered under another label, that is to say the *convention de prête-nom*.[8] The first terminological choice – mandate without representation – is closer to the idea that the power to represent somebody has little to do with a contract, be it mandate, or any other kind of contract. This approach is sympathetic with the German approach to this area of the law, which will be

[6] Over the centuries, the erosion of the Roman law legacy became more and more visible and the modern law developed, as Reinhard Zimmermann says, 'largely in opposition to the situation in Roman law'. Zimmermann, *The Law of Obligations. Roman Foundations of the Civilian Tradition*, 1st edn (Cape Town, Wetton, Johannesburg, 1990), 45 ff.; on the law of mandate and *procuratio* see ibid., 50 ff., 413 ff. Since the present note covers problems of terminology only, we will not discuss the wider Roman law context.

[7] Cf. Claude Witz, *La fiducie en droit privé français* (Paris, 1981), 229 ff., nos. 236 ff.

[8] Marie-Laure Izorche, 'A propos du "mandat sans représentation"', D. 1999, Ch. 369.

discussed below. As to the *convention de prête-nom*, that notion evokes the idea that, when a person acts for someone else, but not in a representative capacity, a dissimulation is taking place. Today, however, despite these nuances, and the different conceptual backgrounds of *mandat sans représentation* and of *convention de prête-nom*, it can be safely assumed, at least for our purposes, that this is a (terminological) distinction without a (substantive) difference. The terminological problems we are confronted with are further complicated by the fact that the civil code, in France, tells only a part of the story. The French Commercial Code contains articles on the *contrat de commission* (arts. 94 ff.). Contracts of commission are yet another example of how the legal category of mandate has been very productive, in historical perspective. A *contract de commission* is essentially a mandate of a commercial nature. In French law, the intermediary acting on the basis of a contract of commission is called the *commissionnaire*. The person for whom the *commissionnaire* is acting is known as the *commettant*. Traditionally, the contract of commission did not involve the creation of a direct legal relationship between the third party and the person for whom the intermediary was acting, because on the basis of such contract the transaction was carried through by the intermediary who did not act in a representative capacity vis-à-vis the third party. The French *commissionnaire* may, however, if authorised by the *commettant*, act as a representative. The word 'commission' conveys the idea that services rendered by this intermediary are always remunerated, which is not necessarily the case with the contract of mandate of the civil code.

Turning now to German law and to its terminology, the German Civil Code draws a clear distinction between the general institution of representation (*Vertretung*: BGB §§ 164–181) and the contract of mandate (*Auftrag*: BGB §§ 662–676).[9] By drawing that distinction in the clearest terms, the approach adopted by the drafters of the German Civil Code reflected the nineteenth-century German doctrinal trends that insisted on the need to separate the different aspects of the relationship between the parties, i.e. the internal side and the external side of the relationship. These trends soon attracted attention abroad as well, and thus had an impact well beyond German borders. Under this approach,

[9] See Basil S. Markesinis, Werner Lorenz, Gerhard Dannemann, *The German Law of Obligations, I, The Law of Contracts and Restitution: A Comparative Introduction* (Oxford, 1997), 71 ff.; in a broader comparative perspective: Rudolf B. Schlesinger et al., *Comparative Law*, 6th edn (Mineola, New York, 1998), 853 ff.

the power to establish direct legal relationships between the third party and the person for whom the intermediary acts originates from the latter's consent (*Vollmacht*: BGB §§ 166–176). That consent authorises the intermediary to act in a representative capacity. Such authorisation is thought of as distinct from the contract governing the relationship between the intermediary and the person for whom he is acting, or from any other legal act or circumstance that establishes the so-called internal relationship. Representation, under German law, has therefore nothing to do with the contract of mandate. Under German civil law, the contract of mandate is gratuitous by definition (BGB § 662). If the intermediary is entitled to remuneration for the services he renders, there will be a different contract (*Geschäftsbesorgungsvertrag*), which is distinct from the contract of mandate simply because the German Civil Code follows the Roman law on the essential gratuitousness of mandates. Of course, in Germany, like elsewhere, an intermediary need not always act in a representative capacity, in the name of the person who appointed him to act as a representative. In that case, German lawyers speak of indirect representation (*mittelbare Stellvertretung*). This expression – which is also in use in other legal systems and is adopted by the Principles of European Contract Law, chapter 3, section 3 – conveys the idea that the intermediary does not establish a direct legal relationship between the third party and the person who will eventually reap the benefits and bear the burdens of the transaction between the intermediary and the third party.[10] German legal terminology on the contract of commission (*Kommissionsvertrag*), that is concluded between the *Kommissionär* and the *Kommittent*, poses no special problems when compared to French usage in the same field (cf. HGB §§ 383–406).

In some other national legal systems, just like in France, the distinction between mandate and representation is not expressly stated in the civil code, but has evolved by doctrinal development, inspired by the German approach to this field of law. This is the situation in Belgium and in Austria, where the codes belong to the first historical wave of European codifications. On the other hand, general provisions on the power to authorise an intermediary to act in a representative capacity (and on the effects of acts done in such capacity) are a feature of all the

[10] For difficulties in understanding the idea of indirect representation in the framework of the English law of agency, see Danny Busch, 'Indirect Representation and the Lando Principles. An Analysis of Some Problem Areas from the Perspective of English Law', (1999) 7 ERPL 319.

civil codes enacted in the Member States since the entry into force of the German Civil Code in 1900. In Italy, for example, the contract of mandate can be coupled with the power to represent the mandator (*mandato con rappresentanza*), or can be concluded without authorising the mandatary to act in a representative capacity (*mandato senza rappresentanza*).[11] Here, it is clear that mandate and representation are different legal institutions, and rules concerning them are contained in different parts of the code, though for certain aspects (e.g. termination of the relationship) the distinction is not really watertight. The terminology related to the contract of commission, where the unification of the civil and commercial codes has not closed the gap between commission and mandate, seems to be relatively uniform across Europe.

3 The agency problem: how to translate civilian terminology into English

The terminology of the English law of agency owes little to the Roman law of mandate, or to the German theories on representation which became known during the last hundred years or so across Europe. True, 'mandate', as it was known to the Roman law, is mentioned in some English cases[12] and in some current textbooks on English law.[13] But though these references may satisfy historical erudition or contemporary curiosity, they hardly reflect current English usage. On the other hand, the English law of agency still shows its debt to the historical experience of the law merchant. The very terms 'principal' and 'agent' come from that background.[14] It could therefore be tempting to draw from this branch of the English law the legal terms that are needed to express in English concepts of Austrian law, German law, French law, etc. The temptation should, however, be resisted for at least two reasons. First of all, the relationship between principal and agent under English law does not fit into the framework of a law of contracts which

[11] Italian Civil Code, arts. 1704, 1705.

[12] See the famous case of *Coggs* v. *Bernard* (1703) 2 Ld Raym. 909; more recently see: *Barclays Bank Ltd* v. *W. J. Simms Son & Cooke (Southern) Ltd* [1980] QB 677; *Conservative and Unionist Central Office* v. *Burrell (Inspector of Taxes)* [1982] 1 WLR 522 (CA).

[13] N. E. Palmer, *The Law of Bailments*, 2nd edn, is the latest author in a line that goes back to the famous treatise of Sir William Jones, *An Essay on the Law of Bailments* (London, 1781), 52–54.

[14] Roderick Munday, 'A Legal History of the Factor', (1976) 6 Anglo-American L. Rev. 221; Maurizio Lupoi, 'Elementi di "civil law" nell' "agency": la terminologia', Foro it., 1980, V, 137.

still distinguishes between the various kinds of nominate contracts, as many legal systems do, paying homage to the Roman law tradition. Second, in England the law of agency covers both the so-called internal relationship between principal and agent *and* the external side of the same relationship. In other words, the law of agency regulates both the reciprocal obligations of principal and agent inter se *and* the agent's power to establish a direct legal relationship between the principal and the third party. To be sure, the distinction between the different sides of the agency relationship comes into play, when necessary, in England too. But that distinction has not been elevated into a reason to treat those two sides of agency as separate branches of the law.

To keep track of these different approaches, the expressions 'contract of mandate' and 'mandate' as used by lawyers based in continental countries have not been turned into 'agency', though in our cases an English lawyer would at times see an agent acting for a principal. The terms 'mandator' and 'mandatary' are accordingly introduced to name the parties to a contract of mandate. Since in different European countries a contract of mandate may have different legal consequences, it remains necessary to make clear in what capacity the mandatary enters into a contract with the third party. Is the mandatary acting in a direct representative capacity? Even though in some countries (e.g. France) it is obvious that the mandatary is authorised to establish a direct legal relationship between the mandator and the third party, this is not always true in other countries. Therefore, answers to the questionnaire should in any case let the reader know whether the mandatary is acting in a representative capacity, i.e. is establishing a direct legal relationship between the third party and the mandator, or not. On the basis of the same considerations, 'representation' is used as a translation of the French word *représentation*, of the Italian *rappresentanza*, of the German *Stellvertretung*, etc., that is, of the legal relationship which in civilian contexts is deemed to exist whenever an intermediary establishes a direct legal relationship between the third party and the person granting the intermediary the power to do so. 'Agency' was thought to be too general to convey this specific meaning, though, once more, an English lawyer would consider this relationship as a typical instance of agency. The expression 'power of attorney', on the other hand, always indicates that a person is appointed to act as a representative *under a document* granting that authority.

Turning to the problem of how to render in English the French 'commission', the German 'Kommission', etc., the preferred solution was to translate these expressions as 'contract of commission' (and to use 'commission agent', if needed, to refer to the intermediary employed under that contract). Once more a caveat is necessary: these terms are used as translations of the corresponding terms of several legal systems of continental Europe only. A German or a French commission agent is not necessarily in the same legal position as an English agent who is known by that name.

4 The trust problem

The questionnaire was *not* designed to elicit answers that would tell readers whether 'trusts' were part of the legal system covered by the national reporter or not. It was designed to know what the law on certain facts was in the various jurisdictions covered by our study. Nonetheless, it soon became apparent that on both sides of the Channel several of our cases triggered responses evoking institutions redolent of the idea of 'trust' (though, to be sure, not across the entire European continent!). The Spanish 'fiducia cum amigo', the German and Austrian 'Treuhand' that is created for the administration of assets, the Italian 'fiducia a scopo di gestione', etc., are examples of this phenomenon. In historical perspective, these are all inter vivos transactions that are conceptualised under the heading of 'trust' as a consequence of the renewal of the Roman law tradition and the rediscovery of German legal antiquities that took place during the nineteenth century.[15] They are structurally close to the contract of mandate without representation. Indeed, in some instances, this is the classic distinction without a difference. During the twentieth century, scholarly contributions on these topics became part, once more, of the stream of civilian legal thinking. They thus prepared innovations that eventually bore fruit in legal practice too. The fact that for many purposes words like 'fiducia', or 'Treuhand', can be translated as 'trust' – think of everyday conversations – does not mean, however, that they should be so translated in this study. Readers need to know to what legal institution the country report is referring in each case. These expressions, therefore, will often be left untranslated, but to speak of 'fiduciary contract', or of

[15] Cf. Sibylle Hofer, 'Treuhandtheorien in der Deutschen Rechtswissenschaft des 19. Jahrhunderts', in Richard Helmholz and Reinhard Zimmermann, eds., *Itinera Fiduciae. Trust and Treuhand in Historical Perspective* (Berlin, 1998), 398. On this legacy in Liechtenstein law see Alexandra Braun, 'Caught in the Crossfire: Is the Liechtenstein Treuhanderschaft a Trust or a Treuhand?', (2004) Trust L. Int. 26.

‘fiduciary transfer of ownership’ it is not inappropriate to refer to any of those institutions. Though the English term, as such, has no settled legal meaning across Europe, it will put readers on the alert as to the context to which it belongs. There is room for an exception to this approach where the point is to discuss the question in Case 7. Since that question speaks of a trust governed by Jersey law, the answer will be framed by using the notion of ‘trust’ which features in the question.

3 The Hague Trusts Convention twenty years on

DONOVAN WATERS QC

1 Introduction

In June 1982 the delegates to a Special Commission that was to prepare for the Fifteenth Session of the Hague Conference on Private International Law met for the first time. They represented twenty-one states which were members of the Hague Conference, a number that was to swell to thirty-two at the meeting of the Fifteenth Session in October 1984. The common law states represented were the United Kingdom, the United States, Australia and Canada. There were observers of various international organisations both to the Commission and to the Fifteenth Session. The task of the Special Commission, set by the Fourteenth Session in 1980, was to design a Convention for presentation to the Fifteenth Session on the applicable law to govern trusts and on the recognition to be accorded the trust by a state that ratifies the Convention.

The text of a draft Convention was completed in October 1983, and a year later, following a full consideration of this text and significant changes, the final text of the Convention was adopted by the Fifteenth Session held in October 1984.[1] The Convention came into force on 1 July 1985.

The present writer, representing Canada, was one of those delegates. This chapter looks back to the Convention that the Fifteenth Session adopted, and to the reception of the Convention during the following twenty years. It is intended as an entirely personal view of both events, the international agreement and its reception. There is one caveat.

[1] The full text of the Convention is available at www.hcch.net, where a complete bibliography on the Convention is also available.

Perhaps inevitably it will reflect the hand of one whose primary training is in the common law.

2 The concept that is the trust

The trust is usually understood around the world to refer to the legal notion whereby property is held as a segregated asset or fund of assets, the benefit of which accrues solely to described persons or to the accomplishment of charitable purposes. Charitable giving benefits the public at large. In the common law system title to the fund is held by a trustee, or another, such as a corporate custodian, on the trustee's behalf. The fund, segregated from the trustee's own assets, is retained, administered or invested by the trustee. The trustee, who may be a natural person or a corporation, is said in common law terminology to hold the title on certain 'trusts'. From this language originates the title of 'trustee' or one who carries out the 'trust' or 'trusts'. These 'trusts' are the so-called objects, i.e. the persons to be benefited or purposes accomplished, of this property-holding and management device.

The 'trust' is the name popularly given to these circumstances when certain property is managed by A for B or for the carrying out of a purpose. It is the term of art used by common law lawyers themselves. However, the 'trust' more correctly means the obligation owed by the trustee to the beneficiary or to discharge the charitable purpose. The consequent essential characteristic of the trust – and I deliberately use the popular name – is the relationship of obligation and right that exists respectively between the trustee and the beneficiary (or purpose).

The relationship is known to common law lawyers as a fiduciary relationship, because the English courts historically understood the trustee as one who is held to the highest standards of integrity, application and selfless service. This is explained by the fact that the beneficiary is placed by the concept at the mercy of an empowered trustee who has the means to act for the beneficiary's good, as he is intended to do, or for that beneficiary's ill. The trustee is charged to adhere to this level of conduct in the management of property, whose enjoyment is a right belonging to another or adhering to a purpose. The accompanying essential characteristic of the trust is the segregated nature of the trust property. The fund is dedicated to the furtherance of the beneficiary's benefit or the purpose. The heirs and creditors of the trustee in his affairs having nothing to do with the trust have no right to claim that fund. Nor has the spouse of the trustee any claim against the trust fund on his marriage breakdown, nor have his close relatives on his death, any claim against the trust fund. Otherwise either may have rights to the trustee's own property.

The trust is used within the common law system not only for private client transfer of individual wealth to family and charitable purposes, but within a wide range of commercial and business operations. In each of these various employments of the trust, it is property holding, property management or investment that is being carried out. While the trust concept in many private and commercial transactions is used together with a legal *persona* – a corporation – and with agency, including the power of attorney, conceptually the trust itself is neither an entity nor an agency (or mandate).

However, whatever clarity of understanding the Anglo-American law student has in seeing the distinctions of trust, *persona* and agency, common law lawyers have had their own problems in characterising the trust device. For the first 300 years of its life the trust was essentially thought of as the *in personam* relationship of trustee and beneficiary (or purpose). The trustee owed the beneficiary – and for ease of expression I will hereafter refer to the trust object in this manner – the duty to account for a due and proper administration of the trust property for the beneficiary's benefit, and the remedy was therefore *in personam*. In the nineteenth century, however, the trust beneficiary came to be seen as having an interest in the trust property itself. He was seen to have the right to recover the trust property taken out of the fund by a fraudulent trustee, and the additional right to recover the property from a third party who acquired that property with actual or constructive notice of the trustee's wrongdoing. If he might bring such an *in rem* remedy – went the thinking – had he not a right in the trust property itself reflecting his interest as a 'trust beneficiary'? Today most would accept that in the common law the trust is a property concept, but the thought prevails with many that essentially it is a personal relationship. The dispute is not over.

Then for tax purposes some common law jurisdictions like Canada expressly describe the trust as a person and tax it as such. Others like the United States treat it as a 'flow through' vehicle, meaning the trust relationship can be ignored and the trust beneficiaries taxed as if they are the direct recipients of income generated by the capital, or of the capital itself. This – falsely – might suggest that the property manager (the trustee) is but an agent of the beneficiary. An agent is an extension of the principal's arm.

In the United States also there is significant academic support for the argument that the trust should be regarded as a legal person. The reason for this contention is that in any event US practitioners think of the trust as an entity, and 'entification' would relieve the trustee from what is now seen as an unreasonable exposure to personal liability. Directors and senior managers of a limited liability corporation in their dealings on behalf of the corporation expose the corporate assets only. Why should not the same facility in contracting with third parties be extended to trustees?

It has been said too, as these comments have suggested, that the vital elements of a trust are a segregated fund of assets and good faith, i.e. honest endeavour and vigilance, in the administrator of that fund on the beneficiary's behalf. If the right to the enjoyment is the essence of a property right, the dispositive and management rights that the trustee has are solely of a complementary nature. This suggests the trustee is but an executive administrator, and that good faith is merely the honesty and involvement that is expected of any person in office. The 'fiduciary relationship' loses its status as an essential characteristic, and fades into the background of the concept.

Finally, statutory developments in the offshore jurisdictions, such as the Channel Islands, Bermuda and the Caribbean 'tax havens', to use the popular description, have shifted the conceptual axis of the trust in private client property management and disposition work. It has shifted away from the fiduciary relationship between a trustee and a beneficiary with property rights, to another relationship. The emphasis is now upon the creator of the trust (the settlor) and the trustee. What is of interest is the arrangement with the trustee contained in the trust documentation and the settlor's 'letter of wishes' given to the trustee. The beneficiary is one who may or may not benefit as the result of the way in which the ongoing settlor/trustee arrangement works out. This is precisely where the civil law advocate or notary interjects, 'You see! It really is but a contract for the benefit of the creator of the trust or a third party.' If the civilian knew that with the settlor's empowerment in the trust instrument the trust instrument may be both amended and terminated by the trustee at discretion, his (the civilian's) conviction that the trust is nothing but a bilateral or unilateral contract would – in his mind – be confirmed.

A leading United States scholar has described the trust as a 'deal' between a trust creator and a trustee. This is the so-called contractarian theory.[2] In the United States this seems to be a minority opinion, but the theory appears to lead to the conclusion that the trust is an arrangement between the property transferor and the trustee manager for the benefit of the transferor or a third party.

3 The common law trust in the conflict of laws

Though there is the one common law tradition, there are two manifestations of it in the present world. The first is that of the forty-nine common law 'states' of the United States, and the second is that of the Commonwealth. Formerly known as the British Commonwealth, the Commonwealth comprises the joint jurisdictions of England and Wales, and the now independent countries that were once colonies of the United Kingdom and became fully independent states only within the last century. The reference is to the common law jurisdictions of Canada, the seven 'state' jurisdictions of Australia, and the unified country of New Zealand. Also included within the Commonwealth are Northern Ireland, Singapore and Malaya, and the majority of the offshore centres, being the financial centres previously mentioned. Hong Kong remains a ratifier within China in the Commonwealth legal tradition.

While in the unified country of New Zealand, as in England and Wales, the issue does not arise, in the United States, Canada and Australia each unit (state, province or territory) has constitutional authority over the local law of trusts. The central authority in each case has no federal sovereignty on this subject.

On the subject of trusts the conflict of law rules in the Commonwealth were embryonic and always debated until the UK ratified the Hague Convention on Trusts in 1987, and Australia and seven Canadian provinces followed in the 1990s. In Ontario, which has not adopted the Convention, and other Commonwealth jurisdictions in Ontario's position, the case law conflict rules remain the same. In some degree this undeveloped state of affairs was due – and remains so in non-Convention Commonwealth jurisdictions – to the fact that the case law and statutory law of trusts throughout the Commonwealth were very much the same, the overseas jurisdictions having traditionally followed English law and statute.

[2] John H. Langbein, 'The Contractarian Basis of the Law of Trusts', (1995) 105 Yale LJ 625.

In many jurisdictions the reported case authorities on the treatment of trusts were very few. In some instances the so-called *lex situs* of the trust was described as its governing law, and though formerly this was usually a reference to the *situs* of the trust fund assets, particularly land, latterly it has more generally been understood to be the place where the trustees reside and carry out the administration of the trust. Possibly because the trust is thought to be an obligatory relationship, other authorities understand the trust to be governed by the law that governs the instrument or the transaction that created it. A typical instrument would be a will or deed; a typical transaction would be a contract. This approach is very revealing. It suggests there is no independent concept called a trust; it is a dispositional *modus* and may sometimes create inter-party relationships.

The situation in the United States in the exposure of the states to inter-jurisdictional conflicts is very different. With so many jurisdictions and a separate law of trusts in each, and a constant stream of inter-jurisdictional (interstate) issues, conflict of law rules for trusts have long been much developed. Choice of law is left to settlor (or testator) autonomy, and where no express or implied choice is made the 'proper law', being the law of closest connection, is applied. To assist the court in making a determination as to which law is 'of closest connection', a number of relevant factors are given by the *Restatement of the Law, 2d, Conflict of Laws*.[3]

In any jurisdiction, whether common law or civil law, it is the task of the court to go through a series of enquiries in determining which jurisdiction's law is to govern the issue in dispute. The first question is whether the court of the jurisdiction in which action is brought should accept jurisdiction. In the case of a trust this will usually be decided on the basis of whether the trustee(s) are subject to the court's jurisdiction (an *in personam* liability), or there are trust assets within the jurisdiction. The presence of beneficiaries but no trustee or assets must frustrate any order of the court unless the asset jurisdiction(s) are prepared to enforce the foreign judgment. Whether the jurisdiction is also a *forum conveniens* may also have to be decided if trustee and assets are absent.

If the court will hear the case, the second question is as to the characterisation (or classification) of the issue. This process requires the court to determine the nature of the case, i.e. which branch of law and which concept within that branch is involved. This will allow the

[3] St Paul, Minn., 1971.

court to apply the conflict of law rules of the jurisdiction (the *forum*) in order to determine which jurisdiction's law is to be applied when the court has made a finding on the facts.

When the facts concern what a common law lawyer would recognise as a trust, conflict of law problems can arise. We are supposing a trust with an international element, e.g. trust assets are located, or one or more of the trustees are resident and have a personal law, in a jurisdiction other than the forum, and the question is which law shall apply and provide an answer to the dispute or court application in the forum. Civil law states, as we will note hereafter, either do not know the trust or understand the term 'trust' or 'trust and confidence' differently from the manner in which it would be understood in a common law jurisdiction. This same difficulty can occur with a common law forum puzzling over a civil law concept, but here we are concerned with a trust.

Instead of a trust the civil law jurisdiction in question will have other, usually a number of, legal concepts with which its courts and lawyers are familiar when common law lawyers would use a trust. But that makes for part of the problem. If the trust is not in the legal lexicon of the court, it will either ask how its legal system would deal with the litigant's wishes or instructions, or it will look for analogies in its system. Most frequently in mainland Europe the trust is not a domestically known concept, and the court will characterise the concept as a contract between a creator and a titled administrator. It is said the contractual provisions concern the benefit of a third party (the beneficiary). It is further described in civil law judicial language and among academics as constituting the contracts of mandate and deposit. Alternatively, the inter vivos and the testamentary trust has each been classified as a legal person or as an *institution*. This has occurred in Germany and in Switzerland.[4]

It need hardly be said that, if these are the various jurisprudential directions that may be taken in a civil law court at the characterisation stage, it is not likely that the subsequent application of the connecting factor and then of the choice of law rules of the jurisdiction will end up with the rights and obligations a common law court, accustomed to the trust, would have reached.

These are the thoughts that we might have at the back of our minds as we move to consider any international convention on the subject.

[4] See Christian von Oertzen, 'Planning with Trusts in Germany', [2003] JTCP 197; Luc Thévenoz, *Trusts in Switzerland* (Schulthess, Zurich, 2001), at 205–209.

4 A Convention on the law applicable to trusts and on their recognition

4.1 *An introduction to the Convention*

The adoption of the Trusts Convention was a unique occasion because no internationally agreed conflict of law rules had previously existed for the trust concept. As was said frequently at the time, it is a 'first step' in the task of determining internationally what is a trust, and what law shall be recognised as governing its creation. It was also a first step, in a forum where civilian member states far outnumbered common law member states, in obtaining agreement on what is involved when state A 'recognises' a trust governed by the law of state B.

The Convention follows the long-established policy of the Hague Conference that its Conventions do not apply as between units within a state, each unit having its own legal system.[5] This has particular significance for federal states, but it also has effect for states, like Spain and the United Kingdom, which have distinct legal systems within unitary state borders. In this chapter, as in all Hague Conference Conventions, the word 'state' always refers to the nation state, like the USA and Spain, not to a domestically described unit within the nation state.

4.2 *The circumstances that led to the 1982–1984 Conference*

In the civilian Roman law tradition the trust, as it is conceived in the common law tradition, would be a cuckoo in the civil law nest. The dichotomy of property and obligation is at the base of civil law, and the common law trust violates that distinction. The common law trust is obligation as to the relationship of trustee and beneficiary, and property as to the trust asset title that is held by the trustee. Common law merges obligation and 'ownership' in one concept. This means that for the average civilian 'ownership' (which in Roman civil law cannot be broken down into the ownership of severable rights) is either with the trustee or the beneficiary. It cannot be with both, i.e. the rights of disposition, management and enjoyment cannot be divided between them.

[5] The USA and Australia have 'states', Canada has 'provinces', and any federal country may have 'territories', which are units progressing towards full status as 'state' or 'province'. Even when there are two or more units within the state and an international element in the fact situation affecting them both, issues as between the two – as opposed to either or both of them, and the foreign state – are governed solely by the rules followed within the state that contains the units.

This can lead to the result that the trustees of a pension plan are denied registration as owners of shares or debentures, because the civil law jurisdiction in question regards the plan beneficiaries as the owners and the trustee as an agent of the beneficiaries. In another civil law jurisdiction the personal creditors of the trustee holding security can attach the trust assets because the trustee is then regarded as the owner, and may not shelter any of 'his' assets from those who claim as family members, successors or personal creditors.

In a situation within the writer's experience the testamentary life tenant, who was the surviving spouse of a second marriage, was classified by the *situs* of the trust asset as owner, and the children of the trust creator's first marriage, who took in remainder, were held to be persons who asserted rights against the asset itself. The jurisdiction in question analysed the children's rights as being outside the *numerus clausus* (i.e. recognized *in rem* rights) and therefore invalid. Without question it was unwise for the testator to have created a trust in a common law jurisdiction over an immovable (a villa) in a civil law jurisdiction that knew nothing of trust. But it had happened. And the outcome was a travesty of the testator's considered intent.

Civil law also possesses the principle that all assets of an 'owner' must be available to meet the claims of his creditors and his trustee in bankruptcy. It follows that the assets owned by a trustee, though they be owned for the purposes of a trust, may be claimed by his personal creditors, his mandatory heirs and a matrimonial property rights claimant.

Even as between common law states, to which the historic conveyancing language, 'unto and to the use of in trust for', is familiar, the lack of internationally accepted analysis of the trust (and therefore appropriate conflict of law rules) can be frustrating. The decision of the Supreme Court of Canada in *Jewish National Fund* v. *Royal Trust Co.*[6] is an instance of this. This leads to added puzzlement for the civil law court. An instrument – for instance, a will, a deed or a contract – brings into being the fiduciary relationship between a trustee holding property and a beneficiary with the right of enjoyment in that property. Is the will, the deed or the contract the trust? Or is the 'trust' the fiduciary relationship itself plus the rights and obligations to which that relationship gives rise?

The *Jewish National Fund* case concerned a testamentary trust of residue, which comprised solely movables. The trust was in favour of a

[6] [1965] SCR 784, 53 DLR (2d) 577.

charitable purpose and was valid in New York State where a charitable organisation was expressly to hold the fund pending its required usage. However, the will itself was made by a British Columbia domiciliary where the purpose was not charitable and such a trust governed by British Columbia law would fail. The Court held that the trust, being created by the will, was governed by BC law, and failed. That decision is still binding upon the courts of the three Canadian provincial jurisdictions, which includes Ontario, that have not adopted the Hague Convention on Trusts.

4.3 The objectives of the Trusts Convention and its present status

A 'Report' is issued by the Hague Conference after every Hague Convention has been signed by the participating Member States and Observers. It is written by the appointed Rapporteur for that Convention. The Explanatory Report on the Trusts Convention by Professor Alfred von Overbeck, the Swiss delegate, explains the principal objective of that Convention.[7]

The initial idea of the Conference had been that such a Convention would assist civil law jurisdictions which are increasingly being confronted by common law trusts operating with assets inside civil law borders. Originating historically in England, common law trusts across the world retain a remarkable similarity, and they are international in operation.

In those jurisdictions for which the common law trust is a totally foreign concept, experience shows that, when an issue concerning a trust arises, anything can happen. If there is no such concept in the internal law, then there are no elements that assist the courts or law practitioners of the jurisdiction to characterise the facts for the purpose of discovering the legal subject area to which the concept belongs. This means that there are no relevant connecting factors that lead the lawyer or the court to the governing law of the concept. Lacking any conflict of law rules, all the judge can do, having the forum's domestic concepts in mind, is to draw analogies between one or more of those concepts and what appears to be the character, perhaps the effect, of 'a trust'. If they are called upon at all, forum conflict rules are then applied. To observers it is evident that this practice has been the approach to trust interpretation in non-common law jurisdictions for many years. Nor is there any

[7] *Proceedings of the Fifteenth Session (1984), Book II, Trusts – Applicable Law and Recognition*. This Report is available at www.hcch.net.

criticism in these remarks. The substantive or doctrinal analogy approach would be natural in such circumstances in any jurisdiction anywhere.[8]

The Convention was to supply the principal characteristics of the common law trust by way of a description of the concept for which the Convention was providing conflict rules, and then to supply the means for determining what law should govern it. For instance, if a Dutch court determined that the matter before it fell within the descriptive article then it would look to see to what foreign law the Convention points when the facts are applied.[9]

However, a Convention of the Hague Conference always confers immediate benefits upon all participating states, because it supplies harmonising rules where the subject matter – i.e. contracts, torts (delicts), matrimonial property, wills and succession – is to be found within each state that ratifies. Trust law was not such subject matter. Or at least by dwelling on the common law trust it seemed not to be a matter of harmonisation. When the delegates first met in 1982 the law and equity expression of trust, or of 'the trust' itself, as if it were an entity, had been the subject of debate, sometimes passionate, for the past eighty years.

It soon became apparent that, while the civil law delegations sought to understand the operation of this long-established and universal institution, several of these delegations considered that there should be the familiar two-way flow of gains from the Convention. At the Fifteenth Session in 1984 these delegations sought inclusion within the Convention of those civil law institutions that also constitute the management and disposition of assets by one person for the benefit of another. Nobody wanted to oppose this very understandable position, but the approach the Conference had taken prior to that last meeting was reflected in the Conference's reference in its final meeting to

[8] E.g. an Austrian or Liechtenstein *privatstiftung* would be taxed as a 'corporation' in Canada, and as a 'trust' in the United States.

[9] The Convention (art. 2) applies not only to trusts in writing where there is a transfer by a settlor or testator to a trustee, but where there is a declaration by a settlor that he will hold 'as trustee' specific assets already owned by him. This is the commonly held view because there could be no reason for excluding the declaration of trust. However, the article does not exactly help with this question. Perhaps the Conference should have been direct, puzzling though this 'self-declaration' can be to a person from elsewhere than a common law state.

'analogous institutions'.[10] This term also revealed the lack of any internationality of any of these comparable institutions; each of the 'institutions' canvassed at that meeting is singular to the jurisdiction with which it is associated. These included in 1984 the Luxembourg *fiducie*, a property management vehicle widely referred to as a 'trust', the Quebec *fiducie*[11] which largely mirrored in 1879 the common law trust, and the Liechtenstein *treuhanderschaft* or 'trust' which is a creation of a 1926 statute drafted by a lawyer trained in the common law, who expressly adopted the common law model. At that Fifteenth Session meeting, as the Rapporteur records,[12] the Egyptian and Polish delegations sought inclusion of institutions of their countries that were said to be comparable to the common law charitable trust. The delegates representing Japan, Luxembourg and Venezuela each also sought inclusion of their local institutions. The solution reached was to hold to the existing wording of article 2 but to say that any institution that satisfies article 2 of the Convention – the 'gateway' clause – can properly be claimed to be a 'trust' within the meaning of the Convention.

Whether the Fifteenth Session at its final meeting was wise to depart from the 'Anglo-American' trust – the scope of the Convention as recommended by the final meeting of the Special Commission – is arguable. Seen in retrospect the whole flank of the Convention was turned by this decision. We had set out to see whether recognition could be given to the express Anglo-American trust through conflict rules. In the final session of the Conference we determined to secure recognition for a concept called 'a trust' in any system of law in the world. Is the Islamic *wadf* included? Few, if any, delegates would have appreciated at the time what a 180° turn had taken place; we were then within an ace of signing a convention for which so much effort had been made, and then article 2 miraculously (as it then seemed) presented

[10] The term was also employed in the 'Report on Trusts and Analogous Institutions' prepared prior to the 1982 Special Commission by Adair Dyer and Hans van Loon, then First Secretaries to the Conference's Permanent Bureau. This report was of considerable value to the Special Commission. See *Proceedings of the Fifteenth Session, Book II*.

[11] Civil Code of Lower Canada ('CCLC'), arts. 981a–981n. See Donovan William Mockford Waters, *Law of Trusts in Canada*, 2nd edn (Toronto, 1984), ch. 28 'The Trust in Quebec'. A new Civil Code of Quebec, and a new conception of the *fiducie*, was enacted in 1994: see Waters, Gillen, Smith, eds., *Waters' Law of Trusts in Canada*, 3rd edn (Toronto, 2005), ch. 28.

[12] *Proceedings of the Fifteenth Session, Book II*, para. 26. A move to exclude 'business trusts' from the Convention was unsuccessful (ibid., para. 27), but the grounds for the exclusion argument – an argument that appeared hostile to the very conception of a trusts convention – were ultimately accepted in art. 15, paras. d, e and f, as 'escape' clauses.

itself as a solution. Any 'trust' that could meet the requirements of that article qualified for recognition under the Convention. However, the miracle meant that article 2, designed to familiarise non-common law states with the trust emanating from Anglo-Saxon design, would thereafter be analysed on the basis of how well it captures the elements of the universal 'trust', assuming the existence of such a thing. Again in retrospect article 2 has survived remarkably well.[13] But the debate as to what are those elements continues unabated.[14]

Modes of fiduciary property management are widely known around the world, and, except for the common law trust, none of these modes is to be found outside its own national borders. No jurisdiction at The Hague seemed likely to contemplate ratification solely because its 'analogous institution' would then be recognised by other ratifying states. However, looking back over the twenty years since the Convention was signed, and though no such 'analogous institution' has yet sought to be recognised,[15] the writer's own opinion is that in an international setting the most that could be asked of analogous institution states was that those institutions that satisfy article 2 are included within the Convention. At least the Special Commission's article 2 was not dismantled. The delegates to the final plenary session were not necessarily comparative law specialists, and they were not all in a position to examine the substantive law issue as to whether the 'analogous institutions' sought to be included were indeed capable of description as trusts. But they did appreciate equality of treatment, and that an international agreement confers benefit on all parties. The Rapporteur has understandably pointed out that as a 'first step' it was right that the Conference leave room for judicial interpretation as to the language and the applicability of the Convention. This was done with article 2.

[13] This is probably because it speaks of the trustee's 'control' and the beneficiary's 'rights'. It also deliberately avoids all reference to 'equity' in the common law system, and does not describe the trustee obligations as 'fiduciary'. This was done to facilitate understanding by non-trust states; it doubled ultimately as a description of the universal 'trust'.

[14] See Maurizio Lupoi, *Trusts: A Comparative Study* (Cambridge, 2000). For the full argument see Lupoi, *Trust* (Milan, 1997). See also Tony Honoré, 'Trusts: The Inessentials', in Joshua Getzler, ed., *Rationalizing Property, Equity, and Trusts: Essays in Honour of Edward Burn* (London, 2003), 7, reprinted in (2003) *Trusts e attività fiduciarie* 497.

[15] It seems likely that following the Luxembourg ratification in 2003 the Principality will expect recognition, as a 'trust' within the terms of the Convention, of its Law of 27 July 2003, which amends its contractual *fiducie* so that it can be said to have the required elements of article 2.

The scope of the Convention being determined by article 2's criteria with regard to a trust, the specific objectives of the Convention are set out in chapter II (Applicable Law) and in chapter III (Recognition).

Chapter II (arts. 6–10) sets out how in the creation of trusts the governing (or applicable) law is to be determined. It is to be at the express choice of the trust creator, and in the absence of choice it will be the law of closest connection. Some assistance is given in finding this connection. Attention is to be had to the *situs* of the trust assets, the place of business or residence of the trustee(s), and the objects of the trust and where they are to be carried out. Carefully not specified is the domicile or nationality of the trust creator. It would be too easy for such a factor to mislead. The trust creator is no more than a transferor to the trust; the trust itself, as we have said, is a relationship of the trustee and the beneficiary.

What 'recognition' of a trust by the foreign law means (chapter III) is the second objective. It might be thought that, 'trust' as a gateway having been described in article 2 and rules for determining the applicable law of each trust having then been put in place, further articles are unnecessary. The content of recognition is surely decided by the governing law. However, the Conference delegates from civil law jurisdictions remained concerned. What about the possible deleterious effects upon their domestic laws consequent upon their recognition of an unknown foreign concept through their choice of law rules?

It has been said that the scope and 'applicable law' articles look like ten steps forward, and the articles thereafter pertaining to 'recognition' of the applicable law as eight steps back. The steps back are that a jurisdiction is freed from recognising a chosen governing law where the trust is 'more closely connected' with another state (art. 13), and is authorised to apply its own law, despite recognition of the governing law, when certain high-profile rules of legal obligation (art. 15) are involved, whose observance is compulsory. Under article 16 refusal to recognise is also permitted in the presence of *lois de police* of the forum or even those of a third 'connected' state, though a ratifying state may declare on ratification that it will not enforce the mandatory laws of the 'connected' state. The justification for the article 16 permission is that the forum's public policy tenets are challenged. As usual in these Conventions tax issues are excepted, and in that context also a ratifying state can ignore the Convention.[16]

[16] An analysis of the Convention two years after it took effect by David J. Hayton, 'The Hague Convention on the Law Applicable to Trusts and on Their Recognition', (1987) 36

The objective of the Convention through an international agreement is to secure and harmonise the manner of deciding upon what law governs a trust, and to describe the consequences of recognition of the trust concept for those jurisdictions that are not familiar with the concept. By not forcing upon ratifying states all the established consequences of recognition, the Convention also seeks to encourage ratification. The significance the Convention will have really depends upon the willingness of the ratifying states, particularly those which are not of the common law tradition, to give it life. The Convention offers a series of opportunities to the courts of the ratifying state in any court hearing to refuse meaningful recognition. Ultimately, of course, the contradictions will become apparent when, following state ratification, there is subsequent judicial refusal to accept the legal implications of recognition. But the Conference for its part felt that civilian jurisdictions that are at first apprehensive about the consequences of ratification will gather confidence with time and experience in handling the trust. They should be given the means to limit those consequences because in due course, it was thought, they will voluntarily feel less need to invoke the articles that permit limitations upon recognition.

The Convention has now been in force for some time. It has been ratified by the UK for itself and a number of its overseas territories, as was previously mentioned, by the federal authority in Ottawa for seven Canadian provinces, and by Australia. Strikingly missing from that list of common law national states that have ratified is the United States. Also absent are Canada's two largest provinces, Ontario and Quebec. Five 'pure' civil law jurisdictions have ratified or acceded to the Convention; these are Italy, the Netherlands, Luxembourg, and most recently Liechtenstein and San Marino. The Swiss government announced, in October 2004, its intention to ratify.[17]

ICLQ 260, of the UK delegation, presents a comprehensive and balanced picture of the applicable law articles and the recognition articles.

[17] By 'pure' is meant those civil law jurisdictions for which the common law has always been a foreign phenomenon. Throughout the world by contrast there are several so-called 'mixed' jurisdictions where in the historic or more recent past, whether by settlement, conquest or proximity, the common law or significant areas of that legal system have taken root there, rubbing shoulders with the already present civil law. Today as a consequence these jurisdictions, each in its own way, share intertwined laws of both legal systems. See J. M. Milo and J. M. Smits, eds., *Trusts in Mixed Legal Systems* (Nijmegen, 2001). South Africa, Malta, Quebec and Scotland are instances of such intertwining, and the Convention has been ratified in the case of both Scotland and Malta. In different ways, to differing degrees and with varying results, these 'mixed' jurisdictions have therefore developed a measure of familiarity with common law

4.4 *An overview of the terms of the Trusts Convention and how the terms operate*

If there is one provision in this Convention that really emphasises what is a trust, as opposed to how it is brought into being, it is article 4. The article is short and elusive as to its significance. It reads:

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

In commenting on this article, the Rapporteur writes:[18]

> the law designated by the Convention applies only to the establishment of the trust itself, and not to the validity of the act by which the transfer of assets is carried out. This act is entirely governed by the law to which the conflicts rules of the forum submit it. It may be moreover that different laws will be applicable for the substance and for the form of this act, or yet for the capacity of the person who has effected it. If it turns out that under the applicable law the transfer is not valid, one may consider at the start that the trust has not come into existence.

Though the Rapporteur speaks solely of an instrument of transfer, such as a will or deed or other mode of assignment, it should not be assumed that it is not intended by the Convention that a contract or statement of gift is not included as a 'preliminary issue'. The undertaking for value to transfer or the statement of giving that in either case requires a successive act of transfer means that both the undertaking or statement and the subsequent act of transfer are 'preliminary issues'.

This distinction between (i) the vehicle for creation of the trust and (ii) the trust itself has always been the common law, though no Commonwealth courts have explicitly recognised it and more than one has violated it. This international Convention has finally confirmed it.[19]

There are four sections of the Convention. The first is concerned with defining the scope of the Convention, the second with how the choice of governing law is to be determined and what constitutes the trust law issues that are governed by this law, the third with the implications of recognition for the ratifying state, and the fourth with the

thinking; 'pure' civil law jurisdictions have never had any such experience. It is the latter among civil law locations with which the present writer is concerned in this chapter.

[18] *Proceedings of the Fifteenth Session, Book II*, para. 54.

[19] The British Virgin Islands have recently amended their Trustee Act to clarify the case law conflict of law rules for the transfer of assets to the trustees: the Trustee (Amendment) Act 2003, s. 83A. And it is manifest that the existing case law is not clear. Nevertheless, that subject was outside the scope of the Convention.

circumstances in which local law of the forum is permitted to prevail over the recognised governing law.

4.4.1 The 'gateway' provision

The most important article in the first section (chapter I) is article 2, the 'gateway' provision, because any 'analogous institution' to the common law trust that is to be included within the Convention must satisfy the criteria of article 2. The article sums up the trust as essentially a relationship between (i) a trustee with the assets and 'special duties' (which a common law lawyer would call fiduciary obligations) and (ii) a beneficiary who has the right to enjoyment of those assets. The article then sets out the principal characteristics of a common law trust, emphasising that the fund is distinct from the trustee's personal assets, that title is in the trustee's name or under his 'control' (i.e. in the name of a custodian on the trustee's behalf), and that the powers of management and disposition are in the trustee who is accountable. The fact that the settlor may retain powers, and also be a beneficiary of the trust the settlor is creating, was introduced into the article in order to emphasise for civilians that the settlor's role is complete once the assets are acquired or held by the trustee as trustee. If it is to be otherwise, the settlor must expressly be brought into the relationship of (i) trustee obligations and powers of the trustee and (ii) beneficiary enjoyment, or else he has no place in it. The natural instinct of those civilians who framed their thoughts in terms of contract was to see the 'trust' as originating a continuing relationship between the settlor and the trustee, to which the beneficiary in some manner is a party.

The Convention is limited to trusts arising from the intent of a settlor or testator (constructive trust situations are brought within ratification only by the ratifying state's acceptance), and evidenced by a written document. As previously noted, the Convention is concerned with 'legal relationships' alone; not with the will or deed or other instrumentality that creates the trustee/beneficiary relationship.

Has article 2 stood the test of time? Since to date only a small number of civil law states have ratified the Convention, there has been little opportunity for the practical effects to be assessed. As we have said, the Netherlands asserts no 'analogous institution' of its own for which it claims recognition by other ratifying states, and the present writer is not aware that recognition under the Convention has been sought in any other jurisdiction of fiduciary relationships existent in the Italian Civil Code. Luxembourg's ratification in 2003 is so recent that the effects of ratification have not yet emerged.

However, opinion of an academic nature has been expressed. Perhaps the most interesting civilian reaction, published long after the Convention took effect, has been that 'trust' is an idea – indeed a concept – known throughout the jurisdictions of Western civilisation.[20] The English development of the institution with its legal and equitable estates, and 'legal ownership' mandatorily in the trustee, it is said, is but one manifestation. It is no more exclusively valid a 'trust' structure than any other, even as to the necessity of a segregated fund. Though the 'Anglo-American' trust structure has proved remarkably flexible and adaptable, and has travelled with its essential characteristics intact to the majority of places to which the English-speaking peoples have gone, it is but an assembly of particular doctrinal ideas whose singular form grew out of England's historic and unique Norman landholding system.

Article 2, which reflects the 'Anglo-American' institution, is therefore, it is said, a description of 'trust' that is too narrow. Moreover, in an attempt to reach out to civilian fiduciary property-holding and administration notions, diverse and numerous though they are, the Hague 'trust' describes the trustee as having mere 'control' of the trust property. What for a civilian should 'control' be taken to mean? The verdict is that the Hague 'trust' is 'shapeless'.[21]

Whether or not one shares this view that in medieval Western legal ideas there is a discoverable concept of the fiduciary management of property, it underlines that there is a lack of consensus as to what is a 'trust'. The Hague Conference noted that common law text writers on the subject of the trust are not in agreement even as to their own institution. It was for this reason that the Special Commission made no effort to define a trust, something which common law legislatures for their part also consistently avoid. It preferred to set out in article 2 the characteristic elements of the widely employed Anglo-American trust. This description, rather than an attempted definition, it was thought, lent itself more effectively to understanding by civilian jurisdictions.

The adoption by the Conference of the analysis of a trust in article 2 as involving 'legal relationships', i.e. the plural, is in the writer's opinion not the happiest. The relationship of trustee and trust object is at the epicentre of the trust. The Convention suggests perhaps that settlor and trustee is another significant relationship, and the writer would rate

[20] Lupoi, *Trusts: A Comparative Study*.

[21] See Maurizio Lupoi, 'The Shapeless Trust', (1995) *Trusts and Trustees* 15.

that unfortunate. Settlor and trustee is the very relationship that, like the transfer of property to the trustee, is nothing to do with the trust itself. However, that was not the view of the Hague Conference,[22] and to be fair the use of the plural has not apparently created any problems in practice.

It is worth keeping in mind when discussing the merits or otherwise of this Convention that the Hague Conference did not seek to compile conflict rules for common law states inter se. It was pleased to learn that by adopting the distinction between trust and the instrument for creation of a trust, and the choice of law rules it agreed upon, it was bringing some useful development, i.e. more than updating, to trust conflict rules as between states of the Commonwealth in which the common law is found. These would include England and Wales, Canada, Australia and New Zealand. However, its object was to assist civilians to understand the mechanics of the common law trust and to produce choice of law rules that would facilitate uniform recognition of this trust. In that sense the Hague Conference was stepping on new ground. The introduction of instruction or an elucidatory element into a convention was a step both bold and controversial.

4.4.2 Choice of law rules

This Convention does not tackle the issue of the jurisdiction of courts to hear and decide trust disputes. Jurisdiction was left for another occasion. Agreed choice of law rules were considered to be a more immediate need.

The second section of the Convention provides those choice of law rules. The object of a rule of the conflict of laws is to recognise so far as possible the autonomy of the party or parties, and after this to apply to an issue involving foreign elements that law which appears to be most intimately associated with the issue. As a vehicle for the creation of obligations a contract has traditionally been governed by the law of the place where the binding obligations were entered into, and in the case of a tort where the wrongful act was done. Even though in some jurisdictions it may be deemed so for tax purposes, a trust is not a legal person, so it can have no domicile, nationality or place of 'incorporation'. If it is a matter of a legally binding relationship between a trustee and a beneficiary, this suggests it should be categorised as an obligatory

[22] See the Report, *Proceedings of the Fifteenth Session, Book II*, para. 40. Nor is it the view of Professor Langbein, 'Contractarian Basis of the Law of Trusts', above, note 2.

concept. Such a conclusion would lead to the law of the place where the obligations were made or are to be performed. On the other hand, it essentially concerns the holding and administration of property, and this points to its appropriate classification as a property concept. This could lead to the law of the *situs* of the particular assets, especially in a scissionist state[23] where the trust assets constitute or include an interest in land.

If the trust is seen as merely the terms of the instrument of its creation, the law governing that instrument then becomes the law governing the trust. The instrument may be a contract, a will or a deed. Even the words accompanying a physical transfer to the intended trustee may be enough to create those terms. Indeed, it may have been the absence of a clear focus as to what is a trust that led the majority in the Supreme Court of Canada in the *Jewish National Fund* case[24] to ascribe to the trust the governing law of the testator's will, which was the instrument of creation.

In jurisdictions like those of the United States, a state which has the most developed conflict rules for trusts of any nation state, it has been recognised for many years that emphasis upon one single element, be it obligation or property, can lead to undesired results. In terms of the actual operation of the trust a governing law may be applied to the trust that is in fact more remote than another would have been. This is the reason for the increasing adoption of the so-called 'proper law' theory, or finding the centre of gravity of the trust. Moreover, emphasis upon the instrument of creation, like the domicile of the settlor, not only misses entirely what concept it is that is so created, it suggests to those unacquainted with the concept that the creator of the trust remains involved with the property after its transfer to the trustee. It might well appear to the civilian that, putting aside the trustee and the beneficiary, there is an even more significant relationship between the creator of the trust and the trustee.

Article 6 provides that the governing law is that which the creator of the trust chooses, and in the absence of intent (article 7) the law of closest connection. The latter allows the court to weigh in each case every factor. Four factors are picked out by the Convention as having 'particular' importance for determining the law of closest connection: the place of administration designated by the creator of the trust, the

[23] I.e. different governing laws for movables and immovables.

[24] [1965] SCR 784, 53 DLR (2d) 577.

situs of the trust assets, the place of residence or business of the trustee, and the objects of the trust, plus where they are to be carried out. Consistently with the Convention's emphasis on 'trust' as being a matter of a trustee with obligations and a beneficiary with right of enjoyment, what is not mentioned is the domicile or nationality of the trust creator. Nothing in the article rules out consideration of any conceived factor such as this, but the Conference attempted in this way to guide the courts of non-trust states. The mentioned factors will also have different weighting for different national courts, and civilians may attach importance to the order in which article 7 sets out the factors. But again agreement was reached by not saying too much. And that must have been the right approach. Civilians can read the factors as a hierarchy, and common law judges will find the factor or factors they consider crucial. In common law jurisdictions, when the settlor has not chosen a governing law, the place where the trustees administer the trust is now widely adopted as the governing law. Indeed, a court may hold that the trust creator's choice of who is to be the first trustee or trustees is such a designation.[25]

The chapter on 'Applicable law' describes in article 8 what it means to speak of a 'governing' law. Such a law, as the article spells out, describes what subject-matter it is that is decided by reference to that law. It determines the validity of the trust, its construction, its effects and its administration. Article 8 also lists, in particular for the guidance of civil law jurisdictions, the well-established substantive trust law matters (as opposed to matters of procedure) that are subject to the governing law.

Of interest to those drafting and working with the international trust is the fact that in article 9 the Convention authorises the trust creator to have 'severable aspects' of the trust governed by different laws. For instance, the settlor for purposes of family disposition or of business may choose to have the administrative matters of the trust governed by a law that is different from that which determines validity, construction and effects. English law may be the overall governing law chosen by the trust creator, but the creator may also have provided that matters of administration – and the trust instrument will need to define the scope of that term for the purposes of the trust – shall be governed by Italian law, where the trustees will be discharging trust business. 'Severable aspects' is not defined as a term by the Convention. Though validity, construction, effects and remedies, as well as administration which is

[25] *Proceedings of the Fifteenth Session, Book II*, paras. 71–80.

specifically mentioned, are readily apparent 'aspects', the term remains to be explored by the courts asked to rule on this issue. The Rapporteur records[26] the view expressed by some civilian delegations at the Conference table, namely, that different trust assets and different beneficiaries may be governed by different laws. Supposedly this might occur where two families, beneficiaries in two separate states, are to enjoy the same trust fund which consists of two family homes, land and contents, one in each state.

The Convention also provides in article 10 that the principal governing law is to decide whether that law itself, or the law governing a severed aspect, e.g. administration, may be changed to another law. This could be important for the lawyer drafting an international trust, though little in the Convention is otherwise concerned with the trust that has connections to a number of jurisdictions.

4.4.3 Meeting the civilian apprehensions

The 'Recognition' articles and the 'General Clauses' of the Convention, as has been noted, may seem to common law lawyers to detract from what is provided as to the 'scope' of a trust and the 'applicable law'. However, these parts of the Convention have to be seen in context. Civil law delegations were apprehensive that the foreign trust might be employed within an uninformed civil law jurisdiction in order to perpetrate fraud or to evade local law.

Already in article 5 this fear of what some saw as the unknown is evident. It is there provided that the Convention does not apply when the chosen law or the law of closest connection does not know the trust or 'the category of trust' in question. By 'category of trust' is apparently meant express or implied, resulting or constructive trusts, but that term also is left to state courts to interpret. Does it mean that a mainland onshore common law jurisdiction, such as England or a US state, can refuse to recognise an offshore common law non-charitable purpose trust? That proposition has been mooted and is arguable; recognition would appear inevitable, but in some quarters this trust form gives rise to apprehension of thereby facilitated illegalities. Rejection would be justified on public policy grounds.

Constructive trusts for their part are not included within the Convention, unless the ratifying state agrees to include them (art. 20). Overall, it is difficult to envisage circumstances (art. 5) where a settlor or

[26] Ibid., para. 91.

testator would choose that his or her trust, or a severable aspect of the trust, be governed by the law of a jurisdiction that does not know the trust concept. It is almost as difficult to imagine the circumstances in which the jurisdiction of closest connection would not know the trust. This is conceded in the von Overbeck Report.[27] All the same, the delegates wanted its inclusion.

The 'Recognition' article of possibly the greatest significance is article 11. This spells out the minimum features of a 'trust' (art. 2) that the ratifying state *must* recognise. These features are, first, that the trust fund is separate and segregated from the personal or other assets held by the trustee, so that claimants on whatever basis against the trustee personally have no call on the trust fund. This means that when the trustee has been acting in some other capacity, e.g. as an agent acting for a principal having nothing to do with the trust, trust assets are not attachable by the claimant. Secondly, the trustee may sue and be sued as a trustee, and for all purposes represent the trust obligation. Thirdly, trust assets may be recovered from a trustee when the trustee, in breaching the trust, has mixed trust assets with his own.

Then there is the third party who, knowing of the wrongdoing, received trust assets from the breaching trustee. Can specific recovery, as in common law jurisdictions, be had from such a person? The concern of banks in civil law jurisdictions was that monies held by them as bankers should not be subject to the governing trust law when as a result there might be a tracing of wrongfully acquired trust funds paid into bank accounts. Since banks in common law jurisdictions know well this kind of exposure, and manage to live with it as a risk element in doing business, that may seem an unpersuasive pleading on the part of the civil law bankers. But there are two different legal cultures here. Tracing that in common law jurisdictions is available as a general equitable right, i.e. not necessarily in a trust action, always causes concern in civil law jurisdictions. In the latter tracing is unknown. Only an allegation of personal fraud (*dolus*) can challenge the third party. In the end the Conference agreed that the third party with trust assets should be subject to action in accordance with the conflict of law rules of the trial jurisdiction. The Convention therefore does not reach trust assets in a third party's name, or any fourth or subsequent party in a chain of wrongdoing. Personal damages will then alone be possible.

[27] Ibid., paras. 61–62.

The Convention means that, if the bank's actual or constructive knowledge does not constitute fraud in the forum, or in the law which the forum would apply, no action – let alone a proprietary action – may be brought. And, if the forum does not admit tracing, it is evident that the forum's conflict of law rules are not likely to get the plaintiff from a foreign tracing jurisdiction very far. The wronged plaintiff, faced with an insolvent and fraudulent trustee, may wish to recover the exact assets that were acquired wrongfully from the trust fund, e.g. works of art of any kind, or to assert a personal *in rem* interest before available assets are distributed in the third party's insolvency or bankruptcy. Nevertheless, when lines are drawn in the sand, in the nature of things every international agreement is an accommodation. The Conference considered this accommodation – *in rem* recovery may be had against the trustee – reasonable for both sides.[28]

Article 13 also reflects the fear of civil law jurisdictions that their own nationals and residents as settlors or testators might evade local law by the simple device of choosing the law of a common law jurisdiction as the governing law. Trustees would also be selected to administer the trust in that foreign trust jurisdiction, when all the other factors – the trust beneficiaries or the trust purposes, and the trust assets – are located with the settlor in a civil law jurisdiction that knows nothing of the trust or has but a nodding acquaintance with it. However, it was agreed that a ratifying state should merely not 'be bound to recognise' such a trust. The accent once again was upon encouraging recognition, a policy which explains article 14 – nothing in the Convention prevents a jurisdiction from being more favourable to trust recognition than the Convention provides.

This statement of article 13 that a ratifying state in not 'bound' to recognise a trust with these limited foreign connections has been interpreted by Italian courts as saying that a ratifying state is therefore empowered – under the terms of the Convention itself – to recognise

[28] Civilian lawyers stoutly defend the unavailability of *in rem* recovery against the person who received from the trustee knowing of the latter's wrongdoing, or who was one of a series of wrongdoers. Advocates of the contrary common law trust position must also concede that a finding of a defendant's unjust enrichment can result, as in common law Canada, in the court awarding at discretion either a proprietary or a personal remedy. Though not for reasons civilians would immediately recognise, the constructive trust (proprietary recovery) is a flashpoint as between English courts and Canada. When decisions have to be taken in a limited time, as at the Hague Conference around the table, what is reasonable is not an easy judgement call.

the trust. And it is certainly an interpretation of which the writer does not recall any discussion at The Hague. There were those delegations that wished to exclude altogether from the Convention such a trust with these minimal connections with the chosen governing law, and those that were striving to uphold recognition of the chosen law without an additional test that weighs the degree or extent of foreign connection. But what was seen by the Hague Conference as a compromise, allowing a state to recognise a choice of law despite trustees and place of administration being the only foreign elements, can obviously be read as an approval. The Italian courts have gone further and, since the Convention says nothing as to which and how many foreign elements are necessary, accepted the absence of even those two elements. Given the tide of apprehension among civil law delegations at The Hague, the writer suspects that few delegates from any legal background foresaw this turn of events. It is surely one of the most remarkable outcomes that the Convention has triggered.

The ‘General Clauses’ of chapter IV conclude with familiar provisions regarding public policy, non-applicability of the Convention to tax issues, the manner of taking effect of the Convention, and the effect of ratification by a federal state. However, there are two articles that add to the cautious character of this Convention. Civil law codes not infrequently provide that one or more particularised matters, usually those involving public policy concerns, shall not in any circumstances be excluded or otherwise rendered inapplicable. In article 15 three of such policy areas were specified, and the rule imposed that in those situations the governing law of the trust give way to the domestic law of the forum or of a ‘connected’ third state. These areas are the protection of minors and incapacitated persons, personal obligations and property in the context of marriage rights (e.g. community of property), and the imposition of mandatory or ‘forced’ shares in estate assets for surviving spouse, children and other relatives on the occasion of the asset owner’s death.

Those at The Hague who were concerned with the prospect of civil law trusts in business and commerce, i.e. investment, security and banking, sought again to exclude such recognition – foreign trusts, or local trusts with a foreign governing law – that might affect rights *in rem* established under local civil law. As a consequence in article 15 three more substantive law areas were added, where the governing law need not be recognised. These are the transfer of title to property and security interests, creditors’ rights in insolvency, and the protection of third parties who in good faith have acquired ownership or a possessory interest.

Once more, however, efforts were made to save as much as possible of the principle of true recognition, as opposed to selective recognition by apprehensive forums. Article 15 carries the concluding and extraordinary exhortation, for that it surely must be, that a court which is excluding one or more of these six areas shall attempt 'by other means' to give effect to the object or objects of the particular trust. This language binds no one to anything, and is by any measure a puzzling paragraph to find in an international agreement that is to bind adherents. But it reveals at least the real wish of the Conference to achieve a meaningful recognition of the trust concept, whatever the fears. It tries to bring the apprehensive 'on side'. Nevertheless, it seems today a curious way in which to have left things. Following the article 11d decision, the concession in article 15 to states' internal laws of title, security, bankruptcy, insolvency and good faith purchase was likely to be seen as inexplicable. Some have said it is the low point of the Recognition provisions. And looking back over the years, even though the atmosphere was one of obtaining consensus, it is hard to refute this charge. The thought is nagging that the Conference should have gone further to support the mandatory requirement of article 2 that a trust fund is in all respects a totally segregated body of assets. That, as everyone seems now to agree, is the key element of the universal trust idea.[29]

Considerable debate was caused by the subject-matter that became article 16. This article permits a ratifying state to refuse recognition of the otherwise governing law when an issue of particular social or economic policy significance for the forum would be differently regarded by the governing law. The particular policy may be reflected in the law of the forum itself, or in the law of another state that the forum would honour. The Rapporteur gives as instances of these issues:[30] protection of national cultural heritage, public health, vital economic interests, such as waterfront real estate or the location zones of nuclear power plants, the protection of employees in contractual bargaining, and currency exchange regulations. Most common law

[29] Despite the separate fund required by articles 2 and 11, the recognition article 15e in particular (d and f aside) was the Trojan horse. In preparation for their ratification of the Convention the Dutch legislated in 1995 to prevent domestic Dutch law from being invoked under article 15d and e, and so from 'destroying the recognition of the trust as prescribed by' article 11. See M. E. Koppenol-Laforce and R. J. P. Kottenhagen, 'The Institution of the Trust and Dutch Law', in Madeleine Cantin Cumyn, ed., *Trust vs. Fiducie* (Brussels, 1999), at 296–297.

[30] *Proceedings of the Fifteenth Session, Book II*, para. 149.

jurisdictions would leave this type of non-recognition to statutory provision or, if the courts are to be left to their own devices with such issues, to public policy. Explained in this way these so-called 'mandatory rules' are not so far-reaching as they may at first seem. Again the Convention attempts to isolate particular concerns rather than use general language and thereby apparently give its imprimatur to any long-arm application of the forum's law.

The then embryonic Commonwealth conflict of law rules for trusts, and the considerably more developed US interstate rules, were never directly discussed by the Conference. Rather were they in effect drawn upon, especially in the design of the rules determining governing law. The present writer's impression was that the Conference hoped common law states between themselves would find the international advantages of ratification to be such that with the well-established ultimate protection of 'public policy' objection they could adequately defend local interests. The Convention was concerned with immediate practical problems, such as where trust assets are located in jurisdictions that have no knowledge of trusts. In that regard common law trusts are frequently drawn where in the course of time the trust fund comes to include assets located in continental Europe, Central or South America. Alternatively, such as in Switzerland and Argentina, they are created by expatriates of common law jurisdictions.

The Convention remains the first ever international agreement, bridging the two major legal systems of Western civilisation, seeking to harmonise the reception throughout the Western world of the trust as internationally seeded by English common law. The Hague's Fifteenth Session sought to circumnavigate the arguments and legal chauvinism between academic lawyers of the two traditions that had occupied so many of the previous years of the twentieth century. Instead of seeking a substantive international law of trusts, which a United Nations agency had originally attempted in the 1950s, the Conference aimed through uniform conflict of law rules to start the process of harmonisation. In sum, this Convention aimed to provide choice of law rules, and to suggest in article 2 how the common law trust should be perceived for classification purposes by those states that are wholly unfamiliar or only partly familiar with it. In every case involving a trust the courts of a non-trust state will be called upon to decide whether the 'creature' before the court, or the law practitioner, is indeed a trust. The Convention ultimately took shape as an agreement that facilitates and encourages civil law recognition rather than mandates it.

5 Twenty years on

5.1 The Convention and offshore jurisdictions

Mainland jurisdictions of the developed world, possessing both population and wealth, are the obvious beneficiaries of international conventions that seek to harmonise the laws that these several jurisdictions apply. The principal Commonwealth jurisdictions – the United Kingdom, Australia and Canada – are of this mainland character, and they led the initial ratifications of the Hague Trusts Convention. But in addition the United Kingdom's actions appear to have persuaded a number of offshore jurisdictions, once part of the former British Empire and associated still for constitutional purposes with the UK, also to accept ratification. Bermuda in the Atlantic, the British Virgin Islands and the Turks and Caicos Islands in the Caribbean, and Jersey, Guernsey and the Isle of Man in the waters around the United Kingdom, have ratified, as have Gibraltar and Malta in the Mediterranean.

So far as planning wealth management and distribution for the individual client is concerned, these 'financial centres' (or offshore) jurisdictions are engaged in marketing trusts and investment services to widely invested mainland (or onshore) clients who are seeking a manoeuvrability and probably a tax respite that the home country does not afford. These offshore jurisdictions run into conflict of law issues with trusts on a regular basis. The settlor will be in one jurisdiction of the world, the assets of the trust fund in another, and the management of the trust will be in a third. By the nature of things the work of the offshores is global and the potential conflict problems can be complex and extensive.

What may be classified as mainland jurisdictions, such as New Zealand, also offer these services to investors of other countries; they too will experience conflict of law problems. Then there are actual mainland jurisdictions, significant ones being the civil law jurisdictions of Liechtenstein and Luxembourg, but also Switzerland, which possess international banking and fiduciary services that are used extensively by foreign clients.

All these jurisdictions, island and mainland, have to consider whether ratifying the Hague Convention advances their particular type of business, which is the foreign investor who is planning his or her personal affairs. The necessary approach of these jurisdictions lends vivid colour to the considerations that states must entertain with regard to international agreements in the conflict of laws. While a succession of offshore jurisdictions have adopted in their own domestic trusts legislation the choice of law rules of the Hague Convention, the trust recognition obligations involved in Convention ratification have proved another thing.

Whereas common law mainland jurisdictions have populations that use the trust, mostly for internal private or business purposes, as one of several property management vehicles that are available, offshore island jurisdictions are small, sparsely populated locations which market banking and trusts as their main economic activity, usually ahead of tourism. Mainland jurisdictions generate the wealth in which the trusts of offshore jurisdictions invest; offshore jurisdictions do not. It is therefore apparent that, while mainland jurisdictions seek the harmonisation of conflict of law rules for the advantages harmonisation offers in smoothing social and economic inter-country relationships, the position of the offshores is different. Such an international agreement as the Trusts Convention is likely to be of little interest to jurisdictions engaged between themselves in a competitive industry where the accent is upon producing a quality and attractiveness of service to foreign investors that others do not and cannot match. Harmonisation with mainland jurisdictions may be of advantage for the older, well-established offshore financial centres with long-standing connections with mainland institutions, but for the more recent or market-conscious centres harmonisation is likely to be less of an interest than maintained competitiveness.

The offshores for the last quarter century have been the most active common law jurisdictions in considering conflict of law rules for trusts. This has included reflection upon the Hague Convention and its provisions. It has been noted that the UK ratified the Trusts Convention at a fairly early date, and shortly thereafter through the offices of the UK government a number of existing or former British overseas territories also ratified the Convention. However, two very significant jurisdictions,the Bahamas and the Cayman Islands in the Caribbean, took the decision not to ratify. That speaks volumes.

Any state in the world that ratifies is not likely to be solely motivated by the desirability of harmonising international trust recognition. It seeks advantage for itself in terms of its own internal affairs. Common law states that have significant trust contact with civil law states derive the benefit of certainty, that is, of having the article 2 scope of their trusts, and their trustees, recognised by ratifying civil law states. Civil law states in ratifying may seek to hold and attract further trust business, particularly from pension and business trusts that are investing, or would invest, very considerable sums in the civil jurisdiction's corporate shares, debentures and real estate.

However, so far as advantage is concerned, it is unavoidable that there are two sides of the coin for those jurisdictions that in a competitive climate are marketing the trust. Being able to meet the requirements of the settlor of a personal trust who wishes to retain maximum control during his lifetime, and a privacy for his trust that would frequently extend to the beneficiaries themselves, is not helped if the governing law is bound to an article 2 description of the trust as a 'legal relationship' between the trustee and the beneficiary. The very reason for the mainland settlor investing and conducting his estate planning in an offshore jurisdiction is in large measure to avoid the features of an article 2 trust. Article 2 clearly conceives of the trustee having control of the assets and the beneficiary having the traditional right to information. Tax saving is an important consideration, but the settlor seeking retained control of assets, and complete confidentiality, even from beneficiaries, or something as close to those ends as his offshore jurisdiction can extend to him, is not assisted by the harmonising Convention. And presumably a common law offshore jurisdiction would not ratify with the idea of taking advantage of those provisions in the Convention that permit the recognition effects of ratification to be avoided.

There are other issues that an offshore jurisdiction would need to consider. The Convention offers clear rules for establishing the governing law, namely, settlor-choice or, failing choice, the law of closest connection. But modern case law conflict rules offer this already. For over thirty years it has been a feature of the US *Restatement, Conflict of Laws*. The offshore jurisdiction may wish to introduce legislation that adopts shorter limitation periods than the onshore jurisdictions permit. The settlor as a debtor to creditors within his home jurisdiction will have greater protection for the assets he has put into trust than his homeland makes available. The offshore may also wish to restrict the definition of 'creditor' to those who were creditors with claims when the fund assets were put into trust. And there is added advantage to the settlor/debtor if the creditor is required by the offshore to prove the debtor was insolvent at the time of the transfer of the disputed assets into trust or that the transfer itself caused insolvency. If the governing law is the law of the particular offshore jurisdiction, such limitation legislation and debtor protection will be attractive to many settlors.

Similarly, mainland settlors who are facing actual or expected claims by the alienated spouse asserting matrimonial property rights, or settlors who are apprehensive of a spouse or family members in the settlor's home jurisdiction claiming mandatory inheritance rights ('forced shares') once he or she is dead, are looking for relief from, not international recognition of, those claims.[31]

It is evident that for an offshore jurisdiction wishing to accommodate such a settlor, article 15 of the Convention offers no encouragement to that jurisdiction to ratify. If the creditor-protection law of the mainland state which is the residence of the claimant provides that no voluntary act of the indebted person or of any other person shall deny recovery of those debt or 'forced share' entitlements, the Convention in effect supports that law. The offshore state, whether or not it ratifies, has to accept the continued enforcing of that mandatory law by the courts of the mainland ratifying state. It matters not that the mainland state has ratified; article 15 means that nothing is changed so far as 'forced shares' are concerned. This is so even though the settlor selects the law of the offshore state that has no 'forced shares' law as the governing law of his trust. Article 18 expressly confers upon states the right on matters of *ordre public* to refuse to recognise the governing law, but public policy aside article 15's object is to allow the ratifying state in its own courts with regard to the areas of law listed in the article to apply the conflict rules that that state prefers.

For the offshore state wishing to assist the settlor who wants to write his or her own 'share' provision for the several members of the family, what is the incentive to the offshore jurisdiction to abolish its own self-drawn conflict rules and to adopt the Convention? The settlor subject to 'forced shares' or matrimonial property rights will still have to move all her creditor-attachable assets out of her home jurisdiction – the 'forced shares' state – before she sets up her offshore trust. In other words, given that article 15 spells out no less than fifteen distinct areas of law, this may call in question for the offshore trust state any advantage in ratification.

[31] However, a leading text on English trust law, *Lewin on Trusts*, 17th edn, by W. Mowbray, et al., (London, 2000), at para. 11–59, argues for an interpretation of Article 15c that in an English court would allow no 'claw back' of property conveyed inter vivos, even though the estate at death of the deceased is not able to meet the deceased's 'forced share' obligations.

Finally, there is article 13 providing for when the mainland state is not 'bound to recognise' a trust. Mainland settlors looking for an offshore haven, and trusteeship and trust administration in that haven, their assets being in the home jurisdiction, might see this article as actually inviting the situation they already fear.

It should be underlined that the foregoing is no criticism of the Convention. For one thing it can confidently be said that the Convention could not have been drafted with the problem of the offshore financial centre in mind. Though the Conference has been taken to task for not considering the offshore jurisdictions' situation, that is not altogether fair. At the time when the Trusts Convention was being discussed in the early eighties the 'offshores' had not yet burst upon the consciousness of the mainland states. No one at The Hague of whom the present writer is aware thought of the trust being marketed by one state among the residents of another state. The delegates to the Hague Conference saw the 'trust' as a concept in frequent 'Anglo-American' usage which is just another instrument, if for some a puzzling one, facilitating the individual disposition of wealth to family members and charities. Some thought of it also as advancing business and commercial purposes. The question before the Hague Conference in 1984 was whether a Convention could be designed that would bring together the common law and civil law mainland traditions in this area. And there was nothing a foreseeing Hague could have done to mitigate the coming offshore concern.

Indeed, it is likely that, even if the delegates to the Fifteenth Session of the Hague Conference had been able to foresee the coming age of 'the international trust', that foresight for more than one delegation might have gnawed at their ultimate willingness to go along with the draft as the Convention began to take shape. Was the significant trust of the future not the mainland trust offering merely another property management vehicle, but an 'international trust' seeking to provide creditor protection for mainland clients?

However, a significant number of 'offshores' have not sought to avoid the Convention. The 'offshores', too, live and serve a clientele in a global scene, and we are constantly reminded by media speakers and writers that today's world is a village. It is precisely because trust usage is universal that harmonisation must be the eventual aim of every state. The reaction of American courts and authorities to offshore asset protection trusts settled by US citizens also suggests that harmonisation ultimately pays. Competitive edge must be sought elsewhere.

5.2 *Ratification in civil law jurisdictions*[32]

This chapter has emphasized, possibly to distraction, that the 'pure' civil law jurisdictions and their problems with the trust were centre stage for the purposes of this Convention. The von Overbeck Report said the same thing:[33]

> If other Hague Conventions sought to reconcile countries having the nationality principle and those having the principle of domicile, this Convention is more particularly intended to build bridges between common law and civil law countries.

Looking back over the years since the Convention came into force, the question is how effective the bridge building has been. It has to be said that the enthusiasm of the state delegates at the signing of the Convention in 1984 has not been translated into more than a modest degree of success. To date only five 'pure' civil law jurisdictions – Italy, the Netherlands and, most recently, Luxembourg, Liechtenstein and San Marino – have ratified or acceded to the Convention. However, this is not a Convention that tackles an internationally urgent and human problem, such as child abduction, and trust recognition reaches deep into the traditional legal culture of civil law states. Proposals can stimulate both controversy and apprehension. In academic circles during the pre-1939 period the subject could provoke a palpable hostility across the English Channel or, should we say, La Manche, between the holders of different and strongly held views. Fortunately, that epoch is history, but even today at the popular level the trust not infrequently conjures up thoughts of creditor fraud and tax avoidance, if not evasion. With such a background progress is likely to be slow and carefully considered at each step. This type of Convention is a 'slow burner'; it seems a reasonable expectation that there will be periodic ratifications over the next twenty years, as there have been in the past.

This leads to an assessment of the evidence for such an expectation. Among civil law jurisdictions that have not yet ratified, there has been movement in France towards a domestic 'trust', and furthered by STEP[34] there is today renewed interest that is encouraging. If France ratifies, this may encourage others that follow French practice to do the same.

[32] For state signatures to, and ratifications of, the Convention, including details of reservations made, reference should be made to: http://www.hcch.net.

[33] *Proceedings of the Fifteenth Session, Book II*, para. 12.

[34] The Society of Trust and Estate Practitioners, under whose international aegis a French branch has been established.

When in 1991 a draft statute creating a domestic *fiducie* was introduced by government into the legislature in Paris,[35] the prevailing thought in France appeared to be that first the civil law jurisdiction should introduce its own internal 'trust' and then ratify the Convention. This course encourages capital to remain in the country rather than emigrate to foreign trust arrangements that are then 'recognised' in the civil law jurisdiction. Fears of the French tax authorities that the proposed *fiducie* would facilitate avoidance and evasion of tax appear to have been the cause of the proposed legislation's withdrawal. However, in February 2005 a further *Proposition de Loi* (No. 178) establishing a *fiducie* in the Civil Code was introduced into the French Senate. The speech proposing the measure asserted that France cannot remain insensitive to the globalisation of the trust concept. It is indeed interesting that these new proposals reflect revived pressure from within France for a domestic *fiducie*.

The Swiss banking strength and indeed confidentiality has long encouraged investors from all parts of Europe and North America to that country. Swiss contact with foreign drawn trusts is therefore significant, and slowly and cautiously the country is adjusting to the trust phenomenon. The location of common law expatriates within Switzerland has brought another level of involvement with the foreign trust. In fact much depends on the canton as to the progress being made. The French-speaking canton that includes Geneva appears to be taking the lead, and the recent statement by the federal government of its intention to ratify may have had much to do with the constant contact between Geneva institutions and the Swiss tax authorities creating a climate of confidence.[36] What is encouraging about the Swiss scene is the apparent willingness today to consider the results the trust produces, rather than apply the 'closest' local analogy. The latter was the old *Harrison* v. *Crédit Suisse*[37] approach.

The German civil law tradition appears to have no interest in the Convention. Judging by the addresses and papers of practitioners delivered at professional conferences on various aspects of estate planning, Germany and Austria see for themselves no advantage in embracing any domestic trust, and have little interest in conflict of law rules for use

[35] *Avant Projet de Loi Relatif a la Fiducie*, proposing new articles for the Civil Code. The *avant-projet*, introduced by government, was later withdrawn.

[36] See further Thévenoz, *Trusts in Switzerland*. The Swiss federal government announced its intention to ratify on 20 October 2004.

[37] ATF 96 II 79, Jdt 1971 I 329, a decision of the Federal Supreme Court. See Thévenoz, *Trusts in Switzerland*, at 178 and 201–202.

with foreign trusts having assets or beneficiaries in these countries. Foreign trusts causing taxable events, such as the holding of income-producing property, within these countries will of course attract taxation rulings, but the approach of the authorities seems largely to be to analogise with civil code institutions and concepts, apply to the trust the rules that govern the selected local institution or concept, and to leave it at that.[38] If this observation is fair, it is admittedly disappointing as well as puzzling in the contemporary climate of globalisation. The German and Austrian delegations to the Fifteenth Session played a thoughtful and valuable part in the Convention discussions.

Aside from the long-established *fideicomiso* tradition in a number of South American republics, the Spanish Civil Code tradition also remains distant from much interest in trust recognition. There are those academic circles in Spain that seek to encourage such an interest,[39] but among those practising law in that country the common law trust appears to remain a remote and often ill-understood foreign concept. A Canadian is reminded of a Saskatchewan premier who once remarked, being pursued by the media on a certain subject, that if he had a hundred problems, that would have to be the one hundred and first.

This brings us to three of the 'pure' civil law countries that have ratified the Trusts Convention. The significance of accession in Liechtenstein and San Marino has yet to be seen.

Following ratification in 1996, the Netherlands went off to a flying start with legislation that looked forward to an accommodating approach to the Convention's aims and the recognition of the foreign trust,[40] but since those early days the subject has largely been greeted with silence. Attempts have been made by some academics throughout the last thirty years to have the Dutch legislature introduce an internal trust into Dutch law, but to such action there was always opposition from other academics. The drafters of the new Civil Code of 1992 would have nothing to do with the trust. Today some Dutch commentators who advocate the domestic trust even perceive a legislative hostility towards the idea. The only treatment of foreign trusts that appears to have taken place – and that is more to the point – occurred in tax cases

[38] See further von Oertzen, 'Planning with Trusts in Germany', above, note 4.

[39] See Cristina González Beilfuss, *El Trust* (Barcelona, 1997).

[40] See Koppenol-Laforce and Kottenhagen, 'Institution of the Trust and Dutch Law', above, note 29.

that reached the Supreme Court of the Netherlands in 1998. That Court noted that the Convention excludes fiscal matters from its scope, and analysed certain discretionary and non-discretionary Channel Island trusts, to which the Dutch authorities were applying Dutch taxes, much as civil law courts have traditionally done, matching the trust in question against Dutch civil law institutions.[41]

There is no doubt that the idea of the voluntary segregation of assets by a settlor, and the consequences of segregation for creditors of the settlor, provides real difficulties for the civil law, and academic discussion surrounding the trust is at present seeking how to capture in the domestic law of the Netherlands the notion of a voluntarily segregated fund. No civil law jurisdiction can embrace conflict of law rules that recognise voluntary segregation without knowing what the impact of the recognised concept will be upon an internal law that is fashioned on the notion that the law, not the individual, decrees when a fund shall be treated as segregated and not therefore liable for the fund manager's personal debts, including his judgment debts.

By contrast Luxembourg possesses a contractual fiduciary concept which mirrors in part what a common law jurisdiction would accomplish with a trust.[42] Since 2003 when the Principality ratified the Convention it has significantly increased its ability to attract American and British trustee investment. It can also administer the entire trust fund of the foreign (e.g. English) onshore trust, and confer upon such a trust the advantages of its own tax rates. It is far too early to discern what the long-term effects of the Convention will be upon this economically attractive and successful jurisdiction which plays the role of a continental and international financial centre, or what conceptual problems may surface in the future. However, it is interesting that, whereas the Bahamas and the Cayman Islands have chosen to ignore the Convention, Luxembourg – engaged on

[41] For further reference see ibid., and also Frans Sonneveldt, 'De private express trust in de Nederlandse Successiewet 1956', a Ph D thesis for Utrecht University, March 2000, with a summary of length in English. From the same writer, see a comment on the Dutch tax cases concerning Jersey discretionary trusts: *European Taxation* (April/May 1999), at 190–192. Also D. W. M. Waters, 'The Trust in Civil Law Jurisdictions – The Dutch Experience', [1999] JTCP 131.

[42] Law of 27 July 2003, Title II. This Law was enacted to accompany the ratification of the Trusts Convention. The *fiducie* property constitutes a patrimony (*le patrimoine fiduciaire*) distinct from the *fiduciaire*'s personal patrimony, and the *fiduciaire* becomes the owner of this patrimony (*propriétaire de biens formant un patrimoine fiduciaire*). The beneficiaries are the settlor (*fiduciant*) and such third parties as are added by the contract. The *fiduciaire*, however, must be a financial institution (or a public entity concerned with finance).

a similar financial task of international estate planning for the private individual – has elected after years of consideration to adopt the treaty obligations of the Convention. Clearly the Principality has diagnosed a different future for the Convention and the states that ratify the Convention.

Italy constitutes a striking departure from hesitations and attitudes elsewhere. Who among the Hague delegates would have thought in 1984, as they gathered for a *vin d'honneur* on the closing of the Fifteenth Session, that Italy would fashion a domestic trust for itself through ratification of the Convention? Yet in 2004 the case reports witness without doubt that the Italian courts have accepted the validity of a trust created in Italy by an Italian settlor, with Italian assets transferred to and managed by an Italian trustee for Italian beneficiaries. The trust will be governed by a foreign law, e.g. Jersey, Malta or England, but this is the only foreign element in an otherwise Italian trust instrument. The courts require hesitant notarial officials to register land title holding by an Italian trustee, the trustee being registered 'as trustee' of the Italian land. Securities also, unlike the practice in common law jurisdictions, can be registered in the name of the person who holds them, the recorded notation being – 'as trustee'.[43]

The reasoning behind this development is simple: following ratification, Italians can have money held for them by a non-Italian trustee. Why should the trustee not be an Italian? Nor does the Convention say how many trust elements, or which elements, must be foreign. It is impossible not to listen to Italian academics and practitioners discussing everything from the structuring of a trust to trustee liability and the beneficiary's remedies without reflecting that this was how things must have been in the late seventeenth and early eighteenth centuries in England. The difference, of course, is the twist given to Italian discussions by the fact that they are taking place against the backdrop of the modern sophisticated common law trust reaching into every corner of segregated private and public investment, asset securitisation, creditor security, and asset holding and management. The whole Italian trust scene is fascinating, and for the practitioners and academics involved evidently exciting. The only disappointment for the visitor is that one cannot turn to the last chapter of this Mediterranean saga, and 'see what happens'.[44]

[43] Article 12 of the Convention directly supports the courts' decision.

[44] The journal *Trusts e attività fiduciarie*, scientific director Maurizio Lupoi, published quarterly by Ipsoa Editore srl, Milan, Italy, carries regular features on the trust in Italy.

6 Looking back and looking ahead

The Convention applies only to some Anglo-American trust forms, so that in common law states that have ratified there is always as a consequence a question of whether the Convention applies to the particular trust situation, or whether it does not so that pre-Convention case law conflict rules[45] remain in force. The complexity this produces can be witnessed by reading the current commentary on the Hague Convention found in leading trust texts.[46] However, this is probably the time for a perspective that takes in the whole international scene.

There are those who understandably argue that the Convention's provisions on recognition are so riddled with 'escape' articles that the whole thing is ultimately productive of wide-ranging uncertainty. A would-be ratifying state can have little idea of what recognition its own trust or 'analogous institution' will actually receive. Meanwhile, it is required to recognise foreign trusts, and is permitted to negate its recognition by the same invocation – to choice – of the 'escape' articles,[47] where it has not made reservations.[48] The delegates to the Hague Conference voted to reduce the Convention to small consequence – critics have said – and in civil law jurisdictions their governments have done the rest by ignoring it. An American, accustomed to the most developed conflict of law principles in any country in the common law or civil law world, operating in fifty states across the Union, each with its own sovereign trust law, could understandably reach the conclusion that little was achieved.[49] Commensurately that American might reasonably fail to be persuaded that sophisticated US trust conflict law for international situations should be abandoned for the amalgam of more rudimentary rules and of recognition 'escape' routes that the Convention produced.

Nevertheless, the present writer's response is that we, the Hague delegates, saw the Convention as 'breaking the ice'. There is no better way of summing up our approach; it was an international 'first step' into a scene of two or more systems of law and numerous variations as

[45] Such as they are in Commonwealth states.

[46] See *Lewin on Trusts*, paras. 11–25 to 11–63; David J. Hayton, *Underhill's Law of Trusts and Trustees*, 16th edn (London, 2003), 1011–1062.

[47] Articles 12, 13, 15, 16, 18 and 19.

[48] Articles 21 and 22 offer this opportunity.

[49] Jeffrey A. Schoenblum, 'The Hague Convention on Trusts: Much Ado About Very Little', [1994] JTCP 5.

between states within the same legal system. The civil law jurisdiction would have some idea from article 2 when it had a foreign trust before it, where it might look for the governing law, and what reservations it might fairly make in applying that law. These were early days and few of those states that had no trust institution saw any economic need for recognition. Those other than the few felt no pressure from lobbies or governments at home. They had not come to The Hague to design a trust for inclusion in their domestic laws, and perhaps not all of them could at once articulate any particular advantage accruing to their home states in recognising the trusts of the common law states. They were there perhaps on a voyage of discovery. And then as the Hague discussions developed a number became disturbed at the thought of the confusion, debate and possible litigation recognition might cause for their various domestic laws. As a consequence the Convention took the form of an offer of simple and contemporary choice of law rules, and for the most part an *invitation* to recognise foreign trusts.

Was that worth doing? On the whole in the writer's opinion it was. An international trust code of substantive law was beyond anyone to compose, and most probably still is. Through its choice of law rules, and its pointing the way to what recognition means, the Convention made a start along the road of a positive approach to a worldwide legal concept that for many is elusive. It left behind the sterile pro-trust and anti-trust writing of the pre-1939 years. Having read that writing as a student, the writer even then was left with the lasting impression that we had to get away from that scholastic shadow boxing, for most writers painted a picture of the trust that flattered their own prejudices.

However, again in 1982 these were early days. It is probably fair to say we did not adequately consider the coming phenomenon of holding trusts, investment trusts, security trusts, and trusts in lieu of or combined with corporations, as business management vehicles. In the offshore jurisdictions, where international dealings are so familiar, pension funds, insurance, securitisation, shipping and aviation have all found use for the classic trust or the contemporary non-charitable purpose trust. It is true that we at The Hague were almost exclusively concerned with personal and family *inter vivos* trusts and with testamentary trusts. However, both the description of the classic trust in article 2, and the choice of law rules in chapter II, have been used extensively in commercial and corporate business transactions. Certainly this has been the writer's experience. Perhaps, given the range of commercial circumstances in which the trust can valuably be employed, we were right as to the Scope of the Convention and Applicable Law to adhere closely to classic trust thinking.

There were also developments we could not foresee. The modern offshore non-charitable purpose trust is one. Does the Convention compel recognition by a mainland ratifying state of this trust? The commentators see the inevitability of recognition, but one wonders. If the mainland court is hostile to recognition of this 'category of trust' with regard to assets within its jurisdiction, it might invoke article 13 where the only association with the offshore jurisdiction is the choice of law, the residence of the trustee, and the place of administration.[50] It is evident that, if the persuasion is to the contrary, article 2 facilitates the recognition of the non-charitable purpose trust.

That is the style of the Convention. The interpretation of the Convention is always facilitative, offering a way forward to recognition to those who will take it. It has had a limited success to this point, but for the next twenty years much may turn on the future decisions of France and the United States whether to ratify. If they do ratify, the Hague Conference may be ready for 'the second step', and by that time the economic advantage in ratifying may be real. On the other hand we may increasingly see individual states working towards their own solutions, as Quebec in Canada has done with its trust fund held in title by no one (*patrimoine d'affectation*).[51] Maybe this is the way things will be, but yet it is difficult to believe that the Convention's momentum of the past twenty years, stately as it has been, will peter out. For one thing interest in the trust on the part of non-trust states continues apace. Since 1984 both South Korea and mainland China have statutorily introduced the trust domestically. Taiwan also has its trust legislation. The resistance to the trust is principally in Western Europe.

As to commercial and business use of the trust for the holding of segregated assets, the investment of corporate pension funds or publicly marketed mutual funds, and the provision of security for creditors of corporations, there is too little evidence to date of the impact of the Convention. It seems probable that at least article 2 of the Convention will remain an internationally accepted description of the trust and that the Convention's choice of law rules will also find general acceptance. We shall see whether there is enough in the Convention for these trusts

[50] However, the United Kingdom has undertaken in its act of ratification not to invoke article 13.

[51] See above, note 11, for the pre-1994 Quebec position.

that it will lead to further state ratifications, or whether the Convention will be seen as usefully supplying conflict of law rules for private client trusts only.

Relations between the common law and civil law world with regard to trusts law have come a long way since 1984. Sometimes those days seem long ago. There is noticeably more exchange of ideas and a better understanding between common law lawyers and civilians of what the issues are that have to be met.[52] From the North American perspective, the European Union and the negotiation of its various treaties seem to have encouraged between the United Kingdom and the civil law jurisdictions a more sensitive and accommodating reaction to what the trust achieves in its home climate and how, if at all, it can be adapted or utilised (as is) to advantage elsewhere. The early writings of the commentators expressing criticism of the Convention, some questioning its value root and branch – valid as they may well have been – seem to have been replaced by lower key, constructive pieces that reflect the fact that the Convention is part of the world's continuing legal scene.

The innovative offshore jurisdictions have amended and reworked their various pieces of trust legislation with a frequency that continues to astound those accustomed to pleading with their respective mainland jurisdictions to update the local trust legislation. In the early years of the 1980s pleading with the 'home' authorities was the routine experience of common law trust specialists. In the last ten years the offshore jurisdictions and Italy, each in their own way, have moved us into a completely new age of trust law. Counting the number of ratifications of a Hague Convention is one way in which to judge success. Another perhaps is to judge how far the Convention has changed attitudes and focused thinking about trusts. For instance, common law lawyers have stopped speaking internationally of the essential element of legal and equitable interests; we now emphasise the segregation of a fund of assets and discrete management. Civilians will concede that the trust is not a contract for the benefit of a third party (or one or both of the contracting parties).

The positive focus the Conference has given to trusts with international elements surely adds to the modest success in the number of ratifications the Convention has had. Seen through the telescope of time the Convention in 1984 was a beginning to interstate agreement;

[52] See e.g. D. J. Hayton, S. C. J. J. Kortmann, H. L. E. Verhagen, eds., *Principles of European Trust Law* (The Hague, 1991).

seen in the contemporary world it continues in its attempt to harmonise, to encourage rather than mandate, to be tentative rather than dogmatic. Is invitation to recognise a valid approach to the conflict of laws? There is obviously a sound argument that invitation is not a *rule*. And is harmony itself produced by encouragement? Not only the cynic might find the question simply amusing. Yet it appears to be disinterest in or apprehension of the trust that has discouraged further ratifications, not the character of the Convention. Disinterest and apprehension were assessments that predated the Convention. Perhaps the delegate comes from a different angle in weighing the whole venture. The representative of a state has had the advantage of witnessing at first hand the human elements – the constant enthusiasms and the ever responding concerns – that were brought out by the prospect of a convention being achieved. But whatever the reason, the writer thought the Convention discussions and the outcome of those discussions were eminently worthwhile. For his part he would do it all again. Let us say it was a vital commencement between legal cultures in an agreement as to 'trust' law, and as such it has to be an achievement.

PART II · THE CASE STUDIES

The Cases

GENERAL PART

Case 1:	1	Creation and termination of the management relationship; powers of the manager
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General part

Case 1: Creation and termination of the management relationship; powers of the manager

Case

John is a professional investment manager. Sam decides to make use of John's services after learning that he is a skilful manager. In John's office, Sam signs a document granting John full investment powers over a capital value of €2,000,000. The terms of the document indicate that John's powers are to be irrevocable for the term of five years. These powers enable John, inter alia, to buy and sell any kind of asset, including immovables. The document also provides that John will credit all the income produced by the managed capital to Sam's bank account. It stipulates that John will be entitled to deduct an annual fee, calculated as a percentage of the capital value of the managed assets. Sam then writes a cheque payable to John for €2,000,000.

Alternative 1

In the second year of their relationship, Sam reads in a newspaper that John is implicated in the international trafficking of stolen works of art. He does not know whether the allegations are true but he decides to terminate their relationship. He communicates this to John. He demands restitution of the managed assets, as well as a full account of the investments that have been made. Upon John's refusal, Sam sues, asking for: (a) a judicial declaration that the relationship is terminated; (b) a remedy enjoining John from entering into any further transaction related to the assets; (c) a full audit of the previous period; (d) restitution of the managed assets; and (e) damages. John counterclaims, seeking: (a) a declaration that he still enjoys full managing powers until the end of the five-year term; and (b) damages.

Alternative 2

One of the investments that John buys for Sam is an immovable called Blackacre. In the second year of their relationship, Sam learns by chance that Elinor is purchasing Blackacre from John, at a price that Sam considers too low. He writes to both of them to indicate that he does not want the sale to proceed. His letters are received before any contract is concluded. Nonetheless, John and Elinor make the contract, the immovable is conveyed to Elinor and the price is paid to John. Can Sam recover Blackacre from Elinor?

Alternative 3

In the second year of their relationship, Sam sends a note to John requiring him to purchase Blackacre as an investment. John refuses on the ground that, in his view, Blackacre is not a good investment. Does Sam have any legal recourse?

Discussion

Austria

The legal concepts that fit the framework described in Case 1 are the contract of mandate (*Auftrag*), representation (*Vollmacht*) and the fiduciary contract (*Treuhand*).

The contract of mandate and representation are both regulated in ss. 1002 ff. ABGB under the title *Bevollmächtigungsvertrag*. The contract of mandate can be coupled with the power to represent the mandator, or it can be concluded without authorising the mandatary to act in a representative capacity.[1] Despite the common provisions, there is a clear distinction between these two legal concepts. Mandate obliges the mandatary 'internally', to act according to the mandator's instructions, whereas representation empowers the mandatary to produce legal effects vis-à-vis third parties.[2] Generally, these legal institutions should be analysed independently of each other.

The state of the law with regard to the fiduciary contract is more obscure. Guidelines and definitions have been developed in case law

[1] Strasser in *Rummel, Kommentar zum Allgemeinen Bürgerlichen Gesetzbuch I*^{3} (2000) § 1002 Rz 7.

[2] Apathy in *Schwimann, Praxiskommentar zum Allgemeinen Bürgerlichen Gesetzbuch V*^{2} (1997) § 1002 Rz 1 ff.

and doctrine,[3] due to the lack of statutory rules.[4] In the light of the principle of contractual autonomy, the fiduciary contract is generally considered to be lawful.[5] In addition, Austrian law refers to fiduciary relationships, both explicitly and implicitly.[6] With respect to Case 1, the relevant aspect of the *fiducia* is its modality of management *fiducia*, or *fiducia cum amico* as modelled after Roman law.

The fiduciary relationship is a concept whereby the fiduciary (*Treuhänder*) exercises rights, in his own capacity, but in the interest of the settlor (*Treugeber*). In the modality of the management *fiducia*, the fiduciary obtains complete ownership over the assets, which is exercisable *erga omnes*; whereas 'internally', between the parties, the settlor holds a personal right to claim the enforcement of the agreed terms; this is only exercisable *inter partes*. The internal relationship between the fiduciary and the settlor does not have any effect vis-à-vis third parties.[7] In other words, the fiduciary has the *power* to do more than he is lawfully *entitled* to do.[8] In most cases, the internal relationship is characterised as a contract of mandate, notwithstanding additional relationships that may be present, such as service contracts or contracts for work and services.[9]

Apart from that, the legal relationship between Sam and John might also be appropriately described as indirect representation (*indirekte Stellvertretung*)[10]

[3] See Kastner, *Gesammelte Aufsätze* 592 ff.; Umlauft, 'Die Treuhandschaft aus zivilrechtlicher Sicht', in *Apathy* (Hrsg.), *Die Treuhandschaft* (1995) 19, 23; Jappel, *Treuhandschaften* (1998) 19.

[4] OGH 19.12.1933 SZ 15/252; 17.6.1953 SZ 26/156; 11.2.1971 SZ 44/13; 25.2.1971 EvBl 1972/19; 28.10.1971 JBl 1972, 322.

[5] OGH 17.6.1953 SZ 26/156; 11.2.1971 SZ 44/13; 28.10.1971 SZ 44/166; 16.1.1974 SZ 47/3; 1.4.1976 SZ 49/49; 1.4.1976 JBl 1976, 588; 23.1.1980 EvBl 1980/162; 19.6.1986 JBl 1986, 647 = ÖBA 1986, 647 (Apathy); Kastner, *Gesammelte Aufsätze* 593; Strasser in *Rummel*, *ABGB I*^{3} § 1002 Rz 42.

[6] Kastner, *Gesammelte Aufsätze* 593; Umlauft in *Apathy*, *Treuhandschaft* 23: § 24 Abs 1 lit b und c BAO; § 8 DepG; Art. 126 b Abs 2 B-VG; §§ 64, 226, 233, 234 and 236 AktG; § 21c Z 5 RAO etc.

[7] This is true except for the cases of bankruptcy and execution of the fiduciary.

[8] Kastner, *Gesammelte Aufsätze* 594, 608.

[9] Ibid., 605; Thurnher, *Grundfragen des Treuhandwesens* (1994) 123; Umlauft in *Apathy, Treuhandschaft* 34; Strasser in *Rummel, ABGB I*^{3} § 1002 Rz 42i; OGH 22.3.1950 SZ 23/76; 17.6.1953 SZ 26/156; 23.1.1980 EvBl 1980/162; 23.5.1996 NZ 1997, 222.

[10] The indirect representative has – similar to the fiduciary – the power to establish direct legal relationships between the third party and himself and is bound to transfer the acquired assets and rights to the mandator. In comparison, the fiduciary relationship emphasises the management-thought and is generally established for an extended period of time. Also, in the case of bankruptcy and execution of the indirect representative, the legal consequences differ. The mandator does not hold a right to claim separation (insolvency) or opposition to execution of the assets against the indirect representative. See Kastner, *Gesammelte Aufsätze* 599 ff.; Umlauft in *Apathy, Treuhandschaft* 31 f.; Jappel, *Treuhandschaften* 29 f.; Strasser in *Rummel, ABGB I*^{3} § 1002 Rz 42k; OGH 8.6.1932 SZ 14/121.

or commission (*Kommission*).[11] These legal concepts are very similar to the fiduciary contract, and despite theoretical efforts to determine precise guidelines to distinguish between them, a conclusive determination is not possible.[12] The most practicable way to reach a clear distinction is to focus on the implied intention of the contracting parties. Considering Case 1, it is more appropriate to apply the rules of the fiduciary contract in its modality of management *fiducia* and the rules of the contract of mandate. The concept of *fiducia* has gained considerable importance over the past few years.[13] Apart from the notaries public and the lawyers who administer their clients' assets under the title of *fiducia*, pension funds and collective investment schemes are increasingly important in Austria (see Cases 8 and 9).

According to the principles discussed above, the relationship between Sam and John is best qualified as a management *fiducia*. It is stipulated that John will manage Sam's capital of €2,000,000 for a period of five years, which constitutes a valid basis for the *fiducia* agreement. Sam has also transferred a capital value of €2,000,000 to John's patrimony by writing a cheque payable to John. Externally, John is entitled to buy and sell any kind of asset in his own name and for his own account. As a consequence, he obtains complete title of ownership over the assets vis-à-vis third parties. Internally, John is bound by the terms of the contract of mandate obliging him skilfully to invest Sam's capital during the agreed period of time.

The revocability or irrevocability of the management *fiducia* is determined according to the terms of the internal relationship between John and Sam, which is governed by the rules of the contract of mandate. Section 1020 ABGB indicates that free revocability of the mandate is possible for any reason and at any time, with immediate effect and without violating any contractual obligation. The same holds true for agreements intended to last for some time (*Dauerschuldverhältnisse*), which are usually subject to revocation or termination only for good cause.[14] This essential revocability is to be understood as rooted in the fundamental confidence between the mandator and the mandatary, which serves as the basis of the agreement and constitutes a safeguard of the mandator's economic freedom with respect to his assets.[15]

[11] This legal institution focuses on buying and selling for profit in the name of the commission agent but on account of a third party. Jappel, *Treuhandschaften* 30 ff.

[12] Kastner, *Gesammelte Aufsätze* 599 ff.; Umlauft in *Apathy, Treuhandschaft* 31 ff.

[13] Thurnher, *Grundfragen* 19 f.

[14] Apathy in *Schwimann, ABGB V*^{2} § 1020 Rz 1.

[15] Ibid.

The mandator, however, is free to renounce the revocability of the mandate, so long as it is established that his economic freedom is not endangered in an unjustified manner, and that the period of time is not too extended.[16] This possibility only exists if the agreed irrevocability is founded on a just cause that extends beyond the mandate; it is for the mandatary to prove this.[17] As a general rule, the stipulation of irrevocability is invalid when the mandate is in the exclusive interest of the mandator. On the other hand, if the irrevocability is beneficial to the mandatary and/or a third party, then the limitation of the revocability is considered to be valid.[18] According to the Supreme Court (OGH), it is permissible for the mandator to renounce the revocability of the mandate where the mandatary holds a sole and exclusive mandate (*Alleinvermittlungsauftrag*)[19] or a collection mandate (*Inkassomandat*) in order to satisfy the mandatary's own claim against the mandator, or that of a third party.[20]

Moreover, the possibility to revoke the mandate for substantial reasons, at any time, with immediate effect, exists even if the irrevocability of the mandate is lawfully stipulated.[21] According to the Supreme Court (OGH), the continuation of the relationship can be rendered unreasonable by substantial reasons:[22] examples include abuse of confidence,[23] conflict of interests[24] and gross violation of the accounting duty.[25] It is necessary to declare the reason for revocation to the other party within a reasonable period of time.[26]

[16] Ibid., § 1020 Rz 6; OGH 7.11.1970 SZ 43/37; controversial (strittig): Ehrenzweig, *System des österreichischen allgemeinen Privatrechts. Allgemeiner Teil I/1*^{2} (1951) 283; Flume, *Allgemeiner Teil des Bürgerlichen Rechts. Das Rechtsgeschäft*^{4} (1992) 876 ff.; Larenz/Wolf, *Allgemeiner Teil des Bürgerlichen Rechts*^{8} (1997) § 47 Rz 52 ff.; Stanzl in *Klang, Kommentar zum Allgemeinen Bürgerlichen Gesetzbuch IV/1*^{2} (1968) 867 f.; OGH 1.9.1954 SZ 27/211; 13.12.1962 JBl 1963, 375; 11.2.1970 JBl 1970, 618.

[17] Apathy in *Schwimann, ABGB V*^{2} § 1020 Rz 7; Koziol/Welser, *Grundriss des bürgerlichen Rechts I*^{12} (2002) 190; OGH 22.12.1965 JBl 1966, 364; 8.4.1986 MietSlg 38.092.

[18] Apathy in *Schwimann, ABGB V* ^{2} § 1020 Rz 7 mwN.

[19] OGH 14.10.1982 HS XII/14.

[20] Stanzl in *Klang, ABGB IV/1*^{2} 867; Koziol/Welser, *Grundriss I*^{12}, 190.

[21] Kastner, *Gesammelte Aufsätze* 606; Apathy in *Schwimann, ABGB V*^{2} § 1020 Rz 9; Koziol/Welser, *Grundriss I*^{12}, 190.

[22] E.g. abuse of confidence, abuse of the power of attorney: OGH 19.6.1975 JBl 1976, 100; 4.6.1987 EvBl 1988/5; 12.1.1995 HS 26.587/1.

[23] OGH 7.11.1970 SZ 43/37; 19.6.1975 JBl 1976, 100; 24.6.1976 MietSlg 28.098; 4.6.1987 EvBl 1988/5.

[24] OGH 30.3.1967 MietSlg 19.070.

[25] OGH 1.9.1954 SZ 27/211.

[26] Apathy in *Schwimann, ABGB V*^{2} § 1020 Rz 9; Strasser in *Rummel, ABGB I*^{3} §§ 1020–1026 Rz 4.

With respect to Case 1, it is not immediately apparent whether the agreement between Sam and John regarding the irrevocability of the mandate is based on a just cause. On the one hand, it is clear that the mandate does not exclusively serve Sam's interests, since John shares a percentage of the profit, and the stipulation of irrevocability could therefore be valid.[27] On the other hand, John, as a professional investment manager, is exclusively dependent neither on the relationship with Sam nor on the remuneration he receives from Sam; nor is he solely engaged in managing Sam's assets (*Alleinvermittlungsauftrag*). Moreover, the mandate does not exist in order to allow him to satisfy his own or a third party's claim in the course of his business activities related to the mandate, which would justify irrevocability according to the Supreme Court (OGH). Considering the five-year term, which is fairly long, it can be argued that Sam's economic freedom is unreasonably restrained by the agreement of irrevocability. This would lead to the invalidity of the stipulation of irrevocability. This brings us back to s. 1020 ABGB which provides for free revocability at any time, for any reason, with immediate effect.

On the assumption that the agreement of irrevocability was valid, which is not very likely, the result may differ. It is still possible that Sam could revoke the contract of mandate, or fiduciary contract, after learning about John's alleged criminal activities. The alleged violation of confidence could constitute a reason that justifies the immediate revocation of the contract of mandate. The courts may require some evidence that John was actually engaged in an unlawful activity, or that he failed to meet his obligations.[28]

Alternative 1

The issues in Alternative 1 will be discussed under the assumption that the agreement of irrevocability is invalid, making the termination of the fiduciary relationship by Sam lawful. The revocation of the internally stipulated mandate has immediate effect, whether it was communicated orally or in writing. Thus, Sam will be entitled to a judicial declaration that the relationship is terminated.

[27] The mere fact, however, that John could earn a fee and therefore could have a special interest in the irrevocability of the mandate/fiduciary relationship might not be enough and might not qualify for a 'just cause'.

[28] Apathy in *Schwimann, ABGB V*^{2} § 1020 Rz 1, 9.

Theoretically, there is no reason to file a remedy that enjoins John from entering into any further transactions related to the assets. The revocation of the mandate extinguishes all the powers related to the fiduciary contract with immediate effect. Thus, additional transactions regarding the assets would be unlawful and would make John liable for damages (although they would be legally valid: see below).

Under certain circumstances, Sam would be entitled to a provisional injunction (*einstweilige Verfügung*) awarded by the court. Sam would be required to produce prima facie evidence of his right to the assets, and of the imminent danger of a non-recoverable loss.

According to s. 1012 ABGB, the agent is obliged to deliver regularly an audit of his business activities, at the mandator's request. The termination of the relationship consequently requires a full audit of the previous period, which is enforceable by a separate legal action.[29]

Sam does not automatically recover full powers over the assets after terminating the management *fiducia*. The revocation of the mandate leads only to a personal claim arising from the fiduciary contract, which entails John's obligation to return the managed assets to Sam and to retransfer them into his ownership in the mode prescribed by law (e.g. registration in the land register).[30] Sam cannot exercise the action for recovery of possession (s. 366 ABGB) since he has given up ownership over the assets. If John refuses the restitution of the assets and sells them to a third party, then he will be liable for damages. The transaction itself, however, will be legally valid, provided that the third party was in good faith.

Damages are available if they can be proven by Sam. In this case, however, Sam's claim for damages will not succeed since John has not violated his obligations under the fiduciary contract. The termination of the relationship by Sam is based on subjective grounds. The loss of confidence emerging from alleged criminal activities committed by John is not directly related to John's duties stipulated in the fiduciary relationship.

John's counterclaims will not succeed considering the above findings (lawful revocation with immediate effect: s. 1020 ABGB). John will not be granted a declaration stating that he still enjoys full managing powers until the end of the five-year term. Damages will not be awarded unless the revocation is considered to be untimely, inopportune or an abuse of right, which is not implied by the facts of the case. However,

[29] Ibid., § 1012 Rz 11.

[30] Umlauft in *Apathy, Treuhandschaft* 68.

John will be entitled to claim the agreed remuneration until the extinction of the contract, as well as his allowable expenses.

Alternative 2

The mandatary is obliged to follow the instructions of the mandator regardless of whether they are issued at the same time as the management *fiducia* is concluded, or subsequently during the ongoing relationship. This obligation, however, only applies to orders complementing the mandatary's duties, and not to orders which change them. Instructions that would alter the mandatary's duties do not need to be observed by him. They may be regarded as a revocation of the mandate, and simultaneously as an offer to conclude a new contract.[31]

Sam's instruction that prohibits the sale of Blackacre to Elinor does not alter John's original duties, but rather clarifies the way in which Sam would like John to manage his assets. Therefore, John is bound to comply with this instruction, but only with regard to the internal relationship. In principle, the transfer of a managed asset to a third party is legally valid, even if it is contrary to the explicit orders of the mandator.[32] Third parties are generally not affected by the mandator's orders unless they are aware of them.

In Alternative 2 (knowledge of the third party about the disposition of the mandatary in bad faith), the legal transaction is void as a result of the participation in a criminal act (s. 133 StGB and s. 879 (1) ABGB, embezzlement).[33] The transfer of ownership will be ineffective. The third party will fail to obtain ownership of the managed assets even where he is unaware of the mandatary's breach of trust, if this is due to the third party's own gross negligence.[34] The doctrine and the Supreme Court (OGH) apply the rules developed in relation to the misuse of the power of attorney (*Vollmacht*).[35]

In Alternative 2 both John and Elinor had knowledge of Sam's instruction prohibiting the sale of Blackacre at such a low price. John and

[31] Apathy in *Schwimann, ABGB V*^{2} § 1009 Rz 12.

[32] Kastner, *Gesammelte Aufsätze* 594; Koziol/Welser, *Grundriss I*^{12}, 193 f.; Strasser in *Rummel, ABGB I*^{3} § 1002 Rz 42a.

[33] OGH 24.10.1990 SZ 63/186; 17.6.1993 ecolex 1993, 732 (Wilhelm); Kastner, *Gesammelte Aufsätze* 628; Butschek, *Rechtsstellung* 109 f.; Umlauft in *Apathy, Treuhandschaft* 63; Apathy in *Schwimann, ABGB V*^{2} § 1002 Rz 10; Koziol/Welser, *Grundriss I*^{12}, 193 f.

[34] OGH 13.2.1991 SZ 64/13; 28.11.1991 GesRZ 1992, 51; 25.6.1996 JBl 1997, 108 (Hügel); Stanzl in *Klang, ABGB IV/1*^{2}, 857 ff.; Umlauft in *Apathy, Treuhandschaft* 64.

[35] OGH 17.6.1993 JBl 1994, 118; Kastner, *Gesammelte Aufsätze* 628; Butschek, *Rechtsstellung* 113 ff.; Thurnher, *Grundfragen* 75 f.; Umlauft in *Apathy, Treuhandschaft* 63 ff.

Elinor were both informed of this instruction before the contract was concluded. It follows that Elinor never obtained ownership over Blackacre and thus Sam will be able to recover it from her. Apart from that, the violation of the mandator's instruction makes the mandatary, John, liable for damages for breach of contract.[36]

Alternative 3

The mandatary is under an obligation to follow the mandator's instructions. If compliance with the mandator's instructions appears to impair the interests of the mandator, the mandatary is required to inform and consult the mandator about this. If the mandator nevertheless insists on his original instructions, then the mandatary must follow these instructions.[37] If the mandatary does not follow the instructions and the mandator suffers a loss for this reason, he can claim damages.

In the present case John therefore will have to inform Sam that he thinks the instruction is contrary to Sam's interest. If Sam insists on his instruction, John will have to follow it. If he does not follow it, this will constitute a breach of contract of mandate. It gives Sam the right to terminate the contractual relationship with John; if he suffers losses for this reason, he can claim damages.

Belgium

The most obvious legal institution that captures the relationship between John and Sam is the mandate.[38] This is a contract by which the mandated party or mandatary, John, is authorised to represent the

[36] Jappel, *Treuhandschaften* 50.

[37] Apathy in *Schwimann, ABGB V*^{2} § 1009 Rz 13.

[38] E.g. Commercial Court of Brussels, 9 January 1991, *Revue de Droit Commercial* 1993, 601; H. De Page, *Traité élémentaire du droit civil belge* (Brussels: Bruylant, 1975), Vol. V, no. 362, A. In implementation of the EEC Directive of 18 December 1986, the Belgian Act of 13 April 1995 (*Moniteur Belge* 2 June 1995, as amended by the Act of 4 May 1999, *Moniteur Belge* 2 June 1999 and the Act of 1 June 1999, *Moniteur Belge* 13 July 1999), regarding the contract of commercial agency, has introduced this special type of contract whereby a commercial agent is charged to negotiate and eventually conclude transactions, permanently and remunerated, in the name and for the account of the principal. This type of contract is limited to commercial contexts, and the permanent character of the activities of the commercial agent is essential. As opposed to mandate, the commercial agent is not limited to legal acts but can also be charged with mere material acts such as searching for clients. The very essence of this special regulation is the protection of the commercial agent upon termination of the contract. This contract will not be dealt with further in this report, since it involves two professionals. See the references in B. Tilleman, *Lastgeving, Algemene Praktische Rechtsverzameling* (Antwerp, Story-Scientia,

mandator, Sam, in managing Sam's assets. The mandator continues to hold the title to the assets.[39] The mandatary acts 'on behalf of and (chargeable) to the account of' the mandator; this is called direct representation. Titles, rights and duties that are created by acts of the mandatary fall directly into the patrimony of the mandator. Third parties, with whom the mandatary deals, enter into a direct relationship with the mandator. If the purpose of the contract is investment management, then the contract of mandate is usually combined with a contract for services whereby the investment manager provides services under the supervision of the client.[40]

Although some consider the feature of direct representation as essential to the contract of mandate, it seems acceptable for practical reasons to distinguish between mandate with and without representation. In mandate without representation, the mandatary acts in his own name but remains chargeable to the account of the mandator. Third parties, with whom the mandatary deals, do not enter into a direct relationship with the mandator, but only with the intermediary, i.e. the mandatary acting without representative capacity. The commercial version of the mandate without representation is the contract of commission.[41] The intermediary acting under the contract of commission is presumed to act in his own name, without representation. The fact that he is acting on behalf of another party is disclosed, but the indentity of the mandatary is not. In the civil contract of *naamlening* or *prête-nom*, even the fact that the intermediary is acting on behalf of someone else is undisclosed.[42]

The *fiducia cum amico* is somewhat analogous to the trust, given that it involves a transfer of title. The administrator holds the legal ownership of the managed assets in lieu of the beneficiary.[43] This mechanism offers a large degree of flexibility and confidentiality. It allows the administrator to exercise full powers over the assets without any duty

1997), nos. 58–61 and in R. Van den Bergh, E. Dirix, H. Vanhees, *Handels- en economisch recht in hoofdlijnen,* 5th edn (Antwerp: Intersentia, 1997), no. 151.

[39] According to art. 1984 of the Belgian Civil Code (BCC), mandate is an act by which one person authorises another to act on behalf of the mandator.

[40] B. Feron, 'La gestion de fortune en droit Belge', in *Legal Aspects of Investment Management*, 90.

[41] See Title VII, arts. 12–17 Commercial Code.

[42] See J. Van Ryn, *Principles de droit commercial*, III, no. 1788.

[43] W. Van Gerven, *Algemeen Deel* (Brussels: Story Scientia, 1987), 465; M. E. Storme, 'Van trust gespeend?', *Tijdschrift voor Privaatrecht* 1998, 754; R. Feenstra, *Romeinsrechtelijke grondslagen van het Nederlands privaatrecht* (Leiden, 1990), no. 178; see also several contributions in J. Herbots and D. Philippe, eds., *Le trust et la fiducie* (Brussels: Bruylant, 1997).

of disclosing his relationship with the beneficiary. In return, the administrator has a fiduciary duty towards the beneficiary, i.e. to provide for efficient management in view of the objective of returning profits and assets to the beneficiary when required. This mechanism, in principle, is not regulated under Belgian law. With the exception of some particular legislation, there is no protection for the beneficiary in the case of insolvency of the administrator or abuse of his powers.[44] Therefore, the position of the administrator under the *fiducia* is generally regarded to be excessively powerful, and the risk for the beneficiary too high.

We can conclude that the contract of mandate, with or without representation, is the most appropriate legal concept for organising the relationships described in the case. The rights and duties of both contracting parties are well established under Belgian private law.

The preference for the mandate also appears in the Act of 6 April 1995 regarding secondary markets and the organisation and supervision of investment companies.[45] This Act states that individual investors who are Belgian residents, wishing to purchase securities on the financial

[44] There are some specific provisions governing the financial sector that could be qualified as *fiducia cum amico*. See, e.g., the Act of 15 July 1998 making it possible to transfer shares to an entity (such as a foundation) in return for 'certificates'. The entity (in the Netherlands known as *Stichting-Administratiekantoor*) is the owner of the shares but has a duty to transfer income on the shares to the holder of the certificate immediately. The latter can also, under certain conditions, require conversion of the certificates into shares again. See e.g., A. Verbeke, 'Certificering van effecten. Nuttig instrument voor successieplanning?', *Notarieel en Fiscaal Maandblad* 1999, no. 3, 43–67.

[45] *Moniteur Belge* 3 June 1995 and erratum 1 July 1995. Book II of the basic Act of Financial Transactions and Financial Markets of 4 December 1990 (*Moniteur Belge* 22 December 1990 and erratum 1 February 1991), regarding the secondary markets for financial instruments, has almost entirely been revoked by the Act of 1995, entering into force in general on 31 October 1995 (see Royal Decree of 19 October 1995, *Moniteur Belge* 31 October 1995), and for some exceptions at a later date but not later than 6 January 1996 (see art. 37 and 38 of the Royal Decree of 20 December 1995, *Moniteur Belge* 6 January 1996 and erratum 6 December 1996). Moreover, the Financial Transactions and Financial Markets Act of 1990 has been amended and changed numerous times, amongst others, by Acts of 14 May 1992, 28 July 1992, 5 August 1992, 22 March 1993, 6 August 1993, 30 January 1996, 12 December 1996 and 30 October 1998, *Moniteur Belge* 10 November 1998 with Royal Decree of 18 November 1998, *Moniteur Belge* 28 November 1998; 17 December 1998, *Moniteur Belge* 31 December 1998 second edition with Royal Decree of 29 January 1999, *Moniteur Belge* 5 February 1999; 9 March 1999, *Moniteur Belge* 2 April 1999; 10 March 1999, *Moniteur Belge* 14 April 1999 second edition with Royal Decree of 11 April 1999, *Moniteur Belge* 17 April 1999 second edition. The Act of 9 March 1999 awards the King (which is the Executive Branch) the power to change the Act of 1990 and the Act of 1995 in order to convert the European Directives regarding investment companies and institutions for collective investment into Belgian law and to be in accordance with article 1 of Directive 98/33/EC of the European Parliament and

markets, must conduct their transactions through 'intermediaries acting as mandataries or commission agents'.[46] This Act does not require investment management to be carried out by corporate entities.[47] The Royal Decree of 5 August 1991,[48] which outlines detailed rules on asset management, is limited to corporate entities; similar rules for natural persons are still in progress. Where necessary, the assumption will be made that the investment manager is a corporation.

Alternative 1

According to art. 2004 BCC, the mandator may revoke the mandate at any time, for whatever reason and without any indemnity or notice period.[49] However, contracting parties may provide otherwise in their contract.[50] A clause stipulating that the mandate is irrevocable is valid,[51] although case law requires such clauses to be restricted in time, in field of application or both.[52] It is, therefore, not acceptable to declare a contract irrevocable for an indefinite period of time. However, even during a specified period of time, the stipulated irrevocability of a mandate is not absolute.[53] Within that period, the courts can declare termination of the contract upon the request of either party if

the Council of 22 June 1998. The Act of 10 March 1999 enables the King to coordinate the Acts of 1990 and 1995 in order to assure a uniform terminology.

[46] Art. 2 § 1 Act of 6 April 1995.

[47] Arts. 117 ff.

[48] Awaiting further Royal Decrees implementing the Act of 6 April 1995, in practice the Royal Decree of 5 August 1991 regarding asset management and investment advice (implementing the Act of 1990), *Moniteur Belge* 20 August 1991, continues to be applicable and guiding. That incompatibilities and even contradictions do arise in practice is certainly not a preoccupation of the Belgian legislature.

[49] Tilleman, *Lastgeving*, 301–305.

[50] Some authors claim that a mandate which has been concluded in the exclusive interest of the principal is always revocable, despite any contractual clause providing otherwise. The fact that the mandated party is remunerated is of no importance in determining whether a mandate is in the exclusive interest of the principal. See R. Dekkers, *Handboek van burgerlijk recht*, vol. II, no. 1312; M. Gevers, 'Examen de jurisprudence (1949–1952), Les contrats spéciaux', *Revue Critique de Jurisprudence Belge* 1953, no. 38, 333. If the mandate is in the common interest of the parties, or even of a third party, then revocation will only be possible by consent, and on a legal or contractual basis (see Tilleman, *Lastgeving*, 307–312).

[51] Court of Cassation, 13 January 1938, *Revue Pratique des Sociétés* 1938, 81; Tilleman, *Lastgeving*, no. 566; W. Van Gerven, *Bewindsbevoegdheid*, doct. diss., no. 224, 311.

[52] *Répertoire Pratique du Droit Belge*, s. v. Mandat, no. 969, 806; Tilleman, *Lastgeving*, no. 568.

[53] The same is true if the unilateral irrevocability follows from the fact that the mandate is in the common interest of both parties.

there is a legitimate reason for terminating the contract, i.e. the non-performance by the counterpart.[54]

In Case 1, the issue is whether the allegations against John constitute a lawful reason to terminate the relationship. Belgian case law is flexible and does not exclude any reasons. For example, a serious failure in performance of even a minor duty can constitute a legitimate reason.[55] However, merely external factors would not suffice; some act or omission by the mandatary is required. The mandatary's failure to fulfil his obligations might be sufficient to justify termination of the contract. The mandator's loss of trust and confidence in the mandatary may also be a valid reason justifying termination of the contract. It is John's duty to communicate any circumstance that might influence the contractual relationship with the mandator. The decisive factor is whether Sam would have entered into the relationship with John if he had knowledge of the relevant fact in advance.[56]

This case does not indicate that John is doing something wrong in his work for Sam. Instead, the allegations create a negative image of John, which may undermine Sam's trust in John. The outcome depends on the details of John's implication in the trafficking of stolen art. If he were convicted, then this could serve as a ground for Sam to terminate the relationship. If he has only been indicted, then the question is to what extent the presumption of innocence should prevail. It can be argued that Sam should be permitted to terminate the relationship because it is reasonable to lose confidence in an indicted person. Other factors, such as media reports, would not necessarily qualify as reasonable grounds on which to terminate the relationship. Assuming that John is performing his mandate correctly, it is not certain that termination would be accepted even if John were convicted. Case law indicates that past criminal acts of the mandatary do not constitute a valid reason for termination; however, the false denial of these acts by the mandatary can constitute a valid reason for termination.

If the court refuses to declare the termination of the relationship, then Sam has the option of unilaterally terminating the contract. In this case, Sam would be required to pay an indemnity to John for loss of remuneration, if the latter claims performance of the contract. If the

[54] Art. 1184 BCC.

[55] M. Fontaine, 'La mise en oeuvre des contrats synallagmatiques pour inexécution fautive', *Revue Critique du Jurisprudence Belge* 1991, 27.

[56] See, amongst others, W. Van Gerven and Covemaeker, *Verbintenissenrecht* (Leuven: Acco, 2001), 126.

court does comply with the request for termination, then John has no further authority to act as the mandatary for Sam. This will automatically imply that John is dismissed from his management duties, and thus he may not enter into any further transactions related to the assets. To ensure that John will refrain from any further transactions, Sam can claim an interim injunction, sanctioned by a *dwangsom* or *astreinte*, which is a monetary compensation automatically payable by John if he does not comply with the injunction.[57]

John has the duty to render account of his management to the mandator.[58] This duty has two components. The mandatary is required to inform the mandator of the way in which he is managing the assets. If John cannot sufficiently account for his management, then Sam can request the court to appoint an expert to conduct a full audit.[59] Furthermore, John will be required to return all assets and profits he has collected to the legal owner.[60] Upon John's refusal to return the assets, Sam can seek relief by reclaiming possession of the assets (restitution).[61] Finally, Sam will also be entitled to damages for the loss of profit and the costs incurred as a result of terminating the contract.

As a result, the relief requested by Sam would result in the following: (a) the judicial declaration could be granted, depending on the weight given to the allegations; (b) if the contract is declared terminated, then the injunction would be granted, possibly coupled with a *dwangsom* or *astreinte*; (c) John would be ordered to account for his management and, upon failure to do so appropriately, a full audit would be ordered; (d) the restitution claim would be granted; (e) John would be required to pay damages. The counterclaim would result in the following: (a) the declaration would not be granted, and (b) no damages would be awarded.

Alternative 2

A mandatary may act only if he is authorised, and in the way that he is authorised, under the terms of his mandate. A mandate that is established in an unspecified manner and in general terms authorises the mandatary to administer the assets in a restricted fashion, which does not include, for example, transferring assets.[62] A mandatary needs an

[57] Act of 31 January 1980; art. 1385bis to 1385nonies Judiciary Code.

[58] Art. 1993 BCC. [59] Art. 962 Judiciary Code.

[60] Dekkers, *Handboek van burgerlijk recht*, vol. II, no. 1290, 725.

[61] Art. 1370 Judiciary Code.

[62] Art. 1988 BCC.

express and *specific* mandate to be entitled to alienate some or all of the assets. In the case of immovable property, a mandate must be in authentic form (i.e. authenticated by a notary) if it is going to be attached to a notarial deed that will be registered.[63] Registration is explained immediately below.

In general, land is sold by concluding a written contract (*compromis)*. From that moment, based on the principle of consensualism, there is a valid sale (agreement regarding object and price) and transfer of ownership (unless a contractual clause stipulates otherwise). However, in order to invoke such ownership rights towards *bona fide* third parties, publicity of the transaction is required. For that reason, a notarial deed is signed and then registered at the land registry.[64] Within four months of the contract,[65] the parties usually have a notarial deed drawn up and the title registered. If *A* sells land to *B*, and *B* has his title registered, then *B* may invoke his ownership *erga omnes*. If *B* did not register his title, then he may only invoke his rights against a party with subjective knowledge of the sale. Supposing that *A* sells his house to *B* on day 1, and to *C* on day 2, and neither *B* nor *C* registers their title, then *B* will prevail if he can prove the earlier date of his contract. What if both *B* and *C* registered their title? If *B* has registered first, then he will prevail. If *C* has registered first, then he will prevail unless *B* can prove that *C* had subjective knowledge of the prior sale to *B*.[66] Registration of the notary deed does not correct any intrinsic defects in the title. If there is a defect, complete ownership rights in the land are only acquired after a period of time. The buyer, who acquired in good faith, on the basis of a legal and registered title, will be untouchable after a

[63] Art. 2 Mortgage Act. It is possible to buy land, by notarial deed, on the basis of a non-authentic or even oral mandate, but ratification will then be needed. It is not possible to sell on the basis of such mandate since the party acting for the seller will not be able to justify his ownership right (see A. Verbeke and J. Byttebier, ‘Onroerende en hypothecaire publiciteit’, *Rechtskundig Weekblad* 1997–1998, 1105–1106, no. 30). Also for a mortgage to be granted, the mandate must be authentic (art. 76 Mortgage Act), although this is not necessary for a mortgage to be acquired.

[64] Art. 1–2 Mortgage Act.

[65] This is the period within which the tax on transfer of ownership must be paid (12.5 per cent of the price).

[66] For several cases and complications, see e.g. A. Verbeke, *Cursus Zekerheden* (University of Antwerp, Faculty of Law, 1998), 152–154 and Verbeke and J. Byttebier, ‘Onroerende en hypothecaire publiciteit’, 1123–1124, nos. 112–116.

prescription period of ten or twenty years, depending of the location of the land.[67] The party acting in bad faith, without a legal title, can claim ownership after a prescription period of thirty years.[68]

John has an express mandate, namely 'to buy and sell any kind of asset'. If John is planning to sell an asset at a price that Sam considers too low and John has knowledge of Sam's objection, then it is an act of bad faith for John to proceed with the transfer. By selling Blackacre, John has violated his contractual duties and can be liable to Sam for damages.

In this case, John is acting for the owner, Sam, on the basis of an express mandate. As such, Elinor could assume that the purchase is in order. However, Elinor has subjective knowledge of the fact that John has no mandate to sell under these conditions; therefore, she knows that she is not acquiring from the owner (since John is not validly representing the owner). Sam is entitled to sue John and Elinor and demand that the contract for the sale of Blackacre be declared null and void. According to the general rule that every mandate is revocable, Sam would argue that John had no authority to sell Blackacre and that Elinor was an accomplice by deliberately proceeding with the transaction. Sam could then demand restitution of Blackacre from Elinor on the basis that the title is void and property was not transferred. Sam would be required to repay the purchase price to Elinor. However, this would not prevent Sam from demanding indemnification from John and Elinor for any damages he incurred that were not compensated by the restitution of Blackacre.

In the event that the sale was concluded between John and Elinor, and a notary deed drawn up and then registered at the land registry, Sam would be required to register his claim in the margin of the land register in order to protect his rights against third parties.[69] Ideally this should be done as soon as the notary deed between John and Elinor was drawn up, even before it was registered.[70] The notation in the land register should also mention any court judgment regarding his claim. Since the registration of a title does not cure any defects in the title, third parties should know that a registered title is under attack, and they should be informed about the result of the attack.

[67] Art. 2265 BCC. [68] Art. 2262 BCC.

[69] Art. 3 Mortgage Act.

[70] Court of Cassation, 6 September 1991, *Rechtskundig Weekblad* 1991–1992, 610.

Alternative 3

As a mandatary, John should act according to his mandate and, in principle, perform Sam's instructions.[71] As a professional, John has a duty to inform and counsel. If Sam's request is absurd, then John has the duty to inform Sam in this regard and to try to convince him to change his mind. If Sam nonetheless insists, then John may be required to resign, depending on the absurdity of the request.

If Sam's instructions are sound, then John must act accordingly. If he does not accept Sam's requests, then he should inform Sam and resign by cancelling the mandate. If he does not do so, and Blackacre turns out to be a good investment, then John can be liable for the loss of profit incurred by Sam due to his refusal to buy Blackacre.

Denmark

In Danish law, the relationship between Sam and John is governed by the rules on agency in chapter II of the 1917 Contracts Act, and by the general principles of Danish contract law. The rules of the Commission Act (Consolidation Act No. 636 of 15 September 1986) apply if John buys and sells the assets covered by the agreement in his own name. The Act regulates the activities of commission agents, defined as agents who undertake the task of selling or buying goods or securities for the account of others, but in their own name. It is assumed, however, that John buys and sells assets in Sam's name and consequently the Commission Act will not apply to their relationship.

If the agreement covers security investments (stocks, bonds, futures, options, swaps, negotiable mortgage deeds, etc.), then the Securities Trading Act (Consolidation Act No. 168 of 14 March 2001) must be taken into consideration. The Act deals with commercial securities trading and the provision of investment services concerning securities and portfolio management. Aside from banks, mortgage-credit institutions, the National Bank of Denmark and the Finance Department, only 'stockbroker companies' (*fondsbørsmæglerselskaber*) are entitled to carry on the activities governed by the Act.

According to the Stockbroker Companies Act (Consolidation Act No. 732 of 17 August 2001), a stockbroker company must be a limited liability company (*aktieselskab* or *A/S*) with a minimum share capital of

[71] Art. 1991 BCC.

€300,000. Stockbroker companies are subject to the supervision of the Danish Financial Supervisory Authority. Natural persons cannot be registered as stockbroker companies. However, according to Statutory Order No. 721 of 31 July 1996, investment services concerning securities may be carried out by legal or natural persons performing occasional investment services in connection with their profession, provided that statutory rules or ethical codes apply to them (e.g. lawyers).

Section 6(1) of the Securities Trading Act provides that a security trader is under the obligation to (a) secure the customers' property rights to the securities, (b) ensure that money paid by a customer to the trader is properly secured, and (c) organise the securities trading business in such a way as to reduce the risk of conflicts of interest arising between the customers, and between customers and traders. Section 6(2) of the Act provides that a securities trader shall not enter into commitments concerning securities without the consent of the customer.

The trader may keep securities owned by customers in a joint deposit, provided that the trader registers the ownership to the securities (s. 6(3)). In the event of the insolvency of the securities trader, the customer may take registered securities belonging to him out of the joint deposit and his claim thereto would have priority over the claims of the general creditors.[72] In the event of the insolvency of a stockbroker company, the Danish Guarantee Fund for Contributors and Investors covers registered money contributions paid to the company by an investor up to a maximum amount of DKK 300,000 (approximately €40,000). Furthermore, the Fund covers losses sustained by an investor in the event that the company is unable to return to the investor securities owned by him, up to an amount of €20,000.

The Securities Trading Act and the Stockbroker Companies Act contain rules implementing specific EU legislation on investment services in the securities field, including Council Directive 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions, and Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field.

It follows from the above-mentioned legislation that if John and Sam intend that John shall have the power to use Sam's money for buying and selling securities, then either John must be a limited liability company registered as a stockbroker company, or John must himself be a

[72] Cf. s. 6(4) of the Act.

lawyer or belong to another profession regulated by statutory rules or ethical codes. In the following, it will be assumed that it is not the intention of the parties that the agreement shall cover securities.

The agreement between John and Sam is irrevocable for five years. The Danish Contracts Act of 1917 contains several provisions on revocation of authority. The Act does not, however, expressly prohibit irrevocable authority, and Danish legal theory generally recognises that it is possible for a principal to grant his agent irrevocable authority. Therefore, Sam is not entitled to terminate the agreement within the five-year period. However, according to general principles of Danish contract law, a party to a contract may be released from all or some of his obligations under the contract if the original conditions for entering into the contract are no longer present and it would therefore be unreasonable to maintain that the contract is binding in its entirety. Furthermore, the General Clause in s. 36 of the Contracts Act may apply. According to this provision, a contract may be amended or set aside, in whole or in part, if its enforcement would be unreasonable or contrary to principles of fair conduct, given the circumstances at the time of conclusion of the agreement, the contents of the agreement, and later developments.

Alternative 1

The newspaper accounts linking John with the trafficking of stolen art are clearly of such a nature as to create a general mistrust against him in business affairs. Whether or not the allegations are true, there is a high possibility that this will adversely affect his future business activities, and thereby also the interests of Sam if the agreement between them were to continue to exist for three more years. Under these circumstances, Danish law will most likely allow Sam to revoke the authority and terminate the agreement *ex nunc*, in spite of the irrevocability clause. John must, however, be remunerated for services rendered until the time of termination of the agreement, since the contract can only be terminated *ex nunc*, and not *ex tunc*.

Under s. 16 of the Contracts Act, an authority embodied in a written document, which is given to an agent to be held and exhibited by him to third parties, is revocable by the principal's withdrawing the document, or having it destroyed. The agent is under an obligation to return the document at the request of the principal. The agreement between Sam and John, however, was not created with the intention of exhibiting it to a third party. The authority may therefore, according to s. 18 of the

Contracts Act, be revoked simply by notification from Sam to John to the effect that it is no longer in force.

Since John refuses to recognise the revocation of authority, Sam can seek a judicial declaration recognising the revocation of authority and the termination of the agreement. Furthermore, in accordance with the rules of the Administration of Justice Act, Sam can obtain a preliminary injunction preventing John from entering into any further transactions on Sam's behalf. The injunction must be followed by a lawsuit (action for a declaration) within two weeks.

When the authority granting John full investment powers over the capital value of €2,000,000 is revoked and the agreement terminated, Sam will automatically be entitled to claim restitution of the remaining amount, and of other assets belonging to him that are in John's possession. In addition, he will probably be entitled to a complete audit of the transactions made by John.

If an agent has had his authority revoked and performs a legal act with a party who can be presumed to be unaware of the revocation, then it follows from s. 19 of the Contracts Act that the principal is under the obligation, whenever possible, to inform this party that the authority has been revoked. This obligation, however, only arises in cases where the principal has special reasons to fear that the agent has acted illegally. If the principal omits to do so, then provided the third party was in good faith, the principal may not plead the revocation of the agent's authority against this third party. In this event, however, the principal will be able to claim damages from the agent according to the general rules on damages in Danish law, provided that he has suffered a loss.

Alternative 2

Section 20 of the Contracts Act indicates that an act performed by an agent without authority shall not be binding upon the principal, provided that the third party had or should have had knowledge of this fact. Therefore, under normal circumstances, Sam would be able to recover Blackacre from Elinor since Elinor was notified, before the sale was concluded, that the authority granted to John was revoked.

On the other hand, it could be argued that the irrevocability clause also covers each specific transaction made by John, and thereby excludes Sam's power to revoke the authority in this specific case. If the agreement was intended to operate in this manner, then it would most likely be deemed unreasonable and consequently set aside under Danish law. Therefore, Sam would be able to revoke the authority to sell

Blackacre. Finally, John may be entitled to seek remuneration for his wasted efforts.

Alternative 3

John's refusal to follow Sam's instructions constitutes a breach of contract unless the provisions of the contract indicate otherwise. Under these circumstances it seems unreasonable that Sam shall be bound by the agreement. Therefore, Sam must be entitled to terminate the agreement, if he so wishes, in spite of the irrevocability clause. If John's refusal to buy Blackacre was based upon a well-founded professional judgement, then Sam cannot claim loss of profit from John if it later turns out that Blackacre would indeed have been a good investment and would have made Sam a profit.

England[73]

Since John carries on the business of a professional investment manager, his business falls within the regulatory net of the Financial Services and Markets Act 2000 (FSMA),[74] and he must be approved as a 'fit and proper person' by the regulator.[75] Authorisation can be obtained not only by corporations but also by partnerships, other unincorporated associations, and by individuals.[76] It is assumed that John is duly authorised.

The legal institution by which the arrangement will be understood depends partly on the investments to be made. In the case of investment securities, it is increasingly uncommon for investors to take possession of security certificates, whether for registered or bearer certificates. Rather, the certificates are immobilised in a depository with a custodian, and investment firms have accounts with the custodian which reflect the amount of each kind of security held by the custodian for each investment firm. In such a case, the registered holder may not

[73] In this volume, references to 'England' and 'English law' refer to England and Wales and the law of England and Wales.

[74] This Act, which replaced the Financial Services Act 1986 and consolidated other legislation, received Royal Assent on 14 June 2000 and came fully into force on 1 December 2001.

[75] There used to be multiple regulators for different financial sectors, but on 1 December 2001 the Financial Services Authority (FSA) became the single regulator for financial services in the UK. More detail is provided in the answer to Case 9.

[76] FSMA, s. 40(1). The standards to be applied are set out in Schedule 6 to the FSMA and implemented in detail by the part of the FSA Handbook called The Fit and Proper Test for Approved Persons, or FIT, which is available on their website, www.fsa.gov.uk.

be the investor but rather the investment firm or custodian.[77] The legal analysis of such 'indirect holding' or 'custodian' systems is a matter of some difficulty,[78] and it has been suggested by some that where such a system is in place, an investor can only have personal rights against his investment manager, and cannot truly hold the securities in question.[79] What little case law exists, however, suggests that the courts will interpret such a structure as one in which the investor is the beneficiary of a trust.[80] Similarly, it would be normal for an investment manager to hold clients' money (such as the initial €2,000,000 deposited by Sam) in a 'client account', which is a bank account held in trust for clients.

In the trust, property is transferred from a 'settlor' (called a 'testator' if the trust is testamentary) to a 'trustee', who holds the property for the benefit of the 'beneficiary'. In this case, the assets would be transferred to John (trustee) who would hold them in trust for Sam (who is both settlor and beneficiary).

However, if (perhaps in the case of uncertificated securities) the investments are held with title in the name of Sam, then the relationship would be understood as one of agency. The agreement would be understood as giving John the authority to deal with the relevant assets of Sam. Even money could be held in a bank account in Sam's name, with John holding a power of attorney to deal with the account.[81] The

[77] In the case of company shares, in English law the certificate is not considered an asset (it is not a negotiable instrument); it is only some evidence as to who is the registered shareholder (*Harrold* v. *Plenty* [1901] 2 Ch. 314; *Stubbs* v. *Slater* [1910] 1 Ch. 632 (CA); the common law of North America differs on this point). Because the certificates are not so important, immobilisation is less relevant, especially since there is a strong movement towards the elimination of the certificate (see Companies Act 1989, s. 207, and the Uncertificated Securities Regulations 2001 thereunder (SI 2001/3755, as amended by SI 2003/1633)). This permits fully electronic transfer and settlement, and also makes it more practicable for the individual investor to be the registered shareholder.

[78] See Alberta Law Reform Institute, Report No. 67, *Transfers of Investment Securities* (Edmonton: Queen's Printer, 1993); A. W. Beaves, 'Global Custody: A Tentative Analysis of Property and Contract', in N. Palmer and E. McKendrick, eds., *Interests in Goods*, 2nd edn (London: Lloyd's of London Press, 1998); A. O. Austen-Peters, *Custody of Investments: Law and Practice* (Oxford: Oxford University Press, 2000); J. Benjamin, *Interests in Securities* (Oxford: Oxford University Press, 2000).

[79] R. M. Goode, 'Ownership and Obligation in Commercial Transactions' (1987) 103 LQR 433, 451–453.

[80] *Re Harvard Securities Ltd (in Liquidation)* [1997] 2 BCLC 369, [1998] BCC 567; *Re CA Pacific Finance Ltd* [1999] 2 HKC 632, [2000] 1 BCLC 494 (HK Court of First Instance).

[81] A power of attorney is a written document which evidences the grant of authority to an agent.

difficulty that this may present is that third parties (the bank, or a transferee) would need to be satisfied in each case of Sam's authority. This would not be a concern with investment securities, because it is traditional for stockbrokers to make contracts on behalf of customers, but it might be more of a problem with other investments, such as immovables or valuable art objects. In this case, it would be more convenient for title to be held in John's name, and the arrangement would be understood as a trust. It should also be noticed that if a power of attorney is to confer the power to enter into transactions that must be entered into by deed (such as the transfer of legal interests in land), then the power itself must be in the form of a deed.[82] A deed can be executed privately (there is no requirement to execute it before a notary), but there are requirements as to form.[83]

Finally, it should be stressed that agency and trust are not inconsistent. If there is an agency relationship between the parties, and property has been transferred from principal to agent, the parties' intentions will determine whether the agent owes merely a personal obligation to account for the value transferred, or whether by contrast the agent is to hold the property as a trustee for the principal (who is therefore also a beneficiary).[84]

Alternative 1

It should be said initially that the five-year irrevocable term would be most unusual in practice. Investment advice and management must be conducted according to broad principles issued by the Financial Services Authority.[85] These principles are probably inconsistent with such an arrangement.[86]

[82] *Berkeley* v. *Hardy* (1826) 5 B & C 355, 108 ER 132.

[83] Law of Property (Miscellaneous Provisions) Act 1989, s. 1. Unlike in many other common law jurisdictions, a seal is no longer required in England. However the signature must be witnessed.

[84] The classical case, *Henry* v. *Hammond* [1913] 2 KB 515, is still referred to today: *Box* v. *Barclays Bank* [1998] Lloyd's Rep. Banking 185.

[85] See FSMA, s. 64. The current version of the Principles, which the FSA calls PRIN, is available as part of the FSA Handbook on their website, www.fsa.gov.uk. These principles were formerly called the 'ten commandments' but there are now eleven, the eleventh commandment being a requirement to co-operate with the regulatory authority.

[86] Principle 1: 'A firm must conduct its business with integrity.' Principle 6: 'A firm must pay due regard to the interests of its customers and treat them fairly.' Note however

In any event, whether the arrangement is understood as an agency relationship or a trust, it will be determinable by Sam despite the agreement to the contrary. Authority given to an agent over one's property is revocable even if the terms of the power of attorney suggest that it is irrevocable.[87] As for the trust, it can always be terminated according to its terms. Usually an investment management trust would be determinable at the request of the client. It would be a 'bare trust' under which the trustee must follow the directions of the beneficiary. Even in the case at hand, with the five-year irrevocable term, there are two possible solutions for Sam. He could either seek to terminate the trust contrary to its terms, or seek to have John removed as trustee.

In the English tradition, while a trust can be seen as an institution which facilitates a settlor's intentions as to his property, the trust once established is understood as existing for the benefit of the beneficiaries, and the settlor's desires cease to be a consideration. Hence the rule in *Saunders* v.*Vautier*[88] provides that a trust may be terminated if the beneficiary is of full age and full legal capacity and his entitlement is unconditional.[89] He may then demand the trust property and the trustee must comply, even if this is contrary to the terms of the trust. The involvement of the court is not necessary. Where there is more than one beneficiary, they must all agree to termination and must all be of full age and full legal capacity. In this case, it appears that Sam would be able to take advantage of this principle. There is no one else who stands to benefit from the trust, so (as long as he is of full age and full legal

that the Principles are not understood to have 'direct effect' in private law (see PRIN 3.4.4 and Schedule 5 to the Principles for Business).

[87] Authority is clearly irrevocable when it is given as a kind of security: F. M. B. Reynolds and M. Graziadei, *Bowstead and Reynolds on Agency*, 17th edn (London: Sweet & Maxwell, 2001), art. 120; Powers of Attorney Act 1971, s. 4. The loss of John's future commission will not activate this principle, although the principle might be operative if John had exposed himself to liabilities in managing the assets. Otherwise, a power of attorney is not irrevocable even if the parties say that it is: T. M. Aldridge, *Powers of Attorney*, 9th edn (London: Sweet & Maxwell, 2000), 62–63.

[88] (1841) 4 Beav. 115, 49 ER 282, affirmed (1841) Cr. & Ph. 240, 41 ER 482. The position in the United States is different: in most states, a trust may only be terminated if no material purpose of the settlor remains to be carried out. Most of the Commonwealth follows the English rule, though two Canadian provinces (Alberta and Manitoba) have enacted statutes which require judicial approval for a trust to be terminated otherwise than according to its terms.

[89] His entitlement is not unconditional in this sense if (a) it is *contingent* on the happening of an uncertain event, e.g. he must qualify as a lawyer or survive some other person; (b) it is *defeasible* by some other event or interest, e.g. the exercise by the trustee of a power of appointment over the property in question.

capacity) the view is taken that the trust exists solely for his benefit and he may choose to terminate it. Looking at the relief requested by Sam:

(a) A judicial declaration that the relationship is terminated, and
(b) a remedy enjoining John from entering into any further transaction related to the assets. Declarations and injunctions are discretionary remedies. It used to be the case that declarations were granted only very sparingly, the courts not wanting to be in the position of acting as legal advisors. This has now changed, and so long as there is a real dispute, the court will grant a declaration.[90] The injunction seems to be superfluous, but if it was sought as an interim injunction it might well be granted, if the court concluded that otherwise Sam might suffer irreparable harm.
(c) A full audit. Trustees and agents are always obliged to account for their trusteeship or agency; they can be made to do so without any allegation of breach of trust or other unlawful act. Summary procedures are available to compel accounting.[91]
(d) Restituton of the managed assets. The assets would be ordered to be transferred to Sam.
(e) Damages. Any loss caused by any breach of trust would be recoverable.[92] That would include the cost of opportunities lost to Sam through John's refusal to transfer the assets when demanded. John's failure to comply with any order made against him (including an interlocutory injunction) is punishable as contempt of court at the motion of Sam. This can result in a fine or sequestration of assets; that is, the court's taking control of the defendant's assets until the contempt is purged. In the case of an individual, contempt can also lead to imprisonment.

As for John's requests, (a) a declaration that he still enjoys full managing powers until the end of the five-year term: this declaration would be denied; (b) damages: no damages would be recoverable except for his remuneration as agreed, up to the end of the trust, as provided by the trust terms. It is possible that John might establish that alongside

[90] P. B. H. Birks, ed., *English Private Law* (Oxford, 2000), para. 18.245.

[91] J. Mowbray et al., *Lewin on Trusts*, 17th edn (London, 2000), 626–634, 1188.

[92] In general, any loss caused by a breach of trust is recoverable. Note however s. 61 of the Trustee Act 1925, by which a trustee in breach may be excused from liability if he has acted honestly and reasonably, and ought fairly to be excused. There is not much case law interpreting this provision, but what exists suggests that a professional trustee is less likely to be excused: *Re Rosenthal* [1972] 1 WLR 1273.

the trust, there was a contract providing for the creation of the trust and the other incidents of the relationship. In this case, he might (if he himself had not breached the contract) obtain contractual damages for his loss of future earnings. Whether he had breached the contract would be resolved by an enquiry into its terms, but this would include implied terms. If the relationship is one involving trust and confidence (as this one does), there may well be an implied term that the manager shall not conduct his business in such a way as will destroy the trust and confidence between the parties. In *Malik* v. *Bank of Credit and Commerce International SA*,[93] the House of Lords allowed a former employee to claim 'stigma damages' suffered when the employer breached an implied term that it would not 'conduct itself in a manner likely to destroy or seriously damage the relationship of confidence and trust between employer and employee'. The parties had agreed that the employment contract contained such an implied term. It would seem natural that the contract between John and Sam would also contain such a term. If the allegations were unfounded, John of course might argue that he had not breached this implied term. The resolution of this issue would turn on a factual enquiry.

The other possibility for Sam would be to seek to have John replaced as trustee. The terms of the trust may provide for this, and if so there will be a power to appoint a new trustee.[94] The court also has an inherent power to remove a trustee who is violating his duties, and may then appoint a new trustee.[95] Perhaps most significantly, if Sam is of full age and capacity, he can also use a statutory power to direct John to retire as trustee and to appoint a new trustee.[96] This leads to a different situation: the trust continues on the same terms, but with a new trustee. The relief granted would be altered accordingly.

Alternative 2

Generally speaking, the beneficiary of a trust cannot direct the trustee in the exercise of the trustee's duties, and in fact it would be a breach of trust for a trustee to take directions from a beneficiary.[97] This is a default

[93] [1998] AC 20.

[94] Whether or not the terms of the trust provide for appointment, there is a statutory power of appointment in s. 36 of the Trustee Act 1925.

[95] Trustee Act 1925, s. 41.

[96] Trusts of Land and Appointment of Trustees Act 1996, s. 19.

[97] *Re Brockbank* [1948] Ch. 206, [1948] 1 All ER 287 (trustees may not be directed to exercise a power to appoint new trustees); *Stephenson (Inspector of Taxes)* v. *Barclays Bank Trust Co. Ltd* [1975] 1 WLR 882, [1975] 1 All ER 625 (trustees may not be directed as to investment).

rule, not a mandatory rule, and can be overridden by the terms of the trust. One example where it is overridden is the 'bare trust', that is a trust in which the trustee's only duty is to hold the trust property to the direction of the beneficiary.[98] Such a trustee is called a 'nominee' in some contexts, and this type of trust is usually used to achieve some goal of convenience that dictates that title should be in the trustee. For example, a group of joint venturers may want title in the name of one of them to make it easier to deal with the property, or an investor may want title to investments in another person while the investor is out of the country.

So in the first place, the solution to this question is provided by the terms of the trust. Even if the terms of the trust do not permit Sam to direct John, some exceptions can be noted. One is the ability to collapse the trust under *Saunders* v. *Vautier*, discussed above. Moreover, under the Trusts of Land and Appointment of Trustees Act 1996, John, as the trustee of a trust of land, has certain duties if Sam is of full age and capacity. In exercising his power to sell the land, John must 'have regard to the rights of' Sam.[99] That probably does not add much to his general duties as a trustee.[100] If Sam were entitled to possession of the land, then John must also consult Sam and give effect to his wishes, 'so far as consistent with the general interest of the trust'.[101] Thus if Sam were entitled to possession he would be able to tell John not to sell. Assuming that Blackacre is an investment and Sam is not entitled to possession, this does not apply. As long as John is acting properly, the sale is one that Sam cannot stop, unless he terminates the trust under *Saunders* v. *Vautier*.[102]

[98] Mowbray et al., *Lewin on Trusts*, 12–13.

[99] Section 6(5).

[100] See G. Ferris and G. Battersby, 'The General Principles of Overreaching and the Modern Legislative Reforms 1996–2002' (2003) 119 LQR 94, 100–102.

[101] Section 11(1).

[102] *Saunders* v. *Vautier* operates 'all or nothing' in the sense that while Sam can terminate the trust completely, or leave it as it is, he cannot interfere with its operation without collapsing it: *Stephenson (Inspector of Taxes)* v. *Barclays Bank Trust Co. Ltd* [1975] 1 WLR 882, [1975] 1 All ER 625. Similarly, in *Re Brockbank* [1948] Ch. 206, [1948] 1 All ER 287, it was held that even fully capacitated beneficiaries who are in a position to collapse the trust cannot dictate to the trustees how they should exercise their discretions. (The law has been changed by legislation in relation to the discretionary power which was in issue in that case, namely a power to appoint new trustees (Trusts of Land and Appointment of Trustees Act 1996, s. 19), but the general principle otherwise survives.) One might think that if Sam has the right to terminate the trust, it follows that he has the right to vary its terms unilaterally, but this can only work by the termination of the old trust and the creation of a new one. No one can be compelled to be trustee of an express

If John is not acting properly the position may be different. If the price is really too low, then he would be breaching his duties as trustee. Alternatively, if the trust terms give Sam a power to control dispositions then again the sale would be improper. Even in this case of an improper transfer, there is some protection for third parties even if they are aware of the trust. In other words, the trustee's power to make an effective disposition may be wider than his authority to make a disposition which is lawful as between him and the beneficiary. If a sale of land that is held in trust meets certain conditions, then the beneficiary's interest in the land is said to be 'overreached' and extinguished, and instead the beneficiary has only an interest in the proceeds of sale, which are held in trust in substitution for the land. This is so in any case of a lawful sale, but it can sometimes also apply even if the sale is in breach of trust, and even if the purchaser is aware of the trust. In the nineteenth century the marketability of land had become restricted by fears on the part of purchasers that they would be bound by unknown trust interests.[103] One response was the statutory provisions on overreaching which are in the Law of Property Act 1925, ss. 2, 27. These provisions require that the purchase money be paid to at least two trustees (or to a trust corporation).[104] Express trusts usually have either

trust against his wish, and it follows that if the existing trustee is not willing to hold the property on the new trusts, the beneficiary must either leave the existing trust on foot, or else collapse it and direct the trustee to transfer the property to the trustees of the new trust.

[103] See C. Harpum, 'Overreaching, Trustees' Powers and the Reform of the 1925 Legislation' [1990] CLJ 277. The fears were in response to the judicial expansion of 'constructive notice' of trust interests in land; that is, although a purchaser might not actually know of a trust interest, he might find after the purchase that a court would hold that he should have known of it, and therefore was bound by it. Constructive notice could apply not only to the existence of the trust, but also to the question whether the trustees were lawfully excercising any power of sale they had over the trust property. This in turn led to the need for exhaustive and cumbersome enquiries before land purchases could be securely made, in order to be certain that the trustees were acting properly. This expansion of constructive notice, and the legislative response which it generated, appears to be particular to England among the countries in the common law tradition.

[104] Again, a trust interest can be overreached even if the purchaser was aware of the trust. The purchaser need not even be in good faith, so long as he is not a donee: this follows from the statutory definition of 'purchaser' which applies for Part I of the Law of Property Act 1925, found in s. 205(1)(xxi); Part I includes ss. 2 and 27. 'Trust corporation' is also a defined term in the Act (s. 205(1)(xxviii)); the term does not refer to any corporation which is a trustee, but by further cross-referencing to rules made under the Public Trustee Act 1906, it requires (in summary), for companies incorporated in England, a minimum issued capital of £250,000, of which at least £100,000 must be paid up; or, that the corporation be a charitable trustee.

multiple trustees or a corporate trustee. In our case, there is only one trustee and so Elinor would not be able to rely on this statutory doctrine. In any event, although the position is not entirely clear, it appears that the overreaching provisions of this Act only protect the purchaser where the trustee exercises an existing power of sale in an unauthorised way; they do not apply where the trustee acts without any power of sale.[105] In our case, we are assuming that the terms of the trust do not allow a sale of the land by John.[106]

Given that overreaching does not apply, Elinor's position may differ depending on whether the land is registered or unregistered.[107] If the land is unregistered, then before 1996 Elinor's position would have been governed by the common law rule, which is that a purchaser of trust property takes free of any pre-existing beneficial interest if the purchaser gives value, *bona fide* and without notice of the pre-existing interest. This is a defence, and the purchaser must establish each element of it.[108] The notice may be actual or constructive.[109] In relation to unregistered land, however, the protection of a purchaser was improved somewhat by s. 16 of the Trusts of Land and Appointment of

[105] See Harpum, 'Overreaching', and G. Ferris and G. Battersby, 'The General Principles of Overreaching and the Reforms of 1925' (2002) 118 LQR 270; G. Ferris and G. Battersby, 'The General Principles of Overreaching and the Modern Legislative Reforms 1996–2002' (2003) 119 LQR 94.

[106] Even though the Trusts of Land and Appointment of Trustees Act 1996, s. 6(1) indicates that every trustee of land has a power to sell (although not necessarily an authority to sell), this is cut down by ss. 6(6) and (8), and s. 8 which allows the terms of the trust to prevail. See G. Ferris and G. Battersby, 'The Impact of the Trusts of Land and Appointment of Trustees Act 1996 on Purchasers of Registered Land' [1998] Conv. 168; Ferris and Battersby, 'General Principles of Overreaching and Reforms 1996–2002'.

[107] The Registered Land Act 1925 created an optional system of land registration. (There was an older optional system as early as 1862.) It was hoped that by allowing parties to register land on transfers, the whole country would gradually move over to the registered land system. There was little uptake, however, and compulsory 'triggers' for registering land were introduced in 1990 and expanded in 1997. The triggers were further widened by the Land Registration Act 2002, ss. 4–5. To give some examples, unregistered land must be registered when it is transferred, whether by sale or gift (inter vivos or on death), when it is first used to secure a loan, and when a long lease (seven years or more) is granted. Significant amounts of land remain unregistered.The Land Registration Act 2002, which came into force in 2003, made a number of changes to the system of land registration. Perhaps the most significant change is that the new Act paves the way for fully electronic land transfers.

[108] *Re Nisbet and Potts' Contract* [1906] 1 Ch. 386 (CA).

[109] As mentioned above, the impetus for the legislative introduction of the doctrine of overreaching was that, in relation to land, the doctrine of constructive notice had been greatly expanded by judicial decisions.

Trustees Act 1996, which will protect a purchaser so long as he lacked actual notice; in other words, liability for constructive notice is excluded. Here, since Elinor has actual notice, she would not be able to rely on either version of this doctrine. So if the sale was improper, Sam could recover Blackacre. In fact he would be able to get a declaration that Elinor held it in trust for him: since Elinor did not buy the land *bona fide*, for value and without notice of Sam's trust interest, she would be bound by the pre-existing trust. Elinor would be able to recover the purchase price from Sam. If Elinor no longer had Blackacre, it would be impossible to demand the land from her. The only way to make her liable would be for a kind of wrongdoing, which is commonly called 'knowing receipt of trust property'.[110] Under this doctrine, a recipient of property transferred in breach of trust commits a wrong against the beneficiary if the recipient knew or ought to have known that the transfer was in breach of trust.[111] Elinor therefore could be made personally liable to Sam to repay the value of Blackacre, unless she took reasonable steps to determine that the sale was proper.

If the land is registered, the common law doctrine of *bona fide* purchase for value without notice does not apply; nor does s. 16 of the Trusts of Land and Appointment of Trustees Act 1996, because that section applies only to unregistered land.[112] There was some question whether there existed an indefensible difference between the two systems, regarding the protection of third parties.[113] However, this has

[110] See e.g. *Bank of Credit and Commerce International (Overseas) Ltd* v. *Akindele* [2001] Ch. 437, [2000] 3 WLR 1423, [2000] 4 All ER 221 (CA). There is a related kind of wrongdoing, which does not depend on receipt of trust property, usually called 'dishonest assistance in a breach of trust': see *Royal Brunei Airlines Sdn Bhd* v. *Tan* [1995] 2 AC 378 (PC, Brunei). Both of these liabilities are commonly deployed in cases of international fraud; they are the main private law weapons against money laundering. See e.g. *Agip (Africa) Ltd* v. *Jackson* [1991] Ch. 547 (CA).

[111] There has been a great deal of argument about how to formulate the mental element which is necessary in order to make the defendant liable. Some cases have effectively required dishonesty; others, only carelessness; and some academic commentators have even suggested that liability should be strict. For discussion, see S. Gardner, 'Knowing Assistance and Knowing Receipt: Taking Stock' (1996) 112 LQR 56; L. D. Smith, 'Unjust Enrichment, Property and the Structure of Trusts' (2000) 116 LQR 412. In the *Akindele* decision, [2001] Ch. 437, the court tried to cut through all of this by saying that '[t]he recipient's state of knowledge must be such as to make it unconscionable for him to retain the benefit of the receipt'. This return to the foundational language of equitable jurisdiction may lack sufficient certainty for some tastes.

[112] As provided in s. 16(7).

[113] Statutory overreaching arguably only applies to protect a purchaser where the trustees have a power of sale but exercise it improperly; on this approach, it does not apply to a

been addressed by s. 26 of the Land Registration Act 2002. The crucial question will be whether or not Sam's trust interest was recorded in the land register. Such an interest cannot be registered in the fullest sense, with the trust beneficiary listed as the registered proprietor of the land, simply because the trust beneficiary is not the legal owner of the land; but the trust interest can still be recorded in the register, and this is generally required in order for a third party purchaser to be bound by it.[114] The interests of a beneficiary under a trust of land are usually protected by an entry called a 'restriction', which prevents any transfer of the land unless the terms of the restriction are complied with.[115] In the ordinary case of a trust of land, where there are multiple trustees or the trustee is a trust corporation, the terms of the restriction will duplicate the rules about overreaching: that is, the restriction will say that the land may not be transferred unless the purchase price is paid to more than one person (or a trust corporation).[116] The effect is that the only transfers which the Registrar will allow are ones which, by the statutory rules on overreaching, will eliminate the beneficiary's interest in the land, and give the purchaser a clear title. This does not prevent a transfer in breach of trust, but such a transfer is less likely to occur because of the requirement of two trustees or a trust corporation.

In our case, the statutory conditions for overreaching cannot be satisfied because there is only one trustee who is a natural person. In such a case, Elinor has less protection. If the transfer is in breach of

case in which the trustees lack any power of sale, a situation which the Trusts of Land and Appointment of Trustees Act 1996 permits (ss. 6(6), 8). In such a case, it was argued that there was no protection for a purchaser of the land, even one who gave value in good faith to multiple trustees: see Ferris and Battersby, 'Impact of the Trusts of Land and Appointment of Trustees Act 1996'. The overreaching rules did not apply in the absence of the power of sale, the common law rules regarding *bona fide* purchase without notice do not apply to registered land, and s. 16 of the Trusts of Land and Appointment of Trustees Act 1996 also does not apply to registered land.

[114] Until 2003 such interests were called 'minor interests', but this terminology has been abandoned in the Land Registration Act 2002.

[115] The other way to protect interests which are not registrable is through a 'notice': Land Registration Act 2002, ss. 32–39. There may be 'unilateral notices', which take the place of 'cautions' which could be entered before the Land Registration Act 2002 came into force in 2003.

[116] See R. E. Megarry and W. Wade, *Law of Real Property*, 6th edn by C. Harpum (London: Sweet & Maxwell, 2000), at 258–259; Land Registration Act 2002, ss. 40–47. Note that s. 42(1)(b) empowers the Registrar himself to enter a restriction in relation to a trust interest, without the involvement of the parties; s. 44 requires that whenever two or more persons are registered owners of land, a restriction must be entered to ensure that overreaching will occur on a disposition of the land.

trust, Elinor will take the land free of the trust interest only if the trust interest is not recorded in the land register. Again, it is possible to record the trust by a restriction. In fact, where (unusually) there is a single trustee who is a natural person, a restriction should have been entered in the land registry by John, to protect Sam's interest. In the case of a trust of land where the conditions for overreaching cannot be satisfied (such as the case of a single trustee who is a natural person), the proprietor of the land (the trustee) is *obliged* to enter a restriction.[117] The restriction to be entered is one which forbids any disposition of the land by a sole proprietor, unless it is a trust corporation, or unless the transfer is made under an order of the court.[118] This would mean that the transfer to Elinor could not proceed without a court order. Trust beneficiaries have standing to apply for the entry of a restriction where there is a single trustee.[119] Some interests are protected even if they are not registered or recorded in the register, but none of these applies in our case unless Sam is in 'actual occupation' of Blackacre at the time of sale.[120]

Since Blackacre is land, the rules about movables are not directly relevant, but for completeness it should be noted that the statutory rules regarding overreaching have no application to movables sold in breach of trust.[121] Instead, the common law doctrine of *bona fide* purchase for value without notice applies. That is, a purchaser of trust property takes free of any pre-existing beneficial interest if the purchaser gives value, *bona fide* and without notice of the pre-existing

[117] Land Registration Rules 2003 (SI 1417/2003), rr. 94(1)–(2); in particular, under r. 94(2) John should have entered this restriction when he applied to have the land registered in his name.

[118] The Rules require a restriction in Form A, which provides: 'No disposition by a sole proprietor of the registered estate (except a trust corporation) under which capital money arises is to be registered unless authorised by an order of the court.' This is the same form which the Registrar is required to enter whenever land is held by more than one person. The restriction will not be contravened in any case of a disposition by multiple trustees or a trust corporation; that is, it permits dispositions in those cases where statutory overreaching occurs.

[119] Land Registration Rules 2003, r. 93.

[120] See the Land Registration Act 2002, ss. 28–29, and Schedule 3. These interests used to be called 'overriding interests', in opposition to 'minor interests'.

[121] If the trust property is *lawfully* sold by the trustee, then the purchaser takes free of the pre-existing trust interest, and the purchase price received by the trustee of course becomes trust property. This is viewed by many as the paradigm case of overreaching, the effect of the statutory provisions regarding land being simply to widen the doctrine to cover some unlawful dispositions by trustees.

interest.[122] The notice may be actual or constructive; the extent of constructive notice, however, depends on the context.[123] In relation to land purchases, the courts took the view that careful searching was reasonable, and therefore a purchaser had constructive notice of any interest that he would have discovered, had he conducted the usual thorough searches. On the other hand, in relation to movables, where there is no established machinery for recording or searching for trust interests, a purchaser is not required to do so much in order to act reasonably. This is why statutory overreaching was not necessary for movables.

Alternative 3

As discussed at the beginning of the answer to Alternative 2, in general the beneficiary cannot dictate to the trustee. If this transaction, possibly with others, indicates that John is not acting properly as trustee, then Sam might seek to have him replaced. Alternatively, he might choose to terminate the trust, as discussed under Alternative 1. As noted there, it may be that if John has the right to terminate the trust, it follows that he has the right to issue instructions to the trustee.

Finland

Investment agreements that give the mandatary strong managing powers such as those given to John are not very common in Finland, at any rate when the investor is a private person like Sam. First, the investment objects are normally more clearly defined in the contract of mandate.[124] Secondly, the duration of the mandate is usually not as

[122] The rule of *bona fide* purchase is actually slightly more complex. It only protects those who acquire a legal (as opposed to equitable) interest in that which has been purchased. Therefore it does not apply to protect someone who acquires a trust interest in property already subject to a trust; here the rule is *nemo dat quod non habet*, so that the first interest always prevails. See Birks, *English Private Law*, para. 4.452.

[123] See Gardner, 'Knowing Assistance and Knowing Receipt' 60–64.

[124] The mandate means here, in the first place, the agreement between a mandator and a mandatary. The mandate regulates the relationship between those two. The power of the mandatary to represent the mandator, i.e. to establish direct legal relationships between the mandator and third parties, is a different question. If the mandatary has such power, he or she is regarded as a direct representative. In the opposite case, he or she is an indrect representative, e.g. *komissionsaaja* or *kommissionär*. The concept of mandate (*toimeksianto* or *uppdrag*) is used in both cases, and also regardless of whether the mandate is gratuitous or not. See H. Halila and M. Hemmo, *Sopimustyypit* (Helsinki: Lakimiesliiton Kustannus, 1996), 152–156 and M. Hemmo, *Sopimusoikeus I* (Helsinki: Lakimiesliiton Kustannus, 1997), 315–318.

long as described in this case. However, in principle, an irrevocable mandate for five years would be binding *inter partes*, at least if the mandator were a professional in the securities business.

If the intention of the parties was that John would buy and sell securities or derivatives, then the Act on Investment Service Enterprises of 26 July 1996/579 should be taken into consideration. This Act is largely based on the Council Directive 93/22/EEC of 10 May 1993, on investment services in the securities field, and Council Directive 93/6/EEC of 15 March 1993, on the capital adequacy of investment firms and credit institutions. According to the Act on Investment Service Enterprises, only a limited company or a credit institution can acquire the licence that is necessary to offer this kind of service. The Act does not otherwise regulate the problems discussed in Case 1.

In Finland, there is no specific legislation addressing the rights of a mandator or a mandatary in the situation described in Case 1. Thus, the general rules of mandate must be applied. These rules are the same irrespective of whether a corporation or an individual is acting as the mandatary. The mandatary can be a direct representative, who is capable of establishing direct legal relationships between the mandator and third parties, or an indirect representative, who acts in his or her own name with third parties, but acts for the account of the mandator.[125] In Case 1, the latter alternative would be more probable because it would be impracticable to make the investments in Sam's name. If that is true, then John could be called *komissionsaaja* or *kommissionär* and Sam *komissionantaja* or *kommittent*.

Alternative 1

The mandate may be terminated despite the terms of the contract.[126] If the relationship is terminated without due reason, then the

[125] As mentioned in the previous note, a typical case of indirect representation is *komissio* or *kommission*. In this case, the mandatary who contracts with a third party has, in relation to the third party, all the rights and duties deriving from the contract. The mandator is, in that sense, an outsider with respect to the contract made by the mandatary. The mandator is, however, bound to the contract in so far as the mandatary can claim from the mandator the performance of the contract. Additionally, the mandator is regarded as the owner of personal property acquired by the mandatary if the latter becomes insolvent. A direct representative is, on the other hand, an outsider in respect to the contract which he or she creates, through the mandate, between the mandator and the third party. See Hemmo, *Sopimusoikeus I*, 315–318.

[126] See Halila and Hemmo, *Sopimustyypit*, 157–159.

termination is regarded as breach of contract. This would entitle the mandatary to make a claim for damages; however, the termination is valid. Sam will be entitled to a judicial declaration terminating the relationship, although this is not required.

If a plaintiff demonstrates that (a) he has a right to the property in the defendant's possession and (b) there is a danger that the defendant will misappropriate the property, then the court can order the property to be provisionally seized according to the Procedural Code. According to the provisions of the Seizure Act of 3 December 1895/37, the court's decision is to be implemented by execution officials. The court can also grant an interim order, under threat of penalty, enjoining the mandatary from entering into any further transactions related to the assets. The court may grant an interim appointment of a curator who will be responsible for the property.[127]

The mandatary is obliged to render a full account of the period of his mandate.[128] Consequently, Sam is entitled to a full audit. According to the Procedural Code, the court can also request any bookkeeping, correspondence or relevant material in John's possession in the event of a trial. Moreover, a police investigation could be arranged if there are sufficient grounds indicating that John was guilty of a crime while fulfilling his mandate.

As stated above, Sam may terminate John's mandate despite the terms of the contract. Thus, he may seek restitution of the managed assets.

Investment service contracts are largely dependent on the confidence of the mandatary. A factual implication in the international trafficking of stolen works of art would entitle Sam to make a claim for damages if a loss of profit or extra expenses were induced by the premature termination of the mandate or by John's behaviour. However, Sam would be required to substantiate the premature termination and the losses or expenses caused by John. In other words, the burden of proof would lie with Sam. The situation becomes more complex if John's factual involvement in the trafficking of stolen works of art cannot be proven. John's poor reputation may have, on its own, resulted in recoverable damages caused to Sam. However, in this case John could avoid paying damages by proving that he did not cause the damage purposely or by a careless act or omission.

[127] See E. Havansi, *Uusi turvaamistoimilainsäädäntö selityksineen* (Helsinki: Lakimiesliiton Kustannus, 1994), 39–81.

[128] See the Commerce Code, Ch. 18 s. 1 and Halila and Hemmo, *Sopimustyypit*, 158.

John would not be entitled to a declaration that he enjoys full managing power until the end of the term. The mandator is entitled to terminate the mandate even if he or she is acting in breach of contract.

The mandatary can claim for damages if the mandator terminated the contract of agency without sufficient legal grounds, thus inducing economic losses or extra expenses for the mandatary. John's actual implication in the trafficking of stolen works of art would, however, entitle Sam to terminate the contract without any legal consequences. Sam could also terminate the contract without a duty to pay damages even if he could not prove John's actual implication. Because John's questionable reputation could have gravely impaired his abilities to fulfil the contract, it constitutes a sufficient reason for Sam to terminate the contract without a duty to pay damages.[129]

Alternative 2

John bought Blackacre as a mandatary, and thus the immovable is, as between John and Sam, regarded as belonging to the mandator, Sam. As stated above, Sam, as the mandator, can effectively terminate John's mandate at any point. As such, Sam could also deny John the right to sell Blackacre.

Sam and Elinor's relationship must be addressed separately. If John had bought Blackacre acting as a direct representative of Sam, the answer would be fairly obvious. Sam would be regarded as the owner of Blackacre and he alone could have registered himself as the owner of it. Therefore, John could sell the immovable acting only as a mandatary. Because Sam had, on the other hand, the power to revoke John's mandate and his representative capacity, Elinor could not be acting in *bona fide* if she purchased Blackacre after she had been informed about Sam's negative attitude to the conveyance. Blackacre would, thus, still belong to Sam, who could take legal action against Elinor.

If John has bought Blackacre acting as an indirect representative, the answer is a bit more difficult. According to the general rules of the Land Law Code, the protection of the purchaser against the owner of an immovable depends on two criteria: (a) whether the seller was

[129] If the newspaper article could not be proved to be true and John's bad reputation could not be regarded as a sufficient ground for the termination, John could claim for damages. Because Sam's duty to pay damages is, according to the law, based on his negligence, Sam would, however, have the opportunity to exculpate himself. If he had adequate reasons to believe the newspaper article was true, he would, probably, be able to avoid paying damages.

registered as the owner of the immovable and (b) whether the purchaser has been in *bona fide*, i.e. whether he or she knew or should have known that the registered owner was not the true one.[130] According to these general rules, it is most likely that the conveyance of Blackacre would not be legally binding, since Sam indicated to both John and Elinor, before the contract was concluded, that he did not want the sale to proceed. As a result, John's power could be revoked and Elinor would most likely be found in *mala fide*.[131] Therefore, Elinor would not be entitled to Blackacre even if John had registered himself as owner of the land.

If John has bought Blackacre in his own name but on Sam's account, the general rules of the Land Law Code may, however, not be directly applicable. These rules are primarily meant for cases where the owner has acquired the immovable in his or her own name, and not for cases where he or she is undisclosed or 'secret'. It is therefore arguable that these rules do not apply in cases like the one we are facing now. In particular, even if John had registered himself as the owner of Blackacre, and even if Elinor was acting in *mala fide*, the sale may still be effective. Many scholars believe that the termination of the powers of an indirect representative is effective against the purchaser of an immovable only if the purchaser has been acting collusively, i.e. in order purposely to damage the mandator.[132] The Finnish Supreme Court has not laid down clear precedent concerning this problem. The problem arises from the conflict between the official land registration system and secret ownership. Therefore, the rules restricting the protection of 'secret owners' of immovables are not to be generalised and applied to every kind of property. Generally, the purchaser is protected against the undisclosed mandator or other 'secret' owner only if he or she neither knew nor ought to have known that the seller was not the true owner.

Alternative 3

As the mandator, Sam is allowed to revoke John's mandate if John refuses to buy Blackacre. Whether John's refusal can be regarded as a breach of contract depends on the interpretation given to the contract.

[130] See M. Jokela, L. Kartio and I. Ojanen, *Maakaari* (Helsinki: Lakimiesliiton Kustannus, 1997), 267–273.

[131] A certain answer cannot be given, because it is possible that Elinor had some reasonable doubts concerning Sam's rights to Blackacre.

[132] See Jokela, Kartio and Ojanen, *Maakaari*, 267–268 and J. Tepora, L. Kartio, R. Koulu and J. Wirilander, *Kiinteistön käyttö ja luovutus* (Helsinki: Lakimiesliiton Kustannus, 1998), 155–159.

The terms of the contract seem to indicate that John is entitled to make investments according to his own discretion. Thus, John's refusal to make the investment requested by Sam is not regarded as a breach of contract. On the other hand, the refusal would be regarded as a breach of contract if the interpretation given to the contract were different. The latter would entitle Sam to make a claim for damages.

France

Alternative 1

The management of Sam's property by John would most likely, in practice, fall into the category of a disclosed contract of mandate.[133] John as mandatary (*mandataire*) will therefore have the power to manage the property of his mandator (*mandant)*, Sam, in a representative capacity.

The management of a securities portfolio on behalf of third parties is an investment service.[134] It is assumed that John's principal professional activity is to offer portfolio management to his clients. John would therefore need to qualify as an investment enterprise or a qualified credit establishment.[135] In either case, John would be required to operate his business through a legal person, John Ltd.[136]

A contract of mandate may be stipulated to be irrevocable.[137] However, notwithstanding the fact it is so described,[138] a contract of mandate subject to French law is always revocable.[139] The revocation of an 'irrevocable'

[133] Art. 1984 C. civ. defines a mandate as 'l'acte par lequel une personne donne à une autre le pouvoir de *faire quelque chose pour le mandant et en son* nom'. See also, regarding management of a portfolio on behalf of a third party, H. de Vauplane and J.-P. Bornet, *Droit des marchés financiers*, 3rd edn (Litec, 2001), No. 937: 'Le contrat de gestion de portefeuille s'insère dans la famille des contrats de mandat dont le régime est défini par les articles 1984 et suivants du Code civil.'; M. Storck, 'Sociétés de gestion de portefeuille', J.-cl. Banque et crédit, fasc. 2210, No. 4. *Adde* R. Verdot, 'Remarques sur le contrat dit "de gestion de portefeuille" ', in *Dix ans de droit de l'entreprise* (Litec, 1978), 869 ff.

[134] Art. L. 321-1.4 C. mon. et fin.

[135] A prior approval from the AMF (Financial Markets Authority) would need to be granted to obtain these qualifications. See art. L. 532-9 C. mon. et fin.; art. 1 of the Decree no. 96-880 of 8 October 1996; art. 322-3 ff., GRAMF.

[136] Art. L. 531-1 and L. 531-4 C. mon. et fin.

[137] Req. 7 September 1885, *DP* 1886. 1. 310.

[138] See J. Salle de la Martinière, 'Le mandat irrévocable', *RTD civ.* 1937. 241; R. Perrot, 'Le mandat irrévocable', in *Travaux de l'Assoc. Henri Capitant*, (Dalloz, 1959), 451 ff.

[139] An exception to the principle of discretionary revocation of powers is the mandate of common interest between parties (*mandat d'intérêt commun*) which may be revoked only if (i) both parties agree, (ii) the terms and conditions of the agreement provided specifically for this exception, or (iii) a legitimate reason is proved in court. See Civ. 13 May 1885, *DP* 1885. 1. 350. The mere fact that the agent is a professional or that the

contract of mandate will give rise to an obligation to compensate the loss suffered by the mandatary due to the revocation of his powers.

In Case 1, the contract not only stipulates that John Ltd's powers are irrevocable, but it also specifies a term. In the past, French courts have decided that it would be wrong unilaterally to terminate the mandate relationship prior to the term without providing reasons.[140] French courts have authorised the termination of a contract of mandate prior to its term if the mandatary has not fulfilled his obligations.[141] As such, if John Ltd's implication in the international trafficking of stolen works of art is supported by sufficient evidence, then it is very likely that a French court would authorise Sam to revoke John Ltd's powers prior to the end of the agreed five-year term.[142] In any event, French case law has evolved, and the courts now allow revocation of powers prior to a specific term.[143] Therefore, Sam will be entitled to obtain a judicial declaration that the relationship is terminated.

Mandataries are required to justify their accounts when a contract of mandate is terminated. Sam could request a court to appoint an expert to perform a full audit of the period. The appointment of such an expert should be granted once both John Ltd and Sam have presented their arguments in court,[144] and sufficient evidence of potential litigation has been established.[145] In this case, the latter is satisfied by the evidence of international trafficking in stolen works of art.

Sam is entitled to seek a remedy forbidding John Ltd from entering into any further transaction related to the assets. In connection with the above-mentioned actions, Sam could request a judge to prohibit John Ltd from taking any positive action in relation to the assets. To enforce such an injunction, Sam could ask the court to coerce John Ltd into complying with the injunction by coupling it with an *astreinte*.[146] An *astreinte* is an

agent receives compensation from the principal is not enough to qualify the mandate as one of common interest. See Com. 20 January 1971, *Bull. civ*. IV, No. 20.

[140] Soc. 22 June 1977, *Bull. civ*. V, No. 418.

[141] Paris, 8 July 1994, *D*. 1994 IR 223.

[142] See Com. 15 March 1995, *Bull. civ*. IV, No. 83.

[143] Civ. 3*ème*, 27 April 1998, *D*. 1998. 351, comment Atias: 'Le mandat est librement révocable même si sa durée est déterminée'.

[144] The French Court would be the *juge des référés*, who renders decisions within a short time period.

[145] See art. 145 NCPC.

[146] An *astreinte* may be imposed by the court even if Sam does not request one, at the motion of the court itself: see art. 33 of the 9 July 1991 Act.

arbitrary sum of money that John Ltd would be ordered to pay to Sam if John Ltd did not comply with the injunction.[147]

The *astreinte* is independent from the notion of damages (which will repair the loss suffered).[148] The *astreinte* is not compensatory in nature, but is merely a method for the enforcement of obligations. Also, an *astreinte* is threatening by nature, because the amount to be paid can be modified by the courts upon failure to perform.[149]

Sam will be entitled to damages if he is able to prove that John Ltd has harmed or mismanaged Sam's property, and that, as a result, he has suffered a loss.[150] The fact that John Ltd is implicated in the international trafficking of stolen works of art could justify the granting of damages to compensate Sam for a moral loss. This refers to a loss that does not affect the patrimony of the person but rather his or her moral interests. The amount of any such award would be nominal or symbolic; it is not uncommon for French courts to grant damages amounting to FF1 (or €1).

Sam may, at his own discretion, revoke the relationship with John Ltd,[151] provided that Sam does not abuse his right, i.e. that Sam does not revoke the relationship with the sole intention of causing harm to John Ltd.[152] In Case 1, Sam has not abused his right and thus John Ltd's counterclaim, that he still enjoys full managing powers until the end of the five-year period, will fail. For the same reasons, John Ltd's counterclaim for damages will fail.

[147] The *astreinte* used to be ineffective because the courts reduced it to the actual loss suffered, which was then given as compensation. See Cass. 1 January 1913, *D*. 1913. I. 35; Cass. 7 May 1933, *D*. 1933. 425, Civ. 2*ème*, 27 February 1953, *S*. 1953. I. 196. The *astreinte* was then no more than an anticipated damages award. It was ineffective because there was no incentive to perform promptly when the amount of an *astreinte* was always restricted to the actual loss suffered.

[148] Civ. 1*ère*, 29 October 1959, *D*. 1959. 537, comment Holleaux, and see the previous note.

[149] The *astreinte* mechanism has been criticised due to the fact that it over-compensates the promisee, who should be awarded only the amount promised, plus an amount of damages if there has been a loss. It is arguable that the amount of the *astreinte* should revert to the French state, i.e. the entity charged with enforcing the public order, which includes the carrying out of the courts' orders.

[150] Art. 1991 para. 1 C. civ.: 'Le mandataire est tenu d'accomplir le mandat tant qu'il en demeure chargé et répond des dommages et intérêts qui pourraient résulter de son inexécution', and Art. 1992 C. civ.: 'Le mandataire répond non seulement du dol, mais encore des fautes qu'il commet dans sa gestion. Néanmoins la responsabilité relative aux fautes est appliquée moins rigoureusement à celui dont le mandat est gratuit qu'à celui qui reçoit un salaire.' *Adde* Civ. 1*ére*, 14 June 2000, *RD bancaire et financier* 2000. 241i, *RTD com*. 2000. 973, comment Storck.

[151] Art. 2004 C. civ.

[152] Civ. 1*ère*, 2 May 1984, *Bull civ*. I, No. 143.

It is most likely that Sam and John Ltd's relationship falls into the category of a disclosed contract of mandate, but it could also fall into the category of an undisclosed contract of mandate.[153] Two types of undisclosed mandate can be considered.[154] The first is the *convention de prête-nom*, in which the relationship between the mandator and the mandatary is undisclosed to third parties. If, for whatever reason, the 'undisclosed' contract of mandate is revealed,[155] then third parties dealing with the mandatary may decide either (a) that the mandatary (but not the mandator) is bound by the agreement, or (b) that the mandator (but not the mandatary) is bound by the agreement entered into pursuant to the undisclosed contract of mandate. The second type of undisclosed contract of mandate is the contract of *commission*.[156] The commission agent (*commissionnaire*) acts on behalf of a principal (*commettant*), without disclosing his representative capacity. The commission agent (but not the principal) will be bound by the agreement entered into with third parties, which will be enforceable against him.[157]

Alternative 2

In light of the fact that both John Ltd and Elinor were duly notified by Sam that the latter rejected the sale of the land under the present terms, French courts would construe this notification as constituting a

[153] On undisclosed contract of mandate, see M.-L. Izorche, 'A propos du "mandat sans représentation" ', *D*. 1999. 369.

[154] A third type of undisclosed contract of mandate is the *déclaration de command*. This type of undisclosed contract of mandate is, in practice, sometimes used to buy real estate. It can, however, be used to purchase any other kind of assets. See: A. Bénabent, *Les contrats spéciaux*, 2nd edn (Montchrestien, 1995), No. 695. The mere existence of a relationship between the principal (*command*) and the agent (*commandé*) is disclosed to third parties; the identity of the principal is, however, not revealed. Once the agent has entered into agreement with a third party, the agent may, within a specified period, disclose the name of the principal he was acting for. If the agent makes such a disclosure in due time, the principal (but not the agent) and the third party will be bound by the agreement. If the agent does not make such a disclosure, the agent (but not the principal) and the third party will be bound by the agreement. The *déclaration de command* does not exactly fit the aim of John and Sam, due to the fact that the *déclaration de command* may be a tool to buy assets for the account of someone and then to transfer to this person the property of the assets, but not to manage assets on behalf of someone else.

[155] Third parties may demonstrate the existence and the terms and conditions of the undisclosed contract of mandate by any means. See Civ. 3*ème*, 8 July 1992, *Bull. civ*. III, No. 246.

[156] Art. L. 132-1 C. com. Cf. F. Leduc, 'Réflexions sur la convention de prête-nom, contribution à l'étude de la représentation imparfaite', *RTD civ*. 1999. 283.

[157] Com. 18 January 1955, *Bull. civ*. III, No. 30.

termination or a revocation of John Ltd's contract of mandate to sell the land.[158] Elinor will be deemed to be a *mala fide* purchaser, and therefore will not have received a valid title that is opposable to (or effective against) Sam.[159] Sam will, therefore, be entitled to recover Blackacre from Elinor.

Alternative 3

In principle, John Ltd should perform Sam's instructions,[160] provided that they are precise and obligatory.[161] Some legal scholars believe that a contract of mandate granted to a professional investment manager of a portfolio of securities (*gestion sous mandat*) implies that instructions given by the mandator to the mandatary do not have to be performed,[162] notwithstanding the basic principle of French mandate law, which is that instructions from the mandator should be followed by the mandatary. Case law tends to confirm this opinion.[163] This mechanism could be characterised as a kind of non-codal *fiducia*. It can be argued that this case law should be extended to the management of all investments, provided that the terms and conditions of the agreement between the mandatary and the mandator grant discretionary powers to the mandatary to manage the mandator's assets. On this view, John Ltd might not have to follow Sam's instructions, including the request to purchase Blackacre as an investment. It is uncertain whether French courts would adopt this opinion.

[158] Sam will have the burden of proving that John and Elinor were aware that Sam cancelled John's powers to sell the land. See Com. 17 June 1997, *Bull. civ.* IV, No. 194.

[159] See art. 2005 C. civ. *in fine*.

[160] Art. 1991 para. 1 C. civ. *Adde* P.-H. Antonmattei and J. Raynard, *Les contrats spéciaux* (Litec, 1997), No. 452: 'Le mandataire est d'abord tenu d'exécuter le mandat en respectant les instructions qui lui ont été données.'

[161] Ph. Pétel, 'Les obligations du mandataire', preface of M. Cabrillac (Litec, 1988), Nos. 50 ff.

[162] See de Vauplane and Bornet, *Droit des marchés financiers*, No. 952; Ch. Gavalda, comment of Com. 12 July 1971, *D.* 1972. 153, 155; Storck, 'Sociétés de gestion de portefeuille', Nos. 69 ff.; F. J. Crédot and P. Bouteiller, 'La responsabilité des banques en matière de conservation, de gestion et de placement de valeurs mobilières', *Banque* 1988. 615, 617. Cf M. Storck, 'L'activité de gestion de portefeuille', *RD bancaire et bourse* 1990. 191, No. 39.

[163] See Com. 12 July 1971, *D.* 1972. 153, comment Gavalda; *RTD com.* 1972. 144, comment Cabrillac and Rives-Lange; Riom 21 June 1989, *D.* 1989 IR 319; *Gaz. Pal.* 31 October–1 November 1990, 12 (the latter case has been described as 'peu orthodoxe mais significatif' by M. Grimaldi, in 'La fiducie: réflexions sur l'institution et sur l'avant-projet de loi qui la consacre', *Def.* 1991 art. 35085, footnote 29).

If John Ltd does not follow the instructions that are given to him by Sam, then John Ltd will be liable if Sam suffers a loss due to his lack of performance. If (a) Sam confirmed his desire to purchase Blackacre notwithstanding the fact that John Ltd's opinion was that Blackacre was not a good investment, and (b) Blackacre turned out to be a good investment, then Sam could seek damages for the difference between the profit that the investment in Blackacre would have created and the profit that arose from other investments that John made.

Germany[164]

Under German law the relationship between John and Sam is a contract, to be analysed and enforced in accordance with the general rules of contract law. The contract would be a *Geschäftsbesorgungsvertrag* (contract of mandate by which a person agrees to manage another person's business affairs), and there are a number of Civil Code provisions dealing with this type of contract (§§ 675, 663–665, 670, 672–674 BGB). It should be noted that most of these provisions contain merely 'default rules', and they do not apply if there is proof that the parties either expressly or impliedly reached a different agreement.

Alternative 1

It is generally recognised in German law that all agreements intended to last for some time may be terminated by either party if there exists 'an important reason' for doing so. This rule is laid down in § 626 BGB for contracts of services and in § 723 BGB for non-trading partnerships, but is extended by the courts to all contracts of some duration. It is a mandatory rule, which is therefore applicable in this case despite the fact that John was granted 'irrevocable managing powers for a term of five years'.

In Case 1, John's implication in the international trafficking of stolen works of art would surely be held to constitute an 'important reason' justifying termination. The only problem in this case is that the news may be incorrect. This problem has been discussed extensively in relation to § 626 BGB. It is undisputed that even unproven facts could justify termination if such facts would constitute an 'important reason' if they

[164] The German report for Cases 1–7 includes substantial passages of a first, preliminary draft by Prof. Dr Dr h.c. mult. Hein Kötz, who had to withdraw from the project due to his appointment as a founding dean of the Bucerius Law School, Hamburg. I wish to express my gratitude.

were proven. However, mere suspicion without any factual basis is not sufficient.[165] Also, if Sam wants to terminate the contract on such a basis, he must use the means available to him in order to shed light on the affair; this includes hearing out John.[166] The more important a fact would be if it were proven, the less weight is given to existing doubts. Relationships of confidence are particularly delicate, and this may mean that a court is more willing to find an 'important reason' for termination.[167] The allegations made should suffice for termination if the newspaper they were made in is trustworthy, and if Sam took the procedural steps mentioned. Accordingly, Sam would be granted a judicial declaration that the relationship is terminated, and a remedy enjoining John from entering into any further transaction related to the assets. The actions Sam could take include an action for declaratory judgment under § 256 *Zivilprozeßordnung* (ZPO) (confirming that the relationship has been terminated) and an action for preliminary injunction under § 935 ZPO based on the fact that the powers have been terminated.

Sam can seek a full audit of the previous period according to §§ 666 and 259 BGB, and restitution of the managed assets according to §§ 667 and 260 BGB. A claim for damages will also be available on the basis of John's breach of an implied contractual duty to refrain from conduct endangering the purpose of the agreement. In the case that the newspaper was mistaken, there would be no breach of contractual duty. The burden of proof, in this respect, is on Sam. The burden is reversed only in the event that a breach is proven to result from John's neglect.

Alternative 2

Elinor acquired title to Blackacre by way of an agreement with John, whose full and unrestricted ownership in Blackacre would be evidenced by a corresponding entry in the land register. Elinor knew, however, that Sam, as Blackacre's 'beneficial owner', was opposed to the sale. According to § 137 BGB, this fact does not make the transaction automatically void. On this ground, however, it might be argued that (a) the agreement by which ownership was transferred from John to Elinor was void as being contrary to the *boni mores* (§ 138 BGB), or (b) Elinor was

[165] See BGH AP § 611 no. 2 *Fürsorgepflicht* (employer's duty of care); BAG EzA no. 5 *Verdacht strafbarer Handlung* (suspicion of crime).

[166] BAG NZA 1986, 674.

[167] BAG AP no. 13 *Verdacht strafbarer Handlung* (suspicion of crime).

liable in tort damages to Sam for having deliberately caused him harm by conduct offending the *boni mores* (§ 826 BGB). The second allegation gives a direct claim against Elinor, which would include both monetary damages and the possibility to ask for restitution. This is the normal route to be taken, and the case law mostly concerns itself with this line of arguments.

In legal doctrine, the dominant view is that neither of these arguments would succeed unless there was proof that Elinor and John conspired to defraud Sam, or that Elinor induced John to breach his contract with Sam. Elinor's conduct, in the latter case, is regarded as a serious offence to basic notions of decency. According to this view, Sam would not be entitled to ask for damages or restitution since Case 1 only indicates that Sam believed the price to be too low. Recently, however, it has been argued that Sam's 'beneficial ownership' is a vested right since it is protected in various respects under German law. Also, it has been argued that Elinor's right to acquire is a mere chance. There is protection for vested rights under the German Constitution but not for mere chances. Under German law the Constitution is the first body of rules to search when determining the content of *boni mores*. Therefore, this line of argument supports the view that a third party informed of the opposition of a beneficial owner cannot validly acquire title.[168] Case law from the Supreme Court is pointing in this direction. Whereas the wording of the decisions seems to indicate that conspiracy is necessary in order to avoid a transaction, the actual outcome was often different.[169]

The second line of argument is certainly strengthened whenever the beneficial ownership is 'registered'. This holds true for trust accounts, but not for land titles. In the latter case, registration offices refuse to specify beneficial ownership. Registration can give the third party information about the existence of a fiduciary duty. This alone, however, is not sufficient to infer fraudulent behaviour on behalf of the third party. There must also be knowledge of the fact that the beneficial owner was opposed to the specific transaction.

[168] See Grundmann, 'Trust and Treuhand at the End of the 20th Century – Key Problems and Shift of Interests', 47 AJCL 401 (1999).

[169] In RG JW 1925, 1635 and later in BGHZ 12, 308, 310 and 319 ff. (in a parallel corporate setting) it was held that a third party informed of the beneficial owner's opposition acted fraudulently if he went on with a transaction proposed by the fiduciary (corresponding to John in our case).

Alternative 3

John's failure to follow Sam's instruction might render him liable in damages for breach of a contractual duty. Normally under German law, a person who agrees to manage another person's business interest must follow the other person's instructions. Section 665 BGB is clearly based on this assumption. John is therefore in breach unless it can be shown that the agreement conferred on John the exclusive power to manage Sam's assets, as he, and he alone, saw fit. Even if it did, there would be some doubt as to whether it is valid for a person to divest himself irrevocably of the power to control the management of his affairs. The problem is normally discussed in cases where somebody has granted another person an irrevocable power of attorney. According to German Supreme Court case law, an irrevocable grant of such a power is valid only if the attorney has a special interest in the transaction to be executed.[170] A normal investment management contract, however, is entered into for the exclusive interest of the client, not the attorney. This is true at least for investment decisions (duty of loyalty and care). Moreover, the attorney could not invoke his interest in his potential remuneration.[171]

Greece

The EC Directive 93/22 of 10 May 1993 (Investment Services in the Securities Field)[172] became domestic regulation in Greece through L.2396/1996. According to s. 1(g) of the above Act, the management of a portfolio with financial instruments such as securities, money market instruments, futures, swaps or options, in the framework of a related mandate,[173] is an investment service. In Greece, only a corporation can provide such investment services, which should be a *Société Anonyme* (Company Limited by Shares) providing investment services. Companies providing investment services (EPEY) cannot manage assets other than financial instruments, such as real estate, precious metals or works of art. The investment manager of assets other than financial instruments can be either an individual or a legal entity (other than an EPEY).

[170] BGH DNotZ 1972, 229.

[171] See s. 86a para. 2 *Handelsgesetzbuch*, which contains the general principle.

[172] ECOJ L141/11.6.1993, 27.

[173] S. 28 § 1.

In Greek law, the contract of mandate is the legal institution that accounts for the relationship between John and Sam (s. 713 CC). Under this institution, Sam grants John full investment power over the capital of €2,000,000. The contractual obligation of the mandatary (John) is to conduct the affairs of the mandator (Sam). The object of the mandate is the accomplishment of various legal and/or material acts, required for the management of the assets entrusted to the mandatary. The mandatary cannot deviate from the limits set in the mandate. However, the latter can be set in general terms, so that the mandatary holds a discretionary power to conduct the mandator's affairs (derived by argument from s. 717 CC).

Alternative 1

The mandator should pay the expenses required for the performance of the mandate in advance (s. 721 CC). In addition, the mandator should reimburse the mandatary for any amount spent in order to achieve the orderly performance of the mandate (s. 722 CC). In Case 1, however, the annual fee calculated as a percentage of the capital value of the assets under management does not correspond to the expenses incurred by the mandatary (John) in order to achieve the performance of the mandate. In fact, the annual fee represents his remuneration for the investment management services provided to Sam. According to s. 713 CC, the mandator is not obliged to provide remuneration to the mandatary. However, the contracting parties may agree to include a remuneration clause in the contract. This is common practice, in particular if the mandatary is a professional.[174]

According to Greek law, the contract of mandate is revocable at any time, and any agreement which precludes or limits the right of revocation of the mandate is null and void (s. 724 CC). There is, however, an important exception to these rules: the mandate is not revocable at any time if it concerns the interests of the mandatary or a third party (s. 724 CC *in fine*).[175] Greek courts have recognised the existence of such an interest, in particular, if remuneration is due to the mandatary.[176] The clause prohibiting the revocation of the mandate during the

[174] However, see Filios, *Law of Obligations, Special Part*, I (1997), 369–370. See also Kornilakis, *The Fiduciary Cession of Claims* (1978), 49. According to these authors, if remuneration is due, the legal relationship will be considered as a contract for work (ss. 681 CC ff.).

[175] AP 1344/1977, NoB 26/1977, 1054; AP 439/1979, NoB 28/1979, 1912; AP 197/1983, EEN, 1983, 713.

[176] Ef. Thessaloniki, 648/1985, Harm. 40/1985, 619; AP 306/1964, NoB 12/1964, 841; AP 570/1964, NoB 13/1965, 182.

five-year period is therefore valid under Greek law. However, even though the mandate is agreed to be irrevocable for a definite period of time, it may still be revoked for an important reason.[177] Reasons include any illegal, deceptive, misleading or fraudulent behaviour of the mandatary. Sam can, therefore, terminate the contractual relationship with John, if he is able to prove that John was involved in the international trafficking of stolen works of art. If Sam proves this allegation, then John's counterclaim that his managing powers are valid until the end of the five-year term would be denied.

In any event, the mandatary is bound to restore to the mandator everything that he has received for, or acquired from, the performance of the mandate (s. 719 CC). Moreover, the mandatary is bound to furnish information to the mandator about the affairs entrusted to him, and to render account to the mandator upon termination of the mandate (s. 718 CC). Sam's claim should, therefore, be awarded accordingly.

According to s. 714 CC, if the mandatary is at fault, then he is responsible for any damages arising from the performance of the mandate. A claim for damages supposes that Sam is able to prove the damages he has suffered. Similarly, John's claim for damages is also subject to the proof of the damage he has suffered. John's claim for damages should be denied, despite the loss of fees he had suffered, due to the early termination of the mandate, to the extent that John suffered this loss by his own fault, i.e. his implication in the trafficking of stolen works of art (s. 300 CC).

Sam's claim seeking to enjoin John from entering into any further transaction over the entrusted assets is related to representation issues. Representation enables a person (the representative) to bind, by his own legal acts, another person (the party represented, or principal). It should be noted that the internal relationship between the representative and the principal is usually a mandate, while representation operates externally, vis-à-vis third parties.[178] The contract of mandate is the subjacent contract of the representation, and from a legal point of view, the *causa* of the representation. However, representation may also exist under additional *causae*, including a contract for services, a contract for work, a partnership, etc. (s. 722 CC). It has been held that the validity of the representation is not affected if its cause is void, since the

[177] AP 887/1974, NoB 23/1975, 492. See also Karasis, in Georgiadis–Stathopoulos, §§ 724–725, no. 2.

[178] Stathopoulos, *Contract Law in Hellas* (1995), 214.

representation is independent of its cause, being an abstract legal act.[179] Greek law draws further distinctions between direct and indirect representation. Direct representation involves the performance of a legal act in the name of another person who acquires rights and obligations directly from the legal act accomplished in his name. Greek law (ss. 211 ff. CC) regulates direct representation, whereas indirect representation is not regulated. In the case of indirect representation, the representative must transfer rights and obligations to the person represented through a new legal act.[180] A rule of interpretation provided by s. 212 CC indicates that failure to ascertain that a person has acted in the name of another will result in the presumption that the person has acted in his own name. In Case 1, it is evident that John acts as a direct representative of Sam with respect to the management of the entrusted assets. His power to represent Sam is created through a power of attorney (s. 216 CC).

The power of attorney should take the form required for the completion of the legal act to which the power of attorney refers. Furthermore, the power of attorney is given by means of a declaration addressed to the attorney or to the third party with whom the relevant legal act is concluded (s. 217 CC). If the power granted to John enables him to buy and sell immovables, the relevant power of attorney should be incorporated in a notarial deed (s. 217 CC *in fine*), since the buying and selling of immovables requires a notarial deed (s. 1033 CC). A power of attorney can be terminated through revocation (s. 218 CC), whereas a power of attorney given by notarial deed can only be revoked by a notarial deed (s. 220 CC). The revocation of a power of attorney should be addressed to the attorney or to the concerned third party (s. 219 CC). The represented person can renounce his right to revoke the power of attorney only if the power of attorney also concerns the interests of a third person or of the attorney (s. 218 CC, *a contrario*).[181] In Case 1, the power of attorney does concern the interest of the attorney (John), since John is entitled to receive an annual fee for the services provided to Sam. In similar cases, it was held that the represented person may revoke the power of attorney for an important reason. As for the revocation of the contract of mandate, important reasons include any illegal, deceptive, misleading or fraudulent behaviour of the attorney. Sam may therefore enjoin

[179] Ibid., 213. AP 887/1974, NoB 23, 492.

[180] Stathopoulos, *Contract Law in Hellas*, 215.

[181] See Deliyannis, *The Power of Attorney in the Greek Private Law* (1953), 241 ff.

John from entering into any further transaction related to the management of assets in his name, if Sam is able to prove the allegation against John.

Alternative 2

The power of attorney for the sale of an immovable, the revocation of a power of attorney and, more precisely, the revocation of a power of attorney given by notarial deed, are discussed in the aforementioned ss. 217, 218, 219, 220 CC.

A power of attorney given by notarial deed, in particular for the sale of an immovable, is only revocable by notarial deed (s. 220 CC). Thus, the revocation made by a simple letter (Sam does not address any notarial deed to John or Elinor) does not have any legal effect under Greek law. Furthermore, Sam may not recover Blackacre from Elinor under the assumption that the ownership of the immovable has been acquired by Elinor in accordance with the requirements of s. 1033 CC, i.e. that there was an agreement incorporated in a notarial deed between the owner, or his attorney, and Elinor, to the effect that for a valid cause the ownership has been transferred to Elinor, and registration of this agreement has taken place. Elinor is the legal owner of the immovable and thus Sam's claim for restitution of the immovable fails (s. 1094 CC).

However, according to s. 178 CC (Act Contrary to *Bonos Mores*),[182] indicating that any act which is contrary to *bonos mores* is null and void, it is possible for Sam to seek nullity of the sale and of the subsequent transfer of ownership over Blackacre to Elinor, to the extent that Elinor acted against *bonos mores*.

Furthermore, John, acting as a mandatary of Sam, is liable to Sam for any fault (s. 714 CC). Sam has, therefore, a claim for damages against John.

In addition, Sam may also claim damages against Elinor under s. 919 CC. This section is complementary to s. 914 CC, which is the general provision for tort liability under Greek law. Section 914 CC cannot apply to Case 1, since Elinor's behaviour is not 'unlawful' in the contemplation of the law. The agreement between the attorney of the owner and Elinor, regarding the sale of the immovable and the transfer of ownership, is a lawful act, corresponding to the general

[182] Simantiras, *General Principles of Civil Law*, 4th edn (1988), 598–599. Ladas, *Nullity of a Legal Act Contrary to Morality* (1979), 132.

principle *pacta sunt servanda* (s. 361 CC). This is true, even if Elinor knows that the attorney (John) acted against the instructions of Sam.[183]

Since Elinor causes harm to Sam, she will be required to make reparation according to s. 919 CC, which requires the harm to be caused 'intentionally' and 'in a manner which violates the commands of *bonos mores*'. This intentional behaviour, contravening *bonos mores*, establishes the liability of a person under Greek law,[184] even if the prejudicial act is not unlawful.[185]

The main remedy in tort is monetary reparation for both pecuniary and moral harm (ss. 914, 932 CC). However, the courts may exceptionally order, instead of monetary damages, the reinstatement of the former situation (*statu quo ante*), if such method of compensation, taking into consideration any special circumstances, is not contrary to the interests of the injured person (s. 297 CC). If the special conditions set in ss. 919 and 297 CC are met, then Sam may be able to claim reparation *in natura*, resulting in the reinstatement of the ownership of his immovable. The reparation *in natura* would be subject to the restitution of the price paid by Elinor for the acquisition of the immovable, that price being a payment for a consideration which ceased to exist (s. 904 CC).

Alternative 3

According to Greek law, both the mandate and power of attorney do not preclude the mandator or the represented person, respectively, from concluding any legal act for which the mandate and/or the power of attorney was given. Therefore, the managing power over the entrusted assets given to John is not exclusive. Sam may, on his own, proceed with the purchase of Blackacre in addition to making further investments. In addition, Sam may require the sale of an asset entrusted to John in order to get the money for acquiring Blackacre, and, more generally, Sam may

[183] See AP (Plenary Assembly) 33/1987, NoB 36/1988; Hellin.Dni 29/1988; AP (Plenary Assembly) 48/1987, EEN, 1987, 867; AP 404/1987, NoB 36/1988, 907. *Contra* AP 448/1984, NoB 33/1985, 61: a contract regarding the sale of an immovable has been declared null and void according to s. 281 CC (Abuse of Right) and s.174 CC (Prohibited Acts), though the buyer acted in good faith. See also AP 717/1985, NoB 34/1986, 560; Hellin.Dni 28/1987, 629.

[184] AP 40/1960, NoB 8/1960, 496; AP 212/1967, NoB 15/1967, 570; AP 456/1972, NoB 20/1972, 1278; AP 326/1974, NoB 22/1974, 1297; AP (Plenary Assembly) 398/1975, NoB 23/1975, 1164; AP (Plenary Assembly) 821/1977, NoB 26/1978, 669.

[185] Ad hoc AP 925/1991, Harm. 46/1991, 115. See also Stathopoulos, *Law of Obligations*, II (1999), 125–129; Filios, *Law of Obligations, Special Part*, II/2 (1997), 50–54. *Contra* AP 214/1972, NoB 20/1972, 901.

interfere with the discretionary investment power given to John. As mentioned above, the investment power given to a mandatary or to an attorney, even on a discretionary basis, is not exclusive. However, the interference with the discretionary management mandate may constitute an important reason for the early termination of the management mandate by John. On the other hand, although the mandator should set the limits of his mandate, and any deviation from such limits is regulated (s. 717 CC, deviation from the limits set in the mandate), such limits may nonetheless be extremely wide in order to confer a discretionary power on the mandatary. Such discretionary power should be exercised within the scope of s. 717 CC. According to this section, the mandatary should perform the mandate in a way that would have been approved by the mandator if he had knowledge of the particular circumstances.

IRELAND

As a professional investment manager, John is subject to the Investment Intermediaries Act 1995 (the IIA); pursuant to s. 9, he must be authorised by the supervisory authority, the Central Bank and Financial Services Authority of Ireland.[186] Authorisation may be sought by companies, partnerships and sole traders.[187] John is also subject to the principles of common law and equity which are set out in the English report. Furthermore, institutional practices in respect of custody of investment securities are broadly speaking the same in Ireland as they are in England, with the same trust and agency consequences.

Alternative 1

John's conduct in the provision of investment management services under the contract to supply management services to Sam is subject to the IIA conduct of business regime. Section 37 of the IIA requires the supervisory authority (the Central Bank of Ireland) to adopt Codes of Conduct which cover the principles set out in s. 37 which, in turn, reflect Article 11 of the Investment Services Directive[188] and so include duties of honesty, fairness, skill and diligence, and avoidance of conflicts of interest. Section 37 has been amplified in the Central Bank's

[186] The Central Bank of Ireland became the CBFSAI on 1 May 2003. It is made up of the Central Bank and the Irish Financial Services Regulatory Authority.

[187] Section 10(5)(a).

[188] Directive 92/22/EEC, OJ L141/27(1992).

Code of Conduct.[189] The five-year irrevocable term is arguably a breach of the Code, given the Code's requirement that a firm act fairly in conducting its business activities in the best interests of its clients.[190]

Section 20 of the Powers of Attorney Act 1996[191] provides that a power is irrevocable if given as security; but otherwise, as with England, a power of attorney is probably revocable even if expressed to be irrevocable. Hence, the arrangement, whether agency or trust, will be determinable by Sam despite the contrary agreement, and, since the rule in *Saunders* v. *Vautier*[192] also applies as a matter of Irish law,[193] Sam will be entitled to the same relief with the same consequences for John as those set out in the English report.

Furthermore, in terms of Sam receiving a 'full audit' of the investments which have been made, the Code of Conduct requires investment business firms to issue a contract note containing the information required by the Code of Conduct in respect of every sale or purchase of an investment instrument which is executed for a client, unless the client has advised the firm in writing that a contract note is not required.[194] In addition, unless the client has advised the firm to the contrary, where a firm provides discretionary management services (as are at issue here) it must provide statements covering periods which are not less than six monthly in respect of investment instruments and/or cash balances as at the statement date, which provide the information set out in the Code of Conduct.[195] However, the consequences of a failure to comply are unclear. In such a case, there is no statutory right of action for investors, and the IIA does not set out a penalties/sanctions system to be relied on by the Central Bank. However, if the conduct rule in question has been expressly or impliedly incorporated

[189] Handbook for Investment and Stockbroking Firms. Requirements Issues under Section 37 of the Investment Intermediaries Act, 1995. Code of Conduct November 2000 (the 'Code of Conduct').

[190] General Principle 1.1.

[191] Implementing the recommendations of the Law Reform Commission contained in its *Report on Land Law and Conveyancing Law (2) Enduring Powers of Attorney* (LRC 31–1989).

[192] (1841) 4 Beav. 115, 49 ER 282, affirmed (1841) Cr. & Ph. 240, 41 ER 482.

[193] See, e.g., Delany, *Equity and the Law of Trusts in Ireland*, 2nd edn (Dublin: Round Hall Sweet & Maxwell, 2000), 433; Law Reform Commission, *Report on the Variation of Trusts* (LRC 63–2000), 3, para. 1.04.

[194] Principles 11.1 and 11.2.

[195] Principle 17. More specific ongoing disclosure requirements are imposed in respect of particular transactions. Notwithstanding waivers by clients, a statement must be sent on an annual basis.

into the arrangement between John and Sam, then breach by John would amount to a breach of trust, and Sam would be entitled to the same relief as envisaged in the previous paragraph.

The terms of the trust may allow Sam to replace John as trustee. If not, the court has both a statutory power[196] to appoint a new trustee where an existing trustee refuses or is unfit to act, and a common law[197] power to remove a dishonest, incompetent or obstructive trustee and therefore to appoint a replacement. However, there is no Irish equivalent of the English statutory power[198] by which Sam could direct John to retire.

Alternative 2

Whether Sam can recover from Elinor depends on whether John was acting properly when he sold the property.

If John as trustee acted properly, then Sam as beneficiary cannot interfere with John's exercise of his trustee's powers and duties, unless the terms of the trust so provide. Furthermore, there are no Irish equivalents of the exceptions provided in England by the Trusts of Land and Appointment of Trustees Act 1996, which anyhow do not avail Sam. Thus, for so long as John is acting properly, then the sale is one which Sam cannot stop. Elinor will take title to Blackacre free from any claim which Sam may have had, and John will hold the proceeds of sale on the same trust for Sam as he held Blackacre.[199]

However, if John has acted in breach of his duties as trustee in selling Blackacre to Elinor – for example, either because the sale is in breach of the terms of the trust, or because the sale price is too low[200] – then Sam may have a claim against Elinor.[201] If the land is

[196] Section 25 of the Trustee Act 1893; see *Pollock* v. *Ennis* [1921] 1 IR 181.

[197] *Moore* v. *McGlynn* [1894] 1 IR 74 (Chatterton VC) (removal of trustee to prevent conflict of interest); *Arnott* v. *Arnott* (1924) 58 ILTR 145 (HC; Murnaghan J); *O hUadaigh* v. *O Loinsigh* (1975) 109 ILTR 122; *Spencer* v. *Kinsella* [1996] 2 ILRM 401 (HC; Barron J); *Kirby* v. *Barden* (High Court, unreported, 12 March 1999, Carroll J).

[198] Trusts of Land and Appointment of Trustees Act 1996, s. 19.

[199] This is called 'overreaching': see Harpum, 'Overreaching, Trustees' Powers and the Reform of the 1925 Legislation' (1990) 49 CLJ 277.

[200] However, the courts are slow to find that a sale price is so low as to constitute a breach of duty (see, e.g., *Holohan* v. *Friends Provident and Century Life Office* [1966] IR 1 (SC); *In re Edenfell Holdings* [1999] 1 IR 443 (Laffoy J, and SC)); but if it is, the sale may be prevented by injunction.

[201] In the case of a sale in breach of duty, the doctrine of overreaching will not apply (see Harpum, 'Overreaching', 279–280, 286), and there is no possible statutory exception in Ireland similar to s. 2(1) of the Law of Property Act 1925 in England. Hence, if John's

unregistered,[202] the common law rule, by which Elinor would be protected only if she were a *bona fide* purchaser for value without notice of Sam's prior interest in Blackacre, would apply; as she had notice of Sam's interest, she is not protected, and instead holds Blackacre on trust for him. If, on the other hand, the land is registered, Sam could enter a 'caution' on the register before the sale to Elinor, which could not then proceed without notice to Sam, who may then object and prevent the sale.

Alternative 3

Sam, as beneficiary, cannot force John, as trustee, to purchase Blackacre, unless the trust deed provides otherwise; and even if Sam could have John removed under the powers discussed above, he still could not direct John's replacement(s) to purchase Blackacre.

Italy

The outcome of the case will vary depending upon some circumstances that are not set out in the case description, the most important of which is whether or not John is offering his professional services to the public.

If the service is not offered to the public (just as if it is not offered on a professional basis), the case would fall under the provisions of the Italian Civil Code on the contract of mandate (arts. 1703 ff. CC). These articles regulate the accomplishment by the mandatary of juridical acts on behalf of the mandator. Under the Italian Civil Code, the contract of mandate may be coupled with the power to represent the mandator, as in the case of a mandate with representation (art. 1704). This possibility will not be further considered, because there is no clear indication of the grant by Sam of such a power to John. Under Italian law, the holding of property on behalf of another and the accomplishment of juridical acts to manage that property may also be arranged by the conclusion of a fiduciary agreement (i.e. *negozio fiduciario*). The Italian Civil Code does not provide the legal framework of such an agreement, which is a contract. Thus, its effects are shaped by the agreement of the parties

sale is in breach of trust, the doctrine of overreaching will not afford Elinor a defence to Sam's claims.

[202] In Ireland, the current system of optional land registration was introduced by the Registration of Title Act 1964. (There was an older optional system as early as 1891.) Though the optional system has experienced the same lack of uptake as its 1925 English counterpart, the 1964 Act's experiment in limited compulsory registration in three counties has not been extended to the rest of the country.

and by developments in the law fostered by academic writings and judicial decisions, which initially built upon ideas mostly borrowed from German legal thinking during the late nineteenth century and early twentieth century.[203] By now, however, it is clear that in Italy, the law applicable to such contracts does not differ from the law applicable to the contract of mandate.[204]

If the investment service is offered to the public, John shall be a company authorised to carry on its activity in accordance with the provisions applicable to investment firms pursuant to art. 18.1 of the *decreto legislative* (d. lgs.) of 24 February 1998, n. 58, *Testo unico dell'intermediazione finanziaria*,[205] which implements in Italy the relevant EC legislation. Management on a client-by-client basis of investment portfolios is included in the list of activities that are considered to be 'investment services', where such activity concerns investment in financial instruments.[206] In performing its services such a company shall act in the client's name, i.e. in a representative capacity, with the power to establish direct legal relationships between the client and third parties, unless it has obtained the client's consent in writing to operate in its own name, on behalf of the client.[207] The provisions of the d. lgs. 24 February 1998, n. 58, are not clear about whether investment services firms can undertake the management of portfolios that include assets which do not constitute financial instruments, such as immovables.[208]

[203] On the early developments see Jaeger, *La separazione del patrimonio fiduciario nel fallimento* (1968).

[204] Sacco, De Nova, *Il contratto*, I, 3rd edn (2004), 813 ff., at 817 ff. See e.g. Cass., 5 February 2000, n. 1289, Giur. it., 2000, 2258, n. Forchino; Trib. Cagliari, 10 December 1999, Riv. giur. sarda, 2001, 661, n. Cicero. Developments concerning unilateral documents declaring that assets acquired by the author of the document are held by their owner as trustee are discussed under the label of 'fiducia statica'. See Lipari, 'Fiducia statica e trusts', Rass. dir. civ., 1996, 483; Cass., 7 August 1988, n. 4438; Cass., 18 October 1988, n. 5663, Foro it., 1989, I, 101, and subsequent cases.

[205] An English translation of this fundamental text is available on the website of the Italian regulator Consob: www.consob.it.

[206] D. lgs. 24 February 1998, n. 58, art. 1.5. For the definition of financial instruments see art. 1.2 of the same text.

[207] D. lgs. 24 February 1998, n. 58, art. 21.2. Among portfolio managers, *società fiduciarie* (whose history goes back to the 1930s) have traditionally offered nominee and asset management services for their clients. If they perform porfolio management services they must be authorised in accordance with lgs. 24 February 1998, n. 58. It appears, however, that only *società fiduciarie* can hold financial instruments in their own name, on behalf of the clients. See on this point Miola in Campobasso, ed., *Commentario al testo unico della finanza*, I (2002), 176 ff., 178–179.

[208] Annunziata, *La disciplina del mercato mobiliare* (2003), 79.

If the negative opinion is followed, i.e. if an investment firm can only manage assets which are financial instruments, Sam may have to conclude contracts with different service providers to be sure that the portfolio of investments can include immovables as well, or he may have to contract with a management company, which will delegate investment management of financial instruments to an authorised investment services firm.

Alternative 1

The issues arising in Case 1 are first examined with reference to the Civil Code provisions on the contract of mandate, and in particular, to the mandate without power of representation. This first part of the answer covers the case of investment services that are not offered to the public. The second part of the answer covers the hypothesis of investment services that are offered to the public on a professional basis, which probably better corresponds to the factual pattern of the case.

Several Civil Code articles regulate the termination of a mandate. These include art. 1722, which lists the causes of termination of the mandate, and arts. 1723 and 1725, which deal with the revocability of the mandate. Under art. 1722 the contract of mandate is terminated (inter alia) by revocation on the part of the mandator, or by renunciation on the part of the mandatary. Pursuant to art. 1723 CC, the mandator can revoke the mandate, but if it was agreed that the mandate should be irrevocable, he is liable for damages, unless revocation is made for a just cause. On the other hand, a mandate given in the interest of the mandatary, or of third persons, is not extinguished by revocation of the mandator, unless it is otherwise agreed, or unless there is a just cause for such revocation; nor is it extinguished by the death or supervening incapacity of the mandator. According to art. 1725, which covers the revocation of a non-gratuitous mandate, the revocation of a mandate given for a specified period of time, or for a specified transaction, renders the mandator liable for damages, if the revocation was made before the expiration of the time limit, or before the completion of the transaction, unless there is just cause for the revocation. Similarly, in the case of a mandate for an indefinite time, revocation makes the mandator liable for damages if no adequate advance notice is given, unless there is just cause for the revocation.

To summarise, a mandate can be terminated in accordance with its terms. If it is agreed that it is irrevocable, or that it will last for a definite period of time, early termination is nonetheless available in the case of a just cause (i.e. breach by the mandatary of the obligations imposed on him by the law or by the contract of mandate).[209] Early termination of the contract may also occur absent a just cause for revocation, even though the parties agreed that the contract was to be irrevocable. This is so because (except where the contract was concluded in the interest of the mandatary or of a third party) the mandator has the power to terminate the contract at any time, even though the mandate is said to be irrevocable or was concluded for a definite period of time. In that case, however, if the mandator does terminate the mandate early, he is bound to pay damages to the mandatary.[210] It follows that the mandate is truly irrevocable only if it was in the interest of the mandatary or a third party, and even here, it is revocable if there is just cause.

Turning to the facts of the case, let us consider first whether Sam could claim termination of the contract for just cause. In our case, there is no clear indication that the mandatary has committed a breach of contract. However, the contract of mandate is often classified among the contracts which are concluded *intuitus personae*. In those contracts there is a relationship of trust between the parties, which usually requires personal performance of the contract.[211] This is why supervening lack of confidence in the honesty of the mandatary could justify the termination of the contract. However, in determining whether certain facts will constitute just cause for the termination of the mandate, the courts look also to general principles governing breach of contract, and in particular to art. 1455 CC. According to this article, conduct that constitutes only a minor violation of contractual duties cannot amount to a breach which allows termination of the contract.[212] More specifically, contract termination for just cause is available only if certain, unambiguous and unquestionable events, which are prejudicial to the interest of Sam, are identified.

[209] Luminoso, *Mandato, Commissione, Spedizione* (1984), 452, 463 ff.; Nanni, *Dell'estinzione del mandato: art. 1722–1730* (1994), 128 ff., 131 ff., with citations to cases.

[210] Art. 1723, first paragraph, CC.

[211] See, e.g., Santagata, *Del mandato: delle obbligazioni del mandatario, delle obbligazioni del mandante: art. 1710–1721* (1998), 279 ff.; for a recent decision on this point: Cass., 22 July 1999, n. 7888. Arch. locazioni, 1999, 783. Note that pursuant to art. 1710 CC, the mandatary must communicate to the mandator any supervening circumstance which could cause the revocation or modification of the mandate.

[212] Nanni, *Dell'estinzione del mandato*, 66 ff. Cass., 16 October 1984, n. 5209, Arch. civ., 1985, 591.

In Case 1, Sam does not know whether the allegations made by the newspaper are true. Therefore there is no certain, unambiguous and unquestionable event prejudicial to the interests of Sam that would allow termination of the contract for just cause, unless the publication of the newspaper article is by itself that event. This last possibility must be ruled out on the facts, inasmuch as the report, if uncorroborated by other facts, is not sufficient to establish dishonesty, or the appearance thereof.

Having said this, Sam may always proceed to early termination of the contract, but he will have to pay damages to John (i.e. John's loss of earnings which he suffers as a consequence of the early termination of the contract of mandate).[213]

Sam's claims will be dealt with as follows: (a) the judicial declaration that the relationship is terminated will be obtained by filing an appropriate claim against John; (b) an interim injunction against further transactions is also available as a remedy in the event of termination of the contractual relationship; (c) an audit of the previous period is available as a matter of course;[214] (d) restitution of the managed assets is also available upon declaration of termination of the contractual relationship; (e) damages are not available because the contract of mandate was terminated without just cause.

The outcome of the case will be substantially different if John's management services are offered within the framework of the d. lgs. 24 February 1998, n. 58, *Testo unico dell'intermediazione finanziaria*. Under art. 24 of that text, a contract for the management of investment portfolios cannot be irrevocable.[215] Any term that stipulates that the management contract is irrevocable is null and void at the instance of the client of the investment firm. Accordingly, Sam can at any time withdraw from the contract without having to pay damages to John for early contract termination. The remedies available under the general

[213] This would be a proportion of the fee calculated for the three remaining years of the services carried out by John (Cass., 15 October 1992, n. 11283).

[214] Art. 1713 CC provides that the mandatary shall render an account of his activities to the mandator and shall turn over to him all that he has received as a result of the mandate. On this duty see Minervini, *Il mandato, la commissione, la spedizione* (1954), 90 ff.; Luminoso, *Mandato*, 346 ff.

[215] Consob regulation, 1 July 1998, n. 11522, implementing the provisions on intermediaries of the d. lgs. 24 February 1998, n. 58, art. 37, lett e provides that contracts with investors must specify that the investor may withdraw from the contract at any time or order the transfer or withdrawal of all or part of his or her assets without prejudice.

law of mandate mentioned above are also available if the case falls under the provisions of the d. lgs. 24 February 1998, n. 58.

Alternative 2

Sam's instructions were not complied with; this constitutes a just cause entitling him to terminate the contract of mandate with John. This conclusion is based upon John's violation of the duty to perform the contract diligently, which includes the duty to perform the contract in accordance with the mandator's instructions (arts. 1176, 1710; see also arts. 1175 and 1375 CC on good faith and fair dealing in the performance of obligations and contracts).

In any case, even assuming that no breach of contract occurred in this case, Sam can terminate the mandate, notwithstanding agreement to the contrary, on the basis of the Civil Code rules on revocation of the contract of mandate (discussed above, in Alternative 1). Having terminated the contract, Sam will be able to recover the immovable from Elinor, though his right to recover the immovable is personal, not real. The crucial step is to secure the claim to restitution of the land from John, as a consequence of contract termination, through a timely registration of the pending land action in the register of land transactions (arts. 1706, 2652 CC). If the claim is promptly registered, Elinor will acquire the immovable subject to Sam's right to recover it. If Sam's claim is not registered before the transfer of title to Elinor, Sam will pursue his right by bringing against her a tort claim under the general tort provision of art. 2043 CC. The solution of the case, in this hypothesis, will be more uncertain. It will essentially depend upon proof of the fact that Elinor was fully aware of Sam's right to recover the immovable when she bought it, to the point that her behaviour amounts to malice. In that case, Sam has the right to obtain compensation from Elinor, because the acquisition of the land was wrongful, but restitution in kind will be denied.[216]

Alternative 3

As a rule, the mandatary must follow the mandator's instruction. Therefore, the mandatary is bound to comply with the specific instructions of the mandator, even though he would have done otherwise. The

[216] Cf. Cass., 20 October 1983, n. 6160; see also Cass., 22 November 1984, n. 6006; Cass., 8 January 1982, n. 76, Foro it., 1982, I, 1, 1548, n. Pardolesi; Giur. it., 1982, I, 1, 1548, n. Cirillo; Giust. civ., 1982, I, 607; Resp. civ. prev., 1982, 174, n. Benacchio. Monateri, *La responsabilità civile* (1998), 631 ff.; Monateri, in Bussani and Palmer, eds., *Pure Economic Loss in Europe* (2003), 364–365.

power to deviate from the instructions imparted by the mandator is introduced by art. 1711 CC for the case of circumstances unknown to the mandator, that cannot be communicated to him in time. In that case, the mandatary can deviate from the mandator's instruction if he was reasonably convinced that the mandator would have approved such deviation. In any other case, if the mandatary refuses to carry out the purchase as instructed, the mandator can terminate the contract for breach (arts. 1710 and 1375 CC).

Here the mandatary has full investment powers and those powers are stated to be irrevocable for a five-year term. Does this mean that the general rule is derogated from, and that the mandatary is not obliged to follow the instructions given by the mandator? If the mandatary had a special interest in the performance of the contract this derogation could not be ruled out. But no such interest is at stake here.

Therefore, the mandatary has to follow the mandator's instruction, though he advised him to the contrary. It should be kept in mind, however, that the mandatary has the power to terminate the mandate, without incurring liability for breach, by a timely renunciation of it (art. 1727 CC),[217] unless the five-year term was stipulated in the interest of the mandator as well. But, once more, in our case there is no clear indication that the five-year term was agreed in the interest of the mandator. As termination of the contract puts an end to the obligation of acting upon the mandator's instruction, this means that the mandatary has an alternative to the course of action required by the mandator.[218]

Luxembourg

Investment management (*gestion de fortune*) is a regulated profession under Luxembourg law. According to art. 24B of the Law dated 5 April 1993 on the financial sector (the '1993 Law'), any person whose profession involves the management, on a discretionary and individualised basis, of investment portfolios containing one or more financial instruments[219] in the framework of a mandate agreement given by investors, must be authorised under the financial sector legislation. The Minister

[217] Art. 1727 CC specifies that timely termination of the contract means that renunciation of the mandate should leave to the mandator sufficient time to pursue the desired result by other means. See Nanni, *Dell'estinzione del mandato*, 176 ff.

[218] If John is an investment firm regulated by the d. lgs. 24 February 1998, n. 58, he will not be obliged to obey the mandator's instruction concerning an unsuitable operation. See Consob regulation, 1 July 1998, n. 11522, art. 29.1.

[219] Article 24B defines financial instruments by reference to Annexe II, Part B of the 1993 Law.

who has jurisdiction over the financial sector[220] grants this authorisation on the basis of a certain number of conditions laid down by arts. 13 ff. of the 1993 Law, which pertain generally to the financial resources of the applicant, the reputation and experience of its shareholders and directors/managers, and its internal organisation.

The profession of investment management implies the handling of third party funds. This is limited to corporations,[221] which must have a minimum share capital of €620,000.[222] The authorisation to act as an investment manager automatically carries the authorisation to provide investment advice and to carry out brokerage and dealer activities.[223] Investment managers authorised under Luxembourg law are 'investment undertakings' within the meaning of the 1993 Investment Services Directive. Credit institutions within the meaning of Directive 2000/12/EC are also authorised to undertake this activity.

The Law does not prevent investment managers from investing the funds of investors in assets other than financial instruments, such as real estate. Investment managers that do not deal with financial instruments are not specifically regulated, and do not fall under the law of the financial sector. They are, however, subject to authorisation under a general law on access to professions dated 1988. Conditions as to corporate status, minimum capital, professional experience and/or appropriate titles for the profession are set depending on the type of profession and activity involved.

According to the above, the assumption is that John's business is carried on by John SA, a Luxembourg *société anonyme*[224] that is duly authorised to carry out the profession of investment manager under the 1993 Law. Under Luxembourg law, Sam will be considered to have entered into a contractual relationship with John SA, which will, unless otherwise decided by the parties, be considered a contract of mandate (*contrat de mandat*),[225] as regulated by arts. 1984–2010 of the Luxembourg Civil Code.[226]

[220] Currently the Minister of the Treasury.

[221] Art. 17 of the 1993 Law.

[222] Art. 24B(2) of the 1993 Law (as amended by a law dated 2 August 2003).

[223] Art. 24B(3) of the 1993 Law.

[224] Public limited company, the type of company which would most naturally be used for this purpose.

[225] Article 24B(1) defines the profession of investment manager expressly by reference to a mandate. Also TA Luxembourg, 23.12.1992, Pas. 29, 48.

[226] The Luxembourg Civil Code originates from the Code Napoléon as adopted in 1804 and introduced in Luxembourg, then part of France. Even after Luxembourg's independence in 1815, the Civil Code was maintained in its original form, and still bears today a very strong resemblance to the French Civil Code. French law (in

According to art. 1988 CC, a mandate expressed in general terms,[227] such as the mandate to buy and sell any kind of asset, only empowers the mandatary to engage in acts of administration. The mandatary is not permitted to dispose of any assets, and hypothecations would require express authority. Modern case law and legal writing, however, focus attention on the economic characteristics of the action to be taken, and its importance for managing the assets of the mandator.[228] In other words, not all acts of disposal are excluded in a general mandate, but only those that terminally affect the estate under management. Therefore, a mandate expressed in general terms encompasses the power to buy and sell financial instruments and similar investments, in the framework of a general investment policy. This will also be provided for expressly in the agreement itself, which generally gives discretionary powers to the investment manager.

Traditionally, a mandate is always considered to be a contract of representation and therefore to include a power of attorney to take actions in the name of and on behalf of the principal. A specific power of attorney is not required, but included in the terms of the mandate. A mandate is however sometimes also construed today as a contract mainly for the provision of services with little or no legal representation.

Alternative legal forms are all other forms whereby one person represents another person. These include the *commission*, often used in commercial transactions, whereby one person acts in his or her own name, but on behalf of the principal (i.e. the representation is undisclosed), or a *convention de prête-nom*, where the name of the principal is also not revealed.

As an alternative, the relationship could be organised as a *fiducie* under the law dated 27 July 2003 on trusts and fiduciary contracts,[229] if the fiduciary is a qualifying institution (which includes all regulated professionals of the financial sector). This would involve transfer of title to the fiduciary and complete segregation in case of insolvency of the fiduciary. This is sometimes used for the management of a portfolio (*fiducie-gestion*), but the mandate is the more frequent way (although

particular case law and legal writing) is a strong source of inspiration for Luxembourg courts, as is Belgian law.

[227] The Civil Code also refers to the ‘general mandate’, which is the mandate covering all business of the mandator as opposed to a special mandate only covering one or more particular actions.

[228] Philippe Pétel, *Les obligations du mandataire* (Litec, 1988), 44, no. 42.

[229] This law has replaced the 1983 Grand-Ducal Regulation on fiduciary contracts by credit establishments.

with the extension of the scope by the 2003 Law, such use may become more frequent). The fiduciary will act in his or her own name.

Alternative 1

According to art. 2004 CC, the mandator may at any point in time revoke the authority given to the mandatary and force him to surrender any document establishing such power of representation. Luxembourg courts protect this right of immediate revocation (*révocabilité ad nutum*). Thus, even a mandate given for a predetermined period of time and expressly termed 'irrevocable' by the parties[230] can be revoked at any moment by the mandator, and the mandatary will automatically lose all power of representation towards third parties.[231] The rationale for this provision is the protection of the mandator, and the relationship of faith that must exist between mandator and mandatary.

Sam, who revokes John SA's mandate because of allegations regarding the involvement of John SA in the trafficking of stolen works of art, has taken away any power of representation from John SA. The mandator is obliged to notify the revocation to third parties who are dealing with the mandatary, in order to be sure that he can rely on the revocation of the mandate. This only applies where such an individual notification is possible, i.e. where there are one or more identifiable third parties.

Sam may be liable to John SA if the revocation is made without notice, or if the revocation itself constitutes a negligent act under the general principles of civil liability.[232]

The abrupt termination on the basis of unfounded speculations in the press, without any prior discussions between Sam and John SA, and in the absence of any prior criticism of the management services of John SA, may be considered negligent behaviour (*faute*). John SA may claim damages for revenues lost, reputational damage, and any other loss caused by the unlawful revocation either on the basis of the general

[230] Malaurie and Aynès, *Les contrats spéciaux* 14th edn (Paris, 2003), no. 556: even the so-called 'mandate in a common interest' (*mandat d'intérêt commun)* can be revoked, but the burden of proof to establish a valid reason for the revocation is transferred to the mandator. In John SA's case, the mandate would however not be considered to be in a common interest: a salary earned by the agent is not sufficient to create a common interest (ibid., no. 557).

[231] TA Luxembourg, 16.12.1925, Pas. 11, 306; CA Luxembourg, 22.2.1984, Pas. 26, 153. Note, however, that under the new fiducie law passed in 2003 (see text above at note 229), the *fiduciant* may give up his power to give instructions to the *fiduciare*.

[232] TA Luxembourg, 16.12.1925, Pas. 11, 306; TA Luxembourg, 22.1.1947, Pas. 14, 285.

obligation to perform contracts in good faith (art. 1134 para. 3 CC, i.e. liability in contract), or on the basis of abuse of law (*abus de droit*) (art. 6–1 CC).

According to Luxembourg law, Sam's claims will be dealt with as follows. Luxembourg courts are in principle not willing to make declarations regarding the termination of contractual relationships or to grant injunctions for the future. The court may, however, pronounce the termination of a contract where the court's intervention is required by law. However, intervention is not required in situations involving the revocation of a mandate, since the right to unilateral termination is provided for in the Civil Code.

It is unlikely that a Luxembourg court will enjoin a defendant from carrying out any further transaction related to the assets, unless the defendant has already done so. In such a case, Sam would be able to sue for an injunction and couple it with a fine (*astreinte*) that would protect Sam, through summary proceedings (*référés*), against a violation of the order. If this route is adopted, then a full audit and damages will not be granted. The injunction can also be sought in substantive proceedings where a full audit and damages can be claimed.

Sam is entitled to the full audit of the previous period up to the date of the judgment. The mandatary must provide a full audit of his management activities, and an account for any sums he received in relation to the execution of the mandate, even if they are not directly due to the principal (art. 1993 CC).

Sam is also entitled to the restitution of any assets held by John SA pursuant to the execution of the mandate. John SA holds these assets on the basis of an implied deposit agreement (*contrat de dépôt*). This implies an obligation of immediate restitution of the assets held on account.[233] Under certain circumstances, this obligation is subject to the right to withhold a certain part thereof to cover any outstanding payment obligations (*droit de rétention*),[234] or the right to set off the amounts to be returned against any claims that John SA has against Sam.[235]

If Sam can show a breach of a contractual obligation, a loss, and a causal link between the obligation and the loss, then Sam may also claim damages against John SA under contract law. Article 1992 CC

[233] Trib. Arb. Esch/Alzette 14.7.1980, Pas. 25, 37; CA Luxembourg, 15.7.1997, no. 18656 (unpublished).

[234] Art. 1948 CC.

[235] TA Luxembourg, 24.1.1997, no. 72/97 (unpublished).

indicates that the mandatary is liable not only for any intentional misconduct, but also for his simple negligence. Salaried (and professional) mandataries are held to a higher standard of care.

John SA's counterclaim regarding the maintenance of the management powers for the remainder of the five-year period will be rejected. John SA is not entitled to continue the execution of the mandate or to claim a judicial declaration in this respect, even if the mandate was provided to be irrevocable and for a predetermined period of time, if the revocation was completely unfounded or if a negligent act was committed by Sam.[236] The right to terminate the mandate *ad nutum* is absolute.

However, if the revocation is a result of wilful or negligent misconduct, then Sam may be held liable for the loss suffered by John SA from the termination of the agreement. The abrupt and brutal termination of the mandate on the basis of an unfounded speculation in the press, without any discussion between Sam and John SA, and in the absence of any prior complaints about John SA's management, may be considered wilful or negligent misconduct. John SA may claim damages for lost revenues, damage to reputation, and any other loss that is causally linked to Sam's misconduct.

Alternative 2

According to Luxembourg law, the sale of real estate constitutes a two-step process. While both the buyer and the seller are validly bound by their oral or written agreement (subject to rules of evidence), the transfer of property of the land is not complete, *erga omnes*, until the sale is duly recorded in the appropriate public records. In order for the transfer to be recorded, the sale must be documented by a notarial deed. For the sale of a piece of real estate through a mandatary, a special and express proxy is required. The notary public is obliged to verify the powers of each participant to the deed. Therefore, in principle, the situation described may not arise in relation to the sale of real estate. It will be assumed instead that John SA is selling a large shareholding belonging to Sam, and that all other circumstances remain unchanged.

According to art. 1998 CC, the mandator is bound by all the obligations contracted by the agent in so far as the mandatary has not acted

[236] TA Luxembourg, 22.1.1947, Pas. 14, 285 (an insurance company terminated an agreement with a representative for no apparent reason other than mere convenience: damages were awarded to the representative for the loss suffered).

beyond the powers conferred to him. He is not bound by a transaction that goes beyond these powers, unless he has ratified the transaction either expressly or implicitly.

Third parties can, in principle, rely on the powers of the mandatary to conclude the transaction in question. In specific cases, they may be obliged to verify the specific powers of the mandatary. If the third party receives explicit warning from the mandator that the latter prohibits the mandatary to carry out the transaction at the proposed price, which is the case with Elinor, then the third party that nevertheless contracts with the mandatary is said to be in bad faith.[237] The mandator could then rely on the general principle of fraud (*fraus omnia corrumpit*) to claim the nullity of the transaction.

Transactions are not enforceable if they are made beyond the powers of the mandatary, or, as in this case, against the express instructions of the mandator with the notification of the third party. The third party has no action for forced execution against the mandator, and if the transaction has already been carried out, then the mandator can claim the asset since the transfer of property to the third party is not enforceable. During this process he can argue the nullity or non-enforceability of the transaction.

John SA may be held liable in contract to Sam for any loss caused by breach of the express instructions. John SA may also, depending on the circumstances, be held liable in tort against the third party for any loss suffered by the non-enforceability of the transaction. In this case, however, Elinor probably has no claim against John SA, due to her knowledge of Sam's instructions.

Alternative 3

Irrespective of the discretionary nature of the general investment management mandate, if John SA receives specific instructions from Sam regarding a particular transaction, either as to the nature of the transaction or as to the specific conditions thereof, or both, he is obliged to comply with the express instructions that supersede the general mandate.[238] He must execute the transaction as instructed, and may not go beyond or against the precise orders.

[237] CA Luxembourg 30.7.1920, Pas. 11, 1: the situation here was even less clear-cut: despite a prima facie power of representation, the court held that the price of the transaction was so ludicrous, that it must have been obvious to the counterparty that the agent was acting outside his mandate.

[238] Pétel, *Les obligations du mandataire*, 49, no. 56.

However, if the agreement between John SA and Sam excludes the right to give personal instructions, which is frequently the case in discretionary portfolio management agreements in the banking and financial area, John SA can rely on the contract to refuse performance. Other agreements of this type do provide for a different regime for these transactions, in particular in relation to the liability of the manager.

However, the courts have held that professional investment managers, like John SA, have a particular obligation to advise their clients on transactions which they are asked to carry out. As an investment manager, John is only held to an obligation of means (*obligation de moyens*); in other words, he has a duty to manage with due diligence, but not a duty to achieve any particular outcome. If John SA receives a specific and express order from the mandator, then the special mandate supersedes the general mandate. Depending on the degree to which the mandator has experience and knowledge of the market, John SA is obliged to make the mandator aware of any risks involved with the transaction. More specifically, John SA should advise that a particular investment is bad or unsuitable, in the light of the investor's profile. Some courts have even held that a professional has the obligation to refuse to carry out a transaction if a mandator is acting in an absurd or entirely irresponsible way. In the case of a professional investment manager, these obligations also stem from arts. 35 ff. of the 1993 Law and a Circular Letter of the Luxembourg supervisory authority (Circular CSSF/2000/15).

Article 37, in particular, requires investment managers[239] to act in the best interest of their clients; to know their financial situation and their investment objectives; and to know their experience in the market. These rules, introduced at the time of the implementation of the Investment Services Directive (ISD), reflect important developments in case law with respect to the duty to inform and advise the client.

If John SA relies on the duty to prevent irresponsible acts and refuses to implement Sam's request, then Sam may seek damages if he can demonstrate that this refusal caused him a loss (such as the loss of an investment opportunity). He must, however, show that John SA has acted negligently or intentionally in refusing the transaction. Given the recent evolution towards a duty of interference with irresponsible orders of clients, a professional who refuses to carry out the transaction on the basis of valid reasons should not be held liable.

[239] As well as banks and other professionals in the financial sector.

Sam may not obtain an injunction to force John SA to carry out the transaction, under the general principle that a breach of a contractual obligation only entitles the claimant to damages, since a person cannot be forced to act in a certain way except in specific circumstances where positive action by the debtor is required.[240] He may also revoke the mandate and carry out the transaction himself or with another manager.

Netherlands

Investment in securities

Under Dutch law, a professional investment manager offering services in or from the Netherlands and acting as either a broker in securities transactions (*effectenbemiddelaar*) or a portfolio manager (*vermogensbeheerder*) qualifies as a securities institution (*effecteninstellingen*) and thus must obtain a licence from the Minister of Finance.[241] The Minister of Finance has empowered the *Autoriteit Financiele Martken* (Netherlands Authority for the Financial Markets (AFM)) to grant the licences. The exact requirements are laid down in the *Wet Toezicht Effectenverkeer* 1995 (1995 Act on the Supervision of the Securities Trade (ASST 1995)),[242] which is accompanied by regulations.[243] AFM supervises brokers and portfolio

[240] One application is art. 1142 CC: the failure to execute any obligation to do (or not to do) something only entitles the creditor to damages.

[241] There are some exceptions to this rule. No licence is required for securities institutions which are already under supervision because of another Dutch law other than the ASST 1995 (insurance companies), central banks, foreign securities institutions with a European passport (implementation of the Directive 93/22/EC), institutions which offer their services mostly within a closed circle (family corporations, pension funds for a specific company), institutions which offer securities services on an incidental basis in the course of ordinary business (art. 7 ASST 1995). Also art. 10 provides possible generic exemptions. See also Case 9.

[242] Stbl. 1995, 574, last changed in 2003, Stbl. 10. This Law incorporates the Directives 93/22/EC, OJEC L 141 (Investment Services) and 93/6/EC, OJEC L 141. See Niels R. van de Vijver, *Securities Regulations in the Netherlands* (The Hague: Kluwer Law International, 2000); C. M. Grundmann-van de Krol and F. J. P. van den Ingh, *Parlementaire geschiedenis van de Wet toezicht effectenverkeer 1995* (Deventer: Kluwer, 1996); F. H. J. Mijnssen et al., eds., *Geldige effecten* (Nederlands Instituut voor het Bank- en Effectenbedrijf (NIBE), 1999); C. M. Grundmann-van de Krol, *Koersen door het effectenrecht*, 5th edn (Deventer: W. E. J. Tjeenk Willink, 2004) (Grundmann-van de Krol, 2004). See, for more information (also in English), the website of the Netherlands Authority for the Financial Markets (http://www.afm.nl/).

[243] *Besluit toezicht effectenverkeer* 1995 (Bte 1995) (Decree on the Supervision of the Securities Trade 1995; DSST 1995), Stbl. 1995, 623; 1997, 703; 1998, 515; *Nadere regeling gedragstoezicht effectenverkeer 2002* (NRgt 2002) (Further Regulations on Market Conduct Supervision of the Securities Trade 2002; FRMSST 2002), Stcr. 1999,12; and *Nadere regelgeving prudentieel toezicht effectenverkeer 2002* (NRpt 2002) (Further Regulations on Prudential Supervision of the Securities Trade 2002; FRST 2002), Stcr. 2002, 178 (see www.dnb.nl).

managers in the conduct of their business, which involves nearly all behaviour of these professionals. A small part of the supervision is in the hands of the Dutch Central Bank. It supervises the solvency of licencees (that is, prudential supervision: see Case 9).

A broker under the ASST 1995 is (a) someone who acts as a broker in the conduct of a profession or trade in the execution of transactions relating to financial instruments;[244] or (b) someone who professionally offers a facility to obtain receivables by opening investment or giro accounts, whereby transactions in financial instruments can be effected by means of these accounts (*beleggings of effectengiro's*); or (c) someone who acts as a market maker, that is, someone who executes transactions relating to financial instruments for his own account, other than by issuing securities, in order to maintain a market in securities or to make profits on the difference between the demand and selling prices of securities; or (d) someone who acts as an underwriter; or (e) someone who concludes interest rate, currency or equity swaps, or similar agreements as a broker.[245]

Second, a portfolio manager under the ASST 1995 is someone who, in the conduct of a profession or trade pursuant to an agreement, manages financial instruments or monies that will be invested in financial instruments for a client. This includes the transmission of financial instrument orders to other securities institutions in the name of and for the account of the client, and the execution of or the causing of the execution of transactions relating to financial instruments for the account of the client.[246] This definition does not cover collective investment management, but rather individual portfolio management.

In Case 1, it is assumed that the manager falls under the definition of portfolio manager (*vermogensbeheerder*) in art. 1 sub c ASST 1995 as long as he invests money in securities or concludes the interest rate, currency or equity swaps or similar agreements. The second presumption is that he does not fall under a licensing exemption.[247] With an amount of €2,000,000, it can be expected that at least some of the money will be invested in securities.[248] To obtain a licence, the professional investor

[244] This term denotes securities as referred to in art. 1(a) ASST 1995 and interest rate, currency or equity swaps or similar agreements.

[245] Art. 1 sub b ASST 1995.

[246] Art. 1 sub c ASST 1995.

[247] See above, note 241.

[248] In practice it hardly ever occurs that a non-institutional securities institution, such as a small broker or portfolio manager, as well as investing in financial instruments also invests in (im)movables. For large institutional securities institutions this is different. Their investments will cover everything that can be invested in.

has to fulfil several requirements which follow from Directive 93/22/EC and which are laid down in art. 7 ASST 1995 and the FRMSST 2002 and FRST 2002. A securities institution must have the necessary expertise and reliability; must provide financial safeguards; must fulfil certain requirements in the field of the administration of the office and relating to the seat of the main office; must comply with certain rules relating to the information that is provided to the public; and must provide safeguards for adequate supervision in compliance with a number of rules, including the ASST 1995.

The professional investment manager in Case 1 may even qualify as a broker, depending on how he invests the €2,000,000. Requirements for a broker licence are in some cases stricter than those for a portfolio manager. In both cases the ASST 1995 does not require that a legal person such as a limited company carry out the activities. However, in practice this will nearly always be the case. In Case 1, the situation described is in accordance with standard practice, that is, John is one of the managing directors of a *Besloten Vennootschap* (private company). The Directive, and thus Dutch legislation, requires at least two directors to ensure the continuity of the business.[249]

Both forms of securities institutions require that the investor or the managing director(s) of the investment institution have the necessary expertise and be reliable.[250] In general, the AFM will demand specific knowledge of securities, and at least two years of experience in management.[251] The Minister of Finance has made the following remarks with respect to the term 'reliability'.[252] The personal reliability of the securities institution must be beyond any doubt. Whether *mala fide* acts or participating in tax evasion will be sufficient to constitute loss of reliability will depend on the circumstances. If a person wilfully breaks the law, this will certainly cast doubt on his reliability. The AFM will refuse a licence to a person who has a criminal past with respect to the securities trade.

[249] Art. 3 sub 3 93/22/EC, art. 7 sub 4 sub c ASST 1995. The Netherlands Authority for Financial Markets may accord a different arrangement if in the corporation with only one director enough precautions are taken to ensure a decent administration (art. 14 DSST 1995 and the Policy Rules 99–0004 STE (now AFM)). In its decision the Netherlands Authority for Financial Markets must explicitly take into account the nature and scale of the activities of the securities institution.

[250] Art. 7 sub 4 sub a ASST 1995 and art. 10 DSST 1995 and the Policy Rules 99–0004.

[251] College van Beroep voor het bedrijfsleven 3 juli 1997, *Jurisprudentie Ondernemingsrecht* 1997/100, note Grundmann-van de Krol.

[252] Second Chamber 1988–1989, 21038, no. 6, 27–28. See also art. 10 DSST 1995.

It is also presumed that John BV has a licence (see above). Dutch legal writers are divided on the question of what the effect is of not having a licence: is the agreement with John BV void or voidable, or has Sam only a claim for rescission and damages? Some also argue that the contracts John BV concluded with third parties would be void if he did not hold a licence.

The Securities Giro Administration and Transfer Act

In 1977 Dutch law adopted a system in which the risk of insolvency was reduced to a minimum for brokers that make collective investments. In that year, the Securities Giro Administration and Transfer Act 1977 (SGTA 1977)[253] was introduced to give clients who invested in securities a better position vis-à-vis the investment institution. The system of the SGTA 1977 is as follows. Clients do not have any individual rights in the securities; rather, they are joint owners *pro rata*, with regard to the quantity deposited, of the bearer securities and everything that replaces those bearer securities (insurance claims for lost securities, claims in tort). The securities are held in a collective deposit. This deposit can be at an institution, which has been admitted as a member institution by the central institute, the Necigef.[254] It can also consist of the balance of an account that the member institution has with another member institution. A third possibility is that the deposit is at the central institute, the Necigef (where in practice most of the securities are physically present).[255] As a result of the SGTA 1977, the collective deposit does not form part of the patrimony of the member institution (usually a bank).[256] Each joint owner of a collective deposit has a claim *in rem* against the member institution entitling the owner to demand delivery from the jointly owned collective deposit of the quantity of securities deposited. These need not be the same physical securities or the same denominations.

[253] *Wet Giraal Effectenverkeer* (Wge), as amended in 2000 (Stbl. 2000, 485).

[254] *Nederlands Centraal Instituut voor Giraal Effectenverkeer BV*.

[255] Art. 10 SGTA 1977.

[256] W. A. K. Rank, 'Custody of Securities in the Netherlands', In D. J. Hayton, S. C. J. J. Kortmann, A. J. M. Nuytinck, A. V. M. Struycken, N. E. D. Faber, eds., *Vertrouwd met de trust, Trust and Trust-like Arrangements*, deel 5 (Deventer: W. E. J. Tjeenk Willink, 1996), 319–338; E. B. Rank-Berenschot, 'Het Wge-aandeel: een recht op naam van eigen aard', in S. C. J. J. Kortmann et al., eds., *Onderneming en effecten* (Deventer: W. E. J. Tjeenk Willink, 1998), 149–167.

To be admitted as a member institution, the company must be a bank or a broker that qualifies as a credit institution under the Act on the Supervision of the Credit System (ASCS),[257] and it must engage in securities custody and administration for third parties. The securities are only transferred by book-entries. Delivery of the physical underlying bearer securities does not exist. The accounts with the Necigef are in the name of the member institutions. There is no relation between the Necigef and the clients of the member institutions. The accounts at the member institution can be in the name of the clients. They will have an agreement with the member institution and with their broker. Finally, another possibility is that the account at the member institution is in the name of a broker who invests for his clients.

Apart from the ASCS system, banks have set up two additional systems to safeguard the rights of investors, called VABEF I and VABEF II. Under these systems a bank creates a special purpose company that is low risk as a result of its limited purpose, and this company holds securities in safekeeping for the bank's clients and the bank itself. The VABEF I system was set up before the ASCS. The former continued to be useful even after the introduction of the ASCS system since not all bearer securities were eligible to be admitted to the ASCS system. The VABEF II system was set up to provide a safe investment method for both bearer securities held outside the Netherlands and for registered securities.[258] Also, in these cases the insolvency of the credit institution will not affect the rights of clients who have invested in securities through these credit institutions.

It will be assumed that the broker or portfolio manager is not the member institution. A distinction can be drawn between a situation in which the account with the member institution is in the name of the broker or portfolio manager, and a situation in which the account is in the name of the client, the broker or portfolio manager having only a power of attorney which allows him to give directions to the credit institution in respect of the account. In the latter case, the insolvency of the broker or portfolio manager will not affect the client's rights towards the member institution with regard to the securities that are held by the member institution for the benefit of the client. It must be noted that under the requirements of the ASST 1995 and the FRSST 1999 the accounts with the credit institution must be in the name of the

[257] *Wet Toezicht Kredietwezen.*

[258] See Rank, *Custody of Securities*, 319–321, 323–336.

client (see the section titled *The contractual agreement between John BV and Sam*). Thus, the first situation is not likely to occur.

The contractual agreement between John BV and Sam

The contractual relationship between Sam and John has to be laid down in an agreement in writing.[259] This contract will have affinity with a contract for services and a contract of mandate.[260] The securities institution (the portfolio manager) will demand a power of attorney.[261] This power must be limited to the execution of the services agreed to by the portfolio manager and the client. The power of attorney must not grant any other powers to the institution that would enable the institution to hold the client's monies and/or securities on the latter's behalf. It must not be possible for the securities institution to draw on a client's account. The securities institution may not receive money or securities belonging to the client or hold them on behalf of the client. The securities institution will be obliged to ensure that the client opens a money and securities account in the client's name with a credit institution to ensure that the transactions are executed.[262] If the securities institution receives, in its own name, money or securities of a client, then the institution must immediately transfer the money and/or the securities to the client's account with the credit institution. Certain articles in the Civil Code concerning the contract of mandate are mandatory and thus the standard contract terms cannot derogate from these articles.[263]

The contract of mandate

The contract of mandate (*lastgeving*) is a contract for services whereby one party, the mandatary, binds himself towards the other party, the mandator, to perform one or more juridical (legal) acts for the account

[259] The obligation to have a written contract if the client is non-professional follows from arts. 25 and 26 DSST 1995 and arts. 27 and 43 sub 1 FRMSST 2002. See Grundmann-van de Krol 2004, 334–336.

[260] L. D. van Setten, *De commissionair in effecten* (diss. RU Utrecht), (Deventer: Kluwer 1998), 8, and Van der Grinten, Kortmann, Perrick, *Civielrechtelijke gevolgen Van handelen in strijd met effectenregelgeving: preadvies voor de Vereniging voor Effectenrecht 1994* (Deventer: Kluwer, 1996) 8.

[261] Art. 27 sub 1(g) FRMSST 2002.

[262] Art. 16 DSST 1995, art. 13 FRMSST 2002.

[263] See in general about Dutch contract law and property law in English: A. Hartkamp and M. M. M. Tillema, *Contract Law in the Netherlands* (The Hague: Kluwer, 1995); Chorus, Gerver, Hondius and Koekkoek, eds., *Introduction to Dutch Law for Foreign Lawyers* (Deventer: Kluwer, 1999).

of the mandator. The contract may oblige the mandatary to act in his own name, or to act in the name of the mandator (art. 414 Book 7 CC).

A contract of mandate is governed by the general rules on contract for services (contract of instruction, arts. 400–413 Book 7 CC),[264] and the special rules on the special type of contract for services, the contract of mandate (arts. 414–423).[265] In so far as these rules or the standard contract terms do not indicate otherwise, the general rules on contracts (Books 3 and 6) are also applicable. Arts. 400–423 are also applicable by way of analogy to all contracts (other than the contract of mandate) where one party has the obligation or the power to perform legal acts on behalf of the other party, in so far as the meaning of arts. 415–423 is not contradictory to this. As a result, every agreement that involves one party managing property for the benefit of another party will be governed by the rules that are applicable to the contract of mandate (art. 424 Book 7 CC).

The contract of mandate does not require a transfer of the assets, but it does not forbid it either. If the parties want to allow for the possibility that the mandatary acts not only in his own name but also in the name of the mandator, then the rules on power of attorney (*volmacht*) will be applicable (arts. 62 ff. Book 3 CC). It is also possible to give the mandatary an exclusive power over the assets. According to art. 423 Book 7 CC, the mandatary can be granted an exclusive or privative mandate (*privatieve last*). This article states that when the mandator and the mandatary have agreed that the latter shall be exclusively entitled to exercise, in

[264] *Overeenkomst van opdracht*. In a contract for services the one who has accepted the contract binds himself to perform duties outside any form of labour contract. The duties can be anything except the making of goods, the keeping of goods, the publishing of works or the carriage of persons and goods (by himself or by third persons). See Mr C. Asser's handleiding tot de beoefening van het Nederlands burgerlijk recht, *Bijzondere overeenkomsten*, deel 5-III, *Overeenkomst van opdracht, arbeidsovereenkomst, aanneming van werk*, S. C. J. J. Kortmann, L. J. M. de Leede, H. O. Thunnissen, 7th edn (Zwolle: W. E. J. Tjeenk Willink, 1994) (Asser/Kortmann 1994), nos. 33–125; H. L. E. Verhagen, *Agency in Private International Law* (The Hague: Martinus Nijhoff, 1995); S. Y. Th. Meijer, *Middellijke vertegenwoordiging* (Deventer: Kluwer, 1999) and K. F. Haak and R. Zwitser, *Opdracht aan hulppersonen*, SI-EUR-reeks no. 21 (Rotterdam: Gouda Quint, 1999) (Haak/Zwitser 1999), 83–114. See for a translation of Book 7: Peter C. Haanappel, Ejan Mackaay, H. C. S. Warendorf and Richard Thomas, *Netherlands Business Legislation* (The Hague: Kluwer, 1999) (it also contains a translation of Books 2 and 6 and the Bankruptcy Act).

[265] *Overeenkomst van lastgeving*. The contract of mandate requires a steady amount of legal acts to be performed by the mandatary. See Asser/Kortmann 1994, nos. 126–192; Meijer, *Middellijke verteganwoordiging* (1999), 7–15 and chapters 4 and 5; and Haak/Zwitser 1999, 115–143.

his name, rights belonging to the mandator, the mandator shall no longer be empowered to exercise the right himself. Third parties dealing with the mandator cannot be affected by this agreement in so far as they are not, or ought not to be, aware of the exclusive character of the mandate.[266]

According to art. 110 Book 3 CC, some assets that are bought by the mandatary in the course of the mandate will become part of the patrimony of the mandator.[267] Art. 110 Book 3 has two requirements: first, a relationship in which one person is acting on behalf of another person (this is not limited to contracts of mandate), and second, the assets must be acquired in the fulfilment of the relationship. However, it is important to note that art. 110 is limited to assets that are to be transferred by handing over possession (movables and negotiable instruments), and may not be applied to other assets even by way of analogy.[268] With respect to assets that are not covered by art. 110, the mandatary (the manager) will become the owner notwithstanding the contract of mandate and an additional transfer will be required in order to move the assets to the patrimony of the mandator. It is accepted that contracting parties can exclude art. 110, but only if they do so explicitly.

Alternative 1

It is necessary to draw a distinction between the assets in which the €2,000,000 will be invested. One possibility involves investment in securities or contracts for interest rate, currency or equity swaps or similar contracts: these will hereinafter be called 'financial instruments'. This term does not yet exist as an official term, but that will change soon with the coming into force of the Act on Financial Services, which also implements the Directive on Financial Instruments Markets. Another possibility involves investment directly in physical assets such as movables and immovables. In practice, it is not customary for a portfolio manager (other than an institutional investor) to manage investments other than financial instruments. A person who is

[266] The exact scope of the article is under debate. Does an exclusive mandate have as a result that the mandator (owner of the asset) will no longer be able to transfer the ownership of the asset to a third person who knew about the exclusive mandate?

[267] Art. 3:110 Book 3 CC reads: 'Where there exists a juridical relationship between two persons to the effect that what one of them will acquire in a specified manner will be detained by him for the other, the former detains for the latter what has been acquired by him in the performance of the juridical relationship.' See Haak/Zwitser 1999, 56–58.

[268] HR 23 September 1994, NJ 1996, 461 note Kleijn (Kas-Associatie/Drying).

obligated to manage assets other than financial instruments, within the meaning of ASST 1995, will do so under a contract of mandate. There is no special procedure for retaining the contract while replacing the manager. This may be different if the contract has been concluded with a company such that it is everyone's intention that a natural person, X, perform the actual service. In that case, art. 404 Book 7 is applicable. The company and person X are both responsible for performing the contract in good order, although only the company can terminate the contract. In such a situation it is probable that the client will request the replacement of person X without having to terminate the contract with the company.

Investment in financial instruments

Point a: termination

In Case 1, the terms of the document indicate that John's powers are to be irrevocable for a period of five years.[269] With respect to the contract of mandate, the mandator may terminate the contract at any point whether the mandator is a professional or a non-professional (art. 422 sub 2 and art. 408 sub 1 Book 7 CC). It is not necessary for the mandator to have a reason for termination and a notice period is not required. The nature of the contract, or simple reasonableness and fairness, may dictate that the contract cannot be terminated; however this is not applicable to the case at hand.[270] The court has no choice but to grant a declaration that the contract is terminated. In Case 1, a judicial declaration can be requested on the basis of art. 302 Book 3 CC.

There are other possibilities that are available, and it is up to the mandator to select and adopt a particular strategy. If the acts of the mandatary amount to a serious breach of contract, then the mandator may seek rescission of the contract (art. 265 Book 6 CC). Rescission can be accomplished by the mandator sending a written declaration to the mandatary (art. 267 sub 1 Book 6 CC), or by seeking a court decision (sub 2). In order to decide whether the implications against John are sufficient to establish that John has breached the contract in a way that justifies rescission, it is necessary to consider the specific wording of the contract and whether John BV lost his reliability (which is one of the

[269] It is presumed that John BV and Sam have concluded a written contract and that Sam has given a power of attorney to John BV with powers needed for the specific transactions.

[270] Asser/Kortmann 1994, nos. 105–106 and 172; Haak/Zwitser 1999, 106–110.

requirements of the licence: see section titled *Investment in securities*). Although the requirement for the licence is a matter between John BV and the Public Administration, it is accepted that the rules of conduct will have some impact on whether John should be considered to have acted as a prudent mandatary.[271] In Case 1, John's implication in the artwork scandal seems to indicate that he has not acted as a good and caring mandatary and this amounts to breach of contract. The last possibility involves the rescission of the contract on grounds of unforeseen circumstances (art. 258 Book 6 CC); however, this does not apply to the case at hand.

Point b: no further actions possible by John BV

By terminating the contract, the power of attorney is withdrawn as well. Under the requirements of the ASST 1995 and the FRMSST 2002, the accounts with the credit institution are in the name of the client (see the section titled *The contractual agreement between John BV and Sam*). The claim on the credit institution falls into the patrimony of the client and not into the patrimony of the investment institution. John BV is not the owner of the balance of the accounts. Therefore, termination of the contract is sufficient to bring about the withdrawal of the power of attorney. Generally, the mandate is not exclusive;[272] however, whether it is exclusive or not, the power of attorney will be withdrawn automatically upon termination of the contract. To be absolutely certain that the portfolio manager will cease to act with respect to the accounts, Sam should immediately inform the bank of the termination or, more drastically, close the accounts.

Point c: full audit

Art. 27 sub 2(e) FRMSST 2002 provides for the obligation to agree with the client in the written contract on the frequency of a regular audit to be given by the portfolio manager. The obligation and the minimum frequency have been codified in art. 29 DSST 1995 and in arts. 35–37

[271] See for this theory for the broker: van Setten, *De commissionair in effecten*, 38–44. See also in favour of this theory: Grundmann-van de Krol 2004, 485–491. Support for this opinion can be found in HR 23 May 1997, NJ 1998, 192 (Rabo/Everaars); HR 26 June 1998, NJ 1998, 660 note Van Zeben (Van de Klundert/Rabo); and HR 11 July 2003, JOR 2003/199.

[272] In some contracts the mandate will be exclusive if the client, because of his work, has knowledge of a lot of information that influences the rates of securities. The exclusive mandate is possible because of art. 423 Book 7 CC.

FRMSST 2002. On at least a quarterly basis (the client can inform the security institution that he does not want an overview every quarter and in such case the term will be once a year (arts. 35 sub 3 and 37 FRMSST 2002)), the client has to receive a statement that provides true, fair and complete information about the composition of the portfolio, the transactions and the costs that have been incurred by the client. A monthly report is necessary if the client takes positions that involve financial liabilities (art. 36 FRMSST 2002). The Decree and the Further Regulation do not provide a rule on the time of the audit for the case in which the contract will be ended before such audit was due. It can be assumed that a full audit in the spirit of the foregoing articles must be given. Arts. 771–793 of the Book of Civil Procedure provide procedural rules for the cases in which the mandatary (or anyone else who has the duty to give full account) refuses to provide a full account or the mandator refuses to accept the account given.

Point d: restitution of the managed assets

Restitution of the managed assets is not relevant to the portfolio management agreement. The investment institution, or in other words John BV, is not the owner of the accounts (see the sections titled *Investment in securities* and *The contractual agreement between John BV and Sam*). As such, there is nothing to return.

Point e: damages for Sam

Termination of the contract on grounds of art. 422 Book 7 CC

According to art. 74 Book 6 CC, if the situation in Case 1 is considered to be a breach of contract by John BV, then damages will be available for the mandator. In order to establish sufficiently that the implications against John constitute a breach of contract that justifies rescission, it is necessary to consider the specific wording of the contract and whether John BV lost his reliability (one of the requirements of the licence: see the section titled *Investment in securities*). Although the requirements for the licence are a matter between John BV and the Public Administration, it is accepted that the rules of conduct will have a significant impact on whether John has acted as a prudent mandatary.[273] The amount of damages will be assessed according to the rules in arts. 95–98 and 100 Book 6 CC. There must be a causal link between the breach and the damages, and both material and non-material damage is possible. The

[273] See above, note 271.

amount of damages are to be determined by comparing the financial situation that would have resulted if John BV had completely fulfilled his part of the contract and the financial situation that has resulted from the breach. Damages encompass losses as well as missed opportunities.

Rescission of the contract on grounds of art. 265 Book 6 CC

If breach of contract is established (see the section titled *Investment in financial instruments – point a: termination*), then damages can be sought on grounds of art. 277 Book 6 CC.[274] The damages will cover the loss suffered by the breach in addition to the loss caused by termination of the contract. As stated above, the amount of damages will be determined according to arts. 95–100 Book 6 CC.

Point a: John BV wants to prevent termination

Since the mandator has a right to terminate the contract, unless termination is excluded by the nature of the contract, which is not the case here (see section titled *Investment in financial instruments – point a: termination*), John BV cannot prevent it.

If termination is based on rescission resulting from breach of contract rather than on art. 422 sub 1 Book 7 CC, then John BV should argue that the facts are not a reason for rescission and that the agreement still stands. He could argue that a minor breach does not justify rescission (see art. 265 sub 1 Book 6 CC). A second defence would be that the allegations do not currently affect his reliability as a portfolio manager and as such there is no breach of contract (see the section titled *Investment in financial instruments – point a: termination*). A third defence could be that the loss of reliability is something that only affects his licence and in fact has no impact on his obligations towards the client. This is the opposite of the reasoning used under the section titled *Investment in financial instruments – point a: termination*, in which it was stated that loss of reliability has a wider effect than just hampering one of the licence requirements. It is evident that this defence will be unsuccessful when one considers the numerous defenders of the theory of wide effect of loss of reliability.

Point b: damages for John BV

Notwithstanding the possibility of termination, the mandatary, according to the principles of Dutch law, can be liable for damages if

[274] See H. B. Krans, *Schadevergoeding bij wanprestatie* (PhD Leiden), (Deventer: Kluwer, 1999).

termination is regarded as a breach of contract. However, because Sam is a non-professional mandator, the termination of the contract is not considered to be a breach of contract, according to art. 408 sub 3 Book 7 CC. As a consequence, his obligation to pay anything to John BV is limited to the payment of costs which are incurred by the mandatary in acting as such (arts. 408 sub 3 and 406 sub 1 Book 7 CC), damages for risks that are incurred in acting as mandatary (art. 406 sub 2 Book 7 CC), and remuneration over the period that the mandate was supposed to be performed (five years in this case) to be settled reasonably and fairly (art. 411 sub 1 and 2 Book 7 CC).[275] No further amounts are due, even if there was no notice of termination. This rule is mandatory and thus parties cannot derogate from it (arts. 422 sub 1 and 408 Book 7 CC). The Standard Contract does not provide for a specific rule on this point. In the case of rescission on the grounds of art. 265 sub 1 Book 6 CC, Sam may be liable for damages resulting from breach of contract without the limitations of Book 7.

Investments in assets other than financial instruments

If the mandatary invests in assets other than financial instruments, then no special supervision rules on the legal structure of the mandatary, or on licences for the mandatary, are applicable. The mandatary may be a natural person or a company. In practice, the mandatary will be a legal corporation such as a *Besloten* or *Naamloze Vennootschap* (private or public company). If the contracting party is not the same person as the one who performs the actual work (see above), then the changing of the actual manager is probably possible without terminating the contract. In answering the questions in Case 1, a distinction may have to be made between movables and immovables. The contract between John and Sam will be a contract of mandate. Irrespective of whether John is acting on behalf of Sam in his own name or in the name of Sam, art. 110 Book 3 CC indicates that the movable assets will fall directly in Sam's patrimony (see the section titled *The contract of mandate*, pp. 176–178). The only situation in which this rule does not apply is when the applicability of art. 110 is explicitly excluded. In practice this will not happen very often. For other assets it is necessary to distinguish whether John acted in his own name or not. If he acted in his own name, then the assets will fall into his patrimony.

[275] This article does not apply to a contract for an unspecified period of time. See Haak/Zwitser 1999, 112–114.

Point a: termination

With regards to termination of the mandate, the answer is the same as in the section titled *Investment in financial instrument – point a: termination*. According to art. 408 Book 7 CC, a contract of instruction can be terminated by the mandator at any time. This rule also applies to contracts of mandate according to art. 422 sub 1 and 2 (except for the situation in which the mandate (also) has to be performed in the interest of the mandatary himself or a third person).[276] It is not possible for parties to agree on different terms. Generally speaking, no special reason is required to terminate the contract, but the nature of the contract or simple reasonableness or fairness may dictate that the contract cannot be terminated. These reasons do not apply to the case at hand.[277]

Furthermore, the mandator may seek rescission of the contract (art. 265 Book 6 CC). In case of investment in instruments other than financial instruments, where licence requirements do not influence the outcome, it is rather difficult to predict whether the allegations are sufficient to result in rescission of the contract. Essentially, it will depend on the specific wording of the contract (i.e. the qualities that John BV is supposed to display according to the contract).

Point b: no further actions possible by John BV

If the contract is terminated, the mandatary will no longer have the power to deal with the assets. He can be restrained by a court order from acting in his own name or on behalf of the mandator. There is no possibility of registration in order to put third parties on notice, although it is said that the exclusive mandate can be registered if it concerns registered things (immovables). If it is revoked, then the revocation should be registered as well. To secure adherence to this order Sam can ask for a '*dwangsom*', a sum of money which will be payable every time the manager disregards the order.

With respect to the assets owned by the mandator under art. 110 Book 3 CC (see the section titled *The contract of mandate*) but still in John's possession (movables), the mandator can seek leave for an attachment for surrender. If John does something with the assets (i.e. sells them), then the attachment will follow the assets as long as the third person is not acting in good faith. If the contract of mandate is accompanied by a power of attorney that obliges John to act in Sam's name, then the termination of

[276] Asser/Kortmann 1994, no. 173.

[277] Ibid., nos. 105–106 and 172.

the contract will cause the withdrawal of the power of attorney. It is also possible to withdraw this power by a separate statement.

Point c: full audit

Art. 403 Book 7 CC obliges the mandatary to inform the mandator (sub 1) and provide an account (sub 2) of his acts. It is possible for the contracting parties to agree to different terms. The rule is not mandatory except in the case of agency contracts. Arts. 771–793 Book of Civil Procedure provide procedural rules for the case in which the mandatary (or anyone else who has the duty to give a full account) refuses to provide a full account or the mandator refuses to accept a full account. John will be obliged to provide a full audit.

Point d: restitution of the managed assets

Restitution can involve handing over possession (factual power over the assets) and administrative papers. It can also mean that ownership of the assets must be transferred whether or not it is accompanied by actual delivery.

The mandatary is not the owner of the assets

The mandatary need not be the legal owner of the assets even if he acts in his own name (art. 110 Book 3 CC).[278] The claim for handing back the assets and the administrative papers will lapse five years after the contract has been terminated (art. 412 Book 7 CC). A right of retention on administrative papers is possible: however, in such a case, the interests of both parties will be compared.

The mandatary is owner of the assets

If art. 110 Book 3 is not applicable to the movables and negotiable instruments in question,[279] in addition to other assets that the article does not cover, then the mandatary is the owner of the assets and restitution of the managed assets will be ordered if the contract is terminated. It is necessary to transfer the assets. This transfer will not take place automatically upon termination of the contract unless the

[278] This article does not apply to registered assets or other assets that are not delivered by handing over possession. See above, p. 178.

[279] Art. 110 might have been excluded by the parties, or the assets might have become mingled so that they are no longer individually ascertainable, which will negate the rule of art. 110.

parties have agreed otherwise. The assets will be transferred according to the rules that are applicable for each individual asset.

With respect to registered assets, if the manager refuses to transfer the assets, then a court decision can be sought for a notarial deed, which is required for a valid transfer (art. 300 sub 2 Book 3 CC). The court can also appoint a representative who will perform the necessary acts instead of the manager. The requirements follow from art. 301 Book 3 CC.

Point e: damages for Sam

With respect to Sam's claim for damages, the answer is the same as in the section titled *Investment in financial instruments – point e: damages for Sam*, with the exception that failure to comply with the licence requirements is not an available argument since no licence is required here.

Point a: John wants to prevent termination

With respect to John wanting to prevent termination, the answer is the same as in the section titled *Investment in financial instruments – point a: John BV wants to prevent termination.*

Point b: damages for John BV

With respect to John's claim for damages, the answer is the same as in the section titled *Investment in financial instruments – point b: damages for John BV.*

Alternative 2

Financial instruments

The securities institution is bound by the client's instructions. To prevent interference with the policy of the securities institution, many contracts limit the rights of clients so that the client cannot provide instructions at any time. Apart from the unlimited possibility to instruct the securities institution when concluding the contract, the client has the opportunity to instruct every quarter of the year or only once a year, depending on what the parties have agreed to in the written contract (art. 27 sub 1(e) and sub 2(d) FRMSST 2002). If the instruction was within the powers of the client, then John BV would have to follow it. If John BV chose not to follow it, then he would be liable for breach of contract (art. 74 Book 6 CC). In other words, he would have exceeded his power of attorney. In this situation it is not likely that the identity of the purchaser of Sam's securities would be known. However, should the third person be known, then the letter would prevent the third person from claiming that he or she has received in good faith. The sale will be rescinded because the securities institution acted outside the scope of the power of attorney.

Investments other than financial instruments

The ASST 1995 is not applicable with respect to this situation. If the mandatary acts in his own name, then the transfer is considered valid. In such a case, the only kind of claim which the mandator (Sam) can make against the third person (Elinor) is one based on a wrongful act (tort). According to Dutch law, even if a third person knowingly profits from a breach of contract by the mandatary, this fact alone is not enough to conclude that the third person has committed a tort.[280] However, the combination of the letter and the fact that Elinor knew that John was acting as a mandatary would most likely be sufficient to reach the conclusion that a tort was committed. Another, rather theoretical option, is to sue the third person for unjust enrichment (art. 212 Book 6 CC).[281]

If the mandatary was acting on behalf of the mandator in the latter's name, then the situation would be different because the contract of mandate implies a power of attorney. In this case, John acted outside his power of attorney because Sam changed the contents of the power by telling John not to sell below a certain price. Elinor had knowledge of Sam's request because Sam sent her a letter. Elinor will not be able to rely on art. 61 sub 2 Book 3 CC, which protects third parties against claims made by the donor of the power of attorney based on the fact that the donee of a power of attorney has acted outside his authority. Case 1 involves unauthorised representation that will not be binding on the mandator (art. 66 Book 3 CC). In other words, the sale and transfer will not bind Sam.

Alternative 3

Financial instruments

With respect to financial instruments, if Sam orders John BV to buy certain shares, the contents of their written contract for investment services will have to be taken into account. Except for the case in which

[280] Decided in: HR 17 November 1967, NJ 1968, 42 (Pos/V.d. Bosch), HR 17 May 1985, NJ 1968, 760 (Curaçao/Boyé c.s.) and confirmed in HR 30 June 1995, NJ 1995, 693 (G-rekening). See Mr C. Asser's handleiding tot de beoefening van het Nederlands burgerlijk recht, *Verbintenissenrecht*, deel 4-III, *De verbintenis uit de wet*, A. S. Hartkamp (Zwolle: W. E. J. Tjeenk Willink, 2002) (Asser/Hartkamp 2002), no. 51b.

[281] See Verhagen, *Agency in Private International Law* (1995), 61.

the mandate is exclusive,[282] the client never loses his right to act. The rule in art. 402 sub 1 Book 7 CC is equally applicable here. The client can give instructions at any time, unless the parties agreed otherwise. In practice, this will often be limited to the possibility of giving instructions on a quarterly or yearly basis. The portfolio manager must respect his client's instructions with the exception of ill-considered directions. In the case of ill-considered directions the manager can probably terminate the contract, even without giving a period of notice (compelling reasons: art. 408 sub 2 Book 7 CC).

Investments other than financial instruments

According to art. 402 sub 1 Book 7 CC, the mandator may give instructions on how to manage the assets. The mandatary is obliged to respect these directions if he is notified in a timely manner and if the directions are well considered. It is possible for parties to deviate from this rule in their contract (except in an agency contract). In Case 1, the issue is whether the investment instruction is well or ill-considered. If it is not well considered, then the mandatary can choose not to follow it. If the mandator insists, then the mandatary will have the right to terminate the contract of mandate on grounds of compelling reasons (art. 402 sub 2 Book 7 CC).[283]

Portugal

The mandate, with or without representation, is the device normally chosen to construct an express trust for the management of certain assets for certain people. The autonomous patrimony, normally used by the legislator, creates funds for the investment of undetermined sums for an undetermined number of people. Foundations are an apt solution to construct and develop a charitable or protective (spendthrift) trust. The law does not allow foundations for private purposes, but only for relevant 'social interest' (art. 188 CC). This restriction is a historical consequence of the influence that the French Revolution had in restricting all feudal restraints on land circulation. Today, this is a tradition that has become more difficult to justify. Problems related to prodigality would be much better dealt with by a private foundation than by the current ineffective system of curatorship, whereby the prodigal person

[282] See text at note 266.
[283] Asser/Kortmann 1994, nos. 59–60.

needs the special authorisation of the curator to dispose of (and sometimes even to administer) his patrimony. Also, people unable to care for themselves would have better protection through a private foundation than through the system of legal representation by a guardian (arts. 138–156 CC). So too would the several types of funds created by law to incorporate investment funds (*fundos de investimento*), pension funds (*fundos de pensões*), securitisation funds (*fundos de titularização*) and other collective investment schemes.

Case 1 is full of legal questions arising from difficulties of 'transposing' the trust to continental systems. *Fiducia cum amigo* and *fiducia cum creditore* are possible solutions. However, there is a long (and erroneous) tradition in Portuguese legal doctrine of banning the *fiducia* on the grounds of the (misunderstood) doctrine of *causa* and of the *numerus clausus* (*tipicità*) of real rights. Although more recent doctrine accepts the validity of fiduciary contracts on the basis of freedom of contract (*autonomia privada*), courts are still reluctant in this matter. On a comparative basis it is, however, preferable to answer Case 1 with solutions that are commonly provided in cases in Portugal, and to avoid my own solutions when they are not generally accepted.

A new study has recently been published, at the initiative of the Bank of Portugal, dealing with the possibility of the recognition of the trust on the basis of a new law of 'fiduciary ownership' (*propriedade fiduciária*).[284] In accordance with this study, the trust would be a new type of real right whereby the trustee (*fiduciário*) would be bound to manage the trust property (*bens fiduciados*) in the interest of the beneficiary (*beneficiário*). The trust property would constitute autonomous patrimony and would be quite separate from the debts of the trustee.

In Portuguese law trusts are formally referred to only in the Madeira archipelago. In fact, Decree-Law 264/90 of 31 August authorised 'the incorporation and operation of companies, as well as the opening of branches by existing institutions whose sole object was trusts or offshore trust management' in the Madeira Free Zone, but only in the Madeira Autonomous Region. This provision is, however, very restricted both in material and in territorial scope. Still, I am of the opinion that besides residual recognition of trusts in the Madeira tax haven, the several legal solutions of autonomous patrimonies related to collective investment schemes (i.e. investment funds, pension funds, securitisation funds) are in fact (and in law) trust structures. Portugal is

[284] M. J. Campos, D. L., *A Propriedade Fiduciária (Trust)*, (Coimbra: Almedina, 1999).

not a party to the Convention Concerning the Law Applicable to Trusts and to their Recognition of 1 July 1985.

Within the framework of Portuguese law, John's management of Sam's property rests on an irrevocable power of attorney with the underlying relationship being a contract of mandate to manage. This mandate is exercised professionally for a consideration. In Portuguese law the mandate, if it is a general one, only allows day-to-day management; if it goes beyond day-to-day management and includes powers to dispose, sell or hypothecate, it must specify the goods to which it is applicable (art. 1159 CC).

Portuguese legal doctrine and both the Civil Code (CC) and the Commercial Code (ComC) clearly distinguish the contract of mandate from the power of attorney.[285] A mandate may be granted with or without representation. Powers of attorney are governed by the general part of the Civil Code (arts. 262–269) dealing with voluntary representation. The mandate is detailed in the special part of the Book of Obligations, more specifically Contracts. In other words, it is dealt with as a type of contract (arts. 1157–1184). The Commercial Code governs commercial mandates – mandates to undertake commercial acts – and clearly distinguishes between mandates with and without representation, the latter known as 'commission' (arts. 231–277 ComC). Powers of attorney are unilateral and may have an underlying mandate with representation, or any other licit business which necessitates the power. Both the power of attorney and the mandate are extinguished when the underlying relationship terminates (art. 265 CC). Revocation and renunciation of the power of attorney lead to forfeiture of the mandate with representation (art. 1179 ComC).

As a general rule, both the power of attorney and the mandate are freely revocable (arts. 265.2, 1170 and 1171 CC and art. 245 ComC). Revocation without due cause of a professional mandate, or of one granted in the interest of both the mandatary and the mandator, gives rise to a claim for damages (art. 265.3 CC). However, irrevocability of a

[285] Januário Gomes, *Em tema de recogção do mandato civil* (Coimbra: Almedina, 1989), *Assunção Fidejussória de Divida*, (Coimbra: Almedina, 2000); Maria Helena Brito, *A Representação sem Poderes*, Revista Juridica, 9 e 10 (Lisbon: AAFDL, 1987), *Contrato de Concessão Comercial* (Coimbra: Almedina, 1990), *A Representação nos Contratos Internacionais* (Coimbra: Almedina, 1999); Pedro Leitão Pais de Vasconcelos, *A Procuração Irrevogável* (diss., Lisbon, 2001); Pessoa Jorge, *O Mandato sem Representação* (Lisbon: Atica, 1961); Pinto Monteiro, *Contrato de Agência*, 4th edn (Coimbra: Almedina, 2000); Seiça Girão, *O Mandato de Interesse Comum* (diss., Coimbra, 1997).

power of attorney is expressly allowed when the power is executed in the mutual interest of the donor and the attorney (art. 265.3 CC). The same rule applies to the mandate when it is granted in the mutual interest of the mandator and the mandatary (art. 1170.2 CC). The courts accept the validity of powers of attorney and mandates which are granted in the sole interest of either the attorney or the mandatary. Irrevocable powers of attorney which are in the sole interest of the attorney, or the mutual interest of donor and attorney, must be granted by means of a public notarial deed (art. 116.3 of the Notaries Code (NotC)).[286]

The irrevocability of the mandate and the power of attorney stems from the underlying relationship. If the irrevocability is necessary to the satisfaction of the underlying relationship, and provided it is granted to protect the interests of the mandatary against the mandator (for example, a power for compliance), then revocation of the power is ineffective (strong or absolute irrevocability). If it is merely agreed, but not required for the satisfaction of the underlying relationship, then the revocation will be effective, but will give rise to civil liability for violation of the agreement of irrevocability (weak or relative irrevocability). Courts have dealt with problems arising from irrevocability of powers of attorney, and generally consider ineffective the revocation of irrevocable powers that were granted in the interest of both donor and attorney, or in the sole interest of the attorney (Trévora, 16 January 1991, CJ, XVI (1991), I, 286).

The duties of the mandatary, with or without representation, include: (a) carrying out the acts included in the mandate in keeping with the mandator's instructions; (b) providing such information as the mandator may request in respect of the status of the management; (c) notifying the mandator of the execution of the mandate or, if the mandate is not executed, the reasons for this; (d) rendering accounts at the end of the mandate or when so required by the mandator; and (e) delivering and conveying to the mandator what should be received in the execution of the mandate or in its exercise, provided that the mandatary has not spent it in the normal exercise of the mandate (art. 1161 CC).

When a mandate without representation is granted, the mandatary acts in his own name in dealings with third parties, and the legal

[286] Pais de Vasconcelos, *A Procuração Irrevogável*. See also Supreme Court STJ 24.1.1990, BMJ 393–588, STJ 13.2.1996, CJ 1996-I-86, STJ 3.6.1987, BMJ 468–361.

effects of his actions are reflected on his own person. Afterwards, he is obliged to transfer and/or convey the effects of his mandate, i.e. all rights, goods, money or other juridical objects, to the ownership of the mandator (art. 1181.1 CC). This creates a well-known risk for the mandator in the case of insolvency or bankruptcy of the mandatary. Article 1184 CC[287] protects the mandator against the mandatary's personal creditors, who are not entitled to seize any of the goods that were acquired by the mandatary in execution of the mandate and are to be transferred to the mandator. In the case of goods whose transfer is subject to registration (mostly immovables), the exemption is in force only prior to registration in the mandatary's name. As a consequence of the publicity created by the registration, third party interests, including those of any creditors, become more relevant than those of the mandator. This regime of art. 1184 CC is of great importance and effectiveness with relation to trust-like situations. In common practice, management of assets, professionally or otherwise, is normally based upon a mandate with representation or just a simple revocable power of attorney. It is neither normal nor frequent for ordinary people to trust the administration of goods to another person on the basis of a mandate without representation. There are, however, cases where goods are vested in third persons as fiduciaries (*fiducia cum amico*), who own them as proprietors with the aim of protecting the beneficiary from his creditors, from his own prodigality, or for some other reason. These cases of *fiducia cum amico* are usually kept secret or known only by a restricted number of people and/or inside the family.

The case in the questionnaire appears, in the Portuguese context, as a case of an irrevocable power of attorney with an underlying relationship of mandate with representation, in which the legal effects of the attorney's action are produced directly within the legal sphere of the

[287] Artigo 1184ª (*Responsabilidade dos bens adquiridos pelo mandatário*): 'Os bens que o mandatário haja adquirido em execução do mandato e devam ser transferidos para o mandante nos termos do n° 1 do artigo 1181° não respondem pelas obrigações daquele, desde que o mandato conste de documento anterior à data da penhora desses bens e não tenha sido feito o registo da aquisição, quando esta seja sujeita a registo.'Article 1184 (*Responsibility of the goods acquired by the agent*): 'Goods acquired by the mandatary in execution of the mandate that should be transferred to the mandator in accordance with Article 1181.1 shall not be seized for the debts of the mandatary, provided that the mandate consists of a written document issued prior to the date of the seizure and that no registration has yet been made in the event that the acquisition in question is subject to registration.'

mandator. Nevertheless, it is possible to understand it as a mandate without representation (or commission), in which case the legal effects of the attorney's acts are produced within his own legal sphere and must then be transferred to the mandator's sphere. The solutions are different, depending on whether the mandate is granted with or without representation.

As the questionnaire mentions that John carries on the activity of a professional investment manager in his small office, it does not appear to be a case of administration by a portfolio management company. In principle, the professional administration of assets (portfolios) of third persons cannot be done by individuals. In accordance with arts. 4.1 and 8.2 of the Banking Act (*RGICSF – Regime Geral das Instituições de Crédito e das Sociedades Financeiras*, Decree-Law 298/92 of 31 December), the administration of assets must be done exclusively by a special kind of financial company, a management company (*sociedade de administração de patrimónios*), governed by Decree-Law 163/94 of 4 July. This is a consequence of Directives 93/22/EEC and 89/646/EEC.

The legislation that enacts into Portuguese internal law art. 3 of Directive 89/646/EEC goes far beyond its scope in forcing the use of the corporate form for the exercise of professional asset management. Article 8 of the Banking Act states that only credit institutions (*instituições de crédito*) and financial companies (*sociedades financeiras*) can manage third party assets in a professional manner. This provision applies regardless of the nature of the assets being managed. It covers not only management of securities, but also management of other types of assets, including immovables (see also art. 4 Banking Act).[288] In principle, both credit institutions and financial companies have to be created as limited liability companies (*sociedades anónimas*), although some exceptions apply in the case of mutually based banks.

The main point is, therefore, to distinguish between professional and non-professional management activities, because non-professional management is permitted by both corporations and individuals. Management may also be performed by individuals of other professions as an accessory to their main activity (e.g. lawyers, solicitors, etc.). In that context, it has been understood that professional management

[288] F Conceição Nunes, *Direito Bancário* (Lisbon, 1994), I, 233–238; Menezes Cordeiro, *Manual de Direito Bancário* (Coimbra, 1998), 157–159; M. H Brito, 'As Empresas Financeiras na nova Lei Bancária Portuguesa', in *Boletim da Faculdade de Direito de Bissau*, no. 2 (September 1993), 134.

occurs when there is a usual and stable activity, aimed at profitable results,[289] and exercised mainly to the exclusion of other activities. The connection with an enterprise, and an entrepreneurial manner of organisation and performance, could also be taken into account as criteria to characterise professional management, for the purpose of the interpretation of art. 8 of the Banking Act.

Management companies (*sociedades gestoras*) carry out the management of portfolios of assets on the basis of a written mandate granted by the client to the company, specifying the terms, limits and levels of liberty of management, and how discretionary it may be. Management companies are bound by certain obligations, including: the certification of the identity and legal capacity of the parties to contracts they enter into; the presentation of all contracts clearly and exactly so that no error or mistake may arise; non-disclosure of the identity of their clients, except where necessary to the conclusion of contracts; immediately informing clients about the details of contracts entered into on their behalf, unless otherwise agreed in the mandate (in principle, this should be done on the day of the contract); and making best efforts for the fulfilment of contracts. All funds and transferable securities belonging to clients must be deposited in separate bank accounts opened in the name of the respective clients. These accounts may be opened in the name of the management company, but for the account of the clients, provided that this is formally mentioned in each account.

Alternative 1

The irrevocability clause for the power of representation in the contract between Sam and John constitutes a conventional (weak, relative) irrevocability and not a natural (strong, absolute) one.[290] John's interest in the irrevocability arises out of his professional interest in management. Sam is entitled to revoke the mandate and, with it, the power of attorney (the powers of representation), provided that there is due cause. If there is no due cause, then the revocation is effective, though it grants John a right to compensation. The same applies if the management is performed by John SA (a management company).

[289] Athayde, *Curso de Direito Bancário* (Coimbra, 1999), 283–288; Nunes, *Direito Banćario*, 237–238.

[290] Natural irrevocability of the power is a consequence of a right or an interest of the agent (or of a third party) that is to be exercised against the principal; conventional irrevocability is a consequence of a mere bargain or promise: see Pais De Vasconcelos, *A Procuração Irrevogável*.

News appearing in a newspaper concerning John's (or John SA's) involvement in illicit activities constitutes due cause for revocation, provided that the news is true and confirmed. Since newspapers are not always accurate, Sam should hear John's version of the story before revoking the power of attorney in order to maintain good faith. If the news is not true then the revocation is effective, but Sam should compensate John for damages arising from the premature revocation.

a. Revocation is effective upon receipt of notice of revocation sent by Sam to John (or John SA), and there is no need for a judicial claim for revocation. Sam may sue John (or John SA) for the judicial declaration of termination of mandate if he so wishes; although a judicial declaration is not strictly necessary, it might be useful.
b. Prior to the filing of the action, or during its proceedings, Sam may apply for, and obtain, an injunction (*providência cautelar*) to prohibit John (or John SA) from entering into new transactions, or to stop all transactions immediately.
c. Sam is entitled to demand from John (or John SA) a detailed report and accounting of the management that he has carried out (art. 1181 CC and arts. 239 and 240 ComC). Should John refuse, Sam may bring a special rendering-of-accounts action (*prestação de contas*, art. 1014 Civil Procedure Code).
d. Sam is entitled to demand restitution of such property belonging to him as may have been received by John (or John SA) in the execution of the mandate.
e. Sam is entitled to demand compensation for damages arising from the breach of mandate, provided that a breach of mandate by John (or John SA) is proved and damages are suffered by Sam as a consequence of that breach.

John (or John SA) may counterclaim for the declaration that the mandate is still valid and in force, plus damages. In accordance with Portuguese law and as previously stated, the court will deny John's demand concerning the continuation of his mandate powers, as Sam has the right to revoke the mandate. If the ground for the revocation is not considered sufficient as a just cause (*justa causa*) the court will order Sam to compensate John for damages arising from premature revocation (loss of professional fees) in accordance with art. 1172 CC.

Alternative 2

It is John's (or John SA's) duty to obey Sam's instructions and thus he should not act contrary to the instructions by selling Blackacre. Sam is entitled to instruct John (or John SA) not to sell and, upon informing Elinor of these instructions, he is complying with a good faith duty of information that has a particularly important effect in determining Elinor's good faith.

If the mandate was granted with representation, then by selling Blackacre contrary to Sam's instruction, John is abusing the power of attorney. According to art. 269 CC, a contract executed by abusing the power of attorney is ineffective in relation to the principal provided that the abuse was known or should have been known to the third party. In the present case, the sale executed by John and Elinor has no effect as far as Sam is concerned. Therefore, Sam has the right to recover Blackacre from Elinor (*rei vindicatio*).

Sam may, should he so wish, ratify the conveyance (art. 258 CC), although he is not obliged to do so. Ratification takes the form required for the power of attorney. Its effect is retroactive, without prejudice to the rights of third parties, and it is considered not to have occurred if it is not done within the term established by the other party. For as long as the sale is not ratified, the other party has the right to revoke or reject it provided that, at the time of the deal, the party was not aware of the abuse of the power of attorney.

If the mandate was granted without representation, then John's sale of Blackacre against Sam's instructions has a different consequence. Since John acquires ownership of Blackacre as a consequence of the mandate without representation, in principle Sam has no right to recover the land (*rei vindicatio*) from the purchaser. He is only entitled to claim compensation from John for damages arising from the breach of mandate. If John is a management company (John SA), it may acquire Blackacre for itself to the account of its client Sam, only if this is expressly allowed by the mandate.

Since the acquirer (Elinor) was informed of the instructions given to John by Sam, she is considered to be a third party in bad faith and therefore liable for compensation to Sam on the same grounds and jointly with John.

Alternative 3

As a mandatary, John (as well as John SA) may diverge from Sam's instructions or refrain from acting in accordance therewith, provided that it is impossible to contact Sam in time and it is reasonably assumed that Sam would agree with the management decision if he were aware of the circumstances (art. 1162 CC). However, John does not have the power to discuss his mandator's instructions, although he may terminate the mandate if he so wishes. Unless otherwise agreed, both mandatary and mandator may freely revoke the mandate whenever they wish. However, John's opinion (even a professional opinion) that a particular investment is bad is not in itself a specific cause for termination. In case of definite disagreement between Sam and John, regarding the management and/or the execution of the mandate, the contract and/or the relationship should be terminated.

Scotland

In Case 1, effect could be given to the arrangement between John and Sam by making John Sam's agent, acting in Sam's name. (That is to say, mandate with direct representation.) In this case, Sam would be owner of the assets. A second possibility would involve the creation of a limited company, with Sam as the sole shareholder and John as the sole director. The company would hold the assets. The disadvantage of this arrangement is that rules about the management of companies, publication of accounts and so on, would have to be observed.

The trust is the most likely way to give effect to the arrangement between John and Sam, though it has to be said that an arrangement of this sort would in any case not be very likely to occur in practice. In a trust, the assets would be in John's name. Sam would be the 'truster' and also the sole 'beneficiary' while John would be the 'trustee'. If John sells an asset and uses the money to buy another asset, the principle of real subrogation applies, so that the new asset is also part of the trust estate or patrimony.[291] Sam's rights with respect to John are personal rights rather than real rights. However, they are similar to real rights in that if John goes bankrupt, then the trust estate does not form part of his general estate. The creditors of John 'as an individual' and the creditors of John 'as a trustee' have different rights. The former can enforce their claims against John's general patrimony/estate but not against his special (trust) patrimony.[292] The latter can enforce their claims against John's special (trust) patrimony, but not normally against his general patrimony.[293]

[291] In this context 'estate' means patrimony. The terms are used interchangeably.

[292] See Case 4 below.

[293] See Ross G. Anderson, 'Contractual Liability of Trustees to Third Parties' (2003) *Juridical Review* 45.

In many ways, a trust is similar to a juristic person. Lawyers (and others) often speak of a thing being owned by a trust, or of a trust owing a debt. However, in legal theory a trust is not a juristic person.[294] Rather, it is a separate estate, or patrimony, of the owner. The principle is 'one person, two patrimonies'.[295] On this basis, Scots law has developed a system of trust law without the need for the dichotomy between 'law' and 'equity', and without having to conceive of ownership as divided, which is a point of particular importance because Scots property law is a *ius commune* system.[296]

It will be assumed that John and Sam are using a trust to give effect to their relationship. One general comment is that a person acting as John does will be subject to the Financial Services and Markets Act 2000, and will therefore require authorisation from the Financial Services Authority. Such authorisation can be obtained by natural as well as by juristic persons. According to the Act, John will be required to ensure that he holds, in trust for Sam, any investment that is not held by Sam in his own name. The 2000 Act applies in Scotland as it does in England and Wales. Thus, the reader is referred to the English report.[297]

Alternative 1

The beneficiaries of a trust can make a unanimous decision that the trust should be terminated regardless of the terms of the trust itself.[298] In Case 1 Sam is the only beneficiary and so he can end the trust whenever he wishes.

[294] Some Scots lawyers are of the view that the trust should, *de lege ferenda*, be a juristic person.

[295] Though a trust may have two or more trustees.

[296] The standard modern text on Scottish trust law is W. A. Wilson and A. G. M. Duncan, *Trusts, Trustees and Executors*, 2nd edn (Edinburgh, 1995). See also D. Ross et al., 'Trusts and Trustees' in *The Laws of Scotland: The Stair Memorial Encyclopedia* (1989) Vol. 24; Kenneth McK. Norrie and Eilidh M. Scobbie, *Trusts* (1991); James Chalmers, *Trusts: Cases and Materials* (2002). For an account of how the Scottish law of trusts exists without equitable ownership, see Kenneth G. C. Reid, 'National Report for Scotland', in D. J. Hayton, S. C. K. K. Kortmann and H. L. E. Verhagen, eds., *Principles of European Trust Law* (The Hague, 1999), and the same author's 'Patrimony not Equity' (2000) 8 *European Review of Private Law* 427. For the history, see G. L. Gretton, 'Trusts', in Kenneth G. C. Reid and Reinhard Zimmermann, eds., *History of Private Law in Scotland* (Oxford, 2000).

[297] In this and other respects the author is much indebted to Dr Lionel Smith.

[298] *Gray* v. *Gray's Trs* (1877) 4 R 378; *Miller's Trs* v. *Miller* (1890) 18 R 301; *Yuill's Trs v. Yuill* (1902) 4 F 815; Wilson/Duncan, para. 12–02.

However, there seem to be two relations here: the trust relation, and a contract, contained within a single document. The contract provides that the trust shall continue for a certain period. It is difficult to understand why this agreement should be invalid, notwithstanding the principle of trust law mentioned above. Hence it would seem that Sam's right under trust law to terminate the trust would be subject to Sam's contractual obligation to allow the trust to continue for five years.

Possibly Sam would be justified in terminating the contract. However, from the stated facts this seems unlikely: mere rumours would not be enough. Even if the rumours are true it is doubtful whether they would justify termination of the contract.[299] However, lack of probity is a ground on which a trustee can be removed and replaced by the court, on the application of a beneficiary.[300] Since the contract presupposes that John is the trustee, removal of John as trustee would necessarily bring the contract to an end. With the contract at an end, Sam, as sole beneficiary, would be free to terminate the trust.

Assuming that Sam would not be justified in terminating the contract, the question would arise as to the effect of an attempt to do so. Although this is a trust, it is functionally similar to agency. An agency may be irrevocable in two senses. The first is where the revocation will take effect, but, being unjustified, will presumptively give the agent a claim for damages.[301] The principle is similar to that which applies in contracts of employment.[302] The second is where the agency cannot be revoked, even wrongfully. Where the agent acts as a *procurator in rem suam*, the second of these is applicable. The present case would probably be regarded as being of the first kind. Accordingly the revocation would take effect, but Sam would be potentially liable to a claim for damages. The revocation of John's five-year management right would then make it possible for Sam to terminate the trust, since the only

[299] For the rescission of contracts on the ground of breach by the counterparty, see generally William W. McBryde, *The Law of Contract in Scotland*, 2nd edn (2001), chapter 20. Rescission on account of breach is permissible only if the breach is 'material', i.e. a serious breach.

[300] See below, under Alternative 2.

[301] An example is *Galbraith & Moorhead* v. *Arethusa Shipping Co.* (1896) 23 R 1011.

[302] R. G. McEwan, 'Agency and Mandate', in *The Laws of Scotland: The Stair Memorial Encyclopedia*, vol. 1, para. 664; Laura J. Macgregor, 'Agency and Mandate', in *The Laws of Scotland: The Stair Memorial Encyclopedia* (Reissue, 2002), para. 183; W. M. Gloag and R. C. Henderson, *The Law of Scotland*, 11th edn (2001), para. 21.16.

restriction on Sam's right to terminate the trust is John's contractual right against him.

A trustee is under an obligation to keep proper accounts,[303] and a beneficiary has a right to see those accounts.[304] These rights exist whether or not the trust is being terminated.

Judicial declarations of rights (called 'declarators') have always been common in Scots law. John's attempt to obtain one would be likely to fail, since, as has been seen, even if Sam's termination of the contract is unjustified, it will still take effect. But if it is unjustified, then John will have a right to be paid damages.

Alternative 2

Sam is not entitled to recover the property from Elinor. The sale would be in breach of trust only if either (a) the trust deed required John to heed Sam's instructions or (b) the price was unreasonably low. With respect to (a), it is likely in practice that John's powers are discretionary and that as a result he is under no obligation to act as Sam directs. However, even if the sale is in breach of trust, it cannot be set aside.[305] If a trustee sells property in breach of trust, and ownership has passed to the buyer, the right of the buyer cannot be challenged, even if he purchased in bad faith, in the sense of knowing that the sale was in breach of trust.[306] So even if Elinor knew of Sam's opposition, her right to the property could not be challenged.[307]

If Sam had acted quickly, before the sale, he could have applied to a court to stop the sale by means of interdict. But it is too late to do that now. A difficult question would arise if Sam were to seek interdict after the contract of sale but before ownership had passed to Elinor.[308]

[303] *Ross* v. *Ross* (1896) 23 R (HL) 67; Wilson/Duncan, para. 23–05.

[304] *Tod* v. *Tod's Trs* (1842) 4 D 1275; Wilson/Duncan, para. 23–09.

[305] An action to annul a juridical act is called an action of 'reduction'.

[306] Trusts (Scotland) Act 1961, s. 2. This rule is, perhaps, a surprising one. Whether a bad faith purchaser from a trustee might have any delictual liability is unclear.

[307] The fact that Elinor's title cannot be challenged does not alter the fact that if John has sold in breach of trust, and if that breach of trust has caused loss to the trust, then John is liable to make good the loss.

[308] Subject to certain qualifications, Scots property law distinguishes between contract and conveyance, and adopts the abstraction principle. Sale is a contract, not a transfer. Ownership of immovable property passes at the time of registration in the Land Register, not at the time of the contract of sale. See generally K. G. C. Reid, *Law of Property in Scotland* (1996); Land Registration (Scotland) Act 1979, s. 3; Abolition and Feudal Tenure etc. (Scotland) Act 2000, s. 4.

Probably such an interdict would be possible. (But if there were no breach of trust anyway, the question of interdict is irrelevant.)

Sam could apply to the court to have John removed as trustee[309] and to have a new trustee appointed.[310] (In practice the court will remove a trustee only for a serious breach of trust.[311]) In that case the new trustee would be John's universal successor in respect of both the assets and liabilities of the trust patrimony. The new trustee could, if necessary, sue John to compel him to pay the lost value.[312] In cases of serious breach of trust, this is the normal course of things: a new trustee is appointed and it is the new trustee, rather than the beneficiaries, who sues the former trustee to make good the loss caused. (However, as has already been said, it seems unlikely that there has been a breach of trust.) Moreover, any serious misconduct by John might justify Sam in invoking his right to terminate the contract (see the above response in Alternative 1), which would then enable Sam to terminate the trust.

Alternative 3

The answer to this question depends on whether the trust deed requires John to follow Sam's instructions. In practice, it is unlikely that the trust deed would impose such a requirement. In the absence of such a requirement, Sam has no legal recourse against John. If, however, Sam can demonstrate that John's decision amounted to a serious breach of trust, then he could seek to have John removed as trustee: see the above response in Alternative 1. Moreover, any serious misconduct by John might justify Sam in invoking his right to terminate the contract (see the above response in Alternative 1), which would then enable Sam to terminate the trust.

Spain

With respect to Case 1, there are two main legal institutions that fit the arrangement between John and Sam, namely, the contract of mandate and the fiduciary contract in its modality of *fiducia cum amico* (or management-*fiducia*, which is closest to the common law trust).

[309] Wilson/Duncan, para. 22–37. In a case of this sort the removal would be based on the inherent powers of the Court of Session, rather than on any statutory provision. Another possibility, which in substance comes to much the same thing, is to have the court appoint a 'judicial factor' to take over the trust estate.

[310] Trusts (Scotland) Act 1921, s. 22.

[311] Wilson/Duncan, para. 22–37.

[312] *Town & Country Bank* v. *Walker* (1904) 12 SLT 411; Wilson/Duncan, para. 28–12.

Regulations for the contract of mandate are found in the Spanish Civil Code (arts. 1709–1739). The code distinguishes between the *representative* and the *non-representative mandate*; the former depends upon the granting of a power of attorney, and its exhibition to third parties.[313] The same distinction is made in the Code of Commerce for the 'commission', in other words the (mercantile or commercial) mandate, 'when its object is an act or operation of commerce and the commitent or the commissionist are either trader or agent mediator for the trade' (arts. 244–280). The 'agency' is a special kind of commission that is mixed with elements of the contract of distribution. The agency is signed by two independent dealers who normally agree to exclusive agency for all contracts related to the principal's assets and services (and not just, as in Directive 86/563/EEC, for sale). The Law 12/1992 of 27 May distinguishes agency from commission in that agency has a long-lasting character, revocation is considered very exceptional, and the agent is obliged to act in the name of the principal (it is not possible to have a non-representative agency).

The second legal institution is the *management-fiducia* or *fiducia cum amico*, which has no statutory rules. It has been developed by case law and doctrine, and has undergone a significant evolution in the past couple of decades. The double-effect theory (the fiduciary obtains complete title of ownership, exercisable *erga omnes*; the other party has only a personal right to claim the enforcement of the agreed terms) was supported in the 1940s. Since the 1980s, case law, influenced by Prof. De Castro,[314] has declared that the fiduciary has only a 'formal ownership' or a 'fiduciary title' with a 'limited real efficacy'. There is no genuine transfer of ownership to the fiduciary.[315]

Several theoretical differences between the *fiducia* and the non-representative mandate can be noticed. The most simple and evident difference is that indirect representation, in which there is legal protection for the principal, is of a regulated or standardised nature (arts. 256 and 258 Ccom.) whereas the fiduciary contract has a non-standardised

[313] The Spanish Civil Code is in the middle of two traditions: it does not mix up mandate with power of attorney, as happens in the French Civil Code, nor does it establish separate regulations for both institutions, as in the BGB (§§ 164–181 and 662–676), Italian *Codice civile* of 1942 (arts. 1387–1400 and 1703–1730) or Civil Code of Portugal (arts. 258–269 and 1157–1284).

[314] From his essential work: F. De Castro y Bravo, 'El negocio fiduciario. Estudio crítico de la teoría del doble efecto', *Revista de Derecho Notarial* (1966), 7 ff.; also in AAMN, XVII (1972), 5 ff.

[315] Mainly from the Judgments of the Spanish High Court (STS) of 19 May 1982 and 2 June 1982; followed by many others (cf., for instance, 5 July 1996).

character. From the perspective of the double-effect theory, the differences might appear to multiply due to the nature of the fiduciary's rights as compared to those of the manager-mandatary ('agent', *lato sensu*[316]). This is especially true if it is understood that the mandatary does not establish ownership over the object, which goes directly from the mandator's possession to third parties, or vice versa. However, this is a very controversial point that admits diverse nuances in the mandate to alienate and the mandate to acquire.[317] Additional attempts at differentiation indicate that indirect representation usually takes place in purchasing or selling rather than managing, which is more characteristic of the *fiducia*.[318] Furthermore, in contrast to the mandate or commission to buy, the fiduciary not only has to purchase something, but must also preserve the asset for a certain time in his or her power, in keeping with the fiduciary objective (management).[319]

Without rejecting the merits of this theoretical effort, it must be noted that the criteria for classifying a legal relationship as either indirect representation or *fiducia* are not clear. In fact, it is normal to find that similar cases have been treated differently, the courts finding a *fiducia* in one case and a non-representative mandate in another. Moreover, the courts often create a mixture of the two.[320]

Alternative 1

The Spanish Civil Code, which follows the guidelines of the Roman law mandate, establishes that 'the mandator can revoke the mandate whenever he/she wishes' (art. 1733). The same applies to mercantile

[316] In this report, the terms 'principal' and 'agent' are used when the intent is to refer inclusively to a number of institutions, such as mandate, commission, *fiducia*.

[317] See the complete works of J. B. Jordano Barea, 'Mandato para enajenar', ADC (IV, 4) (1951), 1458 ff. (from the perspective of the double effect, and distinguishing between the *causa fiduciae* and the *causa mandati*), and 'Mandato para adquirir y titularidad fiduciaria', ADC (IV, 4) (1951), 1439 ff. (from the perspective of the modern fiduciary title). A presentation of the different theses appears in J. R. León Alonso, 'Comentarios al art. 1717 Cc.' in *Comentarios al Código civil y compilaciones forales*, (Madrid: EDERSA, 1986), XXI, 2, 180 ff.

[318] J. Garrigues, *Negocios fiduciarios en Derecho mercantil*, (Madrid, 1955, 2nd edn, 1981), 52–53.

[319] L. Díez-Picazo, 'Operaciones fiduciarias y servicios fiduciarios', in his *Dictámenes jurídicos*, 2nd edn, (Madrid: Civitas, 1987), 34; L. Díez Picazo, and A. Gullón, , *Sistema de Derecho civil*, 9th edn, (Madrid: Tecnos, 1997), I, 532–533.

[320] A confirmation of this use in case law can be found in De Castro Y Bravo, *El negocio jurídico* (Madrid, 1971, reprint 1991), 425–429. Of more recent judgments, the SSTS of 30 April 1992, 21 March 1995 and 24 March 1997 stand out.

commissions, such as the one established for John (art. 279 Code of Commerce). Based on this precept, and on the fundamental confidence upon which the contract is based, the Spanish Supreme Court began rigorously to defend the essential revocability of the mandate.[321] Since the STS of 22 May 1942, however, case law has also defended, without problems, the legality of a mandate or commission agreement with no revocability term. The current situation is that both mandate/commission and irrevocable powers are fully accepted.[322] According to Spanish law, the most appropriate way to structure the relationship between John and Sam would be through a commission with representation. The representation is effected through power of attorney, which the commissionist may or may not use to contract with third parties; if he does not use it, there will not be direct representative effect (arts. 245–247 Code of Commerce). Agency is another possibility; however it only applies if both contractors are professionals (dealer, 'comerciantes').[323] In Case 1, it is unknown whether Sam is a professional.

Although the validity of the irrevocable power does not present a problem under current law, its effect differs depending on the way in which the irrevocability is configured. The Spanish system is similar to the Italian system in that it recognises a difference between obligational or relative irrevocability and real or absolute irrevocability.[324] In obligational irrevocability, the agreement can be revoked, but this breach of its terms leads to a right of compensation for the losses caused to the commissionist or mandatary. Real irrevocability means that revocation is objectively impossible. In other words, the right to revoke has been eliminated and if it were to be attempted it would fail.

It is necessary to determine which of the above two possibilities applies to Case 1. Generally, the Spanish legal system favours the obligational effect in the standard mandate. The real or absolute effect is considered exceptional by case law, and is applied in the following two situations: (a)

[321] See the SSTS 22 December 1908, 27 October 1909, 31 December 1930, 28 June 1934.

[322] SSTS 6 March 1943, 1 December 1944, 12 June 1947, 3 June 1950, 26 November 1954, 31 January 1956, 2 November 1961, 4 February 1967, 6 May 1968, 4 May 1973, 18 February 1977, 8 April 1980, 21 October 1980, 20 April 1981, 31 December 1987, 27 April 1989, 23 December 1993, 19 December 1994, and so on.

[323] In that case, revocation and subsequent compensation would be ruled by art. 25 ff. of the Spanish Law 12/1992 (similar to arts. 15 ff. of Directive 86/563/EEC).

[324] See F. Crespo Allue, *La revocación del mandato* (Madrid: Montecorvo, 1984), 246 ff.; J. L. Lacruz Berdejo, and F. Rivero Hernández, *Elementos de Derecho civil*, 3rd edn (Barcelona: Bosch, 1995), 246. Case law admits the different effects, but it is not so clear in its formulation.

when the (irrevocable) mandate exists not only in the interest of the mandator but also in the interest of a third party or the mandatary; (b) when the mandate is an accessory condition or clause for the carrying out of another contract, in such a way that revocation of the mandate would offend the objective of the main contract. In both of these cases, the irrevocable agreement does not coincide with the pure mandate as regulated by the Civil Code (rather, it is a mandate *tua vel aliena causa*). Typical examples of real irrevocability (see STS 11 May 1993) include the concession by a debtor of a power of administration and disposal over his or her assets in favour of the creditors, to transfer those assets and meet the debts, or a power to construct a building on an owner's site in exchange for receiving a flat in the new building (STS 30 April 1981).

In Case 1, it seems clear that the five-year irrevocable managing power has an obligational or relative character (*inter partes*). In other words, according to Spanish law, John would be limited to a claim for damages if the revocation (of both the commission, as underlying contract, and the power of attorney, as external title) were untimely or unjust. The agreement would be valid since it covers the legitimate objectives and is not contrary to morality,[325] but its effect would be limited. The foundation of the contract would disappear as a result of the allegations that the agent has been implicated in the trafficking of stolen works of art. There are similar examples in Spanish case law. First, the STS of 25 November 1983 involved a six-year irrevocable agreement that entrusted the management of a piece of land to an agent. The Supreme Court recognised the right to revoke before the six years had expired; however, since there had not been a just cause for revocation, the principal was obliged to indemnify the agent for the losses and harm caused by the untimely revocation. Second, the case of the STS of 30 April 1955 involved a bullfighter who granted powers to his representative for a fixed period of time. The powers were then revoked before the specified period elapsed. The court held that there was no common interest between the principal and agent, so that irrevocability was not absolute; but compensation was awarded to the agent.

It follows that the effect of the agreement between John and Sam would only result in compensation for John. As a last resort, John may claim that Sam has committed an 'abuse of right'. Given the

[325] These are the limits required by case law: SSTS 1 December 1944 and 6 May 1967.

circumstances of Case 1, however, it is unlikely that this would succeed since case law considers this avenue to be an exceptional solution.[326]

In addition to the irrevocability term, the facts in Case 1 indicate that the commissionist is remunerated. The question arises as to whether this in itself eliminates free revocability. According to arts. 277 and 279 Code of Commerce it does not.[327] But in the absence of a just cause for revocation by the principal, which would eliminate the need for compensation (non-compliance with the tasks set, fraudulent or culpable behaviour, etc.), doctrine indicates that the agent has a right to the agreed compensation,[328] in addition to the recovery of any amounts he has spent.

Applying the above to Case 1 will give rise to the following results. First, Sam will have the right to a judicial declaration that the relationship is terminated. Second, according to art. 1733 CC, which states: 'compel the mandatary to return the document in which the mandate is established', John could be enjoined from carrying out further transactions related to the assets. He will be required to give up the power that was granted to him by Sam since the mandate's revocation extinguishes this power. This could be obtained through an interim judicial measure.

Third, restitution of the managed assets would ensure that the claims mentioned above are given effect. Sam could achieve restitution by exercising the action for recovery of possession (*rei vindicatio*, *acción reivindicatoria*).[329] This is possible since Sam had not given up ownership of the assets, but only their possession. Having destroyed the formal title that allowed John to act in his name, Sam would recover full powers over the assets. This follows from the application of modern case law on *fiducia cum amico*. Sam did not lose real ownership and thus

[326] STS 9 December 1926: 'neither one nor the other may prevail in this right at the prejudice of the other's interests'. Revocation should therefore be submitted to the rules on good faith in compliance with contracts: on this, see Crespo, *La revocaió del mandato*, 198–206; A. Gordillo, 'Comentarios al art. 1733 Cc.', in *Comentario del Código civil*, (Madrid: Ministerio de Justicia, 1991), II, 1584.

[327] SSTS 5 February 1887, 14 February 1973, 11 February 1984, 22 March 1988.

[328] SSTS 20 October 1989, 3 March 1998. Revocation itself does not need a cause or justification; they serve only to exonerate the principal from questions of compensation. Another complex question is the assessment of compensation, which could vary (according to the work undertaken and the motives for the revocation) between a small figure and the amount which would have been involved until the completion of the mandate; the latter would be more probable in cases such as this, where the agent did not fail to meet his obligations.

[329] STS of 2 December 1996 is exemplary. Cf., more confusing, STS of 5 July 1996.

John should return all the assets to Sam.[330] It is also common to grant a public document for retransfer.[331]

Fourth, Sam will be able to obtain a full audit of the previous period, according to both the mandate's rules (expressly art. 1720 CC) and the criteria of the management *fiducia* (STS 24 March 1997). However, Sam's claim for damages will not succeed. John did not neglect his duties and the extinction of the contract is due to a loss of confidence, based on a subjective cause that is not directly related to it.

With respect to John's counterclaims, John could receive compensation for losses sustained, but he will not be successful at obtaining a declaration that he still enjoys full managing powers until the end of the five-year term.

As a general remark, according to Spanish law, and due to the extensive authorities that John has received, he does not need to carry on his business under the form of a corporation. It is absolutely lawful and normal that he carries on his activities as an individual (particularly with regard to inmovables). A corporation is only required when management affects securities (*valores*: securities, shares, portfolio, management of issues, participations in investment funds, etc.: art. 63.4 *Ley del Mercado de Valores*, LMV[332]). However, in Spain it is common practice that John will not use a corporate vehicle, but will contract services to market intermediaries who will fulfil the legal prerequisites (corporate form, and others: arts. 66 ff. LMV) for dealing with the assets mentioned above, generally referred to as 'enterprises for investment services', and more specifically, *sociedades y agencias de valores*. If Sam's assets mainly consist of securities and stocks, then he will seek the services of a special corporate manager.

Alternative 2

Article 256 of the Code of Commerce states that 'absolutely never can the commissionist act against the express instruction of the commitent, being liable for all the damages that he would produce doing it'. Article

[330] This is an obligation for the fiduciary: SSTS of 9 December 1981, 4 February 1994, 14 July 1994, 14 October 1994, 5 July 1996, 2 December 1996, 18 March 1997, 24 March 1997. If the fiduciary does not comply, restitution will be ordered (SSTS of 30 October 1965, 4 February 1994).

[331] SSTS of 4 February 1994, 18 March 1997.

[332] In this Law the European Directives on the topic (Directives 93/22/EEC, 93/6/EEC and 97/9/EC) are implemented. See also RD 692/96 of 26 April, 'Régimen jurídico de los establecimientos financieros de crédito'.

1719 of the Civil Code states the same rule.[333] In fact, it is understood that the instructions mentioned in both norms are not those of the mandate or commission contract, nor those externalised by the power of attorney (which would fall within art. 1718 CC), but rather are later and complementary orders following on from the original ones.[334] This is the case in Alternative 1.

The main issue is whether Sam's instructions form part of the power's content and therefore delimit the agent's powers, or whether they lack an *ad extra* character and only affect the internal relationship between the agent and the principal. Spanish case law has produced a very clear rule: the commissionist must follow the principal's instructions and is controlled by them in his or her contracting with third parties (see the response to the following alternative);[335] however, third parties are not in principle affected by the instructions unless they have knowledge of them.[336] Third parties will not be aware of the new limitations imposed by the principal's instructions unless the instructions are included in the agent's power or in the initial commission, or unless the agent communicates the instructions to the third party. For this reason, the rule developed by Spanish case law is necessary. On the other hand, if those contracting with the agent know of the instructions, and their contract contradicts the instructions, then it will be declared invalid as a result of bad faith. The third party will obtain nothing.[337]

In Case 1, John is not the only person to know and be governed by Sam's new instructions prohibiting the sale at such a low price. Elinor (the third party) is also aware of these instructions since she also received a copy of Sam's letter. Sam can therefore recover Blackacre from Elinor. Even where John was the registered owner of Blackacre, the defence available to Elinor via the rules of publicity protection offered by the Property Register does not apply in this case (art. 34

[333] 'In the execution of the mandate, the mandatary must follow the instructions of the mandator'; this rule is an application and concretion of the preceding article, which imposes on the agent the obligation to perform the mandate accepted.

[334] See C. Martín Retortillo, 'Responsabilidad del mandatario por no ajustarse a las instrucciones del mandante', *Revista de Derecho Privado* (1953), 732 ff.; J. M. Garrido, *Las instrucciones en el contrato de comisión* (Madrid: Civitas, 1995).

[335] Cf. STS 5 July 1976.

[336] SSTS 17 May 1971, 22 June 1989, 1 March 1990.

[337] This is a very firm rule settled by the Spanish High Court: SSTS 20 June 1894, 18 February 1941, 22 May 1942, 29 February 1948, 20 December 1949, 23 October 1953, 5 July 1956, 27 May 1959, 29 November 1966.

Mortgage Law), because the essential prerequisite of good faith by the contracting parties is lacking.

Alternative 3

It is necessary to determine the obligation surrounding the principal's instructions in order to address the issues in this section. The following classifications have been given to such instructions by numerous court judgments:[338] (a) imperative or necessary, (b) directional or facultative, or (c) demonstrative or variable. According to the latter classification, the agent is given some definite and express guidelines and he can depart from these instructions only if there is a reasonable cause to believe that, in virtue of grave and compelling circumstances, such action would be the most beneficial for the principal's interests (STS of 26 May 1964; cf. art. 255 Code of Commerce).

Given the above, it is necessary to evaluate the literal sense of Sam's note to John in order to determine the degree of control that Sam desires to maintain over the purchase of land. The case appears to be one of control, because it is required ('requiring him . . . '), although the instruction is not a simple purchase of a determined object but rather that the principal wants the object as an investment. Therefore, if the agent rejects the instruction as a result of believing that the investment is bad, and the agent is a person who understands these matters, then this could have a dissuasive effect on the principal. However, if the note leaves no doubt about the imperative will of the principal, or if the principal refuses to withdraw his wish to purchase, then John must execute the task even though it is a poor investment (art. 256 Code of Commerce). If he does not, it would follow that the commission had not been complied with, which would justify its annulment (as in Alternative 1), with a just cause.[339]

Sweden

The general rules on mandate in Swedish law are found in the Commission Agency Act (*kommissionslagen*, 1914:45) and in the Contracts Act (*avtalslagen*, 1915:218). The former Act regulates the internal relations

[338] SSTS 13 November 1941, 6 March 1943, 26 May 1954, 26 May 1964. In doctrine, see León Alonso, 'Comentarios', 215 ff.

[339] This just cause would reduce or eliminate the commissionist's right to compensation on the breach of the term of irrevocability (differently from the discussion under Alternative 1).

between the mandator (commitent or principal) and the mandatary (commissionist), and the external relations (authority to bind) when the mandatary acts in his own name (cf. undisclosed agency). The latter Act regulates only the external relations when the mandatary acts in the mandator's name (cf. disclosed agency). When the mandatary acts in the mandator's name and internal problems arise, the rules in the Commission Agency Act are applicable by analogy. The Commission Agency Act is applicable to transactions concerning assets other than real property, and therefore applies to financial instruments. When the mandatary administers real property, the rules may in some cases be applied by analogy.

Beside these rules, there are still a few rules on mandate in force in the Commercial Code dated 1734, especially a rule that the mandator is entitled to damages if the mandatary causes damage to him by negligence (ch. 18. 4), and another rule that the mandator shall compensate a third party when the mandatary acts without authority, in so far as the mandator was enriched (ch. 18. 3).

For the financial sector, additional rules are given in the Financial Instruments Dealings Trades Act (*lagen om handel med finansiella instrument*, 1991:980). This statute is of a mixed private and public law character. Of particular importance in private law are chapter 3, on dispositions of instruments belonging to some other person, and chapter 5, on settlement and on additional (marginal) securities.

Another statute is applicable to companies that are trading with financial instruments on another's behalf, namely the Financial Enterprises Act (*lagen om värdepappersrörelse*, 1991:981). This Act is mainly of a public law character, governing such things as authorisation to conduct such business, but the act also imposes duties on the manager in relation to the client regarding such matters as information, secrecy, and separation of the client's money from the manager's own money. It also regulates the manager's right to dispose of the client's assets in the manager's own interest.

Additional directives are issued by the Swedish Finance Inspection Board (FFFS 2002:7), based on the EEC Directive 93/22.

Alternative 1

It is a general principle in Swedish law that a mandator may revoke the mandate unless the mandatary is entitled to administer the assets of the mandator as a security for a loan extended by the mandatary to the mandator (or for some similar reason). Otherwise, the mandatary is understood not to have a legitimate interest in a specific performance on behalf of the mandator. Instead, he should be satisfied with having a right to damages (costs and loss of profit) if his mandate is revoked without cause, and the mandator did not respect a notice period[340] or a fixed term for the mandate. There would be sufficient cause for early termination by the mandator, without any obligation to pay damages, if the mandatary were guilty of negligence, or if it could not reasonably be demanded that the mandate should continue (see ss. 46 and 51 of the Commission Agency Act). A similar rule is laid down in the Commercial Agency Act (*lagen om handelsagentur*, 1991:351), s. 26. A mandator may immediately terminate such a contract if he has sufficient cause. In the preparatory works of the two statutes, the rule is not given the same area of application. In the government's bill concerning the Commission Agency Act, it is said that the mandator must respect a termination period if his loss of confidence in the mandatary is caused by the fact that the mandatary mismanaged duties which were outside the contract with the mandator (NJA II 1974, 591).[341] However, in the bill concerning the Commercial Agency Act it is stated that the mandator may terminate the contract with immediate effect if irregularities have occurred which are likely to destroy the mandator's confidence in the mandatary, even if the irregularities have no direct connection to the contract (Prop. 1990/91:63, 108).[342]

Consequently, unless the investment manager, John, can prove that he was entitled to manage Sam's property as a security (which he cannot), Sam's claim for a declaratory judgment terminating the mandate will be granted. John's counterclaim for a declaration that he still enjoys full managing powers will be denied. A court may enjoin John from entering into further transactions related to the assets if it is apprehended that John will dispose of the assets in some way contrary to Sam's interests (see ch. 15 ss. 2 and 3 of the Code of Procedure (*rättegangsbalken*) of 1942).

Upon termination of the mandate, Sam is entitled to a full account (audit) of the previous period. By the same reasoning, Sam is also entitled to restitution of the managed assets. If they were never conveyed to John but only entrusted to him, Sam's restitutionary claim is

[340] All commission agents (commissionists) are entitled to a notice period if the mandate was lasting (*varaktigt*). Commissionists in the financial sector do not think that this rule is needed for their protection, and in autumn 2004 a proposal that the rule be abolished in the financial sector was presented to the government.

[341] NJA II stands for *Nytt Juridiskt Arkiv* part II and contains the preparatory works to enacted new legislation.

[342] Prop. stands for proposition (the government's bill to the parliament).

protected in relation to John's creditors. If the assets were conveyed to John (which is unlikely in Sweden), Sam's third party protection may require retransfer of possession, denunciation or registration in order to be protected in relation to John's creditors.[343]

As to damages, the crucial point is whether it 'could reasonably be demanded that the mandate should continue'. As stated above, it was said in the governmental bill concerning commission agency that irregularities not connected with the contract did not constitute a cause for immediate termination, and rumours in a newspaper would do so even less. This recommendation in the bill, which is not binding on the courts, might however have been overruled by the later recommendation in the commercial agency bill on the same issue, which was to the opposite effect. Therefore, the position in Swedish law seems to be unclear. My assumption is that the courts would think that it could not be reasonably demanded that the relation should continue if the mandatary has actually (not allegedly) engaged in activities that would be fundamentally harmful to the mandator's business.

Alternative 2

Since the mandator, Sam, is entitled at any time to revoke the specific performance of the mandate, the mandatary, John, is not authorised to convey Blackacre after John has learnt that Sam does not want the sale to proceed. Both the Commission Agency Act (ss. 54–55) and the Contracts Act (s. 11) state that a third party (Elinor) cannot rely on a contract when the third party was aware that the mandator did not want the mandatary to proceed. In addition, no rules on *bona fide* acquisition of real property apply. Consequently, Elinor has not acquired any right to Blackacre, and Sam may have this declared by a court.

Alternative 3

A mandatary is in principle bound by the instructions of his mandator, although supervening circumstances may require that the mandatary deviate from the instructions (s. 8 of the Commission Agency Act). If the mandatary is a professional and he finds that the instructions of the mandator (a layman) are ill-founded, then he may be obliged to advise the mandator not to pursue the instruction, even if there are no

[343] Under Swedish law, even true sales of property often require something in addition to the sales agreement to be binding on the seller's creditors. See Hastad, *Sakrätt avseende lös egendom*, 6th edn (1996), passim.

supervening circumstances (cf. s. 6 of the Consumer Services Act, *konsumenttjänstlagen*, 1985:716). If the mandator persists, the mandatary shall either execute the transaction, resign (if there is no danger in delaying execution of the instruction), or be responsible for any loss caused by his refusal.

Since the mandatary, John, has refused to execute the transaction, the mandator, Sam, must execute it himself. In this connection he ought to be entitled to have John transfer to him whatever financial assets are needed to acquire Blackacre. Because he has this opportunity, Sam should not be entitled to damages from John if Blackacre increases in value after Sam would have been able to buy it himself.

Comparative remarks

Throughout Europe there are two basic legal forms in which to organise the relationship between Sam and John. In continental Europe, the preferred form is the mandate, which might be coupled with a power of attorney.[344] In England, Ireland and Scotland, jurisdictions which have an established trust institution, the preference is for the trust.

The division between 'trust' and 'non-trust' jurisdictions, however, is not as clear as might be expected. England, Ireland and Scotland recognise the possibility of implementing the relationship through agency, the functional equivalent of mandate. Conversely, a number of allegedly 'non-trust' jurisdictions indicate some acceptance of some kind of trust relationship, even if the civil code does not expressly provide for it. In Austria, there is an evolving *fiducia* that involves a transfer of title; indeed, the 'settlor's' assets are protected in the event of the insolvency of the 'trustee' or execution against his assets, which is a characteristic feature of the trust. Belgium is also willing to recognise the *fiducia*, although insolvency protection is limited to cases where there is legislative sanction. Similarly, there is some possibility of the recognition of a non-codal *fiducia* in Greece, Italy, Portugal and Spain, and, in rare circumstances, France.

[344] The relationship between the concept of mandate and that of power of attorney is variable. Some jurisdictions draw a clear conceptual distinction, holding that mandate is the bipartite contract between mandator and mandatary, while the power of attorney is that which allows the mandatary to create legal relationships between the mandator and a third party when acting in that mandator's name (Austria, Greece, the Netherlands and Spain). Elsewhere, power of attorney is merely the name for a document which may provide evidence of the relationship (England and Ireland).

Nonetheless, the clear preference in continental systems is to understand the relationship as one of mandate. Every system, including the trust jurisdictions, seems to permit the possibility that the mandatary can act as such without disclosing to third parties that this is the case. The particular name for this version of mandate is variable, as is the formal relationship between it and the case of 'disclosed mandate' (i.e. representation). In such cases, as for example in the Netherlands with regard to assets other than securities, the ownership of the managed assets may lie with the manager during the relationship.

It is no surprise that a great deal of common ground exists regarding the regulatory control of the relationship, due to the transposition into the national legal systems of the Investment Services Directive (93/22/EEC). In particular, regulatory approval is required in order to carry on the business of managing another's assets in the securities field. Most countries require such authorised persons to be corporations, although this is not the case in some (e.g. England and Ireland).

Alternative 1

There is a clear common core in the domain of termination. In all the systems, Sam can terminate his relationship, however classified (trust or no trust), even though the five-year term has not yet expired.[345] The term may be incompatible with non-derogable rules to preserve free disposition of property rights by competent adults (e.g. England, Ireland). Nevertheless, such termination, despite its effectiveness, might create liability towards the manager for loss of remuneration if it is not grounded in a breach of the manager's duties. In Belgium, there is some disagreement as to whether the ability to revoke can be fettered even by the obligation to pay damages. In some other countries the five-year term is inoperative. Where the transaction comes within investment services legislation, such a term is probably incompatible with

[345] Many systems draw a distinction between grants of authority given in the sole interest of the mandator, and those where the mandatary has an interest (for example, where the mandate serves the function of securing an obligation owed to the mandatary). This distinction is most clearly drawn in the Netherlands, Portugal and Spain, where it is said to give rise to the possibility of 'strong' or 'absolute' irrevocability, as opposed to 'weak' or 'relative' irrevocability, that is revocability subject to an obligation to pay compensation. Without this terminology, the same distinction seems effectively drawn in Austria, Belgium, England, France, Italy, Scotland and Sweden. Those reporters who address this issue generally agree that John's future prospects of earning commission do not activate the principle which may generate 'absolute irrevocability'.

standards established for the protection of investors (e.g. Italy, and probably England and Ireland).

If the five-year term is considered valid, given that there is general agreement that the relationship can be terminated for a sufficiently serious cause, the analysis turns to whether newspaper reports of an alleged crime are sufficient to ground the termination of the contract. Some systems, like Germany, Italy and Portugal, take the view that a mere report is not enough and the manager must be permitted to respond to the allegations. Others, for example Denmark, take the view that the implications of the report on the trust and confidence between the parties will be so serious that termination will be justified. The English and Irish position is that termination will be justified if John has conducted his business in such a way as to undermine the relationship of trust and confidence between the parties: this may be the case even if the newspaper allegations are not precisely true.

All reports note that damages are available in addition to termination if they can be proven. Audit is also universally recognised as a remedial possibility. The question of restitution of the assets is approached differently, depending on the formal analysis of where ownership lies during the relationship. On the termination of a trust, as in England and Ireland, restitution is available, but where title rests with the client, Sam, all along, as with securities under Dutch law, a transfer of the assets to the client is not necessary.

An interim injunction against further dealing is widely available. Those countries that use the trust include the substitution of the manager as a possible remedy.

The right of John to claim damages for the early termination of the agreement generally turns on whether the termination was justified, and, as discussed above, the approaches to this are variable. In all countries, John has the right to be compensated for the value of services already rendered, regardless of the method by which his authority to manage the funds is revoked.

Alternative 2

In England, Ireland and Scotland, Elinor becomes the owner of the land, but the question is understood in terms of whether she owns it as a trustee (in which case she will have to return it). Scotland does not allow recovery even if the sale was in breach of trust. On the other hand, England and Ireland do allow for the recovery but only in the case of a breach of trust, although even in that case recovery would be impossible if the purchaser, Elinor, had followed prescribed procedures. These procedures are not available in the case of a single trustee who is a natural person. Because of that, the land may well be recoverable if transferred in breach, with the details varying depending on whether the land was registered or unregistered.

Other countries, although they may generally separate the transfer of ownership from obligations generated by fault, will nonetheless hold the transfer of ownership to be void if the bad faith of Elinor and John is particularly strong: Austria, Belgium, Finland, Germany, Greece, Luxembourg and Sweden. By contrast, it seems that in Denmark, France, Italy and Spain, Elinor will be the owner of the land as a matter of property law, although she will have an obligation to return it (but that obligation may not always be specifically enforceable). The Italian report mentions the possibility that Sam may preserve his rights by a registration in the land registry before the property is transferred to Elinor. In the Netherlands and Portugal, the question of whether Elinor becomes the owner will turn on whether John acted in his own name; if he did not, the transfer may be void.

Many jurisdictions consider that in any event Elinor has committed a civil wrong that will make her personally liable for any loss suffered by Sam.

In Luxembourg, the land transfer scheme is such that the reporter considers the question to be inapplicable and instead, for the purposes of his answer, treats the property at issue as a batch of shares. In that system, the buyer's knowledge of the mandator's unwillingness to make the transfer is enough to characterise the buyer as acting in bad faith, so that the transfer is unenforceable.

Alternative 3

In Scotland, Ireland and England the default principle is that trustees have an independent role to play and cannot simply follow the instructions of the beneficiary. The continental jurisdictions, understanding the relationship in terms of a mandate, seem to hold almost universally that the manager is obliged to follow instructions; if he thinks the instructions are ill-advised, he may resign. The most interesting exception to this pattern could be the French *gestion sous mandat*. This is a mandate relationship in which the mandator may not necessarily give ongoing direction to the mandatary, but scholarly writings and judicial decisions are divided on the question whether the mandator's instructions to the mandatary are actually without effect in this instance. Note also that under the Luxembourg *fiducie* law passed in 2003 the *fiduciant* may give up his power to give instructions to the *fiduciare*. The Greek report notes that the mandator could simply buy the property himself, although if he had to use funds under the management of the mandatary, this would presumably also raise the problem of following directions.

Failure to follow such instructions is a breach, but some reports (Denmark, Finland, Luxembourg, the Netherlands) note that there could be no claim for damages by Sam if John's reason for not following the instructions is that he thought the investment was a bad one and the interpretation of the agreement between the parties leads to the conclusion that the manager's investment powers are actually unfettered; the same rule may be implicit in other continental systems (e.g. Italy) since they note that John's refusal to follow instructions and his choice to resign in such a case is justified.

Case 2: Investment duties

Case

John is a professional investment manager. Sam decides to make use of John's services after learning that he is a skilful manager. In John's office, Sam signs a document granting John full investment powers over a capital value of €2,000,000. The terms of the document indicate that John's powers are to be irrevocable for the term of five years. These powers enable John, inter alia, to buy and sell any kind of asset, including immovables. The document also provides that John will credit all the income produced by the managed capital to Sam's bank account. It stipulates that John will be entitled to deduct an annual fee, calculated as a percentage of the capital value of the managed assets. Sam then writes a cheque payable to John for €2,000,000.

Alternative 1

In the second year of their relationship, Sam learns that John has made very risky investments that have done poorly. As a result, he has lost 50 per cent of the value of the capital. Does Sam have any legal recourse?

Alternative 2

In the second year of their relationship, Sam learns that John does not use his own judgement to make any of the investment decisions. Instead John relies exclusively on the recommendations in a well-known monthly financial newsletter. Does Sam have any legal recourse?

Discussion

Austria

Alternative 1

The contract between John and Sam is to be qualified as a contract of mandate in accordance with ss. 1002 ff. ABGB. In addition to the rules of the ABGB, the provisions of the *Wertpapieraufsichtsgesetz*[1] (WAG) also apply. With this statute the Investment Services Directive (93/22/EEC) (ISD) was implemented into Austrian law. According to s. 11 (1) WAG an investment firm has always to act in the best financial interest of its clients. According to s. 13 N 1 WAG it has to act with the necessary expert knowledge (*erforderliche Sachkenntnis*), care and diligence in the interest of its clients. It has to seek from its clients information regarding their investment experience, the objectives as regard the services requested and their financial interests, in so far as this is necessary with respect to the services requested. If the investment firm violates its obligations under the law the client is entitled to claim damages.

In our case Sam obviously suffers a loss because of the risky investment made by John. He can claim damages for this loss, however, only if John by making these investments acted *wrongfully*. This is the case if he violated his obligations arising from his contract with Sam. What these obligations are, depends on what those two agreed. Three different situations are to be distinguished:

a. Sam authorised John to make risky, even very risky investments. Such an authorisation is only effective if John fulfilled all his obligations arising from the WAG with respect to the information he has to give his clients and that which he has to request from his clients ('know your customer rule'). Furthermore it is necessary that such an authorisation is in Sam's interest. If it is not in his interest – because he has not the necessary financial means to afford a loss of €2,000,000 – John will have to stress this fact to Sam. If Sam – this information notwithstanding – still insists on such an authorisation, it will be effective.
b. Sam forbade John to make risky investments. In this case John violated an express provision of the contract and his action is therefore unlawful.

[1] BGBl 1996/753, modified by BGBl I 2001/97.

c. The parties did not make any explicit agreement with respect to such investments. This is the most difficult situation. In most cases there will be at least some guidelines made by the investor. If *no* such guidelines exist the investment firm has to structure the investment by taking three basic principles into consideration: security, profitability and liquidity. This is achieved by making different forms of investments and by spreading the risks involved with these investments.

Based on these principles, John's investment decisions seem to be very problematic. Although he will be entitled to make some risky decisions he is under an obligation to make these investments in such a way that they will not lead to a loss, in particular a loss of 50 per cent of the assets. The size of the loss indicates that the risk he took was too much, particularly with regard to John's duty to inform Sam about the possibility of such a loss.

To settle these questions a court in Austria will appoint an expert witness who is familiar with the investment business. He will have to find out whether the investments were in accordance with the principles mentioned above or whether they were too risky.

If John's investment decisions are to be qualified as wrongful Sam in principle would be entitled to claim damages. Here an interesting further problem arises. It could be argued that Sam has to wait till the end of the five-year term before he can put forward any claim. Such a view would be based on the fact that the contract was irrevocable for such a period and that whether there is any damage or not can be determined only at the end of these five years. To defend such a view one furthermore could point out that there is the chance that John in the remaining years will make sufficient gains to offset these losses.

Such a view, however, would be wrong. The mere possibility that John with further investments will remedy the losses resulting from his investments does not have any effect on the qualification of his earlier investment decisions as wrongful. This wrongfulness, however, in itself is sufficient to give Sam the right to claim damages for any losses he has suffered through this wrongful behaviour.

In addition to claiming damages Sam also has the right to *terminate* the contract. Even a contract that is irrevocable for a certain period of time can be terminated before this period ends provided there are *substantial reasons* for such a termination. If the investment manager violates his obligation to avoid risky investments, this will constitute such a reason.

Alternative 2

According to s. 13 N 1 WAG an investment firm has to act with the necessary expert knowledge. This provision implements art. 11 N 1 of the ISD, according to which an investment firm has to have and to employ effectively the resources and procedures that are necessary for the proper performance of its business activities. The investment firm furthermore has to act with care and diligence in the best interest of its clients.

If an investment firm *exclusively* relies on a well-known financial newsletter for its investment decisions, such behaviour has to be qualified as a violation of its obligations under the WAG. The investment firm has to base its decisons on the 'necessary expert knowledge'; it therefore has to make use of *all* the sources available to it. It has to acquire information not just from one source but from as many sources as possible. Otherwise there will be a danger that the investment firm acts on wrong or incomplete information, thereby making wrong investment decisions.

By relying on the monthly financial newsletter as his only source of information, John therefore violates his contractual obligations. This gives Sam the right to terminate the contract. Such a violation is to be qualified as a substantial reason giving the other party the right to terminate the contract even before the end of the term for which the contract was concluded.

Belgium

Alternative 1

According to Belgian law, the general rule is that the mandatary must act just as any other reasonable and competent person would do in his place. If the mandatary is a professional, then the general standard of reasonable behaviour in that profession will be expected of him. Therefore, as a mandatary, John has the duty to manage Sam's assets in an efficient and careful manner. But the mere fact that an investment portfolio has substantially decreased in value is insufficient to justify a claim for compensation against the investment manager. It should be proven that no skilful and diligent manager would have managed the portfolio in that particular way.[2]

[2] See Court of Appeals, Brussels, 12 October 2001, *Tijdschrift voor Belgisch Handelsrecht* 2002, 333, *Jurisprudence de Liège, Mons et Bruxelles* 2002, 1036.

A manager of investments involving financial instruments is guided by specific legislation imposing a particular standard of conduct. The Act of 6 April 1995 introduced the ‘best execution rule’. Article 36 sets out specific standards for all intermediaries for transactions in financial instruments, amongst which we find (a) the duty to act in a loyal and equitable manner in order to promote the integrity and honest practice on the market; (b) the duty to act in the best interest of the client and to be competent, careful and devoted in order to meet the interest of the client while taking into account the extent of the client’s professional knowledge; (c) the duty to demand of the client all useful information regarding his financial position, his experience with investment, and his investment objectives, to the extent that such information may reasonably be considered to be relevant to perform services for the client in an optimal way; (d) the duty to avoid any possible conflict of interest.

Furthermore, for investment companies incorporated under Belgian law, there is an additional duty described in art. 79 of the same Act which requires these companies to act in the exclusive and sole interest of their clients. They are required to abstain from performing transactions for the client that involve a personal interest for the company, including natural persons in charge of or employed by the investment company. An additional requirement involves keeping the services of investment management separate from other activities.

John, as an investment management company under Belgian law, must comply with all these rules. He must perform a sound financial analysis and collect all relevant information before making any investment decision.[3] If Sam can prove that John was negligent by making investments that can be considered too risky, then John will be liable for the loss suffered by Sam.[4] However, the extent to which John will be held liable will depend on the terms of the actual agreement between John and Sam. The Act of 6 April 1995 and the Royal Decree of 5 August 1991 do not contain any detailed provisions on liability for poor investments.

Alternative 2

John is required to manage the assets as a capable professional who is well informed about any relevant evolution on the financial (or other) market and about the commercial aspects of the businesses in which he invests.[5]

[3] M. Flamée and T. Tilquin, ‘La gestion de fortune et le conseil en placements’, *Revue de Banque et Finance* 1991, no. 57, 575.

[4] Art. 1991 and 1992 BCC.

[5] J. Van Ryn, *Principes de droit commercial*, vol. IV, no. 693.

As such, it could be argued that John should be aware of the recommendations made in the well-known financial newsletter. However, it is contrary to his duty of careful, diligent and professional management to neglect all other information and to rely exclusively on these recommendations. Consequently, Sam can sue John for breach of his contractual obligations, to revoke the mandate, and for compensation.[6]

Denmark

Alternative 1

Whether Sam has any legal recourse against John as a result of his poor management will depend on the terms of their agreement. Even if there is no term entitling Sam to terminate the agreement in the event of mismanagement (and it would certainly not be advisable for Sam to enter into such an agreement), it may still be possible for a Danish judge to find it unreasonable for Sam to be prohibited from terminating the agreement under the circumstances.

Generally, an investor must be aware of the risks involved in entering an investment agreement. The poor investments made by John should not be deemed sufficient grounds to terminate the agreement unless the terms of the agreement indicate otherwise. Moreover, termination should not result if the investment manager has at least based the investments on well-founded professional judgement.

Alternative 2

The answer to the question raised in Alternative 2 will depend on the terms of the investment agreement. In the absence of express terms, there is an implied presumption that the investment manager resorts to his own independent judgement when investing the client's money. The manager must be entitled to consult any sources of information generally recognised in the field, when forming his opinion about which investments will be most profitable. It is also a general rule that the larger the amount invested by the client, the greater the demands that can be made on the manager in terms of the professional care he must show regarding the investment of his client's assets.

[6] Art. 1992 BCC.

England

Alternative 1

The investments which trustees may make are regulated primarily by the terms of the trust, and secondarily by statutory default rules. Until recently, the default rules were in the Trustee Investments Act 1961, which limited trustees to fairly conservative investments. This has now been replaced by the Trustee Act 2000. Instead of providing a list of authorised investments, under this Act trustees are allowed to invest as if they owned the trust property, subject to a number of safeguards as to suitability, diversification and so on. However, the regime imposed by the Act can be displaced by the terms of the trust, and a trust for investment management would certainly provide its own principles for permissible investments. If John made impermissible investments that would be a breach of trust, and also a breach of contract in the case of investments not complying with the terms of an investment management contract. Either way, John would be obliged to make up any loss that flowed from the breach.

Even if a trustee has made permissible investments, he is held to a standard of care. The standard that an unpaid trustee must reach in making investments was set in *Speight* v. *Gaunt*,[7] which held that the trustee must take the degree of care that 'an ordinary prudent man of business would take in managing similar affairs of his own'.[8] A professional trustee is, however, held to a higher standard, and is expected to show the degree of expertise that could be expected of a specialist in trust administration.[9] In the Trustee Act 2000, s. 1, this is now codified. The trustee must exercise 'such care and skill as is reasonable in the circumstances, having regard in particular –

[7] (1883) 9 App. Cas. 1 (HL).

[8] *Speight* v. *Gaunt* was concerned with whether the trustee had failed to take sufficient care in employing an agent. In the context of the choice of investments, a more stringent formulation of the standard of care was needed, because a person might take risks with his own money which were not appropriate with trust money. In *Re Whiteley* (1886) 33 Ch. D. 347, 355 (CA), affirmed (1887) 12 App. Cas. 727 (HL), Lindley LJ refined the statement in *Speight* v. *Gaunt* in this way: 'The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider; the duty rather is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide. That is the kind of business the ordinary prudent man is supposed to be engaged in . . .'

[9] *Bartlett* v. *Barclays Bank Trust Co. Ltd* [1980] Ch. 515, 534.

(a) to any special knowledge or experience that he has or holds himself out as having, and
(b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.'[10]

That standard would be applied to John. If he were found liable, he would be obliged to make up any loss caused by his breach of duty.

The terms of the trust may vary these duties. In *Armitage* v. *Nurse*[11] the trust deed contained a provision that exempted the trustees from any liability except in a case of 'actual fraud'. The Court interpreted this to mean that there would be no liability for breach of trust except in a case of dishonesty. The beneficiaries argued that such a clause was ineffective, but the Court held that it was valid. In particular commercial contexts, statutory intervention may reduce the scope for such exemptions.[12] The tight regulation of the business conduct of investment advisors and managers under the Financial Services and Markets Act 2000 would preclude, as a matter of public law, the use of any such wide-ranging exemption.[13]

It should also be noted that under this regulation, and also as a matter of general trust law, a manager/trustee must disclose to the client/beneficiary the nature of the investments held; so Sam should have been aware all along of the investments. A breach of this duty is a breach of trust which generates a right to compensation for losses caused by it.

Alternative 2

The general position is that trustees must exercise their powers personally. Their ability to employ agents may be governed by the terms of the trust. If no provision is made, the Trustee Act 2000 in its Part IV allows

[10] Schedule 1 of the Act sets out when the standard of care applies; in particular, it applies when making investments. It would appear that if a trustee fails entirely to invest, the statutory standard does not apply, in which case the conduct would be tested by the common law standard.

[11] [1998] Ch. 241 (CA).

[12] Liability for negligence may not be excluded in the cases of trustees of debentures (Companies Act 1985, s. 192), trustees of unit trusts (FSMA 2000, s. 253), and trustees of pension funds regarding their investment functions (Pensions Act 1995, s. 33). Note also the Law Commission's Consultation Paper No. 171, *Trustee Exemption Clauses* (2002), in which the Commission provisionally recommends that professional trustees should never be allowed to exclude their liability for negligence.

[13] Investment advice and management must be conducted according to eleven principles set down by the FSA under FSMA, s. 64 (see above, pp. 125–126, nn. 85–86). The second principle is that 'a firm must conduct its business with due skill, care and diligence'.

the employment of agents to perform certain functions on behalf of the trustees.[14] The Act provides that the trustees, in employing agents, are held to the same standard of care (set out above) that applies to trustees in making investments. Some functions may not be delegated. Asset management may be delegated, but it is subject to special rules since it is a core function of trustees.[15] There must be an agreement in writing, which requires compliance by the agent–manager with a written policy statement regarding the assets to be selected.

John cannot rely on these provisions; he has not appointed an agent, but has merely failed to act personally in using his power of selecting investments. This power, like any power of a trustee, must be exercised in good faith and in the best interests of the beneficiaries. If John really relies 'exclusively' on the newsletter, then he is not exercising his power personally. This would be a breach of trust and so a ground for the removal of John as trustee, as discussed above (Case 1, Alternative 1). John would also be liable for any loss flowing from the breach.

Finland

Alternative 1

Sam could, without a doubt, effectively terminate the mandate. Succeeding with the claim for damages will be more difficult. According to the law, if John has acted negligently then he will be responsible for the losses. The standard of care will be relatively high since John is acting as a professional manager who has a great deal of discretion. Nevertheless, John's liability to pay damages will depend on the details of the case at hand, for example the degree to which John's investments are risky (higher risks are generally required in order to reap higher profits), what kind of investments are involved (immovables, bonds, shares, derivatives, etc.) and under which general economic circumstances the loss has

[14] The discussion in the text is concerned with the case in which the trustees *collectively* delegate some function, such as selling a piece of land, or choosing invesments. The Trustee Act 1925 provides for the different case of the delegation by a *single* trustee of *all* of his functions, through a power of attorney: s. 25, as substituted by s. 5 of the Trustee Delegation Act 1999. If this is done, however, the trustee remains liable for any act of the attorney which would be a breach of trust if the trustee had done it himself. The maximum period for such delegation is one year.

[15] Trustee Act 2000, s. 15. See Law Commission Report No. 260, *Trustees' Powers and Duties* (1999), 151.

occurred (generally rising or falling rates of exchange).[16] A definite answer cannot be provided without knowledge of these facts; however the results of John's investment activities are, nevertheless, very poor.[17]

The standard of care required from John could, in principle, be regulated in the investment contract, for example by using some kind of disclaimer. In practice, the possibilities for restricting the responsibility of an investment manager are, however, relatively small. First, contract terms which do not conform with good manners or which are unreasonable for the customer of an investment manager are not valid according to the Securities Market Act of 26 May 1989/495, Ch. 1 s. 4 and Ch. 4 s. 2.[18] According to the regulations of Financial Supervision, an investment service enterprise is always required to reach, carefully and proficiently, the goal of the investment agreement made with a non-professional customer.[19] This responsibility cannot be limited. These regulations and provisions only concern contracts governed by the Act on Investment Service Enterprises. However, even if there were no investment service enterprise in question, a contract term would normally be regarded as unreasonable if it, for example, relieved the other partner of responsibility for his grave negligence or *dolus*.[20]

Alternative 2

A mandatary cannot transfer his or her mandate to someone else if that is not permitted in the contract of mandate. In Alternative 1, however, it is clear that John has not transferred his mandate. The presumption is, on the other hand, that the mandatary is entitled to rely on assistants chosen by him or her.[21] The mandatary is then responsible for what the assistants have done or left undone. Whether it can be said that John has been using

[16] According to regulation no. 201.9, Decree no. 10/152/96, 5.11.1996 of Financial Supervision, an investment contract made between an investment service enterprise and its non-professional customer should contain clauses defining not only the investment strategy, i.e. the desired risk and profit levels, but also the planned investment objects.

[17] If the poor results of John's investment activities could not be regarded as a sufficiently relevant breach of contract, the premature termination of John's mandate could, in principle, entitle him to claim for damages.

[18] The provisions mentioned above are given in order to implement Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field.

[19] See regulation no. 201.9, Decree no. 10/152/96, 5.11.1996 of Financial Supervision and M. Rudanko, *Arvopaperimarkkinat ja siviilioikeus* (Helsinki: Lakimiesliiton Kustannus, 1998), 317–318.

[20] See M. Hemmo, *Sopimusoikeus I*, (1997) 308.

[21] See H. Halila and M. Hemmo, *Sopimustyypit* (Helsinki: Lakimiesliiton Kustannus, 1996), 159.

an assistant remains highly questionable. John has always made his decisions personally and independently on a case-by-case basis regardless of whether he has regularly relied on the recommendations of a financial newsletter. Therefore, the decisive question is simply whether John has been acting negligently by basing his investment decisions on the recommendations of a well-known financial newsletter. In other words, has John been acting with enough care or should he have engaged in more thorough investigation in order to serve the interests of his mandator better?

The contract between Sam and John does not directly forbid John from relying exclusively on the recommendations in a well-known monthly financial newsletter. However, many of the facts in Alternative 1 indicate that John was not acting appropriately. It is, for example, important to note that the amount invested by Sam is relatively high and that John is a professional investment manager given a great deal of discretion. These facts will have a great deal of weight in making the argument that Sam could expect John to pay more attention to his investments. Sam could, therefore, terminate the mandate and claim damages for breach of contract. Also, Sam could make use of his right to terminate the mandate irrespective of whether the mandatary has breached the contract.

France

Alternative 1

John Ltd is liable for any loss suffered by Sam due to his mismanagement.[22] The fact that Sam's expectations with respect to income or value of capital have not been met is not sufficient to give rise to a claim against John.[23] However, provided that Sam is able to demonstrate that John Ltd has mismanaged his assets, Sam will be entitled to sue John Ltd and claim damages, the amount of which will indemnify the loss suffered. The facts that risky investments were made and that, as a consequence, the value of the managed capital was reduced by 50 per cent constitute evidence that could be used to conclude that John Ltd has mismanaged Sam's assets. Finally, it is also possible for Sam to terminate John Ltd's contract of mandate.

Alternative 2

In light of the fact that John Ltd does not personally perform the investment decisions but merely relies on advice from a financial newspaper,

[22] Art. 1991 para. 1 C. civ.

[23] Paris, 12 June 1991, *D.* 1991. 591, comment Martin.

John Ltd may be held responsible for any loss suffered by Sam with respect to the investments based on the financial newspaper's advice, as this should be construed as a breach of his general obligation of care.[24] It is also possible for Sam to terminate John's mandate.[25]

Germany

Alternative 1

Sam can claim damages that result from John's breach of contract. The only exception would be the unlikely case that the parties intended that the investments be high risk. In Alternative 1, John would have to inform Sam very accurately about possible risks, especially if Sam was not experienced in this business (see § 31 para. 2 *Wertpapierhandelsgesetz*, WpHG).[26]

Alternative 2

The relevant rule for Alternative 2 is to be found in § 664 BGB. This rule is currently being applied to non-gratuitous mandate agreements even though § 675 BGB does not mention it (§ 613 BGB would lead to the same results anyway). Under § 664 BGB, a person who agrees to manage another person's business interests must do so in person and is not allowed to put the execution of his contractual managing duties into the hands of a third party. This rule is especially applicable if the third party does not consider the specific case that must be managed (as in the case of a newspaper). The burden of proof, i.e. that John acted in person, rests with John.

Nevertheless, § 664 BGB is merely a default rule and whether John's exclusive reliance on the newsletter was a breach of his duties will depend on the interpretation of the agreement. In the absence of explicit evidence to the contrary, the contract will not be interpreted in John's favour if he did not at least review the third party's recommendations and use them only as a starting point for his decisions. Note that in

[24] Art. 1994 C. civ. See Com. 19 March 1991, *Bull. civ*. IV, No. 102; *D*. 1992. Somm. 81, comment Rémond-Gouilloud; *RTD civ*. 1992. 414, comment Gautier.

[25] Pétel, *Les obligations du mandataire*, No. 124: 'Celui-ci [le mandataire] doit apporter tous ses soins en vue d'accomplir les actes dont il est précisément chargé dès lors que leur accomplissement comporte un caractère aléatoire.'

[26] Transposing art. 11 para. 1 (4) dash 4 and 5 of the Investment Services Directive 93/22/EEC, EC OJ 1993 L 141/27; amended in EC OJ 1995 L 168/7; the WpHG was enacted as art. 1 of the 'Gesetz über den Wertpapierhandel und zur Änderung börsenrechtlicher und wertpapierrechtlicher Vorschriften (Zweites Finanzmarktförderungsgesetz)' of 26 July 1994, *Bundesgesetzblatt* 1994 part I, 1749 now 3. Finanzmarktförderungsgesetz, *Bundesgesetzblatt* 1998 part I, 528.

this case, as in the other cases, there would be additional scrutiny by the courts if the agreement were to be found in standard contract terms. In Alternative 1, even explicit evidence for an interpretation in favour of John would most likely not help.[27]

Section 664 BGB is a key provision. If there were a breach, then this would also constitute 'an important reason' for termination of the contract (see Case 1, Alternative 1). An action for damages, however, is possible only if the breach of duties led to losses or lost profit (§§ 249 and 252 BGB). See Case 3, Alternative 2 for issues related to burden of proof.

Greece

Alternative 1

According to s. 714 CC, the mandatary is responsible for any fault (see Case 1, Alternative 1), and therefore he is responsible for any damage that results from his fault in the performance of the mandate. Furthermore, according to s. 288 CC, a debtor is bound to perform the obligation in accordance with the requirements of good faith while taking into consideration business usages. Moreover, under L.2396/96 (Investment Services in the Securities Field), a code of self-regulation has been published, which is applicable to companies providing investment services (EPEY)[28] (see the introduction at the start of the answer to Case 1). This code provides that companies providing investment services (EPEY) are obliged to protect the interest of their clients. They should particularly be informed of the financial status of their clients, their investment objectives and their experience in investments. This information will allow companies providing investment services to provide their clients with appropriate and suitable investment services. On the other hand, companies providing investment services should provide their clients with any appropriate information regarding the investment policy and the particular risks of their investments. This general obligation of disclosure also arises from s. 718 CC, which provides that the mandatary is bound to furnish information to the mandator regarding the affairs entrusted to him.

Taking into consideration the aforementioned legal framework, the conclusion is that very risky investments do not comply with

[27] See Seiler, in *Münchener Kommentar*, § 664 BGB para. 19.

[28] L.2396/1996, s. 7. Ministerial Decision 12263/B500/11.4.1997 (Code of self-regulation of companies providing investment services).

business usages in the field of investment management, unless the investor is previously well informed of the particular risks and has expressly given his consent to taking these risks. Companies providing investment services in the field of securities are also obliged to protect the interests of their clients and to keep them informed of the risks to be taken. John did not give any information to Sam about his investment policy and the particular risks undertaken, nor did he take the appropriate actions in order to avoid substantial losses of Sam's capital. Rather, John acted with negligence since he did not take the appropriate care in carrying out business (s. 330 CC *in fine*). Sam can therefore sue John for damages. In addition, Sam may revoke the mandate and the power of attorney given to John (see Case 1, Alternative 1).

Alternative 2

Under Greek law a mandatary is not *a priori* entitled to substitute another for him in the performance of the mandate (s. 715 CC). Nevertheless, there are a few exceptions to this rule. First of all, the mandate agreement may include a clause permitting this to take place. Moreover, the mandatary may use a substitute, if he has been forced to do so by the circumstances, or if such substitution is usual (s. 715 CC *in fine)*. The exclusive reliance on the recommendation of a well-known financial newspaper should be considered as a substitution in the performance of the mandate. In the absence of an explicit clause permitting the substitution, and given that John is obviously not forced by the circumstances to rely exclusively on the recommendations of the newspaper, the question whether this substitution is permitted, according to s. 715, depends on whether such reliance is usual. In answering this question, the principle of good faith and business usages should be taken into consideration, as provided for in ss. 200 and 288 CC (Provisions Applicable to the Interpretation of Contracts). The making of decisions about investment policy is a crucial duty of the discretionary manager, since in practice investors rely on the professional capacity of the investment manager. The exclusive reliance of John on the recommendations of a reputable financial newspaper constitutes, therefore, an impermissible substitution of John in the performance of the mandate.

It has been held that the mandator is entitled to revoke the mandate in the case of a prohibited substitution, even if the mandate also concerns the interest of the mandatary. This kind of substitution is an important reason for allowing revocation (see Case 1, Alternative 1).

If the mandator (Sam) has suffered a loss due to the prohibited substitution, he may claim damages from the mandatary (John), since the latter is responsible for the fault of his substitute as for his own fault (s. 716 § 1).

IRELAND

Alternative 1

In the absence of an express investment clause in the trust, the investment powers and duties of a trustee are governed by Part I of the Trustee Act, 1893 as amended by the Trustee (Authorized Investments) Act, 1958, which provides a list[29] of permissible investments. If John's investments were impermissible having regard to the terms of either the trust or statute, he would be in breach of trust and liable to compensate Sam for the loss.[30]

Nevertheless, 'however unlimited the power of investment may be, the trustee remains subject to the jurisdiction of the court. The trustee has no power to act dishonestly, negligently or in breach of trust . . . '[31] Consequently, the trustee must 'take such care as a reasonably cautious man would take . . . and must use as much diligence as a prudent man of business would exercise in dealing with his own private affairs'.[32] In applying this standard, the High Court has held that 'it is the duty of a trustee to confine himself not only to the class of investments which are permitted by the settlement or statute, *but to avoid all such investments of that class as are attended with hazard*'.[33] Since John's investments are described as 'very risky', it is likely that he is in breach of this standard, and thus liable to compensate Sam for the loss.

Furthermore, as John is a professional investment manager, Sam might also seek to claim compensation for the 50 per cent loss in the value of the capital under the terms of the Investor Compensation Act, 1998.[34] However, the Act covers only losses consequent on an investment business

[29] Section 1 of the Trustee (Authorized Investments) Act, 1958 lists the specified investments; section 2 gives the Minister for Finance a power to vary that list which has been exercised on a number of occasions to expand the list of permissible investments: see, most recently, SI No. 28 of 1998.

[30] *Stacey* v. *Branch* [1995] 2 ILRM 136 (HC) 142 *per* Murphy J.

[31] *Re O'Connor* [1913] 1 IR 69, 75–76 *per* O'Connor MR; cf. *Speight* v. *Gaunt* (1883) 9 App. Cas. 1 (HL).

[32] *Stacey* v. *Branch* [1995] 2 ILRM 136, 142 *per* Murphy J; *cf. Learoyd* v. *Whitely* (1886) 33 Ch. D. 347; (1887) 12 App. Cas. 727.

[33] Ibid., emphasis added.

[34] The Act implements the Investor Compensation Schemes Directive 97/7/EC, OJ L84/22 (1997).

firm's inability to meet its obligations from claims by clients 'for reasons directly related to its financial circumstances' (s. 31(1)) and is designed to compensate for losses of money and securities up to a ceiling.[35] It does not apply to losses caused by negligent behaviour or any breaches of statutory duties which might apply.

John would, however, be subject to the requirement to undertake a suitability assessment in respect of Sam's investment objectives and, arguably, risk appetite.[36] It may be, depending on Sam's experience and financial resources, that the 'very risky' investments made are in breach of the Code of Conduct, with the same unclear remedial consequences as those set above (Case 1, Alternative 1).

Alternative 2

A trustee must exercise his powers personally, in good faith, and in the best interests of the beneficiaries; he can take advice or appoint an agent, but he cannot delegate his powers.[37] John does not meet this standard if he relies 'exclusively' on the newsletter: he is not exercising his powers personally, his reliance goes far beyond merely taking advice, and it does not constitute appointment of an agent. He must therefore compensate Sam for any losses flowing from this breach, for which he is also liable to be removed as trustee.

Italy

Generally speaking, if John's investment choice were made in violation of the specific degree of care that is required by the professional nature of John's activity, Sam has the right to obtain damages for breach of contract, pursuant to art. 1710 CC. In this case, according to the Civil Code, the level of diligence required is evaluated by reference to the nature of the activity,[38] that is the professional activity of investment management. There is no evidence, however, that John made investment decisions without complying with the appropriate standard of care. The

[35] 90 per cent of the loss or €20,000, whichever is the lesser.

[36] Principle 6 provides that, having regard to the investment management agreement or terms of business, the relevant facts disclosed by the client and other relevant facts about the client of which the firm is, or ought reasonably to be, aware, a firm must take all reasonable steps to ensure that it does not give advice to, or effect transactions for, a private client (which Sam would appear to be) unless that advice or transaction is suitable to the client.

[37] *Joy* v. *Campbell* (1804) 1 Sch. & Lef. 328 (advice); *Re O'Flanagan's and Ryan's Contract* [1905] 1 IR 280 (no delegation).

[38] Cf. Cass., 11 April 1992, n. 4471.

sole fact that John made risky investments in Sam's interest is not sufficient to ground the claim for damages.

Note, however, that, as a professional investment manager offering his services to the public, John will be subject to the more stringent requirements applicable to the activity of investment firms pursuant to the d. lgs. of 24 February 1998, n. 58, *Testo unico delle disposizioni in materia di intermediazione finanziaria*. This text and the regulations implementing it require investment services firms to keep clients always adequately informed and to undertake a suitability assessment of the client's investment objectives and risk profile.[39] If Sam's experience, risk disposition and financial resources do not match the profile of an investor for whom 'very risky' investments are suitable, the investment manager's decision to make such investments violates the duty to refrain from carrying out unsuitable transactions.[40] Sam can claim damages for the breach of such duty. In considering the probability of success of such a claim, two further points must be kept in mind. Under the present regulatory regime, intermediaries like John must promptly inform investors in writing where the assets entrusted to them for management have diminished in value as a result of actual or potential losses by 30 per cent or more of the total value of the assets under management at the beginning of each year (or, if later, at the date on which the relationship began), taking into account any deposits or withdrawals. An analogous communication must be made at the time of every further diminution equal to or exceeding 10 per cent of such value.[41] Furthermore, under the same regime, the burden of proof of having acted with the required diligence is on the investment firm (d. lgs. 24 February 1998, n. 58, art. 26.3). On this basis, Sam will succeed in an action for damages against John for the loss caused by the violation of his duties.

Alternative 2

From the facts presented in Alternative 2, it appears that John has failed to act in accordance with the degree of care required in the performance

[39] Consob regulation, 1 July 1998, n. 11522, arts. 28, 29, implementing the provisions of the d. lgs. 24 February 1998, n. 58, art. 21, lett a) and b). See Costi, Enriques, *Il mercato mobiliare* (2004), 330 ff.; Sartori, *Le regole di condotta degli intermediari finanziari. Disciplina e forme di tutela* (2004), 201ff. Trib. Mantova, 18 March 2004, Giur. it., 2004, I, 2125 (unsuitable sale of Argentinian bonds).

[40] Consob regulation, 1 July 1998, n. 11522, implementing art. 29.1 of the d. lgs. 24 February 1998, n. 58.

[41] Consob regulation, 1 July 1998, n. 11522, implementing art. 28.4 of the d. lgs. 24 February 1998, n. 58.

of professional investment management services.[42] He has relied exclusively on the recommendations of the financial newsletter without bringing his professional judgement to bear upon those recommendations, which was why he was retained in the first place. His conduct entitles Sam to terminate the contract and seek damages for any loss suffered as a consequence of such conduct.

Luxembourg

Alternative 1

According to Case 1, Sam has the right to revoke the mandate. He will be entitled to a full audit and restitution of the remainder of the funds under management. In addition, he will be entitled to damages if he can show that John SA has failed in the execution of the contractual obligations to manage the funds.

An investment manager is not obligated to achieve a certain result, unless he undertakes it expressly. Rather, he is bound to act diligently and prudently, to the best of his abilities and in the best interest of the client.[43] Luxembourg courts have therefore considered that an investment manager (or a bank undertaking such activities) has an obligation not of result, but of means (*obligation de moyens*).[44] Much will depend on the exact terms of the agreement. Liability will obviously arise if the risky investments were either against the agreed investment policy, or not provided for expressly in the agreement: this is the case in particular for derivative transactions, which, except in transactions with professionals of the same speciality, are required to be specifically accepted. Under Circular CSSF/2000/15, the contract for discretionary portfolio management must define the objectives of the management, the assets under management, how the client will be informed, and certain other provisions. The manager has also the obligation to identify the profile of the customer and specifically warn him in case of unusual and risky transactions.

A further source of liability may be art. 37 of the 1993 Law (which implements the Investment Services Directive), which introduces as a professional obligation for credit establishments and other professionals of the financial sector established or active in Luxembourg a suitability requirement in relation to the investments advised to, or

[42] D. lgs. 24 February 1998, n. 58, art. 21; art. 1710 CC; Costi, Enriques, *Il mercato mobiliare*, 327; Sartori, *Le regole di condotta degli intermediari finanziari*, 151ff.

[43] Article 37 of the Law on the financial sector.

[44] TA Luxembourg, 23.12.1992, Pas. 29, 48; TA Luxembourg, 11.7.1997, no. 560/97, unpublished.

carried out on behalf of, their customers. This obligation was recognised by case law, but has now been introduced in the law as a professional obligation in art. 37 of the 1993 Law and confirmed in Circular CSSF/2000/15. The Circular requires in particular that the manager acts in the best interest of the client, avoids any conflicts of interest and undertakes only transactions which are within its competence (or else sub-delegates them to a specialised third party). In particular, with respect to discretionary portfolio management, the Circular requires the manager to follow the evolution of the portfolio, and to inform the client in case of a significant loss incurred in relation to the portfolio's evolution.

While the regulatory consequences of the breach of those rules are certain, this is not the case for the civil consequences; it is however generally admitted that a breach of such professional obligations will entail a liability in tort or in contract (the latter being the case here). Nor is it clear whether the loss through risky investment will put the burden of proof of suitability on the manager (*obligation de résultat* or *obligation de moyens renforcée*).

Sam must demonstrate that the poor management results are due to a lack of due diligence, effort and expertise on the part of John SA. If he can show this, then he will be entitled to damages, both for *lucrum cessans* and *damnum emergens*, with the added complication of the valuation of such damages in the area of speculative investments.

Alternative 2

There are a variety of remedies available to Sam in this situation. First, Sam can revoke the investment management mandate from John SA. He can claim that John is not accomplishing the work he is being paid to do and thus is effectively in breach of his obligations. More specifically, instead of providing tailor-made investment management, John merely relies on the work of others. Sam can also claim damages if he demonstrates that John's actions have caused him a loss, although proof of loss would be very complicated in this case.

Second, Sam can also claim that John SA's salary should be reduced since his contribution to the investment management is not in proportion to the payments due to him under the agreement. Case law holds that a mandatary's salary must be proportionate to the value of the services he provides to the mandator.[45] The courts have recognised the power to control the remuneration of mandatories.

[45] CA Luxembourg, 18.3.1920, Pas. 11, 80; Malaurie and Aynès, *Les contrats spéciaux*, no. 550.

Third, Sam may also claim that the initial investment management contract with John SA is null. Several grounds of nullity are available. The first ground of nullity is called 'error in the person'. According to art. 1110 CC, a person who has entered into a contract under the erroneous view of the capacities of his contractual counterparty can obtain nullity of the contract if the views are important for the contract. He must show that the erroneous belief bore on the substantive characteristics of the person in question, that it determined his consent to enter into the contract, that it is not due to his own negligence, and that the other party knew the specific qualities sought by the claimant on which the error bore. The second ground of nullity involves an error that affects the object of the contract, i.e. the type of services to be provided by John SA. Third, both of the above errors will entitle Sam to both nullity and damages if the reason for his mistake involves fraud committed by John SA under the heading of '*dol*' (art. 1116 CC). Finally, another ground for nullity is the 'absence of cause' in the agreement. Sam can argue that the cause for entering into the agreement was professional capacity of John SA and the security of individualised investment management. According to art. 1131 CC, any agreement based on a non-existing cause is null.

Not all of the above grounds are equally applicable; rather, their relevance will depend on the exact circumstances. However, the consequences of nullity remain the same. In principle, parties are obliged to make *restitutio in integrum*, i.e. a re-establishment of the situation prior to the conclusion of the contract. However, given the impossibility of implementing this option with respect to contracts that are executed over a long period of time, the consequences of nullity will largely resemble those of revocation (audit, restitution, etc.). This will be combined with a possible reduction (and ensuing restitution) of the remuneration perceived. Sam may also claim damages for losses caused, in particular if the cause for the nullity is a fraudulent misrepresentation by John SA.

Netherlands

Alternative 1

Investment in financial instruments

The portfolio manager is obliged to inform his client about the transactions and risks that are involved.[46] Moreover, the information must be

[46] Arts. 33 and 35 FRMSST 2002.

provided in a timely manner and in a particular form such that the meaning and scope of the information can reasonably be understood.[47] If John failed to provide such information, then he violated his duties under the ASST 1995 and additional rules. The question presented in Case 1 appears in this case as well (see Case 1, Alternative 1 under the section titled *Investment in financial instruments – point a: termination*). If those rules of Public Administration are also for the protection of the individual client, the mandator/client has a right to damages if they are violated.[48] The general notion of breach of contract or misrepresentation of facts will be coloured by the obligations under the ASST 1995 and the further regulations. Whether a breach of contract or a claim for misrepresentation will succeed depends on whether the failure in the performance of the contract is attributable to the portfolio manager (art. 74 Book 6 CC) or whether the portfolio manager provided wrong or incomplete information or none at all where information would have been due, as obliged by art. 32 FRMSST 2002 (art. 228 Book 6 CC). In Alternative 1, whether John BV has breached the contract will depend on the instructions given by the client and the information that was provided by John BV about those security transactions and the risks attached (art. 33 sub 1(c) FRMSST 2002). If the investments fall outside the specified instructions, then John BV will be in breach of contract and thus liable for the losses within the limits of liability as agreed between John BV and Sam in the written contract (art. 27 sub 1(h) FRMSST 2002). It is also possible to argue the liability of John BV on grounds of breach of a duty of care (see below). A full exoneration of the liability will usually not be upheld if John BV acted with gross negligence.

Investments other than in financial instruments

With respect to investments other than those made in financial instruments, the ASST 1995 is not applicable. This has as the main consequence that the breach cannot be founded on breach of specific rules regarding the provision of information and warnings for specific risks (see above). It will depend on the contractual agreement between John BV and Sam whether specific instructions have been given on investments and whether specific duties of care have been agreed on. The mandatary is required to act in a good and caring manner (art. 401 Book 7 CC). The

[47] Art. 38 FRMSST 2002.

[48] With respect to the rules on information this can be well defended. Van Setten, *De commissionair in effecten*, 44; Grundmann-van de Krol 2004, 489–490.

specific standard of care required by this article will be measured by the circumstances. There are no concrete rules available.[49] It is most likely the case that John has violated his duty of care. Thus, he will be liable for the loss that has been caused by his failure to perform the obligations that arise out of the contract, unless the failure is not attributable to him (art. 74 Book 6 CC). If the failure in performance is attributable to John, Sam has two options. He can sue for damages (arts. 74 and 87 Book 6 CC) or he can sue for the rescission of the contract, possibly accompanied by a claim for damages (arts. 265, 270 (partial rescission) and 277 Book 6 CC). In this case John BV can have his liability limited. A full exoneration from liability will usually not be upheld if John BV acted with gross negligence.

Alternative 2

Investment in financial instruments

With respect to Alternative 2, the ASST 1995, the written contract and further rules are all applicable. Art. 401 Book 7 CC obliges the portfolio manager to exercise due care in the performance of the contract. Art. 25 FRMSST 2002 obliges the portfolio manager to take into account the client's interest. It will depend on the written contract whether John BV is allowed to make use of the services of third persons. In selecting these third persons the portfolio manager will have to exercise due care. With respect to Alternative 2, this rule is probably not applicable because it does not literally concern a third person. However, it can be presumed that exclusive reliance on a monthly financial newsletter is a bad performance of these duties. On the basis of art. 74 Book 6 CC, John BV will be liable for any losses that are incurred as a direct result of reliance on the newsletter if that conduct is clearly negligent of the client's interest or otherwise a breach of contract.

Investments in assets other than financial instruments

The mandatary is obliged by art. 401 Book 7 CC to take the proper care that is expected of a good mandatary, which normally means that he cannot exclusively rely on the advice of his stockbroker or the recommendations in a newspaper. This is, however, dependent on the usages in society and what the parties can reasonably expect from each other (the knowledge of the mandatary, the contents of the contract of mandate).[50] In this case it is most likely that the mandator will be able to sue on grounds of breach of

[49] See HR 24 September 1993, NJ 1994, 227 (Beck/Van Wijngaarden).

[50] Asser/Kortmann 1994, no. 58.

contract (art. 74 Book 6 CC). Relying on the advice in a financial newsletter is a rather poor fulfilment of the requirement to take the proper care that is expected of a good mandatary. The difference from the answer above is that in this case no reference can be had to the specific rules on care and information of the supervision legislation. However, the difference in outcome will be small because the supervision legislation is not very precise in the matter of assistance of third persons.

Portugal

Alternative 1

Sam is not satisfied with the economic results of John's management. However, there is no mention in Alternative 1 that John did not comply with the instructions given to him by Sam. Indeed, Sam could have given John instructions that would have required John to act with either greater prudence or greater aggressiveness in his asset management. If the management is performed by John SA, a written mandate should have been granted, specifying the terms of the management. In the absence of instructions, John should act with the diligence and prudence of a *bonus pater familias*, in other words, as a prudent and competent manager. However, if the risky management continued for two years, for example, with the knowledge and complacency of Sam, then the risk should fall where the gains fall. If the very risky investments had generated large gains, then the profit would have accrued to Sam. In Alternative 1, the risk of loss arising therefrom should also lie with Sam.

If the management is conducted through a financial company, the duties of the manager will have to be stricter. The management must be conducted with regard to the client's interests in terms of the degree of the risk therein involved (art. 304 n. 4 Securities Code – *CVM, Código dos Valores Mobiliários*, Decree-Law 486/99 of 13 November). Portuguese securities law establishes the 'know your client rule', forcing the financial manager to inform himself as to the financial situation of his clients, their experience in terms of investment, and the goals of their investment decisions (art. 304 n. 3 Securities Code).

Alternative 2

John shall manage Sam's assets with normal and prudent diligence (*bonus pater familias*) unless they mutually agree to different terms in the contract of mandate. As a professional manager, John is expected to act professionally with a level of diligence that goes beyond relying on the recommendations of a monthly financial newsletter. A professional manager is obligated to act professionally, demonstrating special knowledge, skill and capacity.

In Alternative 2 there are no special instructions given regarding the nature of the management expected of John: that is, whether the management should be more active or more passive in nature. Therefore, with no special instructions provided, John's duty is to act with the caution of a prudent manager. It may be concluded that a passive type of management that only relies on the recommendations of a financial newsletter lies outside the scope of the professional skill and prudence that is to be given in good faith. However, it is also possible to conclude otherwise, depending on the terms of the mandate and on the circumstances at hand. If John's passivity can be considered contrary to the standard of prudent and competent management, then Sam will have due cause to revoke the mandate and claim compensation for *lucrum cessans*. In Alternative 2, Sam can only blame himself for not providing management instructions when he was able to do so. As such, Sam runs the risk of having to accept the management that John considers adequate, or the management that is considered adequate by usage and circumstances.

Scotland

Alternative 1

Negligent administration is breach of trust. If John was negligent in Alternative 1, then he will be liable for the loss that he caused. However, the fact that an investment loses money does not imply that the original decision was negligent. Everyone is wise with hindsight. John will only be found liable if it is shown that the original decision he made was negligent. As in England, trusts deeds sometimes have 'immunity clauses'. The Scottish courts interpret such clauses restrictively, perhaps more restrictively than the English courts: in Scotland they do not protect the trustee from liability for *culpa lata* (gross negligence).[51]

[51] *Lutea Trustees Ltd* v. *Orbis Trustees Guernsey Ltd* 1997 SC 255, 1998 SLT 471 is the leading modern case. See further Chalmers, *Trusts* (2002), para. 9–25, and Wilson/Duncan, para. 28–43 and 28–44. The leading modern English case, *Armitage* v. *Nurse* 1998 Ch. 241 (for which see the English report) has some discussion of the Scottish authorities.

In addition, if the investment were unauthorised by the trust deed, then John would be strictly liable for any loss of value.[52] (If the trust deed were silent on the question of what kinds of investments were permissible, then the Trustee Investments Act 1961[53] would be applicable to determine which investments are allowed and which are forbidden.)

Sam can apply to the court (not necessarily successfully) to have John removed as trustee (see Case 1, Alternative 2). Moreover, if John is in breach of contract, Sam may be justified in invoking his right to terminate John's contractual right to carry on administering the trust (see Case 1, Alternative 1).

Alternative 2

In general a trustee has the right to delegate and the right to act on advice, provided that he does so in a reasonable manner.[54] If the trustee carefully selects the persons to whom he delegates, or from whom he takes advice, then he will not be liable for any losses that result. However, the trustee is expected to 'keep an eye' on such persons to the same extent that would be expected of any other person delegating to professionals.[55]

In Alternative 2 the trust seems to indicate that John will make investment decisions personally, on the basis of his own expertise. Therefore, in such a case John is acting in breach of the trust. If losses result, then John will be liable. The measure of loss is the difference between the trust estate as it is and the trust estate as it would have been if John himself had made the investment decisions. It is obvious that there would be practical problems related to proving the latter figure. If no losses result, then John would not be liable. However, he would still be in breach of the trust. Sam could apply to the court (not necessarily successfully) to have John removed as trustee (see Case 1, Alternative 2). Moreover, if John is in breach of contract, Sam may be justified in invoking his right to terminate John's contractual right to carry on administering the trust (see Case 1, Alternative 1).

[52] Wilson/Duncan, para. 28–21, *Pollexfen* v. *Stewart* (1841) 3 D 1215; *Henderson* v. *Henderson's Trs* (1900) 2 F 1295.

[53] No longer in force in England. In 1999 the Law Commission and the Scottish Law Commission issued a joint Report on *Trustees' Powers and Duties* (Law Com. No. 260; Scot. Law Com. No. 172). This was implemented in England and Wales by the Trustee Act 2000. So far it has not been implemented in Scotland, but it is likely that the Scottish Parliament will legislate in this area.

[54] *Hay* v. *Binney* (1861) 23 D 594; Wilson/Duncan, para. 23–26.

[55] This can be inferred from *Bisset* v. *Standard Property Investment plc* 1999 GWD 26–1253, though that case was not itself one which involved a trust.

Spain

Alternative 1

According to art. 1727 CC, 'the mandatary is liable not only for the wilful misrepresentation (*dolo*), but also for the culpability (*culpa*), which should be considered with greater or lesser rigour by the courts depending on whether or not the mandate was paid'. Therefore, in Alternative 1, where there is no appearance of an action in bad faith by the mandatary, the mandatary will still be held responsible and will be required to compensate the mandator for the damage caused by his bad management. The fact that the mandate was paid raises the standard of the diligence requirement. In the case of commission, this solution is reinforced by art. 258 Code of Commerce (liability for more onerous prices or conditions than normal).

The obligations of the commissionist are those of means and not of ends. Therefore, the commissionist is obliged to act in accordance with the subjective interest of the owner of the assets. This kind of diligence must be akin to that given by the mandatary when managing his own things (*diligentiam quam in suis rebus adhibere solet*, see art. 1719 CC). The mandator can also demand this diligence. This demand would be regarded as normal, since the client gave the manager the task based on his confidence in the agent's business ability and expertise. The Civil Code (arts. 1726 and 1103) leaves open for the courts the possibility of moderating the liability that arises from negligence. Case law has fluctuated between rigour and flexibility without uniform criteria.[56]

Failures to collect income, or risky investments resulting in losses, do not automatically imply liability for the agent. The courts have held that in order to be compensated a principal should prove the existence and the amount of damage suffered.[57] Equally, the culpability of the agent must be shown.[58] Therefore, with respect to Alternative 1 Sam will be required to prove the damages that resulted. John will have a good defence only if

[56] See J. A. Alvarez Caperochipi, *El mandato y la comisión mercantil*, (Granada: Comares, 1997), 190. The STS of 25 March 1993 or the STSJ of Navarre, 20 February 1997 (bad management of an asset portfolio, almost equal to this alternative) emphasise the obligation of diligence and sanction compensation in cases similar to that proposed. See also STS 11 July 1998 and the case law cited in these STS.

[57] SSTS 15 January 1925, 5 June 1944, 1 December 1959, 6 May 1967, 10 February 1979, 1 March 1984, 8 October 1984, 26 November 1984. According to STS 24 May 1979, it is possible to claim not only damages but also that which was not earned (*lucrum cessans*).

[58] STS 25 May 1988.

Sam's orders were to take risks to obtain higher profits, or if he can show that the investments, when made, were without apparent risks.[59]

In conclusion, the remedies open to Sam will include: (a) a full rendering of accounts to evaluate the risk and the culpability in the decisions taken (this is required both via the mandate rules and those of the *fiducia cum amico*); (b) compensation for losses wrongfully caused (on the basis of both the mandate and the *fiducia*, see STS 2 December 1996); and (c) extinction of the management relationship by revocation of the mandate.

Alternative 2

The person who makes decisions is John, although he 'relies exclusively on the recommendations' of an external source. The principal can prohibit the agent from using these substitutes or auxiliaries (art. 1721 CC; art. 261 Code of Commerce) and require the agent to make all of the decisions, since the latter was chosen for this function and for his or her abilities (*intuitu personae*). The management style that directly follows an objective source, such as a newsletter, does not imply 'delegation' or naming of substitutes, *sensu stricto*. Thus, the agent is not prohibited from using an objective source. Nevertheless, the following recourses are available to Sam: (a) if the investments have resulted in a loss, then John is liable if these were caused by his negligence (see Case 2, Alternative 1); (b) it is possible to revoke the mandate within the rules discussed in Case 1; and (c) Sam can prohibit John from relying on one source, and require him to make decisions by himself. If the agent persists in his behaviour even after the prohibition, then he would incur liability for both overextending his power (once redefined by the prohibition) and non-compliance with his obligations.

Sweden

Alternative 1

The question of to what extent Sam has to accept risky investments depends on what he told the manager, John, about his risk inclinations, and what he later learnt of the investments without having made any objections. Pursuant to the directives from the Finance Inspection Board, a manager shall investigate and document the purpose of the services that the client demands. Although this is a public law

[59] If the agent demonstrates his diligence, this does not proceed: SSTS 23 February 1973 and 10 February 1979.

regulation, it should have some impact on what risks a manager is entitled to incur without asking the client. However, no precedents are known in which the risk level as such has made the manager liable for subsequent losses (although the issue has surfaced in recent years after the telecom turbulence, when many managers issued options without informing clients of the implications).

Even if the manager would be liable for risky investments made without informed permission from the client, the client is obliged to protest against the investments within a reasonable time after the investments became known to him and he ought to have understood their character (see s. 20 of the Commission Agency Act).

Alternative 2

When a client asks for services from an investment manager, he reasonably expects more than the implementation of what is recommended in well-known monthly financial newsletters. Therefore, he is probably entitled to terminate the contract for breach of an implied duty. No precedents are known, however.

It is more uncertain whether the client would be entitled to damages, in particular as it would be very difficult to calculate his losses.

Comparative remarks

Alternative 1

There is a clear common core in this case. The question whether the risky investments were permissible investments is governed by the contract between the parties (although trust jurisdictions mention default rules for trustee investments, which would likely not apply in this context). Obviously, loss caused by impermissible investments is recoverable.

More difficult is the case in which the investments were permissible ones. All countries agree that John must meet some standard of managerial care. Moreover, there is general agreement that in the first place, the level of care that John must take is governed by the terms of the agreement between the parties. However, freedom of contract is here limited by the Directive on Investment Services and the national laws which implement it. Many of the reports mention the effect of the Directive in this regard.

Absent any contractual specification, general rules impose a standard of care in managing other people's money. This standard is modified with reference to John's professional status. Most reporters, not surprisingly, did not feel able to venture any conclusion about whether John's behaviour fell below the required standard, since more information would be required as to the arrangements between the parties, and in particular the sophistication (or otherwise) of Sam as an investor, and the knowledge he had as to which investments were being made.

The report from the Netherlands elaborates on this last point, and observes that a failure to keep Sam informed as to the investments being made would itself be a violation of a duty to provide information.[60] In Italy, the financial services legislation specifically requires notification to the client where the client's investments have decreased in value below specified thresholds. The legislation also reverses the burden of proof on the issue of whether the manager took adequate care in choosing investments.

Alternative 2

There appears to be a common core of results considering John's reliance on the newsletter advice both inappropriate and a breach of his obligations, subject to any provision of the contract which might govern the case. This is so even though there is a range of approaches in terms of legal analysis.

Some reporters understood the issue as one of effective sub-delegation of the management function (e.g. England, Germany, Greece), while others (e.g. Austria, Spain) rejected the applicability of the principles governing that kind of case. Delegation or substitution of another decision maker, at least in respect of a central function such as choosing investments, is not permitted unless expressly agreed, and so where the facts were understood as revealing a kind of delegation, John was seen to be in breach. This allows termination and recovery of any losses caused.

Even where the facts were not understood to reveal delegation, John could be understood to be in breach of an obligation (implied if necessary) to use his own professional judgement (Belgium, Denmark, Scotland), or in breach of the general obligation of care (Finland, France, Italy, the Netherlands, Spain). Again, breach of this obligation allows termination and recovery of any losses.

[60] This is also true for England, and probably other jurisdictions. It was not raised directly by the question; see also comparative remarks to Case 3, Alternative 1.

Case 3: Conflict of interest

Case

Jacob is managing Esther's assets with full power to sell them. One of the assets he holds on her behalf is an undeveloped piece of land called Blackacre.

Alternative 1

While exploring investment possibilities for Esther, Jacob learns that the zoning rules for the area that includes Blackacre are likely to change in a way that will make land in that area more valuable. A month before the change is announced, Jacob uses his own money to buy Greenacre, an undeveloped piece of land in the same area. When the zoning change is announced, the value of both Blackacre and Greenacre increases by 100 per cent. When Esther becomes aware of what has happened, she seeks an amount corresponding to the increased value of Greenacre from Jacob. She claims that this increase is a wrongful gain from a transaction that created a conflict of interest and duty, since Jacob's duty involves using the information he acquires in managing Esther's assets for her benefit and not for his own gain. Will Esther's claim succeed?

Alternative 2

Jacob owns Greenacre, an undeveloped piece of land in the same area as Blackacre, in his personal capacity. Jacob sells Blackacre to Bill, a member of the zoning board responsible for the planning of the district including both Blackacre and Greenacre. The transaction is at market value. Six months after the sale, a change in the zoning ordinances (produced by the Board of which Bill is a member) increases the value of Greenacre and Blackacre by 100 per cent. It is possible that the zoning change was brought about by Bill's political influence; however, the matter is not clear. When Esther becomes aware of this fact she claims Blackacre back from Bill. She also claims from Jacob an amount corresponding to the increased value of Greenacre. She claims that this increase is a wrongful gain from a transaction that created a conflict of interest and duty given that Jacob's sale of Blackacre was arguably motivated by a desire to see the zoning ordinances changed so that his own land would be more valuable. Will Esther's claims succeed?

Discussion

Austria

Considering the relationship between Jacob and Esther presented in Case 3, the following are possible ways in which Jacob could manage Esther's assets: (a) in his own name and for his own account, which would imply a fiduciary relationship, or (b) in his own name and for Esther's account, which would imply an indirect representation relationship, or (c) in Esther's name and for her account, which would imply a direct representation relationship. The responses to Case 3 are based on the assumption of a fiduciary relationship, internally combined with a contract of mandate.

Alternative 1

In order to determine whether Esther's claim will succeed it is necessary to focus on the internal relationship between Jacob and Esther, which is governed by the rules of the contract of mandate.[1] According to s. 1009 ABGB, Jacob is obligated to meet a comprehensive fiduciary duty. When conducting his management activities, Jacob must always primarily consider the interests of Esther, his mandator. If the interests of the mandator and the mandatary are likely to conflict, then it is the mandatary's duty to make the mandator aware of this. In general, the interests of the mandator should prevail. With regard to the fiduciary relationship and its inherent fundamental confidence, the fiduciary duty is likely to be even more prominent. It does not need to be stipulated separately in the original contract; it automatically emerges from the relationship as a whole.[2]

[1] See ss. 1002 ff. ABGB as well as Case 1.

[2] Apathy in *Schwimann, ABGB V*^{2} § 1009 Rz 6 ff.; Strasser in *Rummel, ABGB I*^{3} § 1009 Rz 17–19.

After exploring investment possibilities for Esther, Jacob bought Greenacre for his own benefit without informing Esther of the attractive investment possibility. Since Jacob's duty arising out of the fiduciary agreement is to manage Esther's assets, and since he has the power to invest in new assets, the minimum he is required to do is inform Esther about Greenacre. By not informing Esther, Jacob failed duly to preserve Esther's interests and is thus liable for damages (s. 1012 ABGB). In other words, Esther's claim for an amount corresponding to the increased value of Greenacre will succeed. If exploring new attractive investment possibilities for Esther is not covered by the fiduciary contract, then Jacob will not be found to have violated Esther's interests, and he will not be held liable for any loss. The violation of the fiduciary duty also justifies the revocation of the fiduciary contract.[3]

Alternative 2

With respect to Alternative 2, it is not clear whether it was Bill's influence that brought about the change in the zoning ordinances. Thus there is more than one possible solution to this alternative. The crucial point, however, is the presence or absence of intention to cause damage by the contracting parties.

If Esther is able to prove the allegation that the zoning change was brought about by Bill's political influence and that Jacob and Bill were working together, then Esther's first claim will succeed. The purchase of Blackacre will be considered *contra bonas mores* (s. 879 ABGB) since it was not only harmful to Esther's interests, but it was also intended to damage her (collusion).[4] As a consequence, the transaction between Jacob and Bill will be held void and Bill will never have obtained ownership over Blackacre.

Esther, however, is not entitled to claim damages or unjust enrichment from either of the parties, not even with respect to the increased value of Greenacre. Since the transaction of Blackacre was legally void, Esther never lost the piece of land and continues to remain the owner. The only difference is the increased value of 100 per cent, which is now part of Esther's assets. Esther did not suffer a loss and is thus not entitled to damages. Certainly, the gross violation of Esther's interests also enables her to terminate her relationship with Jacob by way of revocation.

[3] Apathy in *Schwimann, ABGB V*^{2} § 1009 Rz 11.

[4] Stanzl in *Klang, ABGB IV/I*^{2}, 857–859; Koziol/Welser, *Grundriss I*^{12}, 193.

If Bill did change the zoning ordinances in abuse of his official position and Jacob did not have knowledge of his intentions when selling Esther's piece of land, then the transaction is legally valid. In this case, Esther cannot recover Blackacre from Bill. Also, she cannot claim damages or unjust enrichment from Jacob regarding the increased value of his piece of land, because Jacob did not violate his contractual duties.

If there is not enough evidence indicating that Bill has influenced the change in the zoning ordinances and that Bill and Jacob intended to prejudice Esther, then the transaction of Blackacre is legally valid. Esther cannot claim damages from either of the contracting parties, nor can she recover Blackacre. The sale of the piece of land was at market value and the increased value of Blackacre and Greenacre emerged by chance later on.

If Jacob, however, sold Blackacre to Bill with the knowledge of the latter's official position and the hope that the purchase would effect a change in the zoning ordinances, then Jacob has violated his fiduciary duty in addition to Esther's interests. Although the purchase would be considered legally valid[5] and Esther would be unable to claim Blackacre back from Bill, Jacob would still be liable for damages (s. 1012 ABGB). Esther could sue Jacob and claim an amount corresponding to the increased value of Blackacre.

Belgium

Alternative 1

The general theory of mandate provides that a mandatary should abstain from entering into transactions in which he has personal interests contrary to those of the mandator. In other words, a mandatary may never enter into a transaction in which he is the counterpart of his mandator, unless he is authorised by the mandator.[6] It is unclear whether Jacob's use of information acquired in the course of his investment duties for his personal gain could be considered a conflict of interest. On the one hand, Esther could refer to the duty of the mandatary to perform the mandate in the interest of the mandator,[7] and argue that Jacob should not have used the information for personal purposes. Consequently, she could revoke the mandate on the grounds that a

[5] Provided that Bill did not know that Jacob was acting against Esther's interests. If he knew that, it would be a case of collusion and bad faith: see above.

[6] P. A. Foriers, 'Le droit commun des intermédiaires commerciaux: courtiers, commissionnaires, agents', in *Les intermédiaires commerciaux* (Brussels: Ed. Jeune Barreau, 1990), 64.

[7] H. De Page, *Traité élémentaire du droit civil belge*, vol. V, no. 412.

mandate is a relation based on trust and that Jacob has violated this trust. On the other hand, whether Esther has any rights to the information acquired by Jacob during performance of his investment duties depends on the wording of the contract. If there is no specific provision in the agreement, then Esther's claim will only succeed if she can demonstrate that she had a reduced return on her investment because of Jacob's personal transaction of Greenacre.

The situation would be somewhat different if Jacob had provided investment management services in relation to financial instruments, through a corporate entity. Such entities fall within the scope of the Act of 6 April 1995 and the Royal Decree of 5 August 1991. According to art. 4 of the Decree, investment management companies cannot engage in any professional activities other than managing their client's assets (financial instruments) or advising their clients about their investments. The administrative organisation of companies that invest in financial instruments must be strictly separated from any other activity. Furthermore, art. 20 of the Royal Decree of 5 August 1991, in addition to arts. 36 and 79 of the Act of 6 April 1995, regulates the conflict of interest issue. In art. 79 § 2 it is explicitly stated that investment companies are prohibited from acting as counterparts to their clients with respect to transactions they perform in their professional activities. Consequently, it could be argued that it is contrary to the law for an investment management company (in financial instruments) to invest for its personal gain, if this could create a conflict of interest with a client. However, it is doubtful whether this would entitle Esther to the increased value of Greenacre. The amount claimed should, at least, be diminished by the profit Jacob has made for Esther, through other investments, with the money that would have been used to acquire Greenacre.

Alternative 2

It is not clear whether the zoning change was brought about by Bill's political influence. If the change was completely out of the question at the time of the sale, then it will most likely be impossible to act against Bill. If the zoning change was already under consideration at the time of the sale, or if it was likely that this change would result, then one could argue that Bill's actions constituted a conflict of interest. As such, Bill could be sanctioned for this behaviour. The fact that the change took place six months after the sale might support the presumption that Bill had knowledge of the change, or the likelihood of the change, at the time of the purchase.

Another issue that arises in Alternative 2 involves Bill's duty to inform Jacob of the possibility of the zoning ordinance change, assuming that it was likely that such a change would be considered. If it can be proven that Bill was aware, at the time of the sale, of the fact that the value of Blackacre would increase substantially in the short term, then it can be argued that Bill did not act in good faith. In fact, it can be said that Bill deliberately omitted essential information.

Aside from specific legislation that imposes a duty to inform, it is accepted under Belgian law that there may be a duty of information in the pre-contractual context, although there is no general duty in all circumstances.[8] The parties should inform each other of information they have, or should have (taking into account any professional capacity). Also, they should inform each other if they know or should know that the other party considers the information to be important, or needs it to evaluate its own contractual position. This duty only exists to the extent that the information is not regarded as data that the other party knows or should know. This is where the connection with the other party's duty to investigate becomes apparent. It is obvious that there cannot be a duty of information if there is a duty of investigation.[9]

If the fact is something that can be publicly known, then it can be argued that Jacob had a duty of investigation that would excuse Bill from his duty of information. However, in Alternative 2, it is clear that the possible change of the zoning ordinance was not available to the public. Thus, assuming that Bill knew about the possible change, he had a duty of information, which he did not fulfil.

The remedies available to Jacob, as mandatary acting for Esther, are mistake, deceit or *culpa in contrahendo*. Mistake[10] is not applicable to the facts presented in Alternative 2, since mistake only deals with incomplete or incorrect information that would result in Jacob's being mistaken about the substance of the asset. In fact, Jacob was not mistaken about the object of the sale, that is, Blackacre.

Deceit[11] exists if a party deliberately presents reality in a false way, in order to induce the counterparty to contract (principal deceit) or to

[8] See A. De Boeck, *Informatierechten en -plichten bij de totstandkoming en uitvoering van overeenkomsten* (Antwerp: Intersentia, 2000).

[9] A. Verbeke, 'Informatie over andermans vermogen', *Rechtskundig Weekblad* 1993–1994, 1129–1155, in particular § 6 and the references to case law and doctrine.

[10] Art. 1110 BCC.

[11] Art. 1116 BCC.

accept certain conditions (incidental deceit). Deceit can involve deliberately omitting essential information, if it is known that the other party would not contract at all, or would not contract on these terms, so long as the information involved is something that the other party neither knows nor should know. It can be argued that Bill acted in (principal) deceit by inducing Jacob to make a contract that Jacob would not have concluded had he known about the likelihood of the change to the zoning ordinance in the near future. There is (incidental) deceit if Jacob was induced to accept contractual conditions he would not have accepted had he known about the change.

A third remedy, which has gained acceptance as the basis for a precontractual duty of disclosure, is the *culpa in contrahendo*, based on art. 1382 BCC (which is a tort-like action based on wrongful behaviour), or on art. 1134 BCC, third paragraph, the rule requiring performance of contracts in good faith. This remedy is also available to Jacob. Therefore, depending on the facts regarding the change of the zoning ordinance, it is possible for Jacob to demand that the sale be nullified on the basis of principal deceit, or that damages should be paid on the basis of incidental deceit or *culpa in contrahendo*.[12]

With regard to the question of whether Esther can claim the increased value of Greenacre, there does not seem to be a conflict of interest. Jacob already had Greenacre in his possession and there is apparently no substantial element indicating fraud on his part. If Esther cannot show that she suffered damage or incurred a loss of return as a result of Jacob's decision not to sell his own property, then she is not entitled to its increased value.

Denmark

Alternative 1

The issue in Alternative 1 is whether Jacob, under his agreement with Esther, was obliged to use the information he obtained primarily for Esther's benefit, and to use the information for his own benefit only in the event that Esther was consulted and refused to buy Greenacre. Under Danish law the answer to this question arises solely from the interpretation of the investment managing agreement. In the absence of express provisions in the agreement, a Danish judge would most likely hold that the agreement implies that Jacob has an obligation to

[12] Van Gerven and Covemaeker, *Verbintenissenrecht*, 60, 70 and 95.

confer with Esther whenever an attractive investment opportunity comes up, and let her decide whether she wishes to invest. If Jacob breached an express or implied term of the agreement, then Esther can claim damages that, in this case, will correspond to the increased value of Greenacre reduced by the expenses Esther would have incurred in connection with the purchase of Greenacre.

Alternative 2

In Alternative 2 it is clear that Esther has the burden of proof. Therefore, Esther must prove that Jacob's sale of Blackacre to Bill was motivated by a desire to have the zoning ordinances changed so as to make his own property more valuable. This argument must be supported by factual circumstances that show that Jacob was in bad faith.

If Esther should succeed in proving that Jacob was in bad faith, then she can claim from Jacob an amount corresponding to the loss inflicted on her. Esther's loss does not, however, correspond to the increased value of Blackacre, since the value would most likely not have increased had Jacob not sold Blackacre to Bill. This depends on the circumstances. If it is possible to prove that the value would have increased even if Blackacre had not been sold to Bill, thereby showing that the zoning change was not brought about by Bill's political influence, then Esther would be entitled to claim an amount corresponding to the increased value of Blackacre from Jacob. If this cannot be proven, then it is difficult to see where Esther has suffered a loss. If Jacob had not neglected his contractual obligations by putting his own personal interest before Esther's, then he would most likely not have sold Blackacre to Bill and thus the value of Blackacre would not have increased.

Whether Esther can claim Blackacre back from Bill depends on whether Bill knew or should have known that Jacob was acting against his contractual obligations when selling Blackacre. If Bill was in good faith, then Esther cannot claim Blackacre back from him.

England

Alternative 1

There is a general rule that trustees may not profit from their office, and to the extent that they do, they must account to the beneficiaries for any such profit. The rule is so strict that trustees, including until recently even professionals, are not entitled to any remuneration unless they can show a specific entitlement overriding the general rule.[13] There is another principle (some suggest that it subsumes the 'no-profit' principle) that a trustee should never put himself in a situation where his personal interest might conflict with his duty to the trust beneficiaries. A breach of that principle also requires the trustee to give up any profit acquired via the breach (it may also impose an obligation to pay damages for any loss caused to the beneficiary). It is important to notice that these liabilities do not require proof of any loss to the beneficiary; they are instead measured by the trustee's gain. These principles also operate to control purchases by the trustee of a beneficiary's interest, or of the trust property in the trustee's personal capacity. Good faith is not a defence, nor is it a defence that the trustee's actions have benefited the beneficiaries.[14]

These principles almost certainly apply to Alternative 1. The profit arises from information acquired in the course of Jacob's duties as trustee. The information could have been used to benefit the trust beneficiary, and thus there is a potential conflict. As a result, Jacob will be required to account for his profit.[15] Even if the terms of the trust did not permit the purchase of land, or if there was insufficient trust money to buy more land, the same result would follow.[16]

Some suggest that the principle has been taken too far. The limits of it are difficult to find, but they must exist. It cannot be the case that a

[13] Conversely, no one can be forced to become trustee of an express trust against his or her will. A professional trustee will generally not act until it has examined the document constituting the trust, to ensure that it will be able to recover its normal fees. The Trustee Act 2000, ss. 29–30, now provides professional trustees with a right to reasonable remuneration in some circumstances. The law distinguishes remuneration from indemnity, and therefore an express provision is not required in order for a trustee to recover from the trust property expenses properly incurred in the administration of the trust (and see now Trustee Act 2000, s. 31).

[14] This principle has been made clearest in cases concerning the actions of company directors, such as *Regal (Hastings) Ltd* v. *Gulliver* [1942] 1 All ER 378, [1967] 2 AC 134n (HL), and in *Boardman* v. *Phipps* [1967] 2 AC 46 (HL), which concerned a solicitor. Company directors and solicitors are subjected to the same duty of loyalty as are trustees, owed respectively to the company and the client.

[15] *Boardman* v. *Phipps* [1967] 2 AC 46 (HL).

[16] In *Keech* v. *Sandford* (1726) Sel. Cas. T. King 61, 25 ER 223, 2 Eq. Cas. Abr. 741, 22 ER 629 (LC), it was immaterial that the opportunity was one which the trustee could not acquire for the benefit of the trust beneficiaries. This case is still considered foundational in this branch of the law. Similarly, in both *Regal (Hastings) Ltd* v. *Gulliver* [1942] 1 All ER 378, [1967] 2 AC 134n (HL) and *Boardman* v. *Phipps* [1967] 2 AC 46 (HL) it was said to be immaterial whether the beneficiary was able to take advantage of the opportunities.

trustee is precluded from doing anything for his own benefit.[17] There must be a possibility of conflict between the trustee's own interest and his fiduciary duty to act in what he perceives to be the beneficiary's best interests. The scope of that fiduciary duty is defined by the trustee's functions. In this case, Jacob was acting for Esther when he acquired the information, which would suggest that he had a duty to use the information for her benefit; he is therefore caught by a conflict between this duty and his own self-interest. The solution in many cases will be for the trustee to get the beneficiaries' consent to take personal advantage of an opportunity. If all beneficiaries are of full age and capacity, and consent in advance with full information, then no accountability arises. This of course is no solution if some beneficiaries lack capacity.

Alternative 2

The profit achieved by Jacob came to him through his office as trustee, and through an apparent conflict of interest and duty. Jacob may possibly keep the profit only if it can be shown that the two transactions (sale of Blackacre and zoning change) were completely unrelated, so that there was no possibility of any conflict of interest and duty. For example, if Jacob did not know who the buyer was at the time of the sale, then there would be no basis on which to impeach the sale. The burden of proof would be on Jacob. If he could not prove that the transactions were unrelated, he would have to account to Esther for his profit.

As for recovering Blackacre from Bill, the crucial question is whether the transfer to him was a breach of trust by Jacob. If Jacob was making the transfer to Bill for any reason other than that he thought it was in Esther's best interests, then the transfer was in breach of trust. The applicable principles are discussed in Case 1, Alternative 2. In short, since the conditions for overreaching are not satisfied, the common law principles apply if the land is unregistered. Bill will hold Blackacre on trust for Esther unless he can prove that he acquired it in good faith and for value, without notice of the trust. If the land is registered, Bill will only be bound by the trust if it was noted on the land register, via a notice or a restriction (on which see the answer to Case 1, Alternative 2).

[17] See Smith,'The Motive, Not the Deed', in J. Getzler, ed., *Rationalizing Property, Equity and Trusts: Essays in Honour of Edward Burn* (London: LexisNexis UK, 2003). Some more recent company law cases suggest a less strict approach, at least in that context: *Island Export Finance Ltd* v. *Umunna* [1986] BCLC 460; *Balston Ltd* v. *Headline Filters Ltd* [1990] FSR 385. But these were cases in which the director had resigned, and pursued an opportunity which the company had not wished to take up.

Finland

Alternative 1

It is clear that Jacob, as a mandatary, is obliged to do his best to serve the interests of Esther, his mandator. Therefore, problems can arise if the mandatary is, at the same time, making investments for his own account. Problems are especially common in situations where the investment agreement grants the mandatary a great deal of discretion, as in the agreement between Esther and Jacob.

The information on which Jacob's investment is based was acquired while Jacob was fulfilling his contract for Esther. It is therefore possible that there is a conflict of interest and duty, and that Jacob breached his contractual duties. Jacob will be in breach of contract if it was possible for him to make the investment on Esther's account, but nevertheless he made the investment for his own personal gain without making an investment that is at least as profitable for Esther. Consequently, Esther may claim damages from Jacob. The amount she claims will be approximately equal to the increase in value of Greenacre, diminished by the profit that Jacob managed to get for Esther from any alternative investment that was made. If, on the other hand, it was not possible for Jacob to buy Greenacre for Esther, e.g. because there was no trust money for that purpose, then Jacob's purchase of Greenacre for his own account will not be considered a breach of contract and will not entitle Esther to claim damages. This is due to the fact that Esther will not be regarded to have suffered a loss.[18]

Alternative 2

It is most likely the case that Esther can claim Blackacre back from Bill, if Jacob were to be regarded as acting against his mandator's best interests and Bill were regarded as acting collusively, i.e. in order purposely to harm Esther.[19] The result may be the same if Bill was in *mala fide*, i.e. if he had known, or in the circumstances of the case,

[18] One could perhaps say that Finnish law is, in this respect, based on the idea of a concrete conflict of interests, while for instance English law seems to put more weight on a mere abstract conflict. Furthermore, entitling Esther to claim damages regardless of her own loss, would, according to the Finnish way of thinking, mean that the damages would have a punitive element, which is unfamiliar to the Finnish legal system.

[19] It is uncertain to what extent the so-called 'secret owner' of an immovable is protected against the purchaser, who has bought the immovable from an 'apparent' owner. See further above, Case 1, Alternative 2.

should have known that Jacob was acting against his obligations when selling Blackacre to him.[20] If Jacob sold Blackacre in order to get the zoning ordinances changed, then there will, no doubt, be a relevant conflict of interest and a breach of contract. The problem in Alternative 2 is the uncertainty of the facts presented. The burden of proof rests with Esther. Esther must also prove the collusive action or *mala fides* of the purchaser, since the purchaser is not presumed to have been acting wrongfully.

Esther is in a better position to claim pecuniary compensation from Jacob. Esther must prove that Jacob caused her damage. It is Esther who has the burden of proof in this respect. However, it is clear that Jacob caused Esther damage by selling Blackacre shortly before the increase in price. Therefore, Jacob will be required to exculpate himself since in contractual relations damages are generally presumed to be caused by negligence or *dolus*. Jacob will have to prove that he tried to serve the mandator's best interests as carefully and proficiently as could be expected of him. Jacob's chances of exculpating himself seem fair, since it is unclear whether Bill's political influence had any effect on the zoning change, and there seems to be no proof that Jacob knew in advance of the pending changes. Therefore, notwithstanding circumstantial evidence, it is difficult to predict the result of a trial in the case of Alternative 2.

Esther cannot claim the increased value of Greenacre from Jacob even if there is a breach of contract. The increased value of Greenacre would not have belonged to Esther even had Jacob fulfilled his obligations as a mandatary.[21] Therefore, the difficulty of assessing Esther's rights arises mainly in relation to the possibility that she could claim damages as a result of the inappropriate sale of Blackacre. If Esther can retrieve Blackacre from Bill, then there will not be any loss caused by Jacob, except perhaps the costs of trial. Esther's right to claim damages is slightly problematic even if it is assumed that she cannot retrieve Blackacre. If Esther cannot get Blackacre back, then she will suffer a loss if we compare her situation with the position she would have been in if she still held Blackacre, and if the new zoning ordinances were in force. But if we compare her situation to the position

[20] The fact that the transaction was at market value does not, of course, exclude the possibility that Bill has been in *mala fide* or has acted collusively.

[21] Entitling Esther to claim damages in spite of the facts mentioned above would mean that the damages would have a punitive element, which is unfamiliar to the Finnish legal system.

she would have been in had Jacob acted according to his obligations, it is difficult to see that Esther suffered any loss, since the zoning ordinances might never have been changed, and the value of Blackacre would not have increased. In spite of these problems, Esther can probably claim damages and Jacob will be liable for the increased value of Blackacre.[22]

France

Alternative 1

Jacob was granted a contract of mandate by Esther to sell Blackacre. Jacob is liable for mismanagement, which includes allowing his personal interests to prevail over the interests of his client.[23] The fact that Jacob learned about the impending zoning change and bought Greenacre with his own money before the change was announced could give rise to a claim by Esther against Jacob. Esther could claim damages from Jacob by arguing that Jacob should have bought Greenacre for her own account, and thus his actions caused her to miss an opportunity to benefit from the increase in value of Greenacre.[24]

Moreover, the French Civil Code provides that mandataries may not become owners of the assets that they have a mandate to sell.[25] French courts have extended this prohibition to bar purchases of assets even if the assets sold were not the client's property, provided that the client had an interest in the purchase of such assets, so that the mandatary should have bought them for the client and not for himself.[26] It is therefore likely that Esther's claim for compensation will succeed. It would be measured by the difference between (a) the increase in the value of Greenacre and (b) the profits she realised by the investments made with the money which would have been used for the purchase of Greenacre.

[22] It is maybe worth mentioning that Jacob's and Bill's behaviour would, most probably, have constituted criminal acts. Jacob was guilty of giving a bribe and abusing the confidence of his mandator. Bill was guilty of taking a bribe. The gain which Jacob and Bill obtained by their criminal acts could be confiscated by the state, to the extent that Esther would not have been entitled to claim it as damages.

[23] Antonmattei and Raynard, *Les contrats spéciaux*, No. 452: 'Le mandataire est aussi débiteur d'une obligation de loyauté fortement marquée dans le contrat de mandat. Le mandataire doit exécuter la mission dans l'intérêt du mandant. Il ne doit pas utiliser le mandat pour servir ses intérêts propres ou ceux d'un tiers.'

[24] Art. 1149 C. civ.

[25] Art. 1596 C. civ.

[26] Civ. 1*ère*, 19 December 1995, *Contrats, conc., consom.* 1996. 57, comment Leveneur.

Alternative 2

Esther could argue that Jacob has breached his duty if she is able to demonstrate that Jacob's action was (a) detrimental to her interest and (b) beneficial to his own interest.[27] In order to claim indemnification from Jacob, Esther would be required to show that she suffered a specific loss as a result of Jacob's action. With respect to Alternative 2, it is unlikely that a claim for compensation by Esther, based on the increased value of Greenacre, would succeed. There is no factual element which could serve as the basis for the claim, other than the fact that the sale 'was arguably motivated by a desire to see the zoning ordinances changed'. Moreover, there is no direct loss suffered by Esther in the increased value of Greenacre.

If either Bill or Jacob, at the time of the purchase of Blackacre, was aware that (a) the zoning ordinances were going to be changed, and (b) such a change would have a material effect on the market value of the land, then the omission to reveal this significant information might make the sale voidable.[28]

In order for Esther to succeed in her claim to recover Blackacre, she would be required to prove that Bill knew that the zoning ordinance was going to be modified in the near future, leading to a substantial increase in the value of the land. The burden of proof lies with Esther. There is no clear evidence that Bill is responsible for the change of the zoning ordinance. It is, therefore, doubtful that French courts would allow Esther to succeed in her claim to recover Blackacre from Bill.

Another legal ground that would permit Esther to recover Blackacre is fraud. Esther would be required to demonstrate that Jacob and Bill acted in a fraudulent manner, detrimental to her own interest. There are, however, no factual elements in Alternative 2 that would permit such a conclusion.

Germany

Alternative 1

Esther would be entitled to claim damages against Jacob since it was a breach for Jacob to profit from a business opportunity that he discovered in the course of exploring real estate investment possibilities for

[27] Req. 14 April 1908, *DP* 1908. 1. 344.

[28] Art. 1116 C. civ. and Civ. 3*ème*, 27 March 1991, *Bull. civ*. III, No. 108; *D*. 1992 Somm. 196, comment Paisant; *RTD civ*. 1992. 81, comment Mestre.

Esther. Note that under German law, virtually no case has been decided in favour of the fiduciary. In certain respects, the German law of fiduciary relationships seems to be stricter than the better-known Anglo-American model (about 50 per cent of cases are decided in favour of the fiduciary in corporate law in the US).[29] The damages include lost profit (§ 252 BGB), and with respect to Alternative 1 this includes the increase in value of Greenacre that Jacob should have bought for Esther (the business opportunity which he diverted to himself). This means that a highly disputed question is only of theoretical importance: that is the question whether Esther could also claim wrongful gains reaped by Jacob (see § 687 BGB), even if she would not have bought Greenacre herself, and would therefore not have made a profit, and so cannot prove any loss. For this question see Alternative 2.

Alternative 2

Three questions can be distinguished under German law: (a) whether Esther could claim damages; (b) whether she could claim Blackacre from the buyer; and (c) whether she could claim the increase in value of Greenacre if the sale was wrongful, even if it is not clear whether this increase in value would have taken place even without the sale of Blackacre (that is, there are doubts about the causal link).

Esther would have a claim for damages against Jacob if the sale of Blackacre amounted to a breach of Jacob's duties. Since Jacob received the market value, the question would be whether a reasonable man in Jacob's shoes would have sold Blackacre to a member of the zoning board of the district. If Jacob had knowledge of the potential change in the zoning ordinance, then selling Blackacre might constitute a breach, since a reasonable man would have done with Blackacre what Jacob did with Greenacre, i.e. held it back until the air was clear. On the issues of whether there was a breach of duty and whether this breach caused damages, in German law the burden of proof has been reversed where it has been established that a fiduciary acted in a way that (also) promoted his own interests, i.e. that there was a material conflict of interest.[30] In Alternative 2 it is not so much the breach but rather the causal link between the sale of Blackacre and the increase in its value that could be

[29] See Chew, 'Competing Interests in the Corporate Opportunity Doctrine', 67 NCL Rev. 435, 452 n. 53 (1988/89).

[30] See Grundmann, *Der Treuhandvertrag – insbesondere die werbende Treuhand* (1997), 254–265.

doubtful. To address this latter issue, there is a statutory rule that deviates from the standard principles on burden of proof in favour of Esther. In order to discharge the burden of proof in the common law, a party must normally show that the facts have occurred 'on a balance of probabilities' or that they are 'more likely than not' to have occurred. German law requires a party to prove the facts to the full conviction of the court (beyond a reasonable doubt). As a result, under this general rule it would be difficult for Esther to prove, beyond a reasonable doubt, that the value of Blackacre went up because Jacob breached his duties by selling it to a member of the zoning board. However, the special rule of § 252 BGB puts Esther in a more favourable position (see also more generally § 287 ZPO). This rule confers a discretion on the court to make a free evaluation of the evidence in order to assess the quantum of damages, and to determine whether it was more likely than not that there was a causal link between the breach and the loss. The scope of this rule has been extended to its outer limits in the case law.[31] The questions raised in Alternative 2 clearly fall under this rule.

There is no legal ground on which Esther might claim Blackacre back from the buyer. In securities transactions, this type of transaction could possibly be qualified as insider dealing. There is, however, no general provision prohibiting insider dealing outside the securities area. The only possible basis for a claim would be that Bill was liable in tort to Esther for having deliberately caused her harm by conduct offending the *boni mores* (§ 826 BGB). At a minimum, Esther would have to prove that Bill knew that she had a beneficial interest in Blackacre, and that the sale was contrary to her interests or intentions. Most authors would even require a deliberate conspiracy between Bill and Jacob (see Case 1, Alternative 2).

It is difficult to answer the question of whether Esther has a claim against Jacob for the increased value of Greenacre. The importance of this question is limited. In practice, it does not matter whether the damages that Jacob owes Esther for the wrongful sale of Blackacre (see above) are equal to the increase in value of Greenacre. This would be the case if Greenacre and Blackacre were of the same size and value (so that the amount of Esther's lost profit was equal to Jacob's wrongful gain), and if the court awarded full damages (Esther's loss of profit) in spite of difficulties about proving causation and loss. The only possible basis for a claim against Jacob for the increased value of Greenacre is § 687 para. 2

[31] For a recent example see BGH VersR 1994, 1467 (1469).

BGB. This rule only applies to situations in which the defendant conducted some business as his own, although objectively it was the plaintiff's business. Thus far, case law clearly holds that the provision covers cases where the agent trades in another person's absolute rights. There is some dispute, however, about cases that more closely resemble Alternative 2. The Supreme Court, in civil law matters, has held that it does not cover cases where the defendant has profited by the violations of a (statutory or contractual) prohibition of competition.[32] In labour law matters, however, the Supreme Court has held that the provision does include cases where an employee or agent received bribes.[33] There is ample case law supporting this view, especially in cases where there was an agency agreement,[34] or where the advantage was received only indirectly.[35] Alternative 2 is close in structure to the bribe cases. More specifically, if there was evidence to show that Bill offered Jacob the chance of increasing the value of Greenacre and thus 'bribed' him to sell Blackacre at market value, then it does not seem unlikely that Esther could claim the increased value of Greenacre.

Greece

Alternative 1

Please see Case 1, Alternative 2 regarding the form of the power of attorney for the sale of immovables, and the relevant form of revocation of the power of attorney. A self-regulatory code has been issued relating to the activity of companies providing investment services in the field of securities (see Case 2, Alternative 1). This self-regulatory code provides that companies offering investment services should avoid conflicts of interest between themselves and their clients. Nevertheless, since the aforementioned code is only applicable to investment services relating to securities, the issues raised in Case 3 will be answered from a Civil Code perspective.

[32] BGH NJW 1988, 3018: no claim to the profits made in violation of the prohibition, here on the basis of an agreement made for the time after termination of the contract; but see also § 113 para. 2 HGB.

[33] BAG AP § 687 BGB nos. 1 and 4; Isele concurs: the principal can claim the sum received in bribery; some parts of the legal literature dissent. For a doctrinal justification for such a claim based on broader fiduciary principles see Grundmann, *Der Treuhandvertrag*, 200–202, with further references.

[34] BGHZ 38, 171 (175 ff.); 39, 1 (3); BGH BB 1966, 99; BGH MDR 1987, 825; NJW-RR 1991, 483.

[35] BGH DB 1987, 1295.

Conflicts of interest between the mandatary and the mandator are not specifically regulated by the Civil Code. Nevertheless, according to s. 288 CC, a debtor is bound to perform his obligations in accordance with the requirements of good faith. In this way, good faith is the source of many collateral duties and obligations, which are implied in the Civil Code.[36] The obligation of the mandatary to avoid conflicts of interest between himself and the mandator is based on the general provision of s. 288 CC. These collateral duties are elements of the internal contractual relationship between the mandatary and the mandator.

The acquisition of the immovable in the name of Jacob cannot be directly contested by Esther, seeking to substitute herself in the place of Jacob as the purchaser of Greenacre. According to s. 212 CC, if it is not possible to ascertain that a person acted in the name of another, then it is considered that the person acted in his own name. Obviously, Jacob acted in his own name and not as a representative of Esther. Viewed externally, this transaction produces an immediate legal effect for Jacob.

However, Esther may claim damages from Jacob for the losses she has suffered as a result of the improper performance of the mandate by Jacob. He was acting in bad faith and failing to take appropriate measures in order to avoid conflicts of interest, in particular by failing to use information he acquired for Esther's benefit (ss. 288 and 714 CC). In Alternative 1 the damages correspond to the increased value of the immovable. The courts may also order, in lieu of monetary damages, the reinstatement of the former situation (*statu quo ante*) under the terms of s. 297 CC. Such compensation may consist of the transfer of the immovable (Greenacre) to Esther, who shall be obliged to pay Jacob the acquisition price of Greenacre.

Alternative 2

Under the assumption that the sale of the immovable (Blackacre) is valid in accordance with s. 1033 CC (see Case 1, Alternative 2), Esther cannot claim Blackacre back from the purchaser (Bill), unless either s. 178 CC or s. 919 CC are applicable (see Case 1, Alternative 2).

It would also be difficult for Esther to establish a claim for damages against Bill. Section 919 CC provides that a person who has intentionally caused prejudice to another in a manner contrary to *bonos mores* is

[36] Androulidaki-Dimitriadi, *The Obligations of Fair Dealing* (1972), 9–27.

liable for damages. However, to establish this liability, it would have to be proved not only that the changes in the zoning ordinance were produced through the political influence of Bill, which might be considered to be contrary to *bonos mores*, but also that Bill intended to cause prejudice to Esther.[37] Provided that both conditions are fulfilled, Esther will be able to sue Bill for damages. Recovery of damages may also include the reinstatement of the former situation (*statu quo ante*) under the terms of s. 297 CC (see Case 1, Alternative 2).

Esther's claim against Jacob for an amount corresponding to the increased value of his own immovable (Greenacre) might be accepted under ss. 288 and 714 CC (see Alternative 1 above), provided that Jacob's bad faith can be established.

Ireland

Alternative 1

'In general terms, it may be said that a trustee is not allowed by the law to obtain any material benefit from his position except with the consent of all the beneficiaries.'[38] A trustee may not therefore profit from his office,[39] or place himself in a position where his interest and duty may conflict.[40] Since the profit made by Jacob flows exclusively from information gathered in his capacity as trustee, and as he did not have Esther's consent to his purchase of Greenacre, he will have to account for the profit to Esther.

Alternative 2

As for Esther's claim against Jacob, a trustee's fiduciary duties are so strict that even an *apparent* conflict between his personal interest and his duty as trustee will be sufficient to make Jacob liable to Esther. Jacob could only avoid this by showing affirmatively (which seems not to be the case) that the sale of Blackacre to Bill, followed by the increase in the value of Greenacre due to a rezoning decision in which Bill was

[37] See, however, AP 448/1984, NoB 33/1985, 61: a contract for the sale of an immovable was declared null and void, according to ss. 281 CC (Abuse of Right) and 174 CC (Prohibited Acts), although the buyer acted in good faith. See also AP 717/1985, NoB 34/1986, 560; Hellin.Dni 28/1987, 629.

[38] Keane, *Equity and the Law of Trusts in the Republic of Ireland* (Dublin: Butterworths, 1988), 120, para. 10.18.

[39] *Armstrong* v. *Armstrong* (1880) 7 LR Ir 207, 218 *per* Lord O'Hagan LC.

[40] Delany, *Equity and the Law of Trusts in Ireland*, 410.

involved, were entirely unconnected. As for Esther's claim to recover Blackacre from Bill, the principles have been set out above.[41]

Italy

Alternative 1

The facts of Alternative 1 give rise to a conflict of interest, because the mandate governing the relationship between the parties includes the duty to acquire land like Greenacre on behalf of the mandatary.[42] Jacob used the information he acquired in managing Esther's assets for his personal gain, instead of using it for Esther's benefit, as he was required to do by the mandate. Esther would, therefore, be entitled to terminate the mandate for breach of contract, inasmuch as Jacob failed – at least – to communicate to her 'circumstances which might cause the revocation or modification of the mandate' (art. 1710 CC). The fact that Jacob acted for his own benefit in a transaction which should have been carried out for Esther allows Esther to claim a loss of confidence in Jacob's ability to act as her mandatary. The Civil Code articles on mandate do not regulate conflicts of interest, but art. 1394 CC on conflicts of interest in the context of representation shows that the transaction would be considered wrongful.[43]

Esther will also be entitled to compensatory damages. The precise amount of damages to be awarded is, however, difficult to establish. Esther's damages will be limited to the actual loss she suffered as a result of Jacob's violation of his obligations under the mandate. It is unclear, however, what that loss is, inasmuch as the value of her land (Blackacre) increased as well. A more promising approach would be to claim that Greenacre was bought by Jacob in his capacity as investment manager for Esther, though not on her express instruction and with his money. On this basis, which may involve ratification of the transaction (cf. art. 1711 CC) and reimbursement of the money spent by Jacob, Esther could strip Jacob of the increased value of the land.[44]

[41] Case 1, Alternative 2.

[42] This point may involve a question of contract interpretation, but it is assumed that the contract should be interpreted as above.

[43] Maffeis, *Conflitto di interessi nel contratto e rimedi* (2002), 56 ff. On the application of art. 1394 CC outside the context of representation: Gambaro, *Il diritto di proprietà* (1995), 623–624.

[44] Cass., 17 November 1994, n. 9710, Giur. it., 1995, I, 1, 1902; Cass., 20 March 1995, n. 3225, Foro it., 1996, I, 203; Giur. it., 1996, I, 1, 657; Maffeis, *Conflitto di interessi nel contratto*, 397 ff., 404 ff.; Sirena, *La gestione di affari altrui* (1999); Sacco, *L'arricchimento ottenuto mediante fatto ingiusto* (1959), 114 f., 125 ff.

Alternative 2

The crucial issue that arises in Alternative 2 is, once more, whether Jacob breached his duties as a manager of Esther's assets by proceeding with the sale of the land to Bill. It is arguable that a diligent manager would not have sold Blackacre to Bill after learning that the zoning rules for that area could change, with the effect of increasing the value of the land. There is, in this case, a breach of the mandatary's duty to act diligently in the performance of the contract of mandate (art. 1710 CC), as well as of the duty to abstain from transactions tainted by conflict of interest (cf. art. 1394 CC) and of the duty to act for the exclusive benefit of the mandatary (cf. art. 1713 CC). Therefore, Esther has a claim for damages against Jacob. It is arguable that the amount of such damages equals the gain she would have reaped if the sale of the land had taken place after the change in the zoning rule.[45] The problem is that it does not appear from the case description that Jacob knew that new zoning rules were going to be adopted when he proceeded with the sale, and that it is also not clear whether such rules were adopted solely *because of* the sale of Blackacre to Bill, or independently of it.

If the strongest case is made, Esther will be able to claim the difference between the value of Blackacre before and after the change of the zoning rules and, on the analogy of the solution to Alternative 1, she will probably also obtain the difference between the value of Greenacre before and after the change of the zoning rules. If, on the other hand, there is no evidence that Jacob knew that a change in the zoning rules was likely to happen (either as a consequence of the sale to Bill, or independently of it), Esther's claims against Jacob will be unsuccessful, inasmuch as no breach of contract or conflict of interest is proven.

Esther's claim against Bill for the recovery of the land will be framed as a claim for avoidance of the sale, because Jacob concluded the sale with Bill in conflict of interest.[46] The claim will only succeed if Esther proves that Bill knew (or could have known) that Jacob was pursuing his interest by proceeding with the sale of Blackacre (cf. art. 1394 CC). But a complication arises, inasmuch as avoidance of the sale will defeat Bill's title only if Esther registered her claim as a pending action in the land register before the sale took place (cf. art. 2652 CC). This is unlikely in the circumstances of our case. Hence, upon proof of Bill's bad faith,

[45] See Maffeis, *Conflitto di interessi nel contratto.*

[46] See above, Alternative 1, note 43.

Esther may only be able to obtain compensation for her loss under the general tort provision of art. 2043 CC.[47]

Luxembourg

Jacob is considered to have full mandate to sell the undeveloped piece of land on behalf of Esther. The complication relating to the need to notarise and register the sale in a public registry is not considered here.

Alternative 1

The criteria for the existence of a conflict of interest are not clearly determined in Luxembourg law. According to case law, a conflict of interest will arise if the action of the agent has an illicit goal, i.e. if it was intended to and succeeded in violating the interests of the principal while favouring the interests of the agent. On the above facts, it is likely that the court will hold Jacob to be in violation of his duty of loyalty (*obligation de loyauté*) to his client, even though Jacob is not subject to any explicit prohibition against using information that he has generated during his work for his clients in his own interest.

Assuming the conflict of interest is held to exist, the basis for Esther's claim for damages would be professional liability. A violation of the obligation of loyalty, arising through a conflict of interest, will entitle the victim to damages for losses incurred and gains foregone. As Jacob was supposed to find investment possibilities for Esther and has misappropriated the information for his own purposes, recovery on this basis would probably be for the gain foregone, with a deduction for the monies invested (as Esther would have had to invest those monies as well).

The claim might be rejected if the investment manager could not have bought the land for Esther, for example if there were insufficient assets or contrary instructions. This would be an argument based on causation. The argument could also be made if Esther's claim was based on loss of opportunity (*perte d'une chance*). Compensation in such a case is calculated by discounting the lost opportunity to account for its hypothetical nature. Esther would then have to show that the probability that the investment would have been carried out on her behalf was sufficiently likely.

[47] See above, Case 1, Alternative 2, note 216.

One possible way to have Jacob account for the increase in value of Greenacre is art. 1993 CC, which states that the mandatary must provide an account to the mandator of everything he has received in the execution of the mandate, even if it was not received in relation to the mandate. This article is generally taken to mean that the mandatary must present a full audit to the mandator for the duration of the mandate; it does not create a direct right for the mandator to claim part or all of the increase in value of an asset that is held for the mandatary's own account alongside the mandator's assets. Therefore, it is unlikely that a claim based on this provision would succeed, especially since there is no case law with respect to this issue in Luxembourg.

Article 36 of the 1993 Law (which implements the Investment Services Directive and which is complemented by CSSF/2000/15) requires professionals of the financial sector (mainly credit establishments and investment firms) to use their best efforts to avoid any conflict of interest. As explained already,[48] it is not entirely clear what are the civil consequences of a breach of these professional obligations, but it is likely that a breach would constitute negligence.

Alternative 2

Esther can rely on the concept of abuse of power (*détournement de pouvoirs*). This is an application of the duty of loyalty, which is continuously applied by the courts, even though it is not referred to by the Civil Code.[49] A violation of the duty can be sanctioned either by the contractual liability of the mandatary (i.e. an award of damages), or by the annulment of the transaction which was carried out in breach of the duty of loyalty.[50]

Here, Esther can claim damages from her mandatary, Jacob, as well as possibly claiming an annulment of the sale of Blackacre. Regarding the claim for damages against Jacob, for the loss suffered by Esther, Esther will have to show that Jacob acted in violation of the duty of loyalty. Although the courts normally consider this duty as an *obligation de résultat*, in practice, to prove a breach Esther would need to show that Jacob's action involved an illicit goal, i.e. that it was intended to violate, and succeeded in violating, the interests of Esther while favouring the interests of Jacob.[51] Luxembourg courts have occasionally adopted a

[48] See Case 2.

[49] Pétel, *Les obligations du mandataire*, no. 196.

[50] Ibid.

[51] Pétel, *Les obligations du mandataire*, no. 199, quoting Cass. Fr. Req. 18.4.1908, DP 1908.1.344.

wider definition of the breach of duty of loyalty, by holding that 'the agent must act in the interest of his client, and not in his own interest, and avoid any action which might harm the client'.[52]

Therefore, if Esther can show that Jacob intended to act in his own interest and to her detriment when he sold Blackacre to Bill, then she will be able to recover her losses from Jacob, i.e. she will get damages in the amount of the increase in value of Blackacre which she was unable to profit from.[53] If she obtains the nullity of the transaction, then no loss will have been suffered, and she will not, in principle, receive any damages.

Regarding the action against Bill, it is generally accepted that the annulment of the transaction carried out in breach of the duty of loyalty is a superior sanction to damages. To recover the land from Bill, Esther must rely on the general principle of *fraus omnia corrumpit*, i.e. the general nullity of fraudulent acts.[54] This means that Esther must show fraud, which in this case means (a) that the action must have been intended to avoid an imperative rule (the duty of loyalty), (b) that there was fraudulent intent on behalf of the mandatary and, normally, his accomplice (Bill), and (c) that the fraudulent action was instrumental in reaching the goal set by the defrauders. Esther will therefore have to show that Bill was at least aware of the fraud committed by Jacob, i.e. that he knew or should have known that Jacob was selling the land in violation of his duty of loyalty, and that, therefore, he knew or must have known that he was causing Esther a loss.

Generally the mandator is not required to show a conspiracy to defraud between the mandatary and the third party.[55] However, in Alternative 2, Esther will most likely be required to show some likelihood of conspiracy with respect to the arrangement between Bill and Jacob. If Bill was not aware of the situation or if he could not have known, then the annulment of the transaction will not succeed, since fraud cannot be annulled to the detriment of a third party acting in good faith.

Finally, it is not likely that Esther's claim for damages for the illegal gain made by Jacob will succeed. Any claim in damages against a mandatary relies on art. 1992 CC, which makes the mandatary liable not

[52] TA Luxembourg, 23.12.1992, Pas. 29, 48.

[53] An interesting question for the defence of Jacob could be causation: if he had not breached the duty, the land would not have been sold, and the zoning rules might not have changed. Therefore, the nullity of the transaction with Bill is a better sanction.

[54] Pétel, *Les obligations du mandataire*, no. 205.

[55] Ibid.

only for his intentional misconduct, but also for negligence committed in the execution of the mandate. However, the general principle of civil liability is compensation for losses suffered. Reparation for Esther's actual loss will involve either the annulment of the sale of Blackacre or the award of damages against Jacob for the loss in value resulting from the transaction made in violation of Jacob's duty of loyalty. The gain made by Jacob, also arising from fraud against Esther, does not correspond to an actual loss on her behalf, and should therefore not give rise to any damages.[56]

Again, one could think of art. 1993 CC as a legal basis for claiming that Jacob must also account for the illegal gain made on his own piece of land. As mentioned before, while the logic and the wording of the article may support such a theory, the question of whether the mandator can benefit from this situation without an actual loss on his behalf remains unsettled. Also, as mentioned above, there is no case law on this point under Luxembourg law.

Esther may rely on the mandatary's duty to provide information when a major event is encountered by the mandatary in his mandate.[57] The planned changes in the zoning rules could have been such a major event. She could argue that as these changes affected her asset, Blackacre, Jacob should have informed her, and she could claim damages (such as lost opportunities) for any loss suffered in this respect.

Netherlands

Alternative 1

The ASST 1995 is not applicable since the investment is an immovable. It is very unlikely that a non-institutional investment institution will invest both in financial instruments and in other assets such as immovables. However, the question raised in Alternative 1 will be answered

[56] Civil liability is not intended to punish fraudulent acts. This function is, in principle, handled exclusively by criminal law. However, in such situations, the courts have often been very generous in evaluating damages, and have added a layer of punishment to the general principle of compensation.

[57] Pétel, *Les obligations du mandataire*, nos. 235 ff.: the duty to inform (which can even be extended to a duty of full disclosure) is very rarely dealt with in French legal writing. Courts have however recognised such a duty, mainly where the mandatary encounters a serious problem in the execution of his mandate, or in relation to the result of his mandate; and, to a lesser extent, a general and continuous duty of information, even where no immediate reaction or response of the mandatary is required.

from the point of view of investing in financial instruments and investing in immovables.

Investments in financial instruments

With regard to investments in financial instruments by a licence holder, art. 25 FRMSST 2002 obliges the securities institution to prioritise its client's interests over its own interests.[58] If the securities institution does not act according to this rule, then it will most likely be liable for failure to perform its contractual obligation (art. 74 Book 6 CC), even though this code of conduct has been laid down in the regulation that governs the relationship between the Public Administration and the securities institution.[59] Apart from this rule, art. 418 Book 7 CC is applicable as well. If the mandatary (the securities institution) has a direct or indirect interest in the occurrence of a transaction, then the mandator must be notified thereof, unless the content of the juridical act is precisely determined so that any conflict of interest is excluded. In Alternative 1, it is most likely that the mandatary will be obliged to notify the mandator. However, the mandatary does not lose his power to act, even if he does not notify the mandator.[60] The mandator can provide new instructions if he is notified of the conflict of interest. If the mandatary does not notify the mandator, then he will lose his right to remuneration, without prejudice to his obligation to repair the damage suffered by the mandator as a consequence of the transaction. The general rules of arts. 95–110 Book 6 CC are applicable. The only damages that can possibly be claimed are patrimonial damages, which comprise both the loss sustained by Esther and the profit of which she has been deprived. This can be seen by comparing the financial difference between the situation in which Jacob acts in accordance with the contract and the situation in which Jacob acts in breach of the contract (art. 96 Book 6 CC). As a result, Esther will be able to claim the gains acquired by Jacob through his acquisition of financial instruments. It is possible that Esther will have to prove that she, had she known, would have given the instruction to buy Greenacre for her as an investment. Therefore, it is possible that the court will award an amount that

[58] The written contract may contain specific rules on conflicts of interest.

[59] See for this accepted reflex working of the rules that aim to protect the investor Case 1, Alternative 1, under the heading *Investment in financial instruments –point a: termination*.

[60] Van Setten, *De commissionair in effecten*, 221.

corresponds to the increased value of the asset, less the amount that would have been paid to buy the asset.

Investment in Greenacre

The relationship between Esther and Jacob is governed by the contract of mandate. Esther can rely on art. 418 Book 7 CC (see above). Jacob will not receive his remuneration if he did not inform Esther of the conflict of interest. Apart from this, Esther can also seek damages, which will be based on breach of contract (art. 74 Book 6 CC). The only possible damage that can be claimed (if breach of contract is established, which is not certain in this case) is the patrimonial damage which comprises both the loss sustained by Esther and the profit of which she has been deprived. This can be seen by comparing the financial difference between the situation in which Jacob acted in accordance with the contract and the situation in which Jacob acted in breach of contract (arts. 95–110 Book 6 CC). Also, here it may be necessary that Esther prove that she would have given an instruction to buy Greenacre, had she known the situation. Therefore, it is possible that the court will award an amount that corresponds to the increased value of the asset, less the amount that would have been paid to buy the asset.

If art. 418 is not applicable, then it is most likely that art. 403 sub 2 Book 7 CC will be helpful. This article obliges the mandatary to account for his acts; he must account for the costs and revenues and explain why he chose to act in a specified manner. It is expected that the mandatary will only act in the interest of his client and avoid any situation that will result in a conflict of interest. It is accepted that the mandator can claim any profits made by the mandatary during his mandate (whether or not they were made with knowledge that was discovered in his capacity as mandatary).[61] However, it is questionable whether it is possible to stretch the interpretation of art. 403 sub 2 Book 7 CC in this manner. If such a stretch is not allowed, then it will not be possible for Esther to acquire any of the profits made by Jacob.

The results of this Alternative would have been different if Jacob should have bought Greenacre as an investment for Esther; that is, if he committed a breach of contract by not doing so and instead buying Greenacre for himself. The mandatary is required to act as a good and caring mandatary (art. 401 Book 7 CC). Esther can claim damages for breach of contract (art. 74 Book 6 CC). It is possible that the court will

[61] Van Setten, *De Commissionair in effecter*, 232.

award an amount corresponding to the increased value of the asset, less the amount that would have been paid to buy the asset.

Alternative 2

Financial instruments

The answer is the same as in Alternative 1, under the section titled *Investments in financial instruments*.

Blackacre

The only claim that Esther can make against the third party is one based on tortious behaviour. According to Dutch law, even if a third person knowingly profits from a breach of contract by a mandatary, this fact is not enough to conclude that the third person committed a tort.[62] Therefore, it is necessary to establish first that Jacob is guilty of breach of contract. Secondly, it must be established that Bill (the buyer of Blackacre) had knowledge of the breach. Lastly, additional circumstances must be present for the behaviour to amount to a tort.

The contractual relationship exists only between Jacob and Bill, and Esther cannot interfere in this relationship. This may be different if it is assumed that art. 419 Book 7 CC applies. Article 419 states that when a mandatary concludes a contract, in his own name, with a third party who does not fulfil his obligations arising from the contract, then this third party is required to compensate for damage which is suffered by the mandator as a result of his or her failure to fulfil the contract. If Jacob refuses to annul the contract with Bill, then under art. 420 Book 7 CC, Esther can take over the claim for annulment.

If Jacob had knowledge of the increase in value and should not have sold Blackacre at the given price, then it is possible that damages will be awarded (art. 74 Book 6 CC). In this Alternative there certainly is a conflict of interest according to art. 418 Book 7 CC. This means that there is no remuneration for Jacob and that he is under an obligation to pay damages.

If Jacob did not have knowledge of the impending change, then he could have the contract annulled on the grounds that he acted on the basis of an error that arose because Bill withheld information (art. 228

[62] HR 17 November 1967, NJ 1968, 42 (Pos/V.d. Bosch), HR 17 May 1985, NJ 1968, 760 (Curaçao/Boyé c.s.) and confirmed in HR 30 June 1995, NJ 1995, 693 (G-rekening). See Asser/Hartkamp 2002, no. 51b.

sub 1 Book 6 CC). The deciding factor will be whether it can be proved that Bill had knowledge of the impending change.

Portugal

Alternative 1

The Portuguese Civil Code deals with conflict of interest in representation in art. 261, under the paragraph called ‘business with oneself’ (*negócio consigo mismo*).[63] In Alternative 1, there is no actual *business with oneself* in the precise terms of the law.

Having knowledge of the future increase in value of Greenacre, Jacob should not have purchased it for his own interest, unless he previously consulted Esther and she was not interested in the investment. As the manager of Esther’s assets, Jacob is bound by good faith to put her interests before his own, and not compete with her for opportunities. It is irrelevant that Jacob used his own money to pay for Greenacre, since it is normal and common practice that the agent uses his own money when acting for the mandator under the terms of the mandate. The mandatary is then entitled to collect this cost from the mandator.

Whether the mandate was granted to Jacob with or without representation gives rise to a relevant distinction. If Jacob is representing Esther (direct representation), then it should be clearly stated in the purchase deeds for whom Jacob was acquiring Greenacre, that is, Esther or himself. If the mandate is without representation (indirect representation), then Jacob is purchasing for himself; however, he would be obliged to transfer ownership of Greenacre to Esther later on.

In a Portuguese civil/commercial court, Esther’s claim will only proceed as a claim for compensation for lack of due diligence in the management of her interests. It would then be considered whether Jacob did all that he was bound to do. Jacob’s lack of professional care and diligence may be considered a breach of good faith in respect of the obligations arising from the mandate, on the grounds

[63] ‘1. A bargain executed by the representative with himself, whether in his own name or in representation of a third party, may be avoided unless the principal shall have expressly consented to its execution or that, by its very nature, the bargain excludes the possibility of a conflict of interests.
2. For the purpose of the foregoing paragraph, execution by the representative is considered as a bargain undertaken by the person on whom the powers of representation shall have been delegated.’

that Jacob should not have retained for himself a business opportunity that should have been taken for his client (art. 762.2 CC). It is possible to establish compensation (as *lucrum cessans)* on the basis of the profit that Esther would have acquired, had Jacob bought Greenacre for her. Similar rules, regarding the duties of the manager and the need to follow the client's interests, would apply if the management were conducted through a financial company (arts. 74, 76, Banking Act).

Alternative 2

It is not clear whether the zoning change is a consequence of the purchase of Blackacre by Bill. It is also not clear whether, when selling Blackacre to Bill, Jacob intended to cause the zoning change, was aware that it might, or was likely to, happen, or even whether both Jacob and Bill agreed to it. However, it looks very much as if, under normal patterns of human behaviour and circumstances, Jacob's action was not innocent. It will be difficult for Jacob to persuade a civil/commercial court of his innocence, although there is the possibility that he may succeed. It is possible that Jacob knew (or was told) of Esther's intention to sell Blackacre as soon as possible for a normal (market) price, but he was willing to keep Greenacre in the hope of a possible zoning change. The solution of this alternative will mostly depend on the evidence produced in court, but, regardless, considerable suspicion will fall on Jacob.

If Jacob's conduct is not considered innocent, then Esther will be entitled to compensation for her losses incurred as a consequence of the breach of mandate, including loss of profit (*lucrum cessans*). This is because Jacob could and should have performed differently, and should not have sold Blackacre for that price. If it is proved that both Jacob and Bill acted with the common intention to profit at Esther's expense, then the sale of Blackacre will be void since it was carried out with a bilateral immoral aim (*contra bonos mores*), in accordance with art. 281 CC. Also, Esther will have the right to revoke the mandate and demand the transfer of Blackacre to herself (*rei vindicatio*).

If an agreement between Jacob and Bill is not proven, but only a unilateral intention or purpose by Jacob to profit from Esther is established, then, since Bill is considered a purchaser in good faith, the sale will not be voidable. With regard to the increased value of Greenacre, the court will not accept Esther's claim, since this enrichment was not obtained at her expense. The same would apply if the management was conducted through a management company (Jacob SA).

Scotland

Alternative 1

A trustee is forbidden to make a profit for himself (except in so far as may be authorised by the trust deed), and if he does make a profit he must hand it over to the trust. However, Alternative 1 is a borderline case; the law is in fact unclear. The opinion of the writer is that the answer depends on whether Jacob had the possibility of buying Greenacre for the trust. If he did have this possibility, then it should have been taken. Jacob will be liable as a result of his failure to act as he should have acted. However, if this possibility was not available to Jacob, then he will not be liable for the profit, since the alternative to Jacob buying the property for himself was doing nothing at all. In other words, if Jacob was unable to buy the property for the trust, then he cannot be considered as having bought it for the trust.[64]

Alternative 2

We do not know, as a matter of fact, whether Jacob personally benefited as a consequence of the sale of Blackacre. Jacob certainly benefited from the increase in value of Greenacre, but there is factual uncertainty as to whether there is a causal link between the sale of Blackacre and the increase in value of Greenacre. Even if such a causal link existed, there would be a further factual question of whether Jacob's decision to sell Blackacre was motivated by the desire for personal gain. For example, he may have been unaware of the possible causal link and may have been genuinely surprised at the subsequent turn of events. These factual issues would have to be clarified.

If both (a) there is a causal link and (b) Jacob had knowledge of this and was motivated by the desire for personal gain, then the legal question is whether he will be bound to hand over a sum representing his own benefit to the trust (see Alternative 1). The law is not certain in this

[64] However, it must be repeated that the law is uncertain. Whilst it is clear that a trustee is not allowed to profit by his position, it is not clear whether this doctrine is to be taken as far as it is in the English authorities, such as *Keech* v. *Sandford* (1726) 25 ER 223. Some Scottish authorities consider Scots and English law to be the same on this point: see e.g. *Halley's Trs* v. *Halley* 1920 2 SLT 343; *The Laws of Scotland: The Stair Memorial Encyclopedia*, vol. 24, para. 181. See further G. L. Gretton 'Constructive Trusts' [1997] Edin. LR 281 and 408.

respect. The writer inclines to the view that Jacob will not be liable, since there was, it seems, no way in which the trust could have obtained this benefit for itself. Finally, Esther cannot claim Blackacre from Bill. The title of a purchaser from a trustee cannot be challenged on the ground that the sale was allegedly in breach of trust.[65]

Spain

Alternative 1

The Spanish Civil Code (cf. art. 1459 CC and art. 267 Code of Commerce) permits the mandatary to purchase an asset over which he has no power (since its management was not entrusted to him). The purchase of Greenacre will be valid; however, there is a conflict of interest in this case, since Jacob is obliged to act in a way that best meets Esther's interest, and he cannot obtain a profit for himself during his management. The duty of loyalty and information that Jacob owes to the mandator (art. 1720 CC) is breached; therefore, Esther probably has a right to compensation based on lost profit (art. 1106 CC), corresponding to the increase in value of Greenacre. Jacob's purchase was made in bad faith, because the information about the future increase of the land's value was obtained in the course of Jacob's duties on Esther's behalf. The remedy will be found in the rules for breach of contract. There is no case law in Spain on the situation proposed in Alternative 1.

Jacob's mismanagement and deceitful behaviour offer another way in which Esther might obtain the increase in value of Greenacre as compensation for her loss (art. 1726 CC). It is possible to apply, directly or by analogy, art. 288 of the Code of Commerce, which is dedicated to a special kind of commissionist (*factor*); the norm forbids the latter to trade on his own account in the same negotiations that he conducts on behalf of his mandator.[66] Lastly, Esther can also revoke the mandate, due to loss of confidence (art. 1733 CC).

[65] Trusts (Scotland) Act 1961, s. 2. Any attempt to argue that Bill was a 'constructive trustee' would presumably be blocked by this statutory provision, and in any case it is doubtful whether Scots law accepts the concept of constructive trust. See previous footnote.

[66] Art. 288: 'Agents (*factores*) are forbidden to trade on their own, or to take an interest on behalf of themselves or of someone else, in negotiations of the same kind that they manage on behalf of their principals, unless the latter give express permission for it. If they negotiate without this permission, profits of the negotiation will be for the principal, and losses for the agent.'

Alternative 2

The mandatary, Jacob, has full powers to carry out a sale with anyone. The transfer of the effects of the sale to Esther would take place regardless of whether Jacob showed the power of attorney to Bill (yielding the direct effect of representative mandate), or whether Jacob acted in his own name when dealing with 'the mandator's own possessions' (art. 1717 CC), in this case Blackacre. Esther will have available to her any action against the buyer (Bill) that is available to any seller, and vice versa.[67]

To recover compensation for losses suffered from the performance of a contract in bad faith (art. 1258 CC), it will be necessary (but difficult) for Esther to prove that both Jacob and Bill had knowledge of the expected increase in the value of the land. If a fraudulent agreement (*consilium fraudis*) between Bill and Jacob can be proven, then Esther can make the following claims. First, she can take direct action against Bill to claim 100 per cent of the land's increased value, in virtue of the sale that was induced by fraud or incidental wilful misconduct (*dolus incidens*; art. 1270.2 CC). It does not appear that Esther can recover Blackacre, since her wish was to sell and she granted Jacob the power to do this. She might recover it on the basis of her lack of genuine agreement[68] to a transfer that harmed her; however, this is doubtful. Secondly, with respect to Esther's claim for the increase in value of Greenacre, it will not be possible to make a claim for the profit until a sale of Greenacre takes place. If Jacob sold Greenacre together with Blackacre, without having power over the former, then it would be possible to claim the increased value from Jacob as mentioned above (art. 1726; see Alternative 1). In Alternative 2, Esther's claim related to Greenacre will not succeed, unless she proves the agreement between Bill and Jacob with complete evidence.

Sweden

Alternative 1

The case highlights two questions, (i) whether the manager is entitled to act for himself when he has a mandate to make the same investments

[67] The same solution was defended for the *management fiducia* by the STS 21 March 1995.
[68] Arts. 1261 and 1265.

for a client, and the consequences of a possible breach of duty, and (ii) how the price should be determined if the manager later sells the acquired property to the client.

There is no rule in the Commission Agency Act which forbids the mandatary from involving himself in transactions which at the same time could have been done for a client. However, it is a generally held opinion among financial institutions that, in principle, they should execute orders from clients before they place their own orders, and that they should not be entitled to invest in contemplation of passing the assets on to clients. In the near future this might be reflected in amended legislation. It could, however, be strongly doubted whether, under the present state of the law, a client would be entitled to claim an increase in the value of property which the manager was entitled to buy for the client but bought for himself, even if he explored the business opportunity when he was administering the client's assets.

This doubt arises from s. 42 of the Commission Agency Act. There is a rule for the situation in which a commissionist, having received a commission from a client, first buys the same (kind of) object for himself and later passes it on to the client. In such a case the commissionist is obliged, but not entitled, to sell to the client at the same price at which he bought himself, unless he can prove that the purchase was made for a person other than the client (for another client or for himself). The purpose of the rule is to preclude the commissionist from postponing the decision as to for whom the purchase was made until he has learnt whether the price increased or decreased. Indirectly, the rule demonstrates that the manager is entitled to buy for himself, unless he has undertaken not to do so, provided only that he can prove that this was his original intention. In reality it amounts to a presumption that the mandatary intended to buy (and therefore bought) for any client who alleges that, and who can refer to a conforming mandate. If the mandatary had promised the client not to buy for himself, he still becomes the owner if it is proven that he had intention when the purchase was made,[69] but in such a case he would be liable to pay damages.

Alternative 2

No legislation or precedents are directly applicable to the case, so the answer must be tentative.

[69] That the mandatary's intention is decisive is also shown by NJA 1937, 619. NJA stands for *Nytt Juridiskt Arkiv* part I, containing cases from the Supreme Court.

A first remark is that Esther presumably believes that the increase of value was caused by the political influence Bill could exercise, and was interested in exercising, after he had bought Blackacre. Thus, it is submitted that Bill would not have caused the changes in the zoning rules unless he had become an owner of land in the area. But Jacob was under no duty to sell his own land, Greenacre, to Bill in order to benefit Esther. And if he had not sold any land to Bill, Esther's Blackacre would not have increased in value. Consequently, Esther was not caused any loss by Jacob's behaviour.

At the same time, Jacob's sale of Esther's property with the purpose of increasing the value of his own similar property might have caused his enrichment, and the enrichment could arguably be considered as unjust. However, Swedish law has no general principle that unjust enrichments should be reversed. There are only a few specific cases in the legislation and in the precedents, and it is not clear that a general principle could be formulated.[70] An argument against a duty on the manager to account for his enrichment to the client is that the Commission Agency Act, as stated above, does not prevent the manager from acting in his own interest. In this case, however, he did so by using an asset of the client. The action is to some degree comparable to a case in which the manager, using a general administrative power, bought assets from the client which he had good reason to believe would increase in value. Therefore, and considering what is stated in the preceding paragraph, I am inclined to say that 50 per cent of the enrichment should be reversed to Esther, if it seems probable that the increase in value was caused by the sale of Esther's property.

Esther may have an even better remedy, if she could recover Blackacre from Bill. Here s. 54 of the Commission Agency Act is relevant, by analogy. It stipulates that, if the mandator's property is sold contrary to the mandator's interest, by the fault of the mandatary, the sale does not bind the mandator if the third party realised or ought to have realised that the mandatary fundamentally neglected the mandator's interest or acted dishonestly. As said above, the sale was not against Esther's interest considering that Jacob was not obliged to sell his own property, but it could be regarded as dishonest on the part of Bill. However, in order to establish bad faith or dishonesty, it would need to be shown that Bill also knew that Jacob owned similar property

[70] See Hellner, *Obehörig vinst* (1951) and Karlgren, *Obehörig vinst och värdeersättning* (1982), passim.

and hoped to be enriched. Strictly construed, the section is applicable only if the sale is both contrary to Esther's interest and dishonest. Nevertheless, Esther might have a right to recover Blackacre if Bill knew of Jacob's interests. Assuming this, the possible fact that Bill was registered as owner of Blackacre would not prevent the sale from being non-binding on Esther, not even if Bill were insolvent. (Swedish law does not have a principle of abstraction, as for instance German law does.)

Comparative remarks

Alternative 1

Every system agrees in general terms that the manager should not take personal advantage from the management relationship without the knowledge of the client. There is, however, a variety of approaches to how this should be understood. The location of the burden of proof is critical to the outcome in most situations of this kind.

Some reporters (Belgium, Denmark, Luxembourg, Sweden) doubt whether Esther can have such a degree of control over information gathered by Jacob that she should have a claim in this type of case. It would be up to her to prove that there was an express or implied term of their contract that required notification of such facts. Otherwise, the manager is free to buy for his own account. Most reporters, however, find that an obligation to communicate information is automatically implicit in the relationship, putting Jacob in breach (Austria, England, Finland, France, Germany, Greece, Italy, the Netherlands, Scotland, Spain). Portuguese law requires the client's consent to self-dealing, but the reporter doubts whether these facts come within that rule; rather, Esther would have to prove that Jacob breached a general obligation of diligence. The Belgian reporter notes that the rules are stricter for managers of investments in financial instruments.

The question of remedy reveals further divergence. Only the trust jurisdictions (England, Ireland and Scotland) seem willing to contemplate a remedy measured directly by the trustee's gain. There is a difference between them, since in England and Ireland the gain must be surrendered even if it could not have been acquired for the trust (this is usually justified as a deterrent); the Scottish reporter indicates that in such a case, the trustee may be able to keep the gain. Most other systems are unwilling to permit any claim except one for Esther's loss. Some reporters, however, suggest that Jacob's gain may be a suitable measure for Esther's loss via the breach (Austria, Denmark, France, Germany, Greece, Spain), which indirectly allows recovery of the manager's gain. The Italian report suggests that a similar result could be achieved by the ratification of the purchase by Esther. Others indicate that it would be very difficult for Esther to prove a loss in this case (Belgium, Finland, Luxembourg, the Netherlands, Portugal). The reporters for Luxembourg and the Netherlands both suggest that the mandatary's obligation to account for his mandate might permit the recovery of his gain as such; this has been suggested in both systems, but not established. Interestingly, it is the conceptual tool of accounting that underlies the gain-based claim in the trust jurisdictions.[71]

Alternative 2

The conclusions reached in this part of the question tend to conform to the approach taken in the previous part. Regarding the claim against Jacob, as in Alternative 1, the burden of proof will be crucial. In England and Ireland, the burden of proof is shifted onto the trustee in any case with a hint of conflict of interest and duty. Any gain realised out of a conflict must be disgorged. As before, the Scottish reporter suggests a less strict rule: a gain need not be given up if there was no way the profit could have been captured by the trust. Elsewhere there is a tendency to find the burden of proof on Esther. She will not have a claim against Jacob unless she can prove that in making the sale to Bill, he was trying to influence the zoning change and so enrich himself. If she can establish this, she will be able to recover the loss she suffered as a result; this raises the same issue as in Alternative 1, regarding the difficulty of proof of loss in such a case. German law forms an exception: the burden of proof can be reversed against a fiduciary in breach, both on the issue of whether there was a breach, and on the issue of whether the breach

[71] That is, the historical foundation for the gain-based remedy is the trustee's obligation to render an account. The account could be falsified by the beneficiary: in other words, its accuracy was subject to scrutiny by the court. If the trustee acquired a gain from his office, he was obliged to enter this in the account as a receipt on behalf of the beneficiary, and so to account for what he had done with that receipt. This is called 'surcharging' the account. If the trustee could not account for what had become of it, he was liable to restore it; the result was that he was liable to pay an amount of money equal to his gain. See R. Chambers, 'Liability', in P. Birks and A. Pretto, eds., *Breach of Trust* (Oxford: Hart Publishing, 2002), 1 at 16–20.

caused loss. German law also will allow gain-based recovery in some cases, but only if a bribe has been given and taken.

There is a common core regarding the recovery of Blackacre from Bill. Generally, it requires that he was, in some way, party to a wrongful scheme with Jacob. Many systems will regard the sale as ineffective if such collusion is proved (Austria, Denmark, Finland, France, Germany, Greece, Luxembourg, Portugal). The same result follows in England and Ireland under trust law, although this is complicated somewhat by the land registration systems. There are some exceptions. The Spanish reporters suggest that even in the case of collusion, there can be no recovery from Bill, although proof of collusion might allow a claim for Jacob's gain on Greenacre. Similarly, the Scottish reporter advises that there cannot be recovery of Blackacre from Bill regardless of what is proved: there is a pure abstraction of the real effects of the transfer from the obligational effects. In the Netherlands, Esther can claim against Bill for wrongdoing, and, in some circumstances, can take over rights which Jacob may have against Bill, including possibly a right to annul the sale.

On the other hand, some systems would allow recovery of Blackacre from Bill even without proof of collusion between him and Jacob, so long as Bill is aware that Jacob is acting improperly; or, more succinctly, so long as Bill is in bad faith (Austria, Denmark, England, Italy, Ireland, Finland, France, Greece, Italy, Luxembourg). In England, Italy and Ireland, the reporters note that recovery of the land may depend upon whether appropriate land registration steps are taken.

Case 4: Basic insolvency situation

Case

Alternative 1

Tom is a real estate agent. One of the immovables he is trying to sell is an apartment belonging to Samantha. Bill is interested in buying this apartment. To show his seriousness in entering into negotiations, Bill writes a cheque for €10,000 as a deposit, which is to be refundable if the sale does not proceed. On Tom's instructions, Bill makes the cheque payable to Tom, and Tom deposits this cheque into his own bank account. The negotiations between Samantha and Bill break off with no contract, and Bill tells Tom to refund the money. Tom, who has made no withdrawal from the bank account in the intervening time, has become insolvent. Does Bill's claim to his deposit have priority over competing claims, or is he treated as a general creditor? Would it make a difference if Tom were a practising lawyer?

Alternative 2

Tom is a travel agent. He sells tickets from various airlines to his customers. The money paid for the tickets by his customers is deposited in a bank account in Tom's name. When Tom becomes insolvent, some customers already have their tickets and some do not (and those who do not have tickets have no contractual claims against the airlines). The customers who have not been issued tickets claim back their money. The airlines claim payment from the bank account for tickets that have been issued. Tom's general creditors also claim the money in the bank account. Do the customers claiming refunds have any priority over competing claims, or are they treated as general creditors of Tom? Do the airlines claiming the money paid for tickets have any priority over competing claims, or are they treated as general creditors of Tom?

Discussion

Austria

Alternative 1

The facts presented in Alternative 1 are not clear as to the appropriate characterisation of the relationship between Tom and Bill. The deposit of €10,000 in Tom's bank account, however, indicates that Tom is to hold this money on a fiduciary basis, while Bill is negotiating with Samantha about the apartment.[1] As such, internally, Tom is bound by the contract of mandate; he must either hand over the money to Samantha if an agreement is reached about the purchase of the apartment, or refund it to Bill if the negotiations do not result in a contract. There is no legal requirement for real estate agents in Austria to deposit their clients' money in separate trust accounts (*Anderkonto*).

If the fiduciary (Tom) becomes insolvent, the decisions of the Supreme Court (OGH) and legal doctrine agree that the mandator (Bill) has a right of separation according to s. 44 KO (Insolvency Act).[2] This means that the mandator's claim to recover the fiduciary property has priority over competing claims, and is to be satisfied first. This approach seems to be inconsistent with the classical concept of property in the Austrian legal system and requires clarification. The reasons are that the mandator actually gave up ownership of the fiduciary property by transferring it to the fiduciary, and also that the right of separation is not allowed under the contract of mandate or under indirect representation, according to the decisions of the Supreme Court and to the doctrine.[3]

Supreme Court holdings and doctrine make a distinction between the 'formal ownership' of the fiduciary and the 'material', or 'economic

[1] Since the money has been mingled with the rest of Tom's money, he has obtained ownership over it anyway (s. 371 ABGB).

[2] Stanzl in *Klang*, *ABGB IV/1*^{2}, 792; Butschek, 'Die Rechtsstellung des Treugebers bei der uneigennützigen Treuhand', JBl 1991, 365; Rechberger, 'Die Treuhandschaft bei Insolvenz und Exekution', in *Apathy, Treuhandschaft* 179, 181 ff.; Apathy in *Schwimann*, *ABGB V*^{2} § 1002 Rz 12; Strasser in *Rummel*, *ABGB I*^{3} § 1002 Rz 42k; OGH 23.1.1963 EvBl 1963/136; 17.3.1977 SZ 50/42.

[3] Rechberger in *Apathy*, *Treuhandschaft* 181 mwN; Strasser in *Rummel*, *ABGB I*^{3} § 1002 Rz 42k.

ownership' of the mandator.[4] In their opinion, the fiduciary property is transferred only formally to the fiduciary, while substantially it remains the property of the mandator. It constitutes a special separate fund, which must not serve as a fund for the satisfaction of claims of the fiduciary's creditors.[5] Consequently, with due regard to the economic interests of the parties, the mandator is entitled to receive preferential treatment if the fiduciary becomes insolvent. This is only the case, however, if there is absolutely no doubt that the fiduciary relationship is not established subsequently in order to damage the creditors of the fiduciary.[6]

Recently, there has been some doctrinal criticism which supports the above reasoning, but attempts to introduce an additional criterion in order to justify the preferential treatment of the mandator in the case of insolvency of the fiduciary. On this view, the mandator holds the right of separation only if the fiduciary relationship was notorious. It is only then that the fiduciary's creditors are not likely to be damaged. The fiduciary relationship is considered notorious if anybody who makes enquiries about the nature of the relationship in question will be able to acquire information about the existence of the fiduciary relationship.[7] While this opinion merits additional consideration, the courts still grant the right of separation to the mandator without making a distinction between notorious and secret *fiduciae*.

If the fiduciary property, however, consists of money as in Alternative 1, then the mandator can only claim the right of separation if the fiduciary property (money) can still be traced and separated from the fiduciary's other property. Otherwise, the fiduciary has obtained full ownership of the money through the confusion of the goods; the money has become part of the bankrupt fiduciary's assets, and so can no longer be subject to separation.[8] This means that Bill's claim to his deposit will have priority over competing claims, if the identification of the money is still possible.

[4] OGH 25.9.1952 SZ 25/249; 25.2.1971 EvBl 1972/19; 28.10.1971 SZ 44/166 = JBl 1972, 322; 23.1.1980 EvBl 1980/162; Kastner, *Gesammelte Aufsätze* 608 f. mwN; Butschek, *Rechtsstellung* 69 ff.; Apathy in *Schwimann, ABGB V*^{2} § 1002 Rz 12; Strasser in *Rummel, ABGB I*^{3} § 1002 Rz 42k.

[5] Apathy in *Schwimann, ABGB V*^{2} § 1002 Rz 12.

[6] Ibid.; Strasser in *Rummel, ABGB I*^{3} § 1002 Rz 42k; see the comprehensive overview on fiducia and insolvency proceedings in Walter, *Die Treuhand im Exekutions- und Insolvenzverfahren* (1998).

[7] Thurnher, *Grundfragen* 66; Rechberger in *Apathy, Treuhandschaft* 183 f.

[8] See s. 371 ABGB; Apathy in *Schwimann, ABGB V*^{2} § 1002 Rz 12; OGH 31.8.1994 ecolex 1994, 812 (Wilhelm).

If Tom is a practising lawyer, then the situation will change in so far as the money will not have been deposited in Tom's own bank account. Lawyers in Austria are obliged by law to keep a separate trust account (*Anderkonto*), whenever they are entrusted with the management of third party funds.[9] Thus, confusion with Tom's own money will never occur, and the fiduciary relationship will always be notorious. Bill will be entitled to preferential treatment. If Tom, acting as a lawyer, did not comply with the above provisions, then he will be liable for damages. These damages must be fully covered by liability insurance, which every lawyer is obliged to take out in Austria. The same is true for notaries public in Austria, whose liability is even stricter.

Alternative 2

Neither Directive 90/314/EEC of 23 June 1990 (Package Holidays and Package Tours) nor its implementation into Austrian law (s. 31 b – 31 f KSchG (Consumer Protection Act)) is applicable to the sale of airline tickets on its own. The provisions apply only if there is a combination of at least two of the following services: (a) transport, (b) accommodation, or (c) other services.[10]

Under Austrian law a special authorisation is required for the sale and issue of airline tickets by a travel agent. The money received must be deposited in a separate account, which is administered by a separate legal entity, being independent of the travel agency. In Austria, Tom would not be allowed to deposit his clients' payments in a bank account in his name.

As far as the legal relationship between Tom and the airlines on the one hand, and between Tom and his customers on the other hand, is concerned, Tom is acting as an intermediary between the different airlines and his customers. As a travel agent he just negotiates the transactions on behalf of the airlines, collects the customers' payments for the tickets, and finally transfers the payments for the airline tickets to a separate bank account without ever obtaining ownership of the funds. The travel agent usually charges a service charge to the customer who only buys an airline ticket, for negotiating the purchase with the respective airline.

[9] Stanzl in *Klang, ABGB IV/1*^{2}, 792. See also s. 43 (1), (3) and (4) RL-BA (Richtlinien für die Ausübung des Rechtsanwaltsberufes, für die Überwachung der Pflichten des Rechtsanwaltes und für die Ausbildung der Rechtsanwaltsanwärter).

[10] See art. 2 of the Directive and s. 31 b (2) ((1)) ABGB.

In Alternative 2 the airlines and the customers are treated as general creditors of Tom, if Tom mixed his clients' money in a single bank account kept in his name, because then the money is not traceable any more (see Alternative 1).

Belgium

Alternative 1

Real estate agents must pay any deposit made by a client into a 'professional bank account'.[11] The agent in his contract with the banking institution must disclose the professional character of the account. The real estate agent's professional account should be construed as a 'special quality account'.[12] Such an account is held in the name of the account holder but on behalf and for the benefit of a third party, i.e. the client who made the deposit. All sums paid into the special quality account are separated from the account holder's private estate, and thus are not subject to the claims of the private creditors of the holder.[13] The special quality account is sometimes justified as a fiduciary arrangement,[14] inspired by Anglo-American law. Some authors explain it as a contract of commission; others claim its legal basis is equity.[15]

In continental systems, the concept of the special quality account stands in critical tension with basic provisions of the Civil Code.[16] Unless a statute explicitly provides that the professional accounts of a certain profession are to be 'special quality accounts',[17] there remains some doubt as to whether the courts will accept the secured status of a professional bank account. There is, however, case law accepting this effect in the absence of specific legislation.[18]

In Alternative 1, the real estate client can try to claim his refundable deposit back from the bank. He will have to argue that the deposit was

[11] Art. 10 Professional Code for Real Estate Agents.

[12] R. Timmermans, *De nieuwe deontologie van de vastgoedmakelaar* (1999), 207.

[13] E. Dirix, 'Kwaliteitsrekeningen', *Tijdschrift voor Privaatrecht* 1996, 76.

[14] See E. Dirix and R. Vriesendorp, eds., *Inzake kwaliteit* (Antwerp: Kluwer, 1998); A. Verbeke and R. D. Vriesendorp, 'Kwaliteitsrekening en faillissement', *Tijdschrift voor Insolventierecht* 2000, 110; A. Verbeke and I. Peeters, *Vijf jaar voorrechten hypotheken en andere zekerheden* (Ghent: Mys & Breesch, 1997), 113–114.

[15] E. Dirix and R. De Corte, *Zekerheidsrechten*, 4th edn (Antwerp: Kluwer 1999), no. 10.

[16] Arts. 7 and 8 Mortgage Act.

[17] Such as the professional accounts of notaries: art. 34 of the Act on the Notary Profession (Acts of 4 May 1999, *Moniteur Belge* 1 October 1999).

[18] See references in A. Verbeke, I. Peeters, J. Byttebier, K. Christiaens, *Voorrechten, hypotheken en andere zekerheden 1996–1997* (Ghent: Mys & Breesch, 2000), no. 155.

made to a special quality account, and therefore has not been mingled with the agent's private patrimony, so that it cannot fall into the hands of the other creditors of the agent.

In any event, real estate agents are – since 1 October 1999 – required by their Professional Code to provide security for each client making deposits.[19] A trustworthy bank or insurance company must issue this kind of security. As a result, Bill can claim his deposit back, and, if Tom does not or cannot comply, Bill can go directly to the issuing bank or insurance company. Bill does not have to compete with the claims of other creditors.

Would it make a difference if Tom were a practising lawyer?

Rules of good professional practice require attorneys-at-law to isolate all sums held on behalf of their clients by placement in a special, separate bank account with a banking institution approved by the Law Society.[20] The character of the bank account is disclosed to the bank through a special agreement, and to the general public by mention on the attorney's letterhead. Legal scholars consider this 'third party account' to be a special quality account, not subject to claims from any creditors other than the attorney's clients.[21] The same principles apply for notaries. There is no duty for an attorney or a notary to provide security to their clients.

Alternative 2

Belgium has incorporated the European Directive on package travels, in art. 36 of the Act applicable to contracts between customers and travel agents.[22] In accordance with art. 36, each travel agent must prove its ability to meet *all* of its obligations in case of insolvency. A Royal Decree, enacted in 1997, provides that such proof can only be given through an insurance policy with a certified insurance company.[23]

Article 36 also applies to the isolated sale of airline tickets, provided that a travel agent has issued the tickets.[24] As such, Belgium has extended the European Directive on package travels to this situation. Consequently, in the case at hand, customers who have not yet received their tickets will be

[19] Art. 10 Professional Code for Real Estate Agents.

[20] Arts. 1–5 National Law Society Regulations of 19 January 1989.

[21] See above.

[22] Act of 16 February 1994.

[23] Royal Decree of 25 April 1997 implementing art. 36 of the Act of 16 February 1994.

[24] Article 36 does not apply if the customer has bought his tickets directly from an airline or from any other person/company which is not a registered travel agent.

able to claim a refund from the insurance company mentioned on the letterhead of the travel agent.[25] Only customers can benefit from the travel agent's insolvency insurance, unless specifically provided otherwise in the policy. Thus, airline companies will in principle be treated as general creditors without priority over other competing claims.

Still, if the travel agent has adopted the Passenger Sales Agency Agreement of IATA and the airline is accredited by IATA, the airline company may try to invoke art. 7.2 of that agreement in order to secure recovery of its claim.[26] Under the conditions of art. 7.2, as long as the airline has not been paid, the ticket fare collected by the travel agent from the passenger is considered to be the property of the airline carrier and must be held 'in trust' for the airline by the agent. This contractual provision may, however, prove to be of little help to the airline. Article 17 of the Passenger Sales Agency Agreement designates the law of the principal place of business of the agent as the applicable law, which will be Belgian law for most Belgian travel agents. Under Belgian law, money belongs to the person who has it in his possession, or the person in whose name the account is held (in this case the travel agent), despite any other contractual arrangement. Thus, the contractual provision that the money collected by the agent will be the property of the airline will not be given effect towards third parties and will not entitle the airline to any priority over the other creditors. Exception can possibly be made for the case where the agent has placed the money collected from the passengers on a special quality account, but – as was explained above – the secured status of such a special quality account is still uncertain under Belgian law.

Denmark

Alternative 1

According to the Danish Bankruptcy Act, s. 32, the estate in bankruptcy shall comprise any property owned by the debtor at the time of the pronouncement of the adjudication order. It follows from this provision that the bankruptcy estate is obliged to respect third party rights in respect of assets which the debtor has in his possession, where such possession is incidental to a contract of loan, hire, bailment or

[25] Travel agents must mention the name and number of their insurance policy on their letterhead: art. 10 § 1, 3° of the Act of 16 February 1994.

[26] See further on this point the German report.

manufacture. The same applies to assets that are deposited with the debtor in order to be sold.

In the event that an asset belonging to a third party is mixed with the debtor's assets, which is often the case in connection with money and securities, the third party, as a general rule, only receives a bankruptcy claim. In special circumstances the third party may, however, claim a part of the money that was present at the time of bankruptcy which corresponds to the part that originated from him, provided that it can be proven that no part of the total amount present, e.g. in the debtor's bank account, has been spent by the debtor since the third party paid the money to the debtor.

Whether the debtor is obliged to keep the money separate from his own money and from the money belonging to third parties, depends on the agreement or the usual practice between the parties. If the debtor is obliged to keep the money separated from his own money *and actually did* keep the money separated, then the owner's claim will take priority over competing claims and the owner will therefore not be treated as a general creditor.

Specific rules apply to the activities of real estate agents: cf. the Real Estate Trading Act (Act No. 453 of 30 June 1993). By way of Statutory Order No. 617 of 19 August 1998, a real estate agent must be covered by a guarantee issued by a bank or an insurance company for the minimum amount of DKK 2,500,000 (approximately €335,000) per annum. The guarantee covers money claims that consumers may have on the real estate agent, provided that the claims are connected with the real estate agent's business activities.

According to the statutory order, a real estate agent is not permitted to take a deposit of more than 7 per cent of the purchase price of an immovable, subject to an absolute maximum deposit of DKK 200,000 (approximately €27,000), unless the money is kept in a separate bank account in the name of the consumer (seller or buyer of the immovable). The provision presupposes that the purchase price has been agreed on, but if this is not the case, the offering price is decisive. The real estate agent is under the obligation to register the money entrusted to him, including money kept in separate client accounts.

In the case of Tom and Bill, there is apparently no agreement between the parties that Tom should keep the deposit paid by Bill separate from his own money, and he has not actually done so, since the money was paid into his own bank account. (If the amount paid by Bill exceeds 7 per cent of the offering price or DKK 200,000, Tom was obliged to keep the money in a separate bank account, under the statutory order mentioned above; but I assume that this is not the case.)

Bill will be treated as a general creditor in the bankruptcy estate, but if he is a consumer, i.e. not professionally involved in buying and selling immovables, then his claim will be covered by the bank guarantee issued in accordance with the statutory order.

If Tom is a practising lawyer, then he will be obliged, pursuant to mandatory statutory provisions, to keep any amount belonging to his clients in separate client accounts. The Danish Guarantee Fund for Contributors and Investors covers deposits into the client accounts of lawyers.

If Tom followed these rules and kept Bill's money in a client account, then Bill's claim will have priority over the general creditors, and the Guarantee Fund will cover his claim if the assets of the bankruptcy estate prove to be insufficient. Since Tom has not actually followed these rules, Bill will also be treated as a general creditor.

Alternative 2

Since the money paid was deposited in a bank account in Tom's name, it cannot be identified as belonging to the customers; thus the customers will be treated as general creditors. The same holds for the money paid for tickets; the airlines' claim for this money does not have priority over competing claims.

The EU Directive on package travel, package holidays and package tours (Council Directive 90/314/EEC) has been implemented into Danish law mainly by way of the Package Travel Act (Act No. 472 of 30 June 1993). According to s. 28 of the Act, a travel agent is directly liable to the customer for any claim of an economic nature which the customer may have on the offeror of the package travel. However, the Act does not contain any rules covering insolvency of the travel agent.

England

Alternative 1

In either case, real estate agent or lawyer, the money would be held by Tom in trust for Bill.[27] Since there was a trust, the correct step would

[27] In the case of a real estate agent there is a statutory trust imposed by s. 13 of the Estate Agents Act 1979. For a solicitor the trust would arise by intention, i.e. the intention of Bill that the money was not to belong beneficially to Tom, and Tom's receipt of the money on those terms.

have been for Tom to put the €10,000 into a trust account.[28] If this had been done, then clearly the funds would not have been available for Tom's general creditors but would have been returned to Bill, since property held in trust is never available to personal creditors of the trustee. Even though, in breach of duty, Tom put the money into his personal bank account, it is still trust property as long as it can be traced.[29] Since Tom did not touch the account after depositing Bill's money, Bill will be able to recover his money; mixing with other money does not defeat the tracing process.

Alternative 2

Here there is a question of fact as to whether the money was paid by the customers in trust or not. If money is paid under an ordinary contract, a trust is not usually intended.[30] This means that whether the payor realises it or not, he takes the credit risk as to whether there will be counterperformance.[31] Even when an agent receives money for his principal, the same question of fact arises. Money may be received by an agent as a trustee, or on the basis that the agent owns the funds beneficially and is only personally accountable.[32] The parties need not use the term 'trust', but there will be a factual enquiry as to whether they intended to create a trust or a debtor–creditor relationship.[33]

[28] For solicitors, this obligation is imposed by the Solicitors Act 1974, ss. 32–33, and the Solicitors' Accounts Rules 1991. For real estate agents, see ss. 12–15 of the Estate Agents Act 1979 and the regulations thereunder. See also the Insurance Brokers (Registration) Act 1977, s. 11.

[29] That is, the trust is not defeated by a breach of trust, even if Tom meant to misappropriate the money, so long as the property is traceable. As to the principles of tracing, see Case 6.

[30] The intention of both parties is relevant. A trust will not arise unless the person transferring property so intends. At the same time, a person cannot be made the trustee of an intentionally created trust unless he consents to be trustee.

[31] *Re Goldcorp Exchange Ltd* [1995] 1 AC 74, [1994] 3 WLR 199, [1994] 2 All ER 806 (PC, New Zealand).

[32] *Henry* v. *Hammond* [1913] 2 KB 515.

[33] *Box* v. *Barclays Bank plc* [1998] Lloyd's Rep. Banking 185. There is an intermediate position. If money is paid by A to B for a particular purpose, to which both agree, it may be held that the result is as follows: if B uses the money for that agreed purpose, there is only a debt owing from B to A; but, if the purpose becomes impossible to fulfil, then B will hold the money on trust for A. See *Barclays Bank Ltd* v. *Quistclose Investments Ltd* [1970] AC 567 (HL); *Twinsectra Ltd* v. *Yardley* [2002] 2 AC 164 (HL); W. Swadling, ed., *The* Quistclose *Trust: Critical Essays* (Oxford: Hart, 2004). The nature of such a trust is controverial: see especially R. Chambers, 'Restrictions on the Use of Money', in Swadling, *The* Quistclose *Trust*, 77. In one case, it was even held that where customers had paid in advance for goods to be delivered by mail, the debtor then unilaterally made itself a trustee of the

Customers claiming their money back will need to establish that they did not pay Tom as a contractual counterparty, taking a credit risk, but as an agent, and moreover as an agent who was not simply to be accountable but was to hold the payment in trust. The core element of the intention to create a trust is the intention that the transferee of the property shall not be at liberty to use the property for his own benefit.[34] If a trust is established, then these customers will be able to recover their advance payments, because the facts indicate that the money paid by the customers remains in a bank account, and is therefore identifiable even though it may be mixed (see Case 6). In the absence of clear language, one might expect that a crucial factor in deciding whether a trust was intended would be whether it was contemplated that Tom should be allowed to mix the money in question with his own money. That might be considered to indicate an absence of an intention that there should be a trust. However, in some recent cases regarding claims by airlines in travel agent insolvencies, it has been held that a clearly expressed intention to create a trust will be effective even though the agent/trustee is permitted to mix the trust funds with its own operating funds.[35] Even so, it would be difficult to establish a trust in favour of the customers unless there was a similarly clear expression of the relevant intention.[36]

Airline tickets sold on their own are not 'package' travel and so are not within the Package Travel, Package Holidays and Package Tours Regulations 1992,[37] which implement the Package Travel

funds paid, with the result that the customers were protected when the debtor become insolvent before shipping the relevant goods: *Re Kayford* [1975] 1 WLR 279. In theory, such a unilateral declaration of trust could occur without the knowledge of the beneficiaries; in this case, the customers. This case is doubted, however, by R. Stevens, 'Insolvency', in Swadling, *The* Quistclose *Trust*, 153 at 158, on the ground that such a transaction prefers one set of creditors over the others.

[34] In the case of a *Quistclose* trust, discussed in the previous note, it must be shown that the parties agreed that the money could only be spent on a particular agreed purpose.

[35] These cases are discussed immediately below, when claims by the airlines are addressed.

[36] In *Re ILG Travel Ltd* [1995] 2 BCLC 128, [1996] BCC 21, a tour operator's agreements with the travel agents who sold the tours stipulated that money received by customers should be held in trust by the agent for the customer until such time as the contract between the customer and the tour operator was confirmed. In turn, the agents incorporated these terms into their dealings with customers. The litigation involved the insolvency of the operator, not the travel agents, and so the effectiveness of this trust in favour of customers was not an issue. It seems, however, that such a trust would be effective, based on the clear expression of an intention to create a trust.

[37] SI 1992/3288, as amended by SI 1995/1648 and SI 1998/1208. If these regulations were applicable, they would require Tom to have in place a system to protect customers against his insolvency. It could be by bonding, insurance or a trust.

Directive.[38] The Association of British Travel Agents has two codes of conduct, for tour operators and for travel agents. The former requires bonding against insolvency.

If customers paid by credit card, then they might have a recourse against the card issuer (usually a bank) under s. 75 of the Consumer Credit Act 1974. The position is unclear.[39]

As for the airlines, they also must establish that in taking payment as their agent, Tom received the payments as trustee. In this case, that is almost certainly provided for expressly in the contract governing the relationship. There is a standard form contract for travel agents issuing tickets for carriers which are members of the International Air Transport Association, and this agreement states that money received from customers for issued tickets is held in trust for the carriers. The effectiveness of this term has been upheld by a number of common law courts, even where the agent routinely mixes such money with its general operating funds.[40] In an English case, *Re ILG Travel Ltd*,[41] the alleged beneficiary of the trust was ILG Travel Ltd, which was not an airline but a tour operator (and IATA member); ILG Travel Ltd's tours were sold by travel agents under the same kind of trust agreement. The judge held that the term did not create a trust

[38] 90/314/EEC, OJ L 158/61, 23.6.1990.

[39] The provision makes the card issuer liable for the contractual obligations of the merchant, but the limits of its application are uncertain: R. Lowe and G. Woodroffe, *Consumer Law and Practice*, 6th edn (London: Sweet & Maxwell, 2004), 382–383; J. Macleod, *Consumer Sales Law*, 2nd edn (London: Cavendish, 2002), 496–503.

[40] *Stephens Travel Service International Pty Ltd* v. *Qantas Airways Ltd* (1988), 13 NSWLR (CA); *Air Canada* v. *M & L Travel Ltd* [1993] 3 SCR 787, 108 DLR (4th) 592; *Royal Brunei Airlines Sdn Bhd* v. *Tan* [1995] 2 AC 378 (PC, Brunei). In *Air Canada* and in *Royal Brunei*, it was conceded that even though a travel agent was allowed to mix funds received for tickets with its own funds, there was still a trust for the airline. The court in the *Air Canada* case nevertheless considered the point, and held that the concession was correct. Iacobucci J wrote, for the majority, 'Since there is clear evidence of intention to create a trust in the agreement between M & L and the respondent airline, the absence of a prohibition on the commingling of funds is not determinative, although it may be a factor to be taken into account by the trial judge, as it was here. Moreover, in the present case M & L acted in accordance with that intention and set up trust accounts, which, although never used, confirm that the relationship was viewed by the directors as a trust relationship.' *Air Canada* and *Royal Brunei* both concerned breaches of trust by corporate travel agents in failing to respect the trust of money received for airline tickets. In each case, the corporate travel agents being insolvent and the money untraceable, individual directors were made liable to the airline beneficiary for wrongful assistance in a breach of trust.

[41] [1995] 2 BCLC 128, [1996] BCC 21.

but rather an equitable charge, that is to say a non-possessory consensual security interest.[42]

If the agreement is held to be effective in creating a trust, the airlines will be able to recover the funds paid by customers for tickets issued (less any agreed commission), so long as they can show that the funds remaining in the bank account are the traceable proceeds of the trust money received earlier. If, however, the reality did not correspond to the contract, then under general principles the formal designation of the relationship as a trust would not be determinative; the court looks at the substance and not the form. The ability of the agent to treat the money as his own, with the consent of the airlines, points away from a finding of a trust.[43] As in *Re ILG Travel Ltd*, the court might conclude that the agreement was effective only to create a charge over the money in favour of the airlines, rather than a trust. In this case, the airlines must still trace the customer money over which they have a charge. More seriously, however, a charge (unlike a trust) must generally be registered or else it is void in the insolvency of the debtor. If that were the result, the airlines would have only an unsecured claim.[44]

[42] In fact the judge stated the slightly unclear conclusion that 'the trust created by cl 19 is a trust under which ILG has a charge in equity over the pipeline moneys to secure payment of the agent's outstanding indebtedness to ILG under the 1990 agreement'. This seems to mix the ideas of trust and charge, but taking the whole judgment into consideration, it is clear that the judge understood ILG's interest as a security interest and not a beneficial interest (which the judge called a 'bare trust'). While he agreed with *Stephens Travel Service*, above, that an ability of the trustee to mix funds with his own money does not automatically exclude a finding of a trust, the course of business in the case before him, including the mixing of funds, was an important factor in his conclusion that there was only a charge.

[43] *Air Canada* v. *M & L Travel Ltd* and *Royal Brunei*, above, are somewhat controversial on this point, but it may be observed that in those cases the airlines were not in competition with the general mass of unsecured creditors of the insolvent travel agents. If they had been, it is possible that the validity of the trust might have been more closely examined.

[44] Companies Act 1985, s. 395. This was not relevant in *Re ILG Travel Ltd* because in that case it was not the travel agents but the tour operator which was insolvent. On the other hand, s. 395 does not require all charges to be registered, but only those which are listed in the provision. The list includes all floating charges, and certain fixed charges, including those over 'book debts.' This is understood to mean debts arising in the course of trade. It has been suggested that a bank account is not a book debt (*Re Bank of Credit and Commerce International SA (No. 8)* [1998] AC 214, [1997] 4 All ER 568 (HL)). This would mean that an airline's charge over a travel agent's bank account would not be registrable if it was a fixed charge, but would be registrable if it were a floating charge. The label chosen by the parties is not determinative; a charge is floating if the debtor is free to dispose of the charged asset in the ordinary course of its business, and in the case of a charge on a debtor's bank account, the charge will be categorised as fixed only if the

Finland

Alternative 1

The real estate agent, under threat of losing his or her licence, is obliged to follow good professional practice. According to traditional practice, money collected by a real estate agent for the account of his mandator should be kept separate from the agent's own money.[45] Recently this practice has been explicitly confirmed in legislation, namely in s. 11 of the Act on Estate and Lease Agencies of 15 December 2000/1075. If the money given by the prospective purchaser is not commingled with the money of the agent, then the purchaser has priority over the competing claims.[46] Otherwise, the purchaser will be treated as a general creditor on the agent's insolvency. In Case 4, the money given by Bill seems to be commingled with Tom's money in the same bank account.

It would not make a difference if Tom was a practising lawyer. In this case the obligation to keep the client's money separate is, however, stated in legislation concerning attorneys.[47]

Alternative 2

The relevant factors are essentially the same as in Alternative 1. The basic questions are, whether Tom was obliged to keep the money separated from his own money and whether he has fulfilled that obligation.[48]

If Tom were acting as a mandatary of the airlines, he would normally be contractually obliged to keep the money separated. The obligation is based on IATA's Passengers Sales Agency Agreement.[49] If Tom were

parties so intend, *and* the creditor exerts some degree of control over the operation of the account in question (*Agnew* v. *Commissioner of Inland Revenue* [2001] 2 AC 710 (PC); note however *National Westminster Bank plc* v. *Spectrum Plus Ltd*, [2004] 3 WLR 503, which has been appealed to the House of Lords).

[45] See R. Rinkama, *Kiinteistönvälittäjän käsikirja* (Helsinki: Rakentajain Kustannus Oy, 1984), 84–85.

[46] The relevance of a duty to keep the money separate is often (see J. Tuomisto, *Omistuksenpidätys ja leasing* (Helsinki: Suomalainen Lakimiesyhdistys, 1988), 338–341), but not indisputably (see R. Koulu, *Tilimaksun saajan suojasta* (Oikeustiede: Jurisprudentia, 1991), 239), accepted in the doctrine. The standpoint of the case law is unclear: see Tuomisto, *Omistuksenpidätys ja leasing*, 339–340.

[47] See Attorney Act, s. 5. The Attorney Act applies only to the members of the Finnish union of attorneys, who are the only ones entitled to use the title of attorney. It is not obligatory for a practising lawyer to belong to the union of attorneys. The good professional practice of real estate agents applies, however, even to that kind of practising lawyer, who also need a normal licence if they want to act as a real estate agent.

[48] On the importance of such an obligation, see Alternative 1.

[49] According to s. 7.2 of that agreement, 'all moneys collected by the Agent for transportation and ancillary services sold under this agreement . . . are the property

selling tickets bought, but not paid for, by him, such an obligation would not exist. This alternative is, however, unusual and presumably not meant to be considered in this case. Therefore, one can say that in practice the airlines would have priority, if the money was kept separated and was not commingled with Tom's money.

The situation of Tom's customers is more uncertain. The basic requirements for their priority are that Tom has been acting as mandatary of the airlines (not selling tickets bought by him), and that Tom was obliged to keep the money separated. Even if these requirements were fulfilled, however, there would be a problem. Tom's obligation is founded on a contract between him and the airlines, and not between him and his customers. An additional problem is that Tom's customers are supposed not to have any contractual claims against the airlines. Under these circumstances, it seems improbable that the customers would have any independent rights to the money they paid.

The Finnish legislation implementing Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours does not seem to be applicable, since Tom is only selling airline tickets and not combined services.[50] However, if Tom sold tickets for charter flights directly to the consumers, then the Act on Package Travel Agencies of 28 November 1994/1080 would be applicable. This means, *inter alia*, that Tom should have obtained security to protect his customers from economic loss, for instance, in the case of Tom's insolvency.

France

Alternative 1

Pursuant to French law, insolvency (*insolvabilité*) does not trigger, *per se*, any specific consequences. Bankruptcy and liquidation procedures (*redressement* and *liquidation judiciaires*) may be opened against (a) a businessman or tradesman (*commerçant*), (b) a self-employed craftsman (*artisan*), (c) a farmer (*agriculteur*), or (d) legal entities governed by private law, which are unable to pay their debts as they fall due (*passif exigible*) with their liquid assets (*actif disponible*).[51]

of the Carrier and must be held by the Agent in trust for the Carrier or on behalf of the Carrier until satisfactorily accounted to the Carrier and settlement made'.

[50] See the Package Travel Act, s. 2.

[51] Art. L. 621-1 para. 1 C. com. Banks are subject to separate conditions to have bankruptcy or liquidation proceedings opened against them: see art. L. 613-26 C. mon. et fin.

If Tom is subject to a bankruptcy procedure, then the principle is that Tom's creditors whose claims predate the bankruptcy proceedings, i.e. antecedent creditors, may not obtain payment of their claim during the bankruptcy proceedings.[52] It would follow that Bill will not be allowed to sue Tom to obtain payment of his claim during the bankruptcy proceedings; he will have to await the outcome of those proceedings. Bill will need to declare his bankruptcy claim against Tom within two months of the publication of the judgment of bankruptcy.[53] Bill will be treated as a general creditor. He will not benefit from any specific priorities. Because the ownership of the money was transferred to Tom and mingled with the rest of Tom's money, Bill has no right to seize (*revendiquer*) the money which was transferred to Tom's account.[54]

However, a recent case[55] would tend to permit Bill to recover the money deposited with Tom, prior to the payment of Tom's general creditors, and even if the money was commingled. In addition, case law has stated that creditors of a real estate agent may not seize funds deposited for the benefit of a client, provided that they were in a segregated account.[56] The rationale seems to be that such funds have not really entered the patrimony of the real estate agent.[57]

A financial guarantee must be established by real estate agents,[58] the purpose of which is to guarantee repayment of funds deposited by the agent's clients.[59] Bill can request the financial guarantor to reimburse him for the funds deposited with Tom.[60] If Tom is an attorney-at-law, then Tom should have deposited Bill's money in the attorney's special account.[61] In this way, the money is not mingled with any other money,

[52] See art. L. 621-40 C. com.

[53] Art. L. 621-43 C. com. and art. 66 of the 27 December 1985 Decree.

[54] Com. 25 March 1997, *Bull. civ*. IV, No. 84; *Quot. jur*. 22 April 1997, 7, comment PM; *D*. 1997. 481, comment Martin; *JCP éd. E* 1997. II. 991, comment Pétel; *Rev. proc. coll*. 1997. 3322, comment Soinne; *RD Bancaire et Bourse* 1997. 128, comment Campana and Calendini; *RTD com*. 1998. 423, comment Martin-Serf; Com. 4 March 1997. 590, *D. Aff*. 1997. 672; *Bull. Joly* 1997. 590, comment Bonneau; Paris Court of Appeal, 14 October 1997, *D*. 1998. 91, comment Larroumet. *Adde* Req. 8 February 1928, *Gaz. Pal*. 1928. 1. 799. See also: B. Soinne, *Traité des procédures collectives*, 2nd edn (Litec, 1995), No. 1942.

[55] Com. 13 November 2001, *Bull. civ*. IV, No. 177; *D*. 2001 *act. juris*. 379; *JCP éd. E* 2002. 641; *Rapport annuel pour 2001 de la Cour de cassation*, 395; *contra*: Com. 4 February 2003, *D*. 2003. 566, obs. Lienhard.

[56] Com. 25 February 1992, *Bull. civ*. IV, No. 92.

[57] R. Perrot and Ph. Théry, *Procédures civiles d'exécution* (Dalloz, 2000), no. 143.

[58] Art. 32 of the 2 January 1970 Act.

[59] Art. 39 of the 20 July 1972 Decree.

[60] AP 4 June 1999, *Act. proc. coll*., 9 July 1999, No. 162.

[61] See art. 12.2 of the Paris Law Society Rules.

and Bill could claim his deposit without any other creditor having a priority.[62] If the attorney misused the money, Bill could take advantage of Tom's insurance.

In practice, if it is the sale of an immovable that is at stake, then it is more likely that Tom will practise law as a notary. In practice, the notary will hold Bill's money under an escrow account and the money will be subject to a pledge, which would give Bill a priority if Tom became insolvent. In addition, an old case forbade the creditors of a notary to seize the funds due to a client, provided that they were segregated.[63] Notaries' clients' debts are also guaranteed by a central agency established under the control of the Notaries Law Society.[64] Bill's money can be paid back by this guarantee agency, provided that Bill establishes that (a) a debt is due to him, and (b) that the notary has not paid him back on time.

Alternative 2

In light of the facts that (a) all of the above-mentioned creditors' claims arose prior to the bankruptcy procedures,[65] and (b) none of the claims are secured, all of the above-mentioned creditors (a) will have to declare their claims to the representative of the bankruptcy proceedings,[66] and (b) will not be allowed to obtain payment of their claim from Tom during the time of the bankruptcy proceedings. They will be treated as general creditors. At the end of the bankruptcy proceedings,[67] Tom can pay the above-mentioned creditors after the post-bankruptcy creditors, i.e. creditors whose claim arose after the commencement of the bankruptcy proceedings, and after secured creditors.[68]

Travel agencies must enter into a financial guarantee agreement benefiting their clients,[69] the purpose of which is, inter alia, to reimburse the clients' funds if the travel agent is unable to do so.[70] Tom's clients should be able to recover their money from Tom's financial guarantor.[71]

[62] Civ. 1*ère*, 19 February 1985, *D*. 1985 IR 319.

[63] Civ. 28 February 1909, *D*. 1909. 1. 421.

[64] Arts. 11 ff of the 20 May 1955 Decree.

[65] See R. Ripert and G. Roblot, *Traité de droit commercial*, t. 2, 16th edn by Ph. Delebecque and M. Germain (LGDJ, 2000), No. 2966.

[66] Art. L. 621-43 C. com. *Adde* Paris 12 May 1998, *Air France* case, *RTD com*. 2000. 180.

[67] See art. L. 621-24 C. com.

[68] Y. Guyon, *Droit des affaires*, t. 2, 6th edn (Economica, 1997), No. 1209.

[69] Art. 4-c. of the 13 July 1992 Act.

[70] Art. 12 of the 15 June 1994 Decree.

[71] Art. 17 para. 4 of the 15 June 1994 Decree.

Germany

The rules giving priority to beneficial owners of bank accounts over general creditors of the account holder are the same in bankruptcy proceedings and in (individual) debt enforcement proceedings initiated by a general creditor. In all cases, Tom would clearly be considered the holder of the bank account. The fact that the money originates from another person is irrelevant, even if it is used to open the account. Beneficial owners clearly have no priority over the rights of the bank, unless the bank is informed. The protection of general creditors does not extend so far as that of the bank, and even in cases in which they are not informed, beneficial owners may have priority.

Alternative 1 concerns general creditors. The main points relevant to Alternative 1 are as follows.[72] The beneficial owner indisputably has priority over the account holder's general creditors if the money is put in a trust account (*Anderkonto*) and declared as such.[73] There are several types of trust accounts, based on special standard term contracts for certain professions, namely notaries public, attorneys-at-law, patent lawyers, certified public accountants, certified economic and tax advisers. However, if asked, banks also open trust accounts for all other professions.

As for money in a 'normal' account, the situation is not completely clear under German law. There is some case law giving priority to the beneficial owner, as long as the money comes from him directly or is paid into the account by one of his debtors.[74] The beneficial owner is not given priority if the money comes from some third party, even if it is the outcome of a transaction that the account holder made using the beneficial owner's assets;[75] nor in the case where the money goes into an account containing a mixture of the account holder's own money and that of a beneficial owner.[76] Many authors dispute the first of these two cases, if the purpose of the account is clearly visible. Some (few) authors dispute both cases, and argue that the beneficial owners should have priority so long as the money can still be traced (*Bestimmtheitsgrundsatz*). The fact that under German law there are hidden security rights which

[72] See more in detail Kötz, 'National Report for Germany', in: Hayton/Kortmann/Verhagen, eds., *Principles of European Trust Law* (1999), 85 ff., at 93–95.

[73] BGH NJW 1959, 1223 (1225 ff.); NJW 1971, 559 (560); NJW 1993, 2622; WM 1996, 662.

[74] 'Unmittelbarkeitsprinzip' or principle of immediacy; see BGH NJW 1959, 1223 (1224 ff.); BGH WM 1993, 83 (84).

[75] BGH WM 1993, 83 (84).

[76] BGH NJW 1993, 2622 (2622); WM 1996, 662 (663).

are honoured under the sole condition that they can be traced (see § 51 no.1 of the Insolvency Code) may speak in favour of the following position: the beneficial owner made the whole investment that produced the money, whereas the holder of security rights normally does not directly produce the value on which the collateral is based.

Alternative 1

Bill will be given priority over Tom's general creditors if Tom placed the money in a trust account (*Anderkonto*). Otherwise, the criteria explained above apply and the situation is disputed.

Alternative 2[77]

Alternative 2 only states that Tom, the travel agent, 'sells tickets from various airlines to his customers'. Since the case description does not mention any other intermediary, it is assumed that Tom sells airline tickets in his capacity as an IATA agent.[78] This is all the more likely given that the vast majority of non-charter tickets are distributed by travel agents who are IATA agents.[79] Under this assumption, Tom will have agreed to the IATA regulations which provide for special rules on how moneys of the air carriers represented by IATA are to be held by the agent.

It is further assumed that the account where Tom deposits moneys received from the sale of the tickets is – although kept in Tom's name – the business account of his travel agency. In this case, the moneys are deposited in Tom's account lawfully and in compliance with IATA regulations.[80]

IATA is a private organisation representing a large number of international airlines. Nowadays, its main tasks are inter alia the coordination of

[77] The answer for Alternative 2 was written by Christian Vogel.

[78] Generally speaking, travel agencies are unable to distribute airline tickets directly from the air carrier to the passenger unless they act as IATA agents. Therefore, non-IATA agents either are authorised to act as distributors for one or several airlines (this is permissible under IATA Resolution 814, cited below), or they sell tickets that they buy as principals from IATA agents or from the airline. In the latter case, they do not act as travel 'agents' in the proper meaning of the term.

[79] Only minor turnover is created by automatic ticket distributors or direct sales by airlines: cf. Conrady/Sterzenbach, *Luftverkehr*, 3rd edn (2003), 411.

[80] If this is not so, please refer to Case 6 of this volume on the recovery of misappropriated money. Of course, the agent who misappropriates the principal's money may be held responsible under the criminal law. For an English extradition case on misappropriation of IATA moneys by a German agent, see *Germany* v. *Kumar* [2000] Crim. LR 504 (QBD).

ticket pricing, the standardisation of ticket distribution and the supply of industrial services, including clearing and settlement.[81] Any travel agent applying to become an IATA agent is required to provide an initial financial security, i.e. a bank guarantee, or a similar instrument (including insurance). In Germany, for instance, the agent shall provide initial financial security in favour of IATA by purchasing a guarantee or an insurance policy for an amount which is calculated on the basis of the expected annual turnover generated by the sale of IATA tickets,[82], starting from a minimum coverage of €25,000. If the liquidity quota of the agent is over 110 per cent of the calculated security needs, the agent has no obligation to provide the above-mentioned security instrument.[83]

Section 7.2 of the IATA Passenger Sales Agency Agreement (Version II),[84] in the relevant English text, states that ' … All monies collected by the Agent for transportation and ancillary services sold under this Agreement, including applicable commissions which the Agent is entitled to claim thereunder, shall be the property of the Carrier and shall be held by the Agent in trust for the Carrier or on behalf of the Carrier until satisfactorily accounted for to the Carrier and settlement made.'

This provision is in force in all the countries where IATA operates with minor variations. For instance, in the version for Germany, the agent is required to pay for the tickets sold to the customers even if he did not receive the corresponding amount from his customers, unless the tickets were issued under the 'Universal Air Travel Plan', or a similar credit agreement.

Agents must settle all amounts due directly with the IATA Clearing Bank via their trust account or current account. Clearing shall take place at least once a month.[85] This way of dealing further reduces the risk that the air carriers represented by IATA may suffer losses as a consequence of the agent's insolvency or mismanagement of the account. To comply with this IATA resolution it is sufficient that customers' payments[86] are deposited in the agent's current account, from

[81] See IATA, *Travel Agent's Handbook* (2003), 139 ff., for a list of members as of 31 July 2002. Airlines operating non-international flights can only become associate members: Conrady/Sterzenbach, *Luftverkehr*, 53.

[82] IATA, *Travel Agent's Handbook* (2003), xxvii.

[83] Ibid.

[84] This is IATA Resolution 824, and applies to all countries except the US. IATA resolutions are reproduced in the *Travel Agent's Handbook* or can be found on the IATA homepage: http://www.iata.org/agenthome/resolutions/index.

[85] IATA Resolution 832, 1.6.2 (b) (i).

[86] The full amount of the ticket is due since the commission of the agent is paid after clearing by the IATA clearing bank.

which the monthly settlement is transferred to the IATA clearing bank. The conduct of IATA agents in Germany corresponds to this pattern. Depending on how much money they receive for the sale of air travel, as opposed to other travel services, they deposit the air travel moneys either in an account that is designated as a trust account (*Anderkonto*),[87] or in a current account.[88]

In our case, Tom becomes insolvent. Under German insolvency law, the assets to be distributed among the creditors are 'all of the assets owned by the debtor on the date when the proceedings were opened and those acquired by him during the proceedings' (§ 35 InsO (Insolvency Act)).[89] According to § 47 InsO, 'anyone entitled to claim the separation of an object from the assets involved in the insolvency proceedings under a right in rem or in personam shall not form part of the creditors of the insolvency proceedings'. The separation of any such object will be governed by other legal provisions, mainly § 771 ZPO (Civil Procedure Act).

Under all these provisions, it is vital for the airlines to establish that they in fact own the claims to the moneys held in the agent's trust account or current account. In addition, to allow separation pursuant to § 47 InsO, those claims have to be identifiable as distinct from other claims belonging to other creditors.

The first prerequisite, namely the carrier's ownership of the claims to the money in the agent's account, must be examined in the light of IATA Resolution 824. This text regulates ownership of moneys paid by the customers to the agent, as noted above.

Before addressing the point, however, it should also be noted that section 17 of that resolution provides a choice of law clause, according to which the agreement between the travel agent and IATA 'shall be interpreted and governed in all respects' by the law of the principal place of business of the agent. In our case, therefore, the agreement between IATA and the agent as to the legal status of the moneys paid to the agent by his customers will be governed by German law. According to German law, wherever a foreign legal term is used (especially where

[87] This is the practice if sufficient air travel tickets have been sold with the remaining sales of travel services reaching an amount which makes it unnecessarily difficult to divide the claims each month for settlement.

[88] This is the normal way of dealing if the remaining travel services are a comparably small amount compared to air travel tickets.

[89] This is the German Law Archive translation of the relevant provision: www.iuscomp.org/gla/index.html.

the relevant contractual document is in a foreign language), the interpretation of the term, though governed by German law, must also take into account its meaning under the foreign law.[90] This is not an instance of *renvoi*, because German law will remain applicable to the whole agreement.[91]

Under German law, the travel agent acts as a true agent between the air carrier and the customer, i.e. he acts as a representative of airlines in the sales transaction, thus establishing a direct contractual link between the carrier and the customer. Therefore, the air carrier, not the travel agent, will acquire the claim for payment of the ticket as soon as the sale of the ticket is concluded. In other words, the airline originally owns a claim against the customer for payment of the air transport. This payment, however, is settled when the agent receives the ticket price from his customer.

Payment by the customer extinguishes the original claim by force of § 362 (1) BGB. But, pursuant to the above-mentioned IATA resolution, the airline becomes owner of the moneys paid by the customer (or, owns the corresponding claim against the bank, if the agent collected the price of the ticket via bank transfer by the customer). Those moneys (or the corresponding claim against the bank) are held by Tom on behalf of the airline for which the ticket was issued. Section 7.2 of IATA Resolution 824 requires the agent to hold the money either in 'trust' or 'on behalf of the carrier', but the foreign concept of 'trust' here will simply indicate that the moneys are held by the agent for the carrier, even though deposited in the agent's account. Reference to the foreign term, though somewhat helpful, will add little to the agent's obligation under the applicable German law to hold the moneys 'on behalf of' the carrier.[92] Section 1.6.1 (a) of IATA Resolution 832 further underlines the point, inasmuch as it calls for either the establishment of a trust account (which under German law will be an *Anderkonto*), or the operation of an account where moneys are held on behalf of the carrier.

Problems arise, however, with regard to the identification of the moneys held by the travel agent for the air carriers in his business account. While legal writers claim that for identification purposes it

[90] Staudinger/*Magnus* (2002), art. 32 EGBGB, para. 30.

[91] Arts. 32 I 1, 35 EGBGB; cf. Staudinger/*Magnus*, art. 32 EGBGB, para. 18.

[92] The German IATA subsidiary issued an information leaflet expressly stating that these moneys are to be administered 'treuhänderisch' by the agent. See *Informationsbroschüre über die Kriterien und Konditionen zum Erhalt der Zulassung als IATA-Passage-Verkaufsagent in Deutschland* (April 2003), 6.

will be sufficient if the moneys held in the bank account are traceable to the customers' payments,[93] courts tend to follow a more rigorous approach. They usually distinguish various situations. In case of a trust account (*Anderkonto*) they will grant priority to the person for whom the account is operated, even though the account may be a personal account in the name of the trustee.[94] The same rule applies if the money in the account is held for several clients of the trustee.[95] However, if moneys paid by customers are put into a current account which also contains moneys of the trustee, the courts deny the possibility of identification.[96] This means that, in practice, the air carriers would obtain priority vis-à-vis the agent's general creditors only if the agent does not mix in the account the moneys he holds for the carriers with his own money.

The facts of the case state that some customers paid for the airline tickets, but did not get them. In addition, it is stated that they have no contractual claim against the airlines. If Tom acted as an IATA agent and sold air transportation to customers accordingly, he must have received the price of the tickets on behalf of the airlines as well.[97] Consequently, the airlines obtained title to those moneys, provided that they were not mixed with the travel agent's own moneys. If the customers never got the tickets for which they paid, though by hypothesis they have no contractual claims against the airlines, they could still hold the airlines liable for the price by bringing against them an unjust enrichment claim based on § 812 (1)(1) Alt. 1 BGB.

Deposits of up to US $80 (or the corresponding amount) constitute an exception to the above-mentioned rule whereby moneys paid by customers to the agent are owned by the carriers (cf. IATA Resolution 824d). In this case the travel agent shall issue a receipt that the money has been

[93] Canaris, *Bankvertragsrecht*, 4th edn, (1988), para. 280; Hadding/Häuser, in Schimansky/Bunte/Lwowski, *Bankrechts-Handbuch*, 2nd edn, (2000), § 37 para. 2.

[94] With regard to an account expressly named as '*Treuhandkonto*', cf. BGH, NJW 1954, 190, 191; for the use of an ordinary current account in the name of the trustee, cf. BGH NJW 1959, 1223, 1225; BGH 1993, 2622.

[95] BGH, 24.6.2003, NJW-RR 2003, 1375.

[96] In BGH, 24.6.2003, NJW-RR 2003, 1375, the account was used by the trustee to collect moneys for various trustors, to collect moneys for his own business and to meet payments originating from his own business.

[97] See s. 3.1 of IATA Resolution 824. Under this section, 'the Agent is authorised to sell air passenger transportation on the services of the Carrier', and 'air passenger transportation' includes, but is not limited to, 'the issuance of a valid Traffic Document and the collection of monies therefore'.

received 'on his own behalf and not as an agent of the air carrier'. Hence, customers' moneys up to US $80 are not to be held by the agent on trust, or on behalf of the air carrier. They simply belong to the agent on the basis of a debtor–creditor relationship. Therefore, the agent's customers would not be able to claim any deposit of up to US $80 other than as general creditors.

The situation is the same if Tom draws his own transportation order on the air carrier to sell the tickets separately to customers,[98] or if he acts outside his capacity as an IATA agent and collects moneys on his own behalf. In both cases, the moneys would inevitably be included among the agent's assets for insolvency purposes (under § 35 InsO). This means that the customers will rank, once more, as general creditors of the insolvent agent.

In German law the ambit of application of the Package Travel and Package Holidays Directive 90/314/EEC[99] has been extended. Occasional organisation of these types of tours has been included, but not for the rules concerning protection in insolvency of the organiser. Isolated services of only one type (journey, hotel, etc.) are not included at all. With respect to these, there is some case law that applies certain rules of the general civil law by analogy, namely § 651f para. 2 BGB (damages for wasted entitlement to holiday).[100]

Greece

Alternative 1

Under Greek law the deposit given as proof of seriousness in entering into negotiations cannot be an 'earnest' (*arrha*) according to ss. 402 CC ff. since the latter is an accessory agreement, which is deemed to have been given in order to cover any potential loss from the non-performance of the principal contract (s. 402 CC).[101] In Alternative 1 the sale contract (principal contract) is not yet concluded. Without this principal obligation, an accessory agreement cannot exist.[102] However, freedom of contract allows an agreement which might be called a 'forfeitable deposit contract'.[103] If negotiations are taking place, then such an agreement enables the debtor to retreat from conclusion of the contract

[98] However, this would not constitute a 'sale of tickets from an airline' as stated in the facts of the case.

[99] EC OJ 1990 L 158/59.

[100] BGH NJW 1985, 906; see, however, BGHZ 109, 29 (38 ff.).

[101] Stathopoulos, *Contract Law in Hellas*, 122, § 163.

[102] Ibid., 122, § 163.

[103] Ibid., 122, § 164.

in exchange for the deposit paid. These 'forfeitable deposit contracts' are not specifically regulated by the Greek Civil Code. They are governed by the provisions applicable to deposit (ss. 822 CC ff.), particularly the provisions on irregular deposit, which cover a deposit of money or other fungible property (s. 830 CC).

According to s. 830 CC, a deposit of money or other fungible property (e.g. securities in bearer form) shall be deemed a loan, if the depository is allowed to make use thereof. A depository of securities is not allowed to dispose thereof unless such permission has been granted to him explicitly and in writing (s. 830 CC *in fine)*. Greek courts have held that, in case of doubt, a deposit of money made in a bank account is an irregular deposit.[104] Since Tom is the beneficiary of the cheque payable to himself, there is no doubt that he is allowed (explicitly and in writing) to use the money. Since, according to s. 830 CC, the (irregular) deposit made to Tom is deemed to be a loan, s. 806 CC (Loan) is applicable. This section provides that through a contract of loan one of the parties transfers to the other the ownership of money, whilst the other party undertakes to retransfer money of the same quantity and quality (same currency). The depository (Tom) first acquired ownership over the deposit when he took possession of the cheque payable to himself. Furthermore, he became the owner of the money at the moment when the cheque was paid into his own account. Nevertheless, the loan exists from, and by, the delivery of the cheque payable to Tom. Tom is therefore obliged to retransfer money of the same quantity (10,000) and quality (same currency, in Euros), as the deposit he has received, if negotiations between Samantha and Bill break off.

A real security right in favour of Bill over the deposit is only possible if Bill takes a pledge over Tom's bank account, in accordance with s. 1248 CC (Pledge Bearing on a Claim), in order to secure the reimbursement of the deposit. Such pledge should have been taken before Tom became insolvent. On the other hand, Bill's claim is not among those mentioned in s. 975 CCProc., enjoying a specific priority over competing claims. These priorities are *numerus clausus*. Consequently, Bill will be treated as a general creditor. Moreover, it makes no difference if Tom is

[104] Ad hoc AP 209/1975, NoB 23/1975, 979; Ef.A 1172/1987, Hellin.Dni, 1988, 517. See also Ef.A 534/1987, Hellin.Dni, 1988, 368; Ef.A 4336/1985, Hellin.Dni, 1985, 739; Ef.A 7583/1979, NoB 27/1979, 1654. Georgakopoulos, *Handbook of Commercial Law, 2/2 Banking Transactions* (1995), 522–523; Filios, *Law of Obligations, Special Part*, I, 409–410.

a practising lawyer, since under Greek law priorities depend on the creditor, whilst the capacity of the debtor (Tom) is not crucial.

Bill would only be protected if he produced to Tom a cheque in bearer form, of which Bill would remain the owner, instructing Tom to keep it in safe custody for himself, and explicitly precluding the use thereof (e.g. precluding the deposit of this cheque in Tom's bank account). Such an agreement is a deposit *stricto sensu*. Bill remains the owner of this cheque, and has a claim of restitution thereof upon demand against Tom (s. 822 CC). If Tom becomes insolvent, then Bill, in his capacity as owner of the cheque in bearer form, may make a motion based on s. 1094 CC[105] in order to obtain the restitution of the cheque. Obviously, this solution is not possible if the deposit is made by a cheque payable to Tom (see above).

Alternative 2

Customers who have not been issued tickets do not enjoy any priority under Greek law. Regarding those claims, Tom's customers will be treated as general creditors (see Alternative 1 above). Airlines claiming money paid for the tickets they have issued do not enjoy any priority over competing claims. Since the money for the tickets has been deposited in Tom's bank account, Tom is considered to have ownership (see Alternative 1 above), and is liable to the airlines as his general creditors.

However, the airlines cannot remain without protection if Tom becomes insolvent. The airlines may issue and sell the tickets, subject to a clause of retention of ownership over those tickets, until full payment of the ticket price (s. 532 CC). This clause means that ownership is transferred to the purchaser upon the full payment of the price due. Since the air tickets are nominative, in case of a default by the purchaser (Tom's customer), the seller (the airline) would be entitled to claim payment of the price directly from the purchaser, or to rescind the sale contract by invoking his right of ownership (s. 532 CC). Consequently, the airlines may either claim the money from the purchasers, or demand the acknowledgement of their ownership and the restitution by the customer of the ticket under s. 963 CCProc.[106]

However, the purchasers can argue that they became owners of the tickets, since they paid Tom for them. This argument will be successful

[105] Georgakopoulos, *Handbook of Commercial Law, 2/2 Banking Transactions*, pp. 522–523; Filios, *Law of Obligations, Special Part*, I pp. 409–410.

[106] Deliyanni-Dimitrakou, *Trust and Fiducia* (1998), 150.

only if Tom acts as a representative of the airlines. In such a case, any payment to Tom produces an immediate effect for the benefit or to the detriment of the represented persons (the airline) (s. 211 CC). Moreover, if the condition of payment of the sale price has been fulfilled, then the purchasers become owners of the tickets and the airlines only have a claim against Tom. On the other hand, if Tom acts as a representative for his customers, then all payments to him do not produce any effect for the benefit or to the detriment of the airlines. This payment is not appropriate for the purposes of paying the sale price (s. 349 CC), since it is not made to the beneficiary, or to a person duly authorised by him (i.e. his representative). The purchasers should be given a notice to pay the sale price, and the rights of the airlines under s. 532 CC may prevail. In such a case, the purchasers have a claim only against Tom, seeking the reimbursement of the price paid.

Directive 90/314/EEC of 23 June 1990, ECOJ 1990 L158/59 (Package Holidays and Package Tours) has been implemented in Greek law by Presidential Decree no. 334/1996. Package tours and package holidays are defined in s. 1 as any combination of two of the following: journey and/or hotel and/or any other tourist service, which is ancillary to the previous ones, under the condition that the whole performance duration exceeds twenty-four hours or includes at least one overnight stay, and the package is sold as a unit at a global price. However, pricing may also be made separately for each service. Presidential Decree no. 334/1996 is not applicable to isolated services, e.g. booking of hotel rooms, sale of airline tickets, etc., and consumers of such services are not protected in the insolvency of the service provider. This particular protection, when applicable, consists of the obligation of the tour operator to effect an insurance policy in favour of his consumers, covering the restitution of all amounts paid by them and the fees for their journey back home, in case of the insolvency of the tour operator. Alternatively, the tour operator may obtain a bank guarantee in favour of the consumers, covering the same risks. Finally, the law also provides for the possibility of creating a specific fund to guarantee the liabilities of the tour operators contributing to the fund.

Ireland

Alternative 1

It is clear that the money paid by Bill to Tom is to be held on trust by Tom, to be applied to the purchase of Samantha's property or returned.[107] Whether Tom is a real estate agent or a solicitor, statute[108] imposes an obligation upon him to lodge such trust funds to a special trust account. However, whether or not he has done so, because the funds are impressed with a trust, they are not available to the general creditors[109] and, if identifiable in his account,[110] must be returned to Bill.

Alternative 2

In principle, the customers and the airlines will simply be unsecured creditors with no priorities over the others' claims or the claims of the general creditors, unless it could be said that Tom held the money on trust for the customers or the airlines. At least three trusts are possible on the facts. First, it is possible but highly unlikely that the customers impressed their advance payments to Tom with trusts;[111] if so, then Tom would hold the money paid by those customers who did not receive tickets on trust for them. Second, it is very likely that the arrangement between Tom and the airline expressly provides that Tom hold the money received from the customers on trust.[112] If neither of these express trusts applies, then, third, there is a general principle that where money is paid for a *specific purpose*, this can give rise to a trust, first in favour of the intended beneficiary, and, if that trust fails, then in favour of the payor,[113] provided that both parties so *mutually*[114] intend. If such an arrangement applied here, then airlines on which tickets had been issued could enforce the primary

[107] *Cf. Barclays Bank* v. *Quistclose Investments* [1970] AC 567 (HL); adopted in *In re Money Markets International Stockbrokers Ltd* (HC, unreported, 20 October 2000, Carroll J). See now also *Twinsectra Ltd* v. *Yardley* [2002] 2 AC 164 (HL).

[108] For solicitors, see s. 66 of the Solicitors Act, 1954 (as amended by s. 76 of the Solicitors (Amendment) Act, 1994), on which see Callaghan, *The Law on Solicitors in Ireland* (Dublin: Butterworths, 2000), chapter 14. For estate agents, see s. 5 of the Auctioneers and House Agents Act, 1967.

[109] *Shanahan's Stamp Auctions* v. *Farrelly* [1962] IR 386, 429, 445 *per* Budd J.

[110] *Cf. In re Money Markets International* [1999] 4 IR 267 (HC, Laffoy J).

[111] *In re Kayford Ltd (In Liquidation)* [1975] 1 WLR 279 (ChD) 282–283 *per* Megarry J.

[112] Cf. the New South Wales decision of *Stephens Travel Service International Pty Ltd* v. *Qantas Airways* (1988) 13 NSWLR 331 (NSW CA), 339–341 *per* Hope JA, interpreting the IATA standard agreement.

[113] See n. 107 above.

[114] *Barclays Bank* v. *Quistclose Investments* [1970] AC 567 (HL) 581 *per* Lord Wilberforce; see also *Re Australian Elizabethan Theatre Trust* (1991) 102 ALR 681, 690–691 *per* Gummow J; *In re Goldcorp Exchange* [1995] 1 AC 74 (PC) 100 *per* Lord Mustill; cf. Worthington, *Proprietary Interests in Commercial Transactions* (Oxford: Clarendon, 1996), 46.

trust;[115] and customers who have not received tickets could enforce the secondary trust.[116] However, it is unlikely that the customers and Tom would mutually have intended such an arrangement,[117] and anyway, the High Court has recently held that such an arrangement is unlikely to arise unless the money so paid is segregated into a separate account,[118] which does not seem to have occurred here. In which case, neither the customers nor the airlines could claim priority for this reason.

Alternatively, the customers might be able to claim against the bonds[119] into which Tom will have been obliged to enter as a condition of his licence, but it is unlikely that they would have any claims against their credit institutions.[120]

[115] *Hassall* v. *Smithers* (1806) 12 Ves. 119; *Re Northern Development (Holdings)* (Chancery Division, unreported, 6 October 1978, Megarry VC); *Carreras Rothmans Ltd* v. *Freeman Mathews Treasure Ltd* [1985] 1 Ch 207; Millett, 'The *Quistclose* Trust: Who Can Enforce It?' (1985) 101 LQR 269. The most recent decision, *Twinsectra Ltd* v. *Yardley* [2002] 2 AC 164 (HL), suggests that a *Quistclose* trust is a trust for the benefit of the person who provides the money, and that the recipient of the money has only a power (but not an obligation) to use the money for the primary purpose. This suggests that the 'primary trust' is not really a trust at all, and the airlines in our case would not have any enforceable rights under such a trust. See generally Swadling, ed., *The* Quistclose *Trust: Critical Essays* (Oxford: Hart, 2004).

[116] This is the usual situation in these *Quistclose* cases.

[117] Cf. *Re Multi Guarantee Ltd* [1987] BCLC 257 (CA).

[118] *In re Money Markets International Stockbrokers Ltd* (HC, unreported, 20 October 2000, Carroll J), though this is probably because such an account is good evidence of the parties' relevant mutual intentions (*In re Kayford Ltd (In Liquidation)* [1975] 1 WLR 279 (ChD) 282 *per* Megarry J), rather than because it is a necessary ingredient of the *Quistclose* relationship.

[119] See s. 13 of the Transport (Tour Operators and Travel Agents) Act, 1982 (relating only to overseas travel); and ss. 22–25 of the Package Holiday and Trade Travel Act, 1995 (which implements the Directive on Package Holidays, Package Travel and Package Tours (Directive 90/314/EEC, OJ L158/61) and relates only to package holidays); see generally Buttimore, *Holiday Law in Ireland* (Dublin: Blackhall Publishing, 1999), chapter 9.

[120] Had the customers simply purchased goods on credit, rather than services as here, then s. 14 of the Sale of Goods and Supply of Services Act, 1980 would have made the credit institutions parties to the contracts and liable for the vendors' misrepresentations and breaches. Furthermore, s. 42 of the Consumer Credit Act, 1995 is much narrower in scope than the anyhow unclear English provision, s. 75 of the Consumer Credit Act, 1974, in that s. 42 applies only where 'the creditor and supplier of the . . . service have a pre-existing agreement whereunder credit is made available exclusively by that creditor to customers of that supplier . . . ' (s. 42(2)(b)), a requirement which is unlikely to be met in the usual travel agency sales context and certainly excludes the normal credit card arrangements; see generally, Bird, *Consumer Credit Law* (Dublin: Round Hall Sweet & Maxwell, 1998), 294–300.

Italy

Alternative 1

The main issue here is the right to obtain restitution of the assets held by the real estate agent. Under Italian law, real estate agents are not required to keep their clients' money separate from their own money, or otherwise to protect clients' assets from the risk of insolvency. Much therefore depends on the intention of the parties: did Bill intend to let Tom have ownership of the money? Generally speaking, in the business context of estate agency this would be the most likely inference. Estate agents in Italy usually do not keep their clients' money separate from their own, and regularly become debtors of their clients for any money they owe them. But the agreement between the parties could regulate the matter differently by making clear that Bill does not intend to become simply one of Tom's unsecured creditors. Yet, even in that case, if the money is in Tom's bank account, Bill's claim to recover all his money could be defeated, as it may turn out to be simply a (worthless) personal claim, despite any contrary expression of intention.

To gain priority vis-à-vis the general creditors of Tom, Bill's claim should be brought as a claim under art. 103 of the Italian bankruptcy law on the vindication, the delivery, or the separation of movable assets that are in the possession of the insolvent.[121] The application of this provision to claims for the recovery of sums of money is, however, problematic. The Court of Cassation has held that the price due on a sale carried out by a mandatary without representation on behalf of a mandator cannot be separated from the rest of the mandatary's assets which make up the insolvent estate if the money is in a current account opened at the bank in the mandatary's name.[122] The Court reached this conclusion even though there had been no withdrawal from that account between the date of the payment and the date of the mandatary's insolvency. The Court maintained that in a vindication claim the assets claimed must be identifiable *in specie*; but money in a current account in the mandatary's name is not identifiable as such. This holding, though by no means isolated,[123] is, however, controversial.

[121] The Italian bankruptcy law is the r.d. 16 March 1942, n. 267, *Disciplina del fallimento, del concordato preventivo, dell'amministrazione controllata e della liquidazione coatta amministrativa.*

[122] Cass., 16 May 1990, n. 4262, Giur. comm., 1991, II, 608; Fallimento, 1990, 1193.

[123] In the same sense: Cass., 18 October 2001, n. 12718; Dir. fall., 2002, II, 61; Fallimento, 2002, 830; Cass., 20 February 1984, n. 1200; Dir. fall., 1984, II, 424. See Castagnola, *Le rivendiche mobiliari nel fallimento* (1996), 317 ff., 333 ff.; for subsequent developments:

The Court of Appeal of Milan in the same case reached a different conclusion, though its judgment was then quashed by the Court of Cassation, as noticed.[124] The reasoning of the Court of Cassation can be criticised on several grounds. It is simply not true that the claimant cannot vindicate a share of an undivided bulk of fungibles, as the Court implicitly maintains (cf. art. 939 CC). Furthermore, the mandatary's claim to the money kept in the account could have been separated from the rest of the insolvent's assets provided that the contract of mandate had a 'certain date' (*data certa*, an officially certified date) pre-dating insolvency (cf. arts. 1705.2 CC, 1707 CC).[125] There are signs that the Court of Cassation may be willing to reconsider its precedent, though, of course, this is only a possibility.[126] Therefore it would be premature to consider this decision obsolete (as it has actually become in respect of clients' assets held by investment firms: see the next case).

If Tom is a practising lawyer, the case will present some variations, but its outcome may still not be favourable to Bill.

In Italy there are no specific legislative provisions governing how clients' money must be kept by lawyers. The general law of mandate is applicable to the facts. The code of conduct of the Italian bar establishes certain very general duties of lawyers towards their clients.[127] In interpreting those codal provisions, the Court of Cassation held that clients' money should be kept according to precise rules and possibly separate from lawyers' own money.[128] Unfortunately, this holding has not yet been translated into precise professional guidelines applicable to the generality of the bar, as the Italian code of conduct does not replicate the European code of conduct

Cristiano, 'Sull'ammissibilità della rivendica di beni fungibili ai sensi dell'art. 103 legge fall'., Giust. civ., 2002, II, 21.

[124] App. Milano, 15 February 1985, Fallimento, 1985, 793.

[125] Graziadei, 'Mandato', Riv. dir. civ., 1997, II, 147.

[126] Cf. Cass., 6 March 1999, n. 1925, Giur. comm., 2000, II, 174, n. Abriani. In this case, the court held that money handed over by the debtor of a company to its de facto director became property of the company upon receipt of it by the director, who misappropriated it. But the claim proposed against the de facto director was a personal claim for restitution of the money.

[127] *Codice deontologico forense* (1997, as amended), approved by the Italian Bar Association (*Consiglio nazionale forense*), art. 41: 'Any lawyer must be punctual and diligent in managing money received from the client or from third parties to carry out specific affairs, or on behalf of the client. He must promptly account for it. It is a violation of the code of conduct to withhold money received on behalf of the client for more time than what is strictly necessary.' See also arts. 35, 36 of the same text. For commentary: Danovi, *Commentario del codice deontologico forense* (2001), 556 ff.

[128] Cass., 4 December 1992, n. 12945 (joint panels).

on this point.[129] Hence, the duty to keep clients' money segregated from other money is affirmed on a case-by-case basis, during proceedings sanctioning its misappropriation, instead of as a general rule enforced by bar regulations. Therefore, there is always the risk that clients' money is commingled with other money. In summary, with respect to money handed over to a lawyer, the claimant has fewer problems in establishing the existence of the duty to treat that money as the client's money; but commingling may often occur, and it probably defeats the client's claim. One further procedural point needs to be mentioned here. Bankruptcy legislation in Italy does not apply to lawyers because its application is limited to traders (cf. r.d. 16 March 1942, n. 267, art. 1). Hence, Bill's claim shall be brought as a claim under the Code of Civil Procedure, art. 619, to oppose execution on Tom's bank account by an individual creditor.

Alternative 2

The customers who paid the purchase price are simply unsecured creditors of Tom, unless a contrary intention can be established (but see above, as to the problems raised by this possibility). Here no such intention was manifested, however. Therefore the customers do not have any priority in the present case. The Italian legislation implementing the European package travel directive contains no provision applicable to our case either (cf. d. lgs. 17 March 1995, n. 111, *Attuazione della direttiva n. 90/314/CEE concernente i viaggi, le vacanze ed i circuiti tutto compreso*').

As to the claims of the airlines, the question is more complex. Travel agents selling international airline tickets are normally IATA agents.[130] Under IATA Resolution 832, applicable to them by way of contract, 'all monies collected by the Agent for transportation and ancillary services ... shall be the property of the Carrier and shall be held by the Agent in trust for the Carrier or on behalf of the Carrier until satisfactorily accounted for to the Carrier and settlement made'.[131] The same resolution specifies that the law applicable to the contract between IATA and the agent is the law of the agent's place of business, i.e. Italy in our case. The choice of law provision concerning the contract

[129] See the *Code of Conduct for Lawyers in the European Community* approved by the Council of European Bars and Law Societies, art. 3.8.

[130] On this point see the German answer to the present case.

[131] IATA Resolution 832, 1.6.2(b)(i).

probably does not settle the question concerning the validity of the trust set out in the contract because the Rome Convention of 1980 on the law applicable to contractual obligations does not extend to 'trusts' (cf. art. 1.2(g)). That question must therefore be answered according to the Hague Convention of 1985 concerning the law applicable to trusts and their recognition that has been in force in Italy since 1992.[132] Lacking an express or implied choice of law, as in our case, art. 7 of the Hague Convention opts for connecting factors that point to the forum law. If it is argued that Italian law does not provide for 'trusts', the clause of the contract intending to establish a trust over the moneys received upon the sale of airline tickets is invalid.[133] In this case it would be appropriate to fall back on the other rule expressed in the abovementioned IATA contractual clause, i.e. that the moneys collected by the agent upon the sale of airline tickets 'must be held *on behalf of* the Carrier until satisfactorily accounted for to the Carrier and settlement made'. Under Italian law this stipulation makes reasonably clear that the agent should receive that money in a ministerial capacity only, as a mandatary should do when collecting money from a third party on behalf of the mandator pursuant to an agreement that makes clear that the money is owned by the mandator. But is this actually the case? It appears that in Italy cash generated by ticket sales must be paid by travel agents to air carriers by the fifteenth day of the following month, by way of bank transfer to an intermediary that allocates the sums transferred by the agents to each carrier. Delays in monthly payments are sanctioned by detracting points from the agent's licence to deal as an IATA agent, plus, of course, by the charging of interest. Serious breaches of the obligation to account for moneys due are immediately followed by cancellation of the electronic codes that travel agents must use to sell carriers' tickets. Furthermore, carriers represented by IATA are reasonably certain that they will receive the moneys owed as price for the tickets sold by agents because the agents are contractually required to buy a guarantee from a financial institution to secure settlement of their obligations in favour of the

[132] See Case 7.

[133] It is by no means clear that this assumption is correct, as the notion of 'trust' under the Hague Convention is wholly or largely autonomous from notions of trusts adopted in national legal systems. But even if we follow the alternative reasoning, which holds the choice of law clause valid, pursuant to the autonomous interpretation of the notion of 'trust' adopted by the Convention, or on the basis of the Rome Convention, the ultimate rule governing the case is the rule outlined below in the text.

carriers. Within this stringent framework, it is no surprise to learn that: (a) in practice travel agents to do not keep air ticket moneys in designated bank accounts; (b) neither IATA, nor air carriers, complain about this; (c) travel agents consider the cash flow generated by the sale of tickets as their own money, subject to the obligation of regular settlement. If this is so, it is arguable that the above-mentioned contractual clause does not reflect the actual course of dealing and will not be enforced. But, of course, even in this case, the air carriers will most likely still get the moneys received upon the sale of the tickets thanks to that financial guarantee.

Luxembourg

Insolvency proceedings are reserved, under Luxembourg law, for 'commercial persons' as defined by arts. 1 and 632 of the Code of Commerce (art. 437 of the Code of Commerce). This includes most corporate persons, to the extent that they are organised as commercial corporations, as well as all persons transacting commercial business in their own name.

Real estate agents are considered as commercial persons and are therefore subject to insolvency rules.[134] Lawyers are civil persons and cannot be subject to a commercial insolvency. There is no organised procedure for the case of general inability of payment by a non-commercial person. The general rules on the execution of debts apply, without any precise organisation or representation of the creditors.

Alternative 1

Cheques that are deposited as a guarantee for a certain action or a further payment have a double nature under Luxembourg law. First, they remain a payment instrument, which is payable upon presentation. Secondly, by agreement of the parties, there is constituted a guarantee, which continues to apply when the cheque is transformed from a payment instrument into a cash collateral. The money is refundable if the guarantee is no longer needed.[135]

However, an obligation to make restitution is merely an obligation to pay, without any particular security or any legally recognised priority. Cash is by essence a fungible asset, and cannot be identified once it has been mixed with other assets. This is especially true if Tom cashed the

[134] CA Luxembourg, 15.12.1905, Pas. 7, 507.

[135] See for the latest decision, and a summary of the prior case law, Cass. Fr. Com. 17.11.1998, *D.* 1999, Somm. 304, note Simler.

cheque into his current account (*compte-courant*). Such accounts are considered as an automatic instrument of novation, i.e. all items lose their nature and their identity, and become simple elements of the account, subject to automatic set-off.

Regardless of the fact that Tom has made no withdrawals before he became insolvent, Bill's claim will have no priority over other creditors and he will be treated as a general creditor. There will be no difference if Tom is a practising lawyer. Although the rules of professional conduct require a lawyer to account separately for money deposited for the account of third parties, and to avoid commingling of funds, there is no legal right to preferential payment out of a third party account, nor any right to separation or isolation of funds.

Alternative 2

The professional travel agent is organised under the law dated 14 June 1994, which implements Directive 90/314/EEC dated 23 June 1990. Unlike the directive, the 1994 law does not cover only some activities of travel agents; it covers the profession more generally. Article 1 defines the scope as any corporation or individual, who, either as a principal or as an accessory activity, repeatedly participates in the organisation or the sale of products related to the travel business. Expressly included is the sale of individual trips, as in the sale of airline tickets.[136]

Travel agents must have authorisation from the Ministry in charge to conduct their business. One of the conditions for the grant of such an authorisation is the existence of sufficient financial guarantees. In particular, the financial guarantee must ensure, in the case of insolvency, the reimbursement to customers of funds received from them for any of the services listed in the definition of the travel agent profession. The guarantee must be given by a collective guarantee entity, a bank or a credit and guarantee insurance company. Under these rules, Tom's clients are protected, and it is certain that they will receive reimbursement of their funds under the guarantee.

This guarantee does not cover any claims by professionals in the travel business, such as the airlines claiming money from Tom for the tickets already issued. The claim is a simple claim for the payment of money arising either from a sale agreement, or from the

[136] Doc. Parl. no. 3775–1, Chambre de Commerce, 1 and 3; Doc. Parl. no 3775–2, Conseil d'Etat, 2.

agent–principal relationship, depending on the legal nature of Tom's relation with the airlines. These companies will be treated as general creditors.

Travel agents are recognised as commercial persons and are subject to the rules of insolvency of the Code of Commerce. In the case of non-payment of the sale price of movable assets, art. 2102–4° CC creates a right to preferential payment and a right to reclaim the object. It is debatable whether this would apply to airline tickets, since they are not considered movable assets as such, but only representative of a service to be rendered. In any event, art. 546 of the Code of Commerce excludes this article in the case of commercial insolvency, except for the seller of industrial equipment and machinery.

Netherlands

Introduction: capacity account

According to unwritten Dutch law, it is possible to open a special nominee account or capacity account only for some specific groups of professions. With these accounts, the balance of the bank account does not fall into the bankrupt estate upon the insolvency of the account holder. This practice of a capacity account – without any limitations as to who could open such an account – was explicitly mentioned in the Dutch Supreme Court case *Slis-Stroom* (which concerned a capacity account with a notary) and has recently been confirmed, although on the basis of a completely different reasoning, by the Dutch Supreme Court in *Koren q.q.*[137] In that case it was not the 'trustee', the holder of the capacity account, that went bankrupt, but one of the 'beneficiaries'. The Court held that the parties that ultimately had a right to the balance of the bank account were to be considered to be joint owners. Who would receive the balance in the end was dependent on the fulfilment of the condition that had been agreed upon by the parties beforehand. The fact that one of the parties went bankrupt did not change this. The trustee in the bankruptcy of that party therefore had to wait for the fulfilment of the condition (the outcome of legal proceedings between the parties) before he would know whether the balance fell into the bankrupt estate or not. This decision kept up the expectancy that a capacity account was open to everyone.

[137] HR 3 February 1984, NJ 1984, 752 note WMK, and HR 12 January 2001, NJ 2002, 371 note HJS.

However, the Dutch Supreme Court, in its decision of 13 June 2003,[138] decided quite differently. It ruled that the notion of equality of all creditors as laid down in art. 276 Book 3 CC was very important and could only be deviated from by a statutory rule (or by an agreement between the debtor and a creditor in which the creditor voluntarily subordinates his claims; art. 276 sub 2 Book 3 CC). The Supreme Court referred to the *Slis-Stroom* case (see above), in which a notary was involved, as an example of a non-statutory deviation that could be accepted. It noted that such deviation should be made only in very specific circumstances where holders of the capacity account in the course of their profession and legal tasks hold money for their clients, and those clients are relying on the fact that these holders will keep these moneys separate from their own patrimony. The Court referred to the specific statutory rules on capacity accounts for notaries and bailiffs.[139] It accepted the possibility that a deviation from the law could be possible if it was in line with the statutory rules on the capacity accounts for notaries and bailiffs, and only if it concerned comparable professions such as accountants and lawyers.

This decision of the Supreme Court brought an end to much speculation in legal writings about whether opening a capacity account was only permitted for specific persons with specific capacity and whether such a capacity account was a real trust or not. The statutory capacity accounts for notaries and bailiffs are not trusts, at least not in the sense of the Hague Convention on Trusts, because the notary and the bailiff are only representatives on an exclusive basis (the parties to whom the balance belongs cannot instruct the bank to pay out the balance due to them) for the parties who have a right to the balance. Those parties are owners in joint ownership of the balance.[140] Because of the specific

[138] NJ 2004, 196 note WMK; *Beatrixziekenhuis/ProCall.*

[139] The Act on Notaries (in force from 1 October 1999, Stb. 1999, 190) provides for a capacity account in art. 25. This article states that a notary is obliged to open such a capacity account. The notary has full exclusive power to manage the account (which will not be affected by his insolvency; the powers automatically devolve upon his substitute (arts. 26 and 103 sub 6 Act on Notaries)), but the beneficiaries of the account are the legal owners, for their respective contributions, of the balance of the account. In the explanatory memorandum it is explicitly stated that this account is not a trust. Art. 19 of the Act on Bailiffs contains the same rules.

[140] See publications in English on the capacity account: M. E. Koppenol-Laforce and R. J. P. Kottenhagen, 'The Institution of the Trust and Dutch Law', in E. H. Hondius, ed., *Netherlands Reports to the Fifteenth International Congress of Comparative Law, Bristol 1998* (Antwerp: Intersentia Rechtswetenschappen, 1998), 137–153 (also published in M. Cantin Cumyn, ed., *La fiducie face au trust, dans les rapports d'affaires/ Trust vs Fiducie, in a*

reference to those notaries' and bailiffs' capacity accounts and the *Koren q.q.* decision (see above), it can safely be presumed that a non-statutory capacity account will be constructed in the same way as the statutory ones. There are still no hard and fast rules on how a capacity account must show that the holder is acting for the benefit of another.[141]

Alternative 1

The first issue is whether the Supreme Court would accept that real estate agents are concerned with public trust in such a manner that a non-statutory capacity account can be accepted, thus allowing a deviation from the principle of equality of creditors in art. 276 Book 3 CC. In my opinion, the chances that the Supreme Court will accept this categorisation are minimal or even nil. It is hence most likely that the account will not be accepted as a capacity account and that, therefore, Bill will not be placed in a special position when Tom becomes insolvent. In other words, he will be an ordinary general creditor.

As a lawyer, Tom has to set up a foundation that has as its sole statutory purpose the management of third party bank accounts (the capacity account), according to the Dutch Lawyers Association Guidelines, which must be obeyed by Dutch law firms.[142] In Alternative 1 the client, Bill, is a third party. The personal insolvency of Tom, or even the insolvency of Tom's law firm, will have no effect on money that has been paid, for the benefit of another party, into the bank account of the Foundation for the Administration of Third Party Money. Thus, in most cases a lawyer will not open a capacity account in his own name.

Supposing that Tom opened a capacity account into which Bill paid the money, the above rules apply. Lawyers are a category that has explicitly been mentioned by the Supreme Court in the *Beatrixziekenhuis* decision (see above). The money will remain separate from the insolvency. Tom will still be required to make it clear that he received the money in the bank account in a special capacity. It is possible that if he did not open a specific account for this transaction,

business context (*XVe Congrès international de droit comparé de Bristol 1998*) (Brussels: Bruylant, 1999), 289–307).

[141] See, in English: D. J. Hayton, S. C. J. J. Kortmann and H. L. E. Verhagen, eds., *Principles of European Trust Law*, (Kluwer Law International – W. E. J. Tjeenk Willink, 1999), 198 (Dutch report); H. L. E. Verhagen, *Agency in Private International Law* (The Hague: Martinus Nijhoff, 1995), 56–57.

[142] *Boekhoudverordening* 1998, in force from 1 March 1999.

the courts will not accept that it is a capacity account. If the money is not paid in to a capacity account, then the money will fall into his insolvent estate and Bill will have no preference whatsoever.

Alternative 2

Dutch practice

In Dutch practice, travel agents do not have capacity accounts. They have one or more accounts through which every financial transaction takes place. The travel agent gives a representative office of the airline the order to print the airline tickets as soon as the customer pays the travel agent. The airline does not receive the money until the tickets are handed to the travel agent. The money remains in the account of the travel agent. The customers who have already paid but have not yet received their tickets, and the airlines that have not yet been paid but have already issued tickets, are only general creditors in the insolvency of the travel agent.

This could be different if the travel agent acted in his own name when he concluded the contract with the customer. In this case, arts. 420 and 421 Book 7 CC are applicable. If the mandatary breaches the contract or falls into bankruptcy, art. 420 CC gives the mandator the right to take over the rights of the mandatary against third parties, as far as these rights are transferable. Article 421 CC gives the same right to the third party: as far as these rights are transferable, the third party can transfer to himself the rights the mandatary has against the mandator. The mandator or the third party must inform the other party by written notification when he wants this transfer of rights to take place. However, in Alternative 2 it is unlikely that the travel agent acted in his name when he arranged the airline ticket for the customer. In this case, these articles will not be applicable.

However, the customers who have already paid but have not yet received their tickets are protected in another way from the consequences of the insolvency of their travel agent, if the travel agent is a member of the *Stichting Garantiefonds Reisgelden* (Foundation for the Guarantee Fund for Travel Money).[143] Every travel agent who concludes

[143] The Fund is financed by the customers themselves. Every time they book a trip with at least one overnight stay, they have to pay a small amount to the Fund. If a customer only buys an airline ticket, he does not have to pay into the Fund, although before 1 October 2001 he was able to claim from the Fund (arts. 2.6 and 4.1 of the Foundation for the Guarantee Fund for Travel Money). On 1 October 2001 these regulations were changed.

contracts that fall under the scope of Directive 90/314/EEC of 23 June 1990 (Package Holidays and Package Tours), as implemented in arts. 500–513 Book 7 CC, must be a member of the Fund. A travel agent must take sufficient measures to guarantee that if he becomes insolvent, his obligations will be taken over by other travel agents or that the customers will get restitution of their payments (art. 512 sub 1 Book 7 CC). The guarantee is the Fund. Article 512 CC and arts. 500–513 CC are not directly applicable in Alternative 2, since no mention is made of an overnight stay in combination with the airline tickets. A travel agent will sell a great number of trips that do fall under these articles.[144] As a result, the travel agent must be a member of the Fund. Reimbursement of travel money by the Fund is not limited to trips that fall under the definition of the Directive and arts. 500–513 Book 7 CC, but since 1 October 2001 the sale of airline tickets alone is no longer covered by the Fund. Thus, if the obligation of Tom involved more than selling an airline ticket, and if (as is probably the case) Tom is a member of the Fund, then the Fund will take over Tom's duties towards his customers. This means that the Fund will reimburse the money to the customers who have not yet received their tickets. If not, the customers are just general creditors in the insolvency of Tom. The Fund is not open to claims from the airline, and thus the airline will not be reimbursed.

The travel agent frequently acts for airlines in his own name (art. 4 ANVR). If a customer pays in cash and the travel agent separates this payment from the rest of the money he holds, then, according to art. 110 Book 3 CC, the airline becomes the owner of the money from the moment the money is handed over to the travel agent.[145] In most cases the money will disappear together with the rest of the cash that is accumulated during that day or week. The money loses its identity, and art. 110 Book 3 CC is no longer applicable. The money belongs to the travel agent. If the customer pays the travel agent electronically, or by way of an interbank transfer into the agent's account, then art. 110 Book 3 CC is not applicable. The travel agent becomes the owner of the claim on the bank.

[144] It is said that these articles will have some analogous application to travel arrangements that do not fall under these articles and which are governed by standard terms. See B. J. Broekema-Engelen, 'Titel 7A: Reisovereenkomst', in Nieuwenhuis, Stolkker, Valk, eds., *Tekst & Commentaar Burgerlijk Wetboek* (2003), art. 500, note 3e.

[145] See, for an explanation of this article, Case 1, under the heading *Contract of mandate*.

Capacity account

According to Dutch practice, travel agents do not work with accounts that qualify as capacity accounts. Also it is debatable whether travel agents qualify as a category as meant by the Supreme Court in the *Beatrixziekenhuis* decision. If they do, which is not likely in my opinion because they have no statutory tasks that imply reception of money in the way notaries and bailiffs have, the balance of the bank account will probably not fall into the bankrupt estate. However there are further hurdles to overcome. It is still not certain whether general capacity accounts are acceptable and, in the case of the travel agent, it is likely that the balance of the capacity account also comprises money of the travel agent himself. Whether these problems of mingling can be overcome is highly questionable. If the cash is still present at the office of the travel agent, then the problem of mingling cannot be solved.

Portugal

Portuguese law does not generally allow separation in respect of assets that were the property of the bankrupt at the time of the bankruptcy. Third parties who make payments in cash to the bankrupt prior to the bankruptcy are merely entitled to claim as ordinary creditors, *pro rata* (*pars conditio creditorum*). However, art. 1184 CC stipulates that goods acquired by the attorney without representation in executing the mandate, and goods that should be transferred to the mandator, shall not answer for the attorney's obligations, provided that the mandate is contained in a document prior to the date of any chattel mortgage placed on the goods, and that in the case of goods subject to registration, the goods have not been registered in the mandator's name (see Case 1).

Alternative 1

Real estate agents in Portugal do not normally act for their clients as mandataries, whether they are acting with or without representation. The contract binding estate agents and their clients falls under the *contrato de mediação* (corresponding to the German *Maklervertrag*). This is an atypical provision of a service contract (*prestação de serviços*) which has no specific regulation under the law and is ruled mainly by the stipulations of the parties and, when necessary, by the legal provisions of the mandate (art. 1156 CC).

Since Bill paid the money to Tom for the purpose of acquiring the property from Samantha, and it was agreed that the money should be repaid if no deal was made, Bill is considered to be a general creditor of

Tom. In the case of Tom's bankruptcy, Bill is entitled to claim his credit *pro rata* with the other general creditors (*par conditio creditorum*). The ownership of the sum of money is transferred to Tom as a consequence of the payment, and there is no right of separation.

There is no difference if Tom is a lawyer. Lawyers are obliged by ethical professional rules of the Law Association (*Ordem dos Advogados*) to open specific or separate bank accounts to deposit money received from their clients, but they are not legally bound to do so. This is important with relation to tax, i.e. IRS (Personal Income Tax) and IVA (VAT). If the lawyer becomes insolvent and/or bankrupt, then the money deposited in bank accounts in the lawyer's name, even if they are client accounts, are not separable and the lawyer's clients are paid *pro rata* with all the other general creditors.

Alternative 2

The response to Alternative 2 does not change if Tom is a travel agent. Only special privileged credits and creditors, such as tax authorities, social security and employees are paid prior to general creditors. Secured creditors also are privileged. Credits arising from payment made in advance for air tickets or other travel expenses (such as hotels or charter cruises) are general credits and are paid *pro rata*. The law treats the credit of customers and air companies as common credit; neither has a privilege of separation. The Law on travel agents (Decree-Law 98/93 of 27 May), which implements Directive 90/134/EEC, of 23 June 1990, does not affect this conclusion.

Scotland

Alternative 1

In Scotland most estate agency work is done by lawyers. However, lawyers cannot normally act for both sides in a sale.[146] Given that Tom is acting for Samantha, it is unlikely that he is also acting for Bill. So the most likely arrangement would be that Tom holds the money not for Bill but for Samantha. Samantha, not Bill, will receive the money from Tom, even though Tom is bankrupt. Bill has a right against Samantha to be repaid his deposit. In other words, the most likely interpretation of what has happened is that when Tom agreed to return

[146] Solicitors (Scotland) Practice Rules 1986, promulgated by the Law Society of Scotland. Such rules have the force of law.

the money, if the sale did not go ahead, he did so merely as Samantha's agent.[147]

Though improbable, it is not impossible that Bill is also a client of Tom's, and that Tom was holding the money either for Samantha or for Bill, depending on how events turned out. Assuming that Tom is a lawyer, then he is under an obligation to 'segregate' all 'client funds'.[148] This is done by holding the funds in one or more separate bank accounts, the account being identified by its name as a client account. The money in such accounts is regarded as being held in trust for the clients. If an asset is held in trust, the creditors of the trustee in his ordinary capacity cannot attach the asset.[149] Thus, if the lawyer becomes bankrupt, then Bill should be repaid in full.[150]

If Tom is not a lawyer then he is subject to the Estate Agents Act 1979.[151] Although this Act applies in England and Wales and in Scotland, it does so in different ways. The Act requires estate agents to segregate client funds from other funds.[152] However, whereas in England and Wales such funds are held in trust for clients,[153] in Scotland this is not the case, the legislation providing that such funds are held by the estate agent simply 'as agent'.[154] Whether and when agency can create a trust is an issue about which uncertainty exists, but in the case of estate agents it is fairly clear that there is no trust.[155] If that is right, then either Bill or Samantha is an unsecured ordinary creditor. (That depends on whether Tom's undertaking to repay the money to Bill

[147] However, factual investigation would be advisable to ascertain precisely what was agreed.

[148] Solicitors (Scotland) Act 1980; Solicitors (Scotland) Accounts Rules 1997.

[149] This is Scots common law. The rule has been given a statutory basis in the bankruptcy of natural persons, and of juristic persons except companies: Bankruptcy (Scotland) Act 1985, s. 33. (See further William W. McBryde, *Bankruptcy*, 2nd edn (1995), para. 9–190.) The rule remains purely a common law rule in the bankruptcy of companies. (Cf. *Turnbull* v. *Scottish County Investment Co*. 1939 SC 5.) It also remains a purely common law rule in respect of non-bankruptcy forced execution by creditors. See generally Wilson/Duncan, paras. 1–10 to 1–22 and 10–06 to 10–07.

[150] If Tom had broken the rules, and taken the money for himself, Bill would still be protected, because there is a 'guarantee' scheme in force to protect clients from the dishonesty of their lawyers.

[151] The 1979 Act applies only to estate agents who are not also lawyers.

[152] Estate Agents Act 1979, s. 14.

[153] Estate Agents Act 1979, s. 13(1). See generally the English report.

[154] Estate Agents Act 1979, s. 13(2).

[155] Scots law is reluctant to accept trusts other than express trusts. For discussion see G. L. Gretton, 'The Scots Law Approach', in William Swadling, ed., *The* Quistclose *Trust: Critical Essays* (Oxford: Hart, 2004).

was made for himself or as agent for Samantha. Since the agency of estate 'agents' is very limited, it seems likely that Tom's undertaking was made on his own behalf.) Although the 1979 Act contains provisions requiring estate agents to have insurance for client funds, these provisions have never been brought into force.[156]

Alternative 2

First, the customers: They are simply ordinary unsecured creditors of Tom, unless it can be established that Tom held the money as trustee. Scots law is reluctant to admit implied trusts. In particular, Scots law appears not to accept 'Quistclose trusts'.[157] (Under this English[158] doctrine, if money is paid for a specific purpose which fails, the money is held on trust – a 'Quistclose trust' – for the payer.[159]) The conclusion must be that almost certainly the money is not held by Tom in trust for the customers.

However, if Tom is a member of an association of travel agents, it may be that the customers are protected. Thus the website of the Association of British Travel Agents (ABTA)[160] states that 'ABTA regulated travel agents and tour operators must comply with our strict financial rules. These rules are to protect your money and allow us to make sure that claims are paid in the event of a company failure.'[161] But the website does not explain the mechanism by which this happens. Perhaps ABTA uses a guarantee system. Conceivably ABTA rules say that customers' deposits and pre-payment are to be held on trust for the customers. But if so that is unlikely to be effective under Scots law. In addition to the issue of public policy, mentioned below, there would be another difficulty. The customer cannot be the truster[162] since the customer knows nothing of any trust. If the travel agent is regarded as the truster there is another, but equally fatal, problem, which is that where a person declares himself to be a trustee of assets that he holds, that declaration must be intimated to at least one of the beneficiaries.[163] It is thus

[156] Estate Agents Act 1979, s. 16.
[157] See the English case of *Barclays Bank* v. *Quistclose Investments* [1970] AC 567 (HL).
[158] Several other countries have also received this doctrine.
[159] For the Scots law in this area, see generally Gretton, 'Scotland', in Swadling, *The* Quistclose *Trust*, 167.
[160] Membership of this association is not compuslory, but many travel agents are in fact members.
[161] http://www.abta.com/.
[162] This is the Scottish term for what in English law is called the settlor.
[163] *Allan's Tr* v. *Lord Advocate on behalf of the Inland Revenue* 1971 SC (HL) 45.

difficult to locate any declaration of will that could validly constitute a trust under these circumstances. The result is that if the customers are unaware of any trust, almost certainly no valid trust exists.[164] (This does not mean that in Scots law there can never be a trust unless the beneficiary knows of the trust. That is not so. For instance if A appoints B as trustee for C, that can be effective even if there is no intimation to C.)

Secondly, the carriers (airlines): Once again, they will be ordinary unsecured creditors unless it can be established that Tom held the money as trustee. As before, it is unlikely that Scots law would recognise an implied trust. However, there may be an express trust. Most air carriers are members of the International Air Transport Association (IATA).[165] Such carriers in practice insist that the travel agents with whom they do business accept the IATA rules. One such rule is that 'all monies collected by the Agent for transportation and ancillary services ... shall be the property of the Carrier and shall be held by the Agent in trust for the Carrier or on behalf of the Carrier until satisfactorily accounted for to the Carrier and settlement made'.[166] The alternative between 'in trust for' and 'on behalf of' is not easy to interpret, but this point will be placed on one side. Assuming that Tom has agreed to this rule, the question arises as to whether this provision would be regarded as creating a valid trust under Scots law. The answer is open to debate. According to one view of the law, it is permissible to rearrange a debtor–creditor relationship as a trust relationship for the purpose of giving the creditor a priority in the event of the insolvency of the debtor.[167] According to the other view of the law, such an arrangement is an abuse of the trust institution, being an attempt to subvert the general law of security rights and insolvency, and hence will be regarded as invalid.[168]

[164] The same argument might be applied to clients' deposits with solicitors, but that seems to be a special case, based on the law applicable to the legal profession.

[165] http://www.iata.org/index.htm.

[166] IATA Resolution 832, 1.6.2(b)(i).

[167] See, for instance, *Tay Valley Joinery Ltd* v. *C. F. Financial Services Ltd* 1987 SLT 207 and *Style Financial Services Ltd* v. *Bank of Scotland* 1996 SLT 421 and 1998 SLT 851.

[168] See, in particular, *Clark Taylor & Co. Ltd Quality Site Development (Edinburgh) Ltd* 1981 SC 111. This is the author's view of the law. The author is indebted to Professor Graziadei for drawing his attention to the US case of *In Re Morales Travel Agency* 667 F.2d 1069 (1981), a case dealing specifically with the insolvency of a travel agent. It was held that there was no valid trust, notwithstanding the applicability of the IATA rules, for policy reasons substantially the same as those applied in *Clark Taylor*. For a study of the use of trust as a security device see Wilson/Duncan, chapter 4.

Spain

Alternative 1

Since Tom holds the money as a deposit, Spanish law will analyse Alternative 1 taking into account the fiduciary nature of the contract. Under contemporary Spanish law a *fiducia cum amico* does not imply the transmission of the property but just the attribution of a fiduciary title. Although the exact meaning of this concept is still under discussion, especially since the distinction between material and formal ownership collides with the classical concept of property, legal writing has accepted the idea that the transfer is only of limited real efficacy and bankruptcy will consequently allow the assets to be claimed back by the transferor.[169] This reasoning is supported by art. 908 of the Code of Commerce and by at least two Spanish Supreme Court judgments.[170] Article 908 of the Code of Commerce is particularly relevant to this situation because it clearly establishes that, in a bankruptcy situation, those goods whose property is not transferred to the bankrupt person under a valid and irrevocable legal title can be claimed by their legal owners.

In order for the bankruptcy administrators to be able to give back the €10,000, Bill will be required to prove that the money was transferred to Tom as a refundable deposit. However, in practice, since Tom is a real estate agent this will not be too difficult since the €10,000 will be transferred as a consequence of the *contrato de arras* which is usually done in writing. '*Arras*' are conceptualised as advance payments which may or may not be refundable if the sale does not take place in the end. Often, in order to reduce risks the money is not paid directly to the seller but to the professional intermediary who is a mere depository of the money.

Tom is not under an obligation to keep the money separate. This will not be altered if Tom is a practising lawyer. Spanish lawyers or notaries are not under a duty to keep money they receive from their clients separate from their own money. In the case of law firms who normally ask for a *provision de fondos* or operational funds it is not even customary to do so. When clients transfer money into a law firm's bank account they do however indicate that the money is paid as a *provision de fondos* or

[169] See S. Cámara Lapuente, 'Operaciones fiduciarias o *trusts* en Derecho Español', *Revista Crítica de Derecho Inmobiliario*, (1999), 1807, with further references in footnote 181.

[170] STS 22 December 1988 and STS 19 May 1989.

otherwise as payment of a bill. This will be sufficient to claim back that money in a bankruptcy situation.

Alternative 2

The relationship between Tom and his clients will be characterised as a *contrato de comision mercantile*. This is a special type of mandate contract that is regulated in the Code of Commerce (arts. 244 ff.). In order to analyse Alternative 2 a distinction will be made between two situations. First, the object of the mandate has already been fulfilled and it is a third party, namely the airlines, which is affected by the travel agent's bankruptcy. In the second situation, the clients transfer money to the travel agent so that he will be able to carry out the mandate.

In the first case the airlines would be treated as general creditors of the travel agent. The travel agent bought tickets from the airlines and then deferred their payment. This is, in fact, quite common in practice since travel agencies continuously buy tickets from airlines in the name of their clients and they usually concentrate payments on previously established dates. It is difficult to distinguish this situation from a normal sales contract. Under Spanish bankruptcy law, which regulates priorities very strictly, there is certainly no heading that seems applicable to this situation.

In the second case, customers claiming refunds will not have any priority. Article 909 of the Code of Commerce contemplates four different situations connected to commercial mandates. These are to be construed strictly and they are not applicable in this case.[171] This is a situation in which customers chose to advance a payment and, since the travel agent is no longer able to carry out the mandate, customers have a claim to be refunded. However, this is a general claim.

[171] Art. 909.4–7 reads as follows: '4° Las mercaderías que el quebrado tuviere en su poder por comisión de compra, venta, tránsito o entrega. 5° Las letras de cambio o pagarés que, sin endoso o expresión que transmitiere su propiedad, se hubieren remitido para su cobranza al quebrado, y las que hubiere adquirido por cuenta de otro, libradas o endosadas directamente a favor del comitente. 6° Los caudales remitidos fuera de cuenta corriente al quebrado, y que este tuviere en su poder, para entregar a persona determinada en nombre y por cuenta del comitente o para satisfacer obligaciones que hubieren de cumplirse en el domicilio de aquel. 7° Las cantidades que estuvieren debiendo al quebrado por ventas hechas de cuenta ajena y las letras y pagarés de igual procedencia que obraren en su poder, aunque no estuvieren extendidas a favor del dueño de las mercaderías vendidas, siempre que se pruebe que la obligación procede de ellas y que existían en el poder del quebrado por cuenta del propietario para hacerlas efectivas y remitirles los fondos a su tiempo, lo cual se presumirá de derecho si la partida no estuviere pasada en cuenta corriente entre ambos.'

The Spanish Law incorporating Directive 90/314/EEC of 23 June 1990, the *Ley 21/1995 reguladora de los viajes combinados*, is not applicable to the situation depicted since it requires the combination of at least two of the following services: (a) transport, (b) accommodation and (c) other services.

Sweden

Alternative 1

What is important is that Tom did not receive the money with a right to use it for his own purposes and to attach any risk to the debt. Instead, he received the money in the interest of the buyer, and should not have jeopardised the money in any way. In legal Swedish, Tom was not an ordinary debtor but was *redovisningsskyldig* (had a duty to account for the money). In such cases the mandator has a right to extract the money in a bankruptcy situation (a *ius separationis*) – no matter whether the mandatary had a duty to hold the money separate from his own – provided only that the money actually was held separate from the assets of the mandatary. See Trust Money Act 1944:181, *lagen om redovisningsmedel*.[172] There is no requirement in the Act that the bank or some similar third person holding the assets is informed of the fiduciary relationship.

A decisive question is, therefore, whether Tom had any money of his own in the same account. In such a case, Bill can, in principle, claim only a dividend in the bankruptcy. If Tom held money from other clients in the same account, the clients have a collective right of separation, in relation to their claims (*pro rata*).

There are two Supreme Court cases which modify the application of the Trust Money Act. In NJA II 1995, 367 it was stated that all commingling did not constitute a commingling in a legal sense. If only a small amount of the mandatary's money was commingled into the client's

[172] The wording is as follows (reporter's translation):

'What a person has received on behalf of another, with a duty to account for it, and for such a purpose holds in a bank account or otherwise separate, shall be reserved for his mandator, provided that the amount has been kept separate without delay from the receipt. The same applies in relation to amounts that have been separated at a later stage, provided that the person with a duty to account was not insolvent when the amount was separated.

What the person with a duty to account holds immediately accessible to be separated also shall be reserved for his mandator, if there is no delay in separation.

If a bank account or a fund is kept for several mandators' money, every mandator has a right in relation to his claim.'

account, the client would nonetheless, in the light of the preparatory works of the legislation, be entitled to separation. Consequently, it was a question of judgement whether deposits to, and withdrawals from, the account were of such significance that the account should be regarded as having changed from being held for some other to being an 'own account'.[173]

In NJA 1994, 506, corn had been deposited with a mill-owner to be ground on behalf of the depositor. However, the corn was commingled with corn of the same kind belonging to the mill-owner. In its reasons, the Supreme Court did not discuss whether the commingling was so substantial that the total quantity should not be regarded as held for the depositor (and other depositors). Instead the Court said that since the commingling was limited to a certain part of the depositor's patrimony, the depositor and the mill-owner were co-owners and the depositor had a right to separate a quantity amounting to what he had deposited. This principle was not applied in the case mentioned above, probably on the basis that no legally relevant commingling had taken place in that case. Thus, it is an open issue whether, and to what extent, co-ownership may exist when money has been commingled in an account.[174]

It makes no difference if Tom is a lawyer. The Trust Money Act is applicable to all fiduciary relations. A lawyer, however, like a financial institute, has an obligation under criminal law to keep clients' money separate, which increases the probability that the money in fact will be kept separate. In other words, the lawyer and the responsible persons of the financial institute may be convicted for illegal commingling because of the commingling as such, not only for embezzlement where the client suffers a final loss.

[173] This ruling may be criticised because withdrawals from the account never cause commingling. They only cause full or partial embezzlement, which should not affect the mandator's right to separate the remainder. But the Supreme Court must have considered that the issue was whether the account was *held for another*, which is a requirement in the Act. However, even if the mandatary firmly resolves and says to himself that 'the account shall no more be held for some other person; instead I embezzle it to enrich myself', the mandator ought to be entitled to separation if no significant commingling has taken place.

[174] In my view there should be no difference between corn and money since both are fungible objects to which the Trust Money Act is applicable directly or by analogy. But the Supreme Court forgot to mention another condition that must be met. The depositor cannot reasonably be entitled to separation of a larger quantity than the smallest amount that was present at all times before the depository became insolvent, i.e. a 'lowest intermediate balance' test. See Håstad, *Sakrätt avseen de lös egendom*, 6th edn (1996), 175 ff. On commingling, see also Walin, *Separationsrätt*, (1975).

In this context a word may be added concerning the so-called *stiftelser* in Swedish law. A *stiftelse* is similar to a trust in common law. A person, the settlor, transfers assets to some other person (an administrator) to be held as a separate patrimony for a certain purpose and for an indefinite time. Then the assets form a separate legal entity. As long as the assets are kept separate from the administrator's own assets of similar kind, the patrimony is not affected by the administrator's insolvency. The settlor is cut off from the administration. Thus he may not give additional directions. The administrator (the board of the *stiftelse*) should only obey what was said in the original stipulations. If, because of changed circumstances, the purpose can no longer be carried out, the purpose may be changed by a public authority. Naturally, many investments are made in the form of a *stiftelse*, for instance for the purpose of supporting research, welfare or even family interests, but it is not the normal way in which persons hold their private money when they want to have unlimited powers as to the money in the future.[175]

Alternative 2

There is no mandate or trust relation between the customers who have paid for tickets and Tom. The customers have paid the purchase price in advance. Therefore, the customers only have a claim for a dividend in the bankruptcy.

However, the money paid by the customers may have been received by Tom in trust for the airline companies. It depends on the agreement between Tom and these companies. It is not a decisive point whether Tom was obliged to hold the money separate from his own (see Alternative 1). But Tom must have received the money on behalf of the airlines and without a right to jeopardise the value of their claims on him. Normally, airline companies accept that the mandatary uses the money as his own (for wages, rents, other expenses, etc.) up to the day when the mandatary should account for the money (one to four weeks later). Hence, in reality the airlines may be said to have impliedly assumed a risk of the mandatary's being insolvent in a situation where he has disposed of the payments received. As soon as the airlines know that the mandatary is insolvent, they usually demand that all money received be held separately and submit that they never agreed that the

[175] See *stiftelselag*, 1994:1220. The standard treatise on *stiftelser* is Hessler, *Om stiftelser* (1952) (it was, however, written prior to the legislation now in force).

mandatary was entitled to use the money as his own when he was on the verge of insolvency.

The Supreme Court has recently tried this issue in the case NJA 1999, 812, pursuant to the agreement that 'all moneys collected by the Agent for transportation . . . are the property of the Carrier and must be held by the Agent in trust for the Carrier or on behalf of the Carrier until satisfactorily accounted for to the Carrier and settlement made'. The Supreme Court stated that the wording obliged the mandatary to hold the money separate. The Court then said that it had not been proved that the airlines had agreed, or by their acts accepted,[176] that the mandatary could deviate from the duties given in the agreement. Therefore, the Trust Money Act was deemed to be applicable to the case. The Supreme Court subsequently observed that some money had been paid to the mandatary in the last three days before the bankruptcy decision. Consequently, there was no delay in separating the money from the mandatary's own account, and such money did not form part of the bankruptcy estate.[177]

The courts have touched upon the same issue in criminal cases where a travel agent has not been able to account for the money and has therefore been charged with embezzlement. This is an intentional crime, and the accused can be convicted only if he knew that he had received the money in trust (that he was not permitted to jeopardise the value of the mandator's claim on him). In these cases courts of appeal have believed the accused when he said that he was convinced that the airlines had accepted that he used the money for his own costs, and therefore the mandatary was acquitted. Since the judgments have been founded on an evidentiary evaluation, the Supreme Court has never allowed an appeal.

If the airlines were not entitled to separate the remaining money in the mandatary's bankruptcy, it would go to the general creditors, including the airline companies and the customers.

[176] The Court did not examine whether the mandator 'without objection knew or ought to have known' that the mandatary used the money for his own purposes. Maybe such circumstances could have been assumed, which would have called for the opposite result. (I did not take part in the case. Otherwise I would probably have denied a right to separate the money provided only that the mandators, without objection, had known that the money was used for the mandatary's own needs.)

[177] This ruling was rather generous to the mandators, considering that the mandatary had never separated any money and that it was probably an enterprise which made bank deposits every day.

It might be added that the borderline between money held in trust (in the Swedish legal meaning, i.e. with a duty to account for it) and a loan can be difficult to draw, but there are two necessary conditions for a (Swedish) trust: the receipt must be for another person, and the mandatary must not be permitted by this person to jeopardise his claim.[178] Technically, it would have been much easier if the right of separation were confined to situations where the mandatary was under a duty at all times to hold the money received apart from his own. However, this would mean that a creditor would have only a dividend claim even in a situation where such a duty was not imposed but the mandatary actually did hold the money separate, for instance where a treasurer collected money for his organisation and – without being obliged – put it in his right pocket, with his own money in his left pocket, and then went bankrupt.

It might also be mentioned that there is a contradiction in the Swedish legislation between the Trust Money Act from 1944 and the Commission Agency Act from 1914. The former Act is said to be applicable by analogy to goods without individual characteristics, such as oil, corn, shares and gold (fungible goods).[179] As already mentioned, the mandator is not protected in bankruptcy if he permitted the mandatary to jeopardise his claim, for instance by accepting that the mandatary use the money (or oil, etc.) for his own purposes when he is insolvent, without having paid for it or separated a substitute in advance. Pursuant to s. 53 first paragraph of the Commission Agency Act, 'goods entrusted to a commissionist for sale remain to be owned by the commitent until the title passes to a third party or to the commissionist where the commissionist himself buys the goods'. Whether the commissionist is entitled to buy the goods is determined by other provisions. In this context it is remarkable that there is no exception where the commitent has permitted the commissionist himself to buy oil or shares, etc., on credit. However, it might be possible that s. 53 – at

[178] The same prerequisites apply in the statute on embezzlement, ch. 10 s. 1 of the Criminal Code (1962:700, *brottsbalk*).

[179] The word 'fungible' refers to the object as such (money, corn, etc.). Sometimes the concept 'generic goods' is used to mean the same thing, but that is quite wrong. Two concepts should not be used in the same meaning when they could better be used to denote different things. 'Generic' should refer to an agreement and be contrasted to goods that are individually defined or ascertained in the agreement. Fungible goods may be individually defined in an agreement if the goods are segregated.

least after 1944 – should be read with a silent proviso that the commissionist is not permitted to buy on credit if he is insolvent and that he, if he later becomes insolvent, is under a duty to pay in such good time that the payment cannot be avoided in bankruptcy. Otherwise one will reach different results depending on whether the 1914 or the 1944 legislation is applied on entrusted oil, shares, etc.[180]

Lastly, one remark should be made on the instructions in the questionnaire. It is said that the customers who paid but did not receive tickets have no contractual claim against the airlines. In Swedish law that would depend on whether the agreement between the mandatary and the customers to transport the customers was made in the mandatary's own name or in the name of the airline companies (the mandators). Normally, the latter is the case, and then the Contracts Act is applicable. Since the agreement was made with authority and not against any internal instructions, the airline companies are bound by the agreement and must provide the transportation (and tickets). Any embezzlement is their risk. If, on the other hand, the agreement was made in the mandatary's name, the customer has a claim only on the mandatary, and the client has no right against the mandator either based on his own claim (direct action) or based on the fact that the mandatary has a right against the mandator to make the mandatary indebted to the customer (see s. 56 of the Commission Agency Act). The claim to be indebted instead belongs to the bankruptcy estate, but the mandator will of course set this off against his claim for money received by the mandatary on behalf of the mandator.[181]

After the EEC Directive on Package Travel, the Travel Guarantee Act (*resegarantilagen* 1972:204) was passed, obliging those who arrange or sell package travel to provide customers with a monetary guarantee for performance.

Comparative remarks

Alternative 1

Contrary to what one might expect starting from the basic division between trust and non-trust jurisdictions, only a minority of countries

[180] See Håstad, *Sakrätt* 157 ff.

[181] Thus Swedish law does not apply the principle given in the Geneva Convention on agency (ratified by two or three countries), which has also been accepted in the Principles of European Contract Law concerning indirect representation.

(Greece, Luxembourg, Portugal) cannot contemplate any protection for Bill on Tom's insolvency. The majority can provide it in at least some circumstances. This protection depends on different requirements. Sometimes it is just a question of the terms on which Tom received the money (Austria, Denmark, England, Ireland, Scotland, Spain, Sweden, and possibly Germany and Italy).

Even so, it must be possible to identify the funds that belong to Bill. In some cases, mixing will defeat this. As the Greek report stresses, if the client authorises mixing the client money with the manager's own money, this is probably inconsistent with the hypothesis that the money was transferred in a fiduciary capacity. In the case, however, the mixing was probably unauthorised. The effects of this are variable. In Sweden, Finland, France, Italy, and probably Germany, and perhaps Austria, unauthorised mixing with the trustee's own money may defeat any protection (subject, in Sweden, to a *de minimis* principle); in other countries (Denmark, England, Ireland, Spain), this mixing will not defeat the priority, at least so long as there are no subsequent withdrawals, as in the case itself. Whether or not Bill's money would be considered identifiable if there had been such withdrawals is not an issue which the case raises.

Other systems will grant a priority only subject to a further requirement of designation of the account, presumably for the benefit of other parties (the debtor bank is often mentioned), but also perhaps as a formal marker that the relationship between Tom and Bill is not intended to be debtor–creditor (Austria (minority view), Belgium, the Netherlands). In those systems, payment into Tom's personal account is fatal to any priority, regardless of mixing, because the required designation is not present. In Germany such designation is possible, but it is not clear whether it is essential to have priority over general creditors; although interestingly the reporter notes that it is clearly essential in order to obtain priority over the creditor rights of the bank where the account is held. In Italy, what is required is a contract between Tom and Bill bearing a *data certa* or date established by law.

Many reporters note that Tom's handling of the deposit (paying it into his own bank account) would be improper or unlawful in their system. Frequently, where a system does provide for a formal designation for accounts containing client money, a real estate agent is supposed to use that kind of account. Many reports also note that real estate agents are required to have some form of security in place to protect client deposits.

Interestingly, in many systems that will allow priority for Bill's claim, the reporter notes that there is a tension between this result and formal theories of property law (Austria, Belgium, the Netherlands, Spain).

The variation in which Tom is a lawyer adds additional detail to the data from the basic case. In Scotland, a lawyer must keep client money in trust, and most estate agency work is done by lawyers; but an estate agent who is not a lawyer need not keep client money in trust. Similarly, other reporters, whose systems recognise a fiduciary capacity (e.g. Italy), note that this capacity is more likely to be found to exist in the case of a lawyer. In those systems that have a specially designated kind of bank account, lawyers are usually required to use it. Apparently uniquely in the Netherlands, lawyers are required to transfer client money to a foundation established for this purpose. In France, client funds held by notaries are placed in accounts that are subject to a pledge, giving the clients a priority. If the lawyer does not follow these required procedures, as in the case itself, Bill will have a priority claim only in those systems where such priority does not depend on a formal account designation. Some systems do not require lawyers to segregate client funds (Portugal, Spain; Italian law is unclear). Of course, many reporters observe that lawyers are required to have insurance in place to cover shortfalls in client funds.

Alternative 2

In general, the same tests are applied as in Alternative 1, but the outcome is that the customers are unlikely to be protected as they made a contractual payment, rather than a deposit. The travel agent would not generally be understood to have any obligation to segregate client funds. Specially designated accounts are not used. England and Ireland suggest that the customers might possibly succeed in establishing a trust. Other reporters indicate that the customers will be general creditors.

The airlines may have a slightly better chance of a priority claim. Here, many reporters mention the standard terms imposed by IATA, requiring travel agents to hold ticket receipts 'in trust for or on behalf of' the airlines. This may provide an example of how transnational commercial practices can bring about some degree of harmonisation. The IATA terms are mentioned as possibly protecting the airlines in the reports of England, Finland, Germany, Italy, Scotland and Sweden. Their effects seem to be unclear in Belgium. On the other hand, the reports of Finland and Germany indicate that any protection will be lost if ticket funds are mixed with the agent's own funds. Moreover, the reports of England, Italy, Scotland and Sweden raise the issue whether the airlines can rely on such terms, where they permit the travel agent to use the ticket funds in its general commercial activities. Permission of that kind seems to be inconsistent with an agreement to hold ticket money in trust for or on behalf of the airlines.

The Directive on Package Travel does not directly apply to sales of airline tickets on their own (that is, not part of a package). In most countries, the implementation follows this. In Belgium and Luxembourg (and in the Netherlands until 1 October 2001), the legislation implementing the Directive extends it to this case, with the result that the travel agent is bound to have security in place for the protection of customers. The reporter for Finland also mentions a requirement of such security for sales of charter flights, which is not referable to the Directive. Other reports (for example England and Scotland) indicate that security may be in place, even though not required by law, as a matter of trade practice. The security, where it exists, benefits customers but not airlines.

Case 5: Insolvency of investment manager

Case

Roberto is a professional investment manager. He manages assets in the interest of different clients, namely Simon, Rebecca and Ruth. The managed assets are bought with money transferred to him by his clients. Roberto offers different forms of services: (a) individual management services, under which he is to keep separate the position of each client; (b) participation in a collective investment scheme, whereby the assets managed for his clients are pooled and each participant in the scheme will share *pro rata* the returns on the collective investments; and (c) shares of an investment company (DEF Ltd) which holds investments chosen by Roberto.

One year after receiving the money from his clients, Roberto becomes personally insolvent. Which of his clients is better off: Simon, who chose *option a*; Rebecca, who chose *option b*; or Ruth, who chose *option c*?

Discussion

AUSTRIA

Option a

Professional investment managers, who offer the individual management services enumerated in s. 1 (1) ((19)) BWG,[1] are not allowed to take over money from their clients. The managed assets are deposited in bank accounts in their clients' names. Professional investment

[1] *BG über das Bankwesen* (*Bankwesengesetz* - BWG) BGBl 1993/532 idF BGBl I 1999/123.

managers do not carry out their services on a fiduciary basis, because they are obliged to act in the name and for the account of their clients. They are direct representatives, who are mandated and authorised by the clients to carry out specific investment services. Thus, the insolvency of the investment manager does not affect the clients' assets: the clients have never given up ownership of their assets, and the money, since it is deposited in separate bank accounts in the name of the clients, is clearly separated from the investment manager's assets.

Roberto was not allowed to take over Simon's money. Simon can only claim a right of separation according to s. 44 KO if his money was not mingled with Roberto's assets and if it is still traceable. If it was mingled, Simon could claim damages.

Option b

Austrian law does not allow for the management of investment funds[2] by individual persons in their own capacity. According to s. 2 InvFG,[3] this kind of business can only be operated by either a private limited liability company (GmbH) or a public limited liability company (AG) as an investment management company. Thus, Roberto Ltd manages the assets.

Rebecca, who invests her money in the fund, becomes co-owner of the fund's property, which is not transferred into the ownership of the investment management company.[4] Although the management of the clients' assets is based on a fiduciary relationship between the investment management company and the shareholders (*Anteilsinhaber*), this underlying legal relationship differs from the classical concept of the *fiducia* as modelled after Roman law (*Vollrechtstreuhand*, see Case 1). The investor (Rebecca) remains the (co-)owner of the fund's property, whereas the fiduciary (Roberto Ltd) is empowered to manage the assets in his own capacity, but for the account of the investors (*Ermächtigungstreuhand*).[5]

According to s. 23 InvFG, Roberto Ltd is obliged to deposit its clients' assets in a separate trust account (*Anderkonto*), which is solely administered and controlled by a separate legal entity, the so-called custodian

[2] This is true for investment funds that are comprised of securities (*Wertpapierfonds*; s. 1 InvFG). See Iro, 'Das Investmentgeschäft', in Avancini/Iro/Koziol, *Österreichisches Bankvertragsrecht II* (1993), 676 (680).

[3] *BG über Kapitalanlagefonds* (*Investmentfondsgesetz* – InvFG 1993) BGBl 1993/532 idF BGBl I 1998/41.

[4] S. 1 InvFG; Iro in Avancini/Iro/Koziol, *Österreichisches Bankvertragsrecht II* 681 f.

[5] S. 3 InvFG; Iro in Avancini/Iro/Koziol, *Österreichisches Bankvertragsrecht II* 710.

bank (*Depotbank*). Thus, the fund's property is clearly separated from the assets of the investment management company.

Since the InvFG, which implemented Directive 85/611/EEC of 20 December 1985 (Undertakings for Collective Investment in Transferable Securities), does not provide specific rules for the insolvency of an investment management company, the general rules apply. As Roberto Ltd becomes insolvent, Rebecca will obtain preferential treatment in the sense of s. 44 KO (right of separation), since she is in the position of a co-owner of the fund's property, which is clearly separated from Roberto Ltd's assets.

Option c

When buying shares of DEF Ltd, Ruth enters into a legal relationship with the investment company. The insolvency of Roberto, since he is only engaged in choosing investments on behalf of DEF Ltd, does not in any way affect the solvency of DEF Ltd. As such, Ruth's assets are not at all endangered. Apparently it is Ruth who is in the best position among the clients.

Belgium

Option a

Investment management services in the securities field are regulated in Belgium by the Acts of 4 December 1990 and 6 April 1995 and the Royal Decree of 5 August 1991.[6] Assuming that the investment activities of Roberto are conducted by a corporate entity – Roberto Ltd – they fall within the scope of this legislation. Article 11 of the Decree requires Roberto Ltd to deposit the managed assets and the acquired securities under Simon's name with a depository as described in art. 165 of the Act of 1990.[7] The deposit is governed by an agreement between the depository and the client, and one between the depository and the investment management company (arts. 13 and 14 of the Decree). The investment management company is only allowed to make use of these assets for management purposes.[8] As a result, the managed assets do not enter the

[6] The implementation of the European Directives on UCITS III (Directives 2001/107/EC and 2001/108/EC of 21 January 2002, amending Council Directive 85/611/EEC), need not be addressed in detail here.

[7] Art. 11 Royal Decree of 5 August 1991, with reference to the abolished art. 165 § 2 Financial Operations and Markets Act of 4 December 1990 .

[8] Art. 13, 2° Royal Decree of 5 August 1991.

estate of Roberto or his company, and they are therefore not subject to any claim by personal creditors. However, the cited art. 165 of the Act of 1990 has been abolished by the Act of 1995. In art. 79 § 2 of the latter Act, it is forbidden for investment management companies to receive funds or financial instruments from investors. The assets under management must be kept by an entity other than the investment management company. With regard to funds and financial instruments, the depository must be a licensed investment company. In practice, the rules of the Decree of 1991, implementing the Act of 1990, continue to be applied since there is no Decree implementing the new Act of 1995.

Moreover, the financial sector has a number of guarantee funds – in the form of either public or private corporate entities – which intervene to the benefit of consumers and investors in case of the insolvency of one of their member-companies.[9] For this purpose, the Act of 17 December 1998[10] implements the European Directive of 3 March 1997.

Investment schemes not included in the scope of this legislation are less safe. In the absence of a legal obligation to isolate the assets of his clients, all securities and other assets bought by Roberto will be mingled with his private estate and will become subject to his creditor's claims. Simon will thus have to reclaim his investment without receiving priority over the competing claims of other creditors. The deposit by Roberto of all the assets in a special quality account, thus preventing mingling, may safeguard Simon's interests (see Case 4). Finally, since the contractual relationship with the investment manager is a mandate, the contract is automatically cancelled from the moment that Roberto became insolvent.[11]

Option b

The Act of 4 December 1990 contains detailed provisions on collective investment funds – referred to as *beleggingsfondsen* or *fonds de placement* – that implement the European Directive 85/611/EEC (UCITS Directive) of 20 December 1985. In Belgium, collective investment funds are the joint property of the investors. A management company manages it as an administrator, on behalf of the investors, whose rights are represented by participation rights.[12] The securities acquired by the fund are

[9] E.g. the guarantee fund for deposits and financial instruments, created under art. 3 of the Act of 17 December 1998.

[10] *Moniteur Belge* 31 December 1998 second edition.

[11] Art. 2003 CC states that the mandate ends with the insolvency of the mandatary.

[12] Art. 111 § 1 Act of 4 December 1990.

deposited in the hands of a separate depository, which will place them in a special quality account.[13] The depository may only carry out instructions given by the administrator if they are in compliance with the mandate of the administrator and the applicable legal provisions.[14] The creditors of the administrator have no claim on the assets of the fund.[15] Thus, the investment fund is safely isolated from the assets of both the administrator and the depository. Hence, the insolvency of Roberto – or Roberto Ltd – will not affect Rebecca.

Option c

Collective investment may also be organised in the form of an investment company, which has separate legal personality. Again, the assets are deposited with a depository and most often managed by a management company acting as an administrator (the investment company may manage the assets itself, but this is never done in practice). If the assets of Ruth are invested in a collective investment scheme through the purchase of shares in such an investment company, then the insolvency of Roberto – or Roberto Ltd – will not affect her investment. Ruth's securities are safely deposited with a depository and she has the title to these securities in the form of shares. She is also protected against the possible insolvency of the investment company. First, the investment company may not engage in any activity other than investment on behalf of clients and the investment company may not own assets other than those needed for the realisation of this objective.[16] Second, the patrimony of the investment company consists of different 'compartments' representing different collective investment schemes. The assets of a compartment can only be seized for debts and commitments related to that specific compartment.[17]

If Roberto files for bankruptcy, then Ruth, as a shareholder of the investment company managed by Roberto, should not fear Roberto's creditors. The only situation in which Ruth's position may be threatened

[13] Art. 11, 1° Royal Decree of 4 March 1991, *Moniteur Belge* 9 March 1991 erratum 27 March 1991 and 20 April 1991; H. Swennen, 'Trustachtige rechtsfiguren in België', *Tijdschrift voor Privaatrecht* 1992, 1113.

[14] Art. 11, 4° Royal Decree of 4 March 1991.

[15] Art. 111 § 5 para. 2 Act of 4 December 1990.

[16] Art. 114 second paragraph Act of 4 December 1990.

[17] Art. 115 § 6 last paragraph Act of 4 December 1990. This is an exception to the general principle, based on arts. 7 and 8 of the Mortgage Act, of the unity of a debtor's estate, meaning that each creditor can seize the whole estate of his debtor, prohibiting him from reserving parts of the estate for particular creditors.

is where Ruth's shares in the investment company are bearer shares and Ruth and Roberto agreed that Roberto should hold these shares on her behalf. Ruth will then have to reclaim the shares from Roberto and his creditors and provide proof that the shares belong to her and have only been deposited with Roberto for safekeeping. This proof may be difficult to present.

Denmark

As mentioned above in Case 1, Alternative 2, Council Directive 93/6/EEC (the Capital Adequacy Directive) has been implemented into Danish law mainly by way of the Stockbroker Companies Act. The legislation implementing the EU Directive does not, however, regulate the insolvency situation.

Furthermore, Council Directive 85/611 of 20 December 1984 on the coordination of regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) is implemented into Danish law by way of the UCITS and Non-UCITS Act (Consolidation Act No. 158 of 7 May 2001). The Act contains rules on the organisation, approval and supervision of UCITS and Non-UCITS by the Danish Financial Supervisory Authority.

Under Danish insolvency law, the question is whether or not the money deposited in Roberto's investment company can be identified at the time of Roberto's insolvency. If Simon's money was actually kept separate, as agreed upon in the individual management services agreement, then Simon's claim has priority over competing claims. As regards the collective investment scheme, Rebecca's investment therein will have priority over general creditors, provided that the contributions under the collective investment scheme are kept in a separate account and that the contributions of each investor and the movements on the account are registered, making it possible to decide which part of the amount present in the account at the time of bankruptcy belongs to Rebecca.

If the collective investment scheme meets the requirements of the UCITS and Non-UCITS Act, and is therefore a UCITS or a Non-UCITS as defined by the Act, the investment scheme must be considered a separate legal person and will therefore not be affected by Roberto's insolvency. Since Ruth bought shares in an investment company that is an independent legal person, instead of transferring money to Roberto personally, her investment will also be protected by the general principles on legal personality.

England

So long as Roberto properly kept his own assets separate from those held for others, each client should be equally protected.

With respect to Simon and Rebecca, as discussed in Case 1, the trust is the natural choice for investment management. Roberto will be required by law to hold the client's money and investments in trust, if they are not registered in the name of the client.[18] Whether each client's position is kept separate will not affect the trust device. It is common to have a trust held for a large number of beneficiaries, whose shares are measured by their proportionate contribution. If Roberto properly kept the managed trust funds separate from his own, then his personal bankruptcy does not affect his clients. If he breached the trust and took trust funds, then the clients will need to try to trace their assets. To the extent that they succeed, they will have a priority claim to the traced trust assets. To the extent that tracing is impossible, they will be reduced to personal claims for breach of trust and will be general creditors in the bankruptcy.[19]

As for Ruth, she will also be protected since Roberto's personal bankruptcy will not affect the investment company. She will continue to hold her shares and their value will remain the same as long as Roberto did not improperly abstract assets belonging to the company. If he did, then again tracing may allow for the recovery by the company of the proceeds of the misappropriations. However, to the extent that this

[18] The seventh of the Principles for Businesses issued by the Financial Services Authority under the authority of the Financial Services Act 1986, s. 47A required segregation of client property. In the current incarnation, the tenth of the Principles for Businesses requires that 'A firm must arrange adequate protection for clients' assets when it is responsible for them.' The current version of the Principles, which the FSA calls PRIN, is available as part of the FSA Handbook on their website www.fsa.gov.uk. The implemention of the principle regarding client assets is through the part of the Handbook called Client Assets or CASS. In particular, CASS 2 deals with the custody of client securities, while CASS 4 deals with client money. Under the authority of FSMA, s. 139(1)(a), CASS 4.2 creates a statutory trust over client money in England, Wales and Northern Ireland (but not Scotland).

[19] There will also be access to the Financial Services Compensation Scheme. Under Part XV of the FSMA, the old system of multiple schemes for different sectors has been replaced by a single scheme. The system is governed by the part of the FSA's rules which it calls Compensation or COMP. The current version is available on the website www.fsa.gov.uk.

fails, the company will only have a personal claim against Roberto for breach of his duties to the company.

Finland

Option a

If Roberto invests his customers' money in securities and/or derivatives, his business activities are probably regulated by the Act on Investment Service Enterprises, which is the Finnish Act implementing Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field. A licence for this kind of business can only be given to a limited company; thus it will only be given to Roberto Ltd.[20] According to the Act on Investment Service Enterprises, s. 3 and the Securities Market Act, Ch. 1, s. 4 and Ch. 4, s. 5a, Roberto Ltd is obliged to keep the property of his principals separated from his company's own property. If Roberto Ltd acted in this way, then Simon can claim that his investments be separated from the bankruptcy estate of Roberto Ltd. Simon will, in other words, get protection against the general creditors of Roberto Ltd.[21]

It is most likely the case that Simon can get protection even if the provisions mentioned above do not apply. Roberto will also be obliged in these cases to keep the property of his customers separate from his own property. His duty can be based on good professional practices even if there is no corresponding provision in the investment agreement.[22] If there is this kind of duty and the property is actually kept separate, then the customers' property does not belong to the bankruptcy estate of the investment manager. There is no special legislation concerning Simon's rights in these situations, but the general rules on property rights in the Seizure Act, the Bankruptcy Act of 9 November 1868/31 and the Act on Reorganization of Enterprise of 25 January 1993/47 lead to the conclusions stated above.

[20] Investment services can also be offered by credit institutions which have a licence under the Credit Institution Activities Act of 30 December 1993/1607. The same applies, of course, to foreign investment enterprises having the appropriate licence in some other state belonging to the EEA.

[21] If Roberto had commingled the property with his own property, Simon could claim damages from the compensation fund, which is regulated in the Act on Investment Service Enterprises, Ch. 6. These provisions implement Directive 97/9/EC of the European Parliament and of the Council of 3 March 1997 on investor-compensation schemes.

[22] See J. Tuomisto, *Omistuksenpidätys ja leasing* (1988), 338–341.

Option b

Participation in a collective investment scheme, whereby the assets of the clients are pooled and each participant in the scheme will share *pro rata* the returns on the collective investments, is one important way for the public to invest their money. If the investments are to be made in securities and/or derivatives, then the investment agreement is regulated by the Investment Funds Act of 29 November 1999/48, which is the Finnish Act implementing, inter alia, Council Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS). The licence to run this kind of business can only be granted to limited companies, thus it will only be given to Roberto Ltd. The insolvency of Roberto Ltd does not diminish the property rights of the customers of Roberto Ltd in the pooled investments, which belong to the investors according to the Investment Funds Act, s. 25. The result is most likely the same in the uncommon case where the agreement is not within the scope of this Act.

Option c

The investment in shares of a limited company (DEF Ltd), which holds investments chosen by a separate investment manager or company, is not very common in Finland.[23] However, the new legislation concerning real property investments, that is, the Real Property Fund Act of 19 December 1997/1173, is based on a similar idea. The insolvency of the investment manager or company does not affect the position of DEF Ltd or its shareholders. The protection of shareholders like Ruth, however, presupposes that the share certificates of DEF Ltd are held in the possession of Ruth or some third person acting on her behalf, or that Ruth's ownership is appropriately registered if DEF Ltd joins the computer-based book-entry system.[24]

[23] Venture capital investments in Finland are sometimes carried out using a special purpose vehicle (SPV). Investors fund the SPV, which then acquires shares of some promising, usually unlisted, company. When the profits of the investments are ready to be taken, the SPV sells the shares or lets them be redeemed by the issuing company. The SPV is then dissolved and the investors get their returns. The SPV is, however, normally a limited partnership instead of a limited company. The investors are acting as (passive) partners with limited liability, and the investment manager or investment company as an (active) partner with unlimited liability.

[24] If DEF Ltd has neither given share certificates nor joined the book-entry system, the company administration, primarily the board of the company, must be notified of the

France

Option a

Individual asset management is an investment service,[25] provided that the assets are securities. Only limited liability companies may provide such services, and such companies may not receive money from their clients.[26] In practice, a limited liability company acting as a depository is set up in addition to the limited liability company acting as the manager of the assets.[27] Roberto Ltd's insolvency will, therefore, not affect Simon's assets.

Option b

Participation in a collective investment scheme, whereby the assets managed for Rebecca are pooled and each participant in the scheme will share *pro rata* the returns on the collective investments, would be managed by a limited corporation, Roberto Ltd.[28] It is assumed that the managed assets are securities. The managed assets would have to be held by a limited liability corporation acting as depository. The depository must be a separate legal entity from Roberto Ltd.[29] Rebecca will, therefore, not suffer from Roberto Ltd's personal insolvency.

Option c

If the money transferred by all of Roberto's clients is used to buy shares of DEF Ltd, Roberto's bankruptcy may prevent him from continuing to manage the investment company.[30] However, provided that DEF Ltd is not itself bankrupt, the shareholders of DEF Ltd will not suffer from Roberto's personal bankruptcy.

transfer. A mere contract of transfer does not give protection to the transferee in the insolvency of the transferor. See the Promissory Notes Act of 31 July 1947/622, ss. 22 and 31, the Companies Act of 29 September 1978/734, Ch. 3 s. 9 and the Act on Security Book-entry Accounts of 17 May 1991/827, s. 26.

[25] Art. 4 of the 2 July 1996 Act, implementing the 10 May 1993 European Directive on Investment Services in the Securities Field, codified under art. L. 321-1 C. mon. et fin.

[26] Art. L. 533-12 C. mon. et fin.

[27] J.-M. Bossin and G. de Lambilly, 'Gestion individualisée sous mandat: le statut se précise', *Banque*, June 1988, 56 ff.

[28] 23 December 1988 Act, implementing the 20 December 1985 European Directive on the Coordination of Laws, Regulations and Administrative Provisions relating to UCITS, codified under art. L. 211-2 and L. 214-15 ff. C. mon. et fin.

[29] Art. L. 214-16 and L. 214-26 C. mon. et fin.

[30] See art. L. 625-2 and L. 625-3 C. com.

Germany

Option a

Simon will be given priority over Roberto's general creditors if the assets acquired by Roberto on Simon's behalf are earmarked as 'belonging' to Simon and are clearly segregated from Roberto's own assets. It is best to keep the money in a trust account (*Anderkonto*) (see Case 4), and to keep the account, credited with shares and bonds bought on Simon's behalf, in Simon's name. There is clearly a duty to segregate for all those rendering investment services under § 31 *Wertpapierhandelsgesetz* (§ 34a WpHG).[31] This includes portfolio management. It is only with respect to other types of assets that there can be some doubt arising from the principle of immediacy (see introduction to Case 4).

Option b

The result is the same as in Option a. Rebecca and the other investors can claim priority over Roberto's general creditors *pro rata*, provided that the conditions stated for Option a are satisfied and each customer's share can be determined on the basis of Roberto's books.

Option c

Under German law this scheme normally falls under the Investment Company Statute. Otherwise, the rule under Option b is applicable. The Investment Company Statute[32] transposes the UCITS Directive 85/611/EEC[33] into German law. The Statute applies to all investment schemes covered by the Directive. Unlike the Directive, it also applies to companies specialising in land investments or equity holdings for which no securities are issued.[34] The only conditions are that the shares of the investment scheme are placed with the public at large, that the investment is made according to the principle of diversification of risks and that the investors have a redemption right (the fund must be open ended). Note that under German law only the contractual or indenture

[31] See above, p. 229, n. 26.

[32] *Gesetz über Kapitalanlagegesellschaften* (KAGG) of 14.1.1970, *Bundesgesetzblatt* part I, 127, in its revised form as in art. 1 of 'Gesetz zur Verbesserung der Rahmenbedingungen der Finanzmärkte (Finanzmarktförderungsgesetz)' of 22.2.1990, *Bundesgesetzblatt* part I, 266.

[33] EC OJ 1985 L 375/3; amended in EC OJ 1988 L 100/31 and 1995 L 168/7.

[34] For a specific report of the transposition and a synopsis, see Grundmann, 'Europäisches und deutsches Investmentrecht', ZBB 1991, 242.

type is possible (alternatives 1 and 2 of art. 1 para. 3 UCITS Directive; § 6 para. 1 [2] KAGG). Roberto holds the positions of the investors in trust, or they are joint proprietors of the investment stock. German corporate law does not allow an open-ended scheme if investors want to acquire shares of the investment company (direct or statutory type). According to § 1 para. 3 KAGG, Roberto has to be organised as a Public Limited Company (*Aktiengesellschaft*, AG) or a Private Limited Company (*Gesellschaft mit beschränkter Haftung*, GmbH).

As required by the Directive, under German law there are various principles aimed at avoiding problems arising from the bankruptcy of the investment company (here DEF Ltd). These include the principle of specialisation (arts. 6, 56 UCITS Directive; § 2 para. 2 lit. c KAGG) and the principle of segregation (arts. 7, 10, 55 UCITS Directive; §§ 10 para. 1 [2], 12 para. 1 [1 and 4] and para. 2 [1] KAGG). The bulk of the rules under the Directive and under German law are concerned with the investment policy of the investment company (DEF Ltd). The insolvency of Roberto clearly does not affect Ruth's position. The position he holds in trust for the investors does not belong to property divisible among (general) creditors (§ 13 para. 3 [2] KAGG). Thus far, I am not aware of any insolvency in this field in Germany.[35]

Greece

Option a

Regarding the legal relationship between Roberto EPEY (see Case 1) and Simon, the following two alternatives are possible. The first alternative involves Roberto EPEY acting as Simon's direct representative under a mandate. Roberto EPEY may be Simon's direct representative if it buys the assets under management in Simon's name. In such a case, Simon becomes the owner of the assets bought (s. 211 CC, see Case 1). Furthermore, Roberto EPEY is the depository of the assets (s. 822 CC). If it becomes insolvent, then Simon may claim restitution of the assets on the basis of s. 936 CCProc. (see Case 4, Alternative 2).

On the other hand, even if the assets under management are considered fungible property, in particular bearer securities, the deposit made to Roberto EPEY will not be an irregular deposit (s. 830 CC), which confers ownership on the depository (Roberto EPEY). Irregular deposit

[35] See Carl/Förster, *Das Recht der Investmentsfonds – Europarechtlicher Rahmen und nationale Gesetzgebung*^{2} (1994), 90.

supposes that the depository is allowed to make use of the deposit. Such permission should be given to the depository explicitly and in writing in order to produce legal effects (s. 830 CC *in fine*). According to L.2396/1996 and the relevant code of self-regulation,[36] companies providing investment services in the field of securities should maintain in separate accounts any property belonging to their customers in order to ensure segregation of this property from their own assets. As a result, the requirements of s. 830 CC cannot be fulfilled, i.e. Roberto EPEY is not granted any permission to use the deposit. Moreover, in practice, such an explicit and written permission would never be granted to the depository, enabling it to use the securities deposited with it under an asset management transaction. Consequently, if Roberto EPEY becomes insolvent, Simon may claim restitution of the assets on the basis of s. 936 CCProc.

Option b

Collective investment schemes are regulated in Greece by L.1969/1991, which has implemented into Greek law EEC Directive 86/611 of 20 December 1985 related to Undertakings for Collective Investments in Transferable Securities, as amended thereafter.[37] Under Greek law, the collective investment scheme (mutual fund) is an undivided joint right over securities (see s. 785 CC).[38] Investors are joint owners of the mutual fund, and they also have joint liability for any indebtedness related to the mutual fund (ss. 17 § 1 and 18 § 1 of L.1969/1991). The rights of investors over the fund are incorporated into parts. The parts of the mutual fund are not transferable. The mutual fund is deposited in a bank (the custodian) for safekeeping (s. 30 §§ 1, 2 of L.1969/1991). The mutual fund is not a separate legal entity. The above Act, however, introduces the rule of segregation of the mutual fund (*Sondervermögen*) from the property of the investment manager.

Under Greek law, the investment manager acts as a representative of the owners of the mutual fund (s. 18 § 1 of L.1969/91),[39] empowered with irrevocable managing authority.[40] Furthermore, according to Greek law, only a specific type of *Société Anonyme*, named AEDAK (*Société Anonyme* for the Management of Mutual Funds), may be an investment

[36] Decision of the Ministry of Finance no. 12263/B500/11.4.1997 (OJ no. 340/24.4.1997).

[37] See Tsimpanoulis, *Investment Services in the Greek and European Community Law* (1989).

[38] Deliyanni-Dimitrakou, *Trust and Fiducia*, 316.

[39] Ibid., 319.

[40] Ibid., 317.

manager of a Greek mutual fund. The insolvency of the investment manager does not have any impact on the investors' rights over the assets under management, as a result of the principle of segregation of the manager's property from the investment scheme. In order to ensure this segregation of property and to avoid any mixture, the law requires the custodian and the investment manager to be two separate entities. Therefore, even if Roberto AEDAK becomes insolvent, Rebecca's rights over the scheme will not be affected.

Option c

Investment companies are regulated in Greece by L.1969/1991. As opposed to collective investment schemes, investment companies are independent legal persons. The law requires these companies to have the legal form of limited company by shares (*Societe Anonyme* for Investments in Securities). As a result, investment companies in Greece are closed-end companies. They have a share-capital held by the investors. The investments under management appear on the asset side of their balance sheet. The investors are entitled to receive an annual dividend. Furthermore, the investors may sell their shares through the secondary market (Athens Stock Exchange). There is an absolute segregation between the property held by the investment company and the property of Roberto, the asset manager thereof. Provided that the investment company does not become insolvent, Ruth's rights over the investments under management are not affected, even if Roberto, the investment manager, becomes insolvent.

Ireland

The result will depend on the extent to which the managed assets are held separately from Roberto's assets. If the assets are appropriately segregated, they will be insulated from Roberto's personal bankruptcy. Professional investment managers such as Roberto are required to segregate client assets, such as those held for Simon and Rebecca. Section 52 of the Investment Intermediaries Act, 1995 (IIA)[41] permits the supervisory authority to impose client asset protection requirements on investment business firms. The asset protection regime for

[41] See also s. 52 of the Stock Exchange Act, 1995 (as amended by ss. 64 and 78 of the Investor Compensation Act, 1998), applied in *In re Money Markets International Stockbrokers Ltd* [2000] 3 IR 437 (HC; Laffoy J) and *In re Money Markets International Stockbrokers Ltd* (HC, unreported, 20 October 2000, Carroll J).

investment business firms is set out in a Central Bank publication.[42] Breach of the Central Bank requirements amounts to an offence under section 74 of the IIA. In addition, where an investment business firm knowingly holds client money at an institution other than one specified by the supervisory authority, it may be guilty of an offence (s. 52(5)). Failure to designate an account in which client money is held as a 'section 52' account in financial records is also an offence. Persons who maintain client money accounts are protected against fraudulent misappropriation liability by s. 52(8), which provides that the person with whom an account is maintained in accordance with client money requirements will not be liable as a constructive trustee where money is wrongfully paid from that account, unless the person making the payment knew that the payment was wrongful or did not make reasonable enquiries as to its validity. Finally, under s. 52(9), it is an offence for a director, officer or employee of an investment business firm to misappropriate fraudulently any client assets held or controlled by the firm. In a bankruptcy where the assets have not been protected and are not available for clients, a compensation claim will be available under the Investor Compensation Act, 1998 in respect of client money and instruments held by the investment business firm on behalf of the investor.

If Roberto has not segregated his clients' assets from his own, then Simon and Rebecca will be able to claim their assets only if they can trace them. If not, they will have (practically worthless) personal claims for the value of missing assets and for breach of trust. Breach of the relevant asset protection requirements can result in sanctions and clients may also be able to benefit from the Investor Compensation Act, 1995 compensation scheme.

As far as Ruth is concerned, Roberto is a separate legal person to DEF Ltd. This company will not be affected by Roberto's bankruptcy. In the event that Roberto has misappropriated assets from the investment company, Ruth's shareholding will be devalued. If DEF can trace any such misappropriated assets, it can recover them. If not, it will

[42] Central Bank Requirements Under Section 52 of the Investment Intermediaries Act, 1995. Safekeeping of Client Money and Investment Instruments (1996). Essentially, these require that client moneys held on behalf of clients be segregated in a client account at an eligible credit institution, and that client investment instruments held on behalf of clients are safeguarded (where documents of title are concerned), properly registered, where appropriate, in the client's name, separately identifiable (where title is recorded electronically) and not used for own account without prior written consent from the client.

have (again, practically worthless) personal claims against him. Furthermore, if Roberto is a director of the company, an action may be available for breach of director's duties based on the misappropriation of assets belonging to the company. Such duties are, however, owed to the company as a whole and not to individual shareholders, so the proper plaintiff would be DEF and not Ruth, and if the assets are not traceable, DEF would only have (again, practically worthless) personal claims against him.

Italy

In Italy, 'Roberto' refers to a company providing asset management services in accordance with the d. lgs. 24 February 1998, n. 58, *testo unico delle disposizioni in materia di intermediazione finanziaria*, and the other norms adopted by the national regulators of financial services providers.[43] With respect to Option a, the authorised assets managers are: (a) banks; (b) *società di gestione del risparmio*;[44] (c) *società di intermediazione mobiliare*;[45] (d) *società fiduciarie*[46], or other authorised firms (art. 18 of the d. lgs. 24 February 1998, n. 58).[47] With respect to Options b and c, 'Roberto' is either a *società di gestione del risparmio* or a *società di investimemento a capitale variabile* (SICAV), which is duly authorised to manage the collective investment scheme (art. 33 of the d. lgs. 24 February 1998, n. 58), or the investment company holding investments selected by Roberto. Notwithstanding some differences between the various services offered by Roberto, there is a basic common solution to the issues raised by Case 5 as to the rights of Simon, Rebecca and Ruth over the assets managed by Roberto. These rights must always be protected from the claims of Roberto's other creditors by the adoption of adequate measures aimed at safeguarding clients' rights over the managed assets (cf. art. 21.1, lett. e, d. lgs. 24 February 1998, n. 58).

[43] See also below, Case 9.

[44] Bessone, 'Le SGR, societá di gestione del risparmio. La *financial industry* e le attivitá di gestione di patrimonio in forma collettiva', Vita not., 2002, I, 630.

[45] Rordorf, 'Societá di intermediazione mobiliare', *Enc. dir., Aggiornamento* V (2001), 1041.

[46] Nisio, 'L'attivitá di amministrazione delle societá fiduciarie (evoluzione e prospettive)', *Banca, borsa, tit. cred.*, 2003, I, 42; Fauceglia, 'Gestione Fiduciaria', in *Enc. dir., Aggiornamento* VI (2002), 381 ff.

[47] For commentary: Palmieri, in Campobasso, ed., *Commentario al testo unico della finanza (d. lg. 4 febbraio 1998, n. 58)*, I (2002), 135 f.; Costi, Enriques, *Il mercato mobiliare* (2004), 279 ff.

Option a

With respect to Option a, the general framework of this protective regime is enacted by art. 22 of the d. lgs. 24 February 1998, n. 58. According to that provision, the financial instruments and funds of individual customers held in whatever capacity by an authorised asset manager who is not a bank: 'shall be separate assets for all intents and purposes from those of the intermediary and from those of other customers. Actions in respect of such assets may not be brought by creditors of the intermediary or on behalf of such creditors, nor by creditors of the custodian or the sub-custodian, if any, or on behalf of such creditors. Creditors of individual customers may bring actions up to the amount of the assets owned by such customers.'[48] Banks hold clients' financial instruments in accordance with the same rule, but clients' moneys in a bank are subject to a different regime, i.e. they are held on current accounts (see art. 22 of the d. lgs. 24 February 1998, n. 58; art. 1834 CC).[49] In this case, if the bank is insolvent, the investors are protected only by the compensation schemes set up under the general banking law for the generality of customers. Their claims will rank *pari passu* with the claims of the other non-secured creditors of the bank.

Option b

With respect to collective investment schemes organised as 'fondi comuni di investimento', i.e. pooled assets managed by a management company, the key provision safeguarding investor's rights in the case of insolvency is art. 36.6 of the d. lgs. 24 February 1998, n. 58. According to it, each investment fund (and each sub-fund) is an independent pool of assets (*patrimonio autonomo*), separate for all purposes from the assets of the management company and from those of each investor, as well as

[48] See also d. lgs. 1 September 1993, n. 385, art. 91 (to which art. 57 of the d. lgs. 24 February 1998, n. 58 makes reference) for the allocation of assets to clients' accounts in case of liquidation of the investment manager. The legal regime of deposits of clients' assets is specified by the Bank of Italy regulation dated 1 July 1998. For commentary: Costi, Enriques, *Il mercato mobiliare*, 353 ff.; Briolini, in Campobasso, ed., *Commentario al testo unico della finanza*, I, 183 ff.; Salamone, *Gestione patrimoniale e separazione patrimoniale* (2001), 301 ff.; D'alessandro, 'Dissesto di intermediario mobiliare e tutela dei clienti', Giur. comm., 1997, I, 465 ff. See also Cass., 28 May 1997, Giur. comm., 1998, I, 299; T. Firenze, 3 February 1999, Fallimento, 2000, 188.

[49] See Briolini, in Campobasso, ed., *Commentario al testo unico della finanza*, I, 185 ff., with further references; cf. Minervini, Corr. giur., 1996, 1298.

from all other assets (*patrimonio*) managed by the same company. Such pools of segregated assets cannot be reached by actions brought by creditors of the management company (or in its interest) or by actions brought by creditors of the custodian or the sub-custodian or in their interest. Actions brought by the creditors of individual investors are admitted only with respect to each investor's share in the fund (*quote di partecipazione*). In no case can the management company use in its own interest (or in the interest of third parties) the assets pertaining to the pooled funds it manages.[50] Similar provisions are enacted for SICAVs and pension funds.[51] The law requires all these collective investment schemes to deposit the assets they hold for investors in a bank, which is responsible for a number of important tasks, including the supervision of the regularity of the instructions of the investment manager concerning the managed assets (cf. d. lgs. 24 February 1998, n. 58, arts. 38, 36.2; d. lgs. 21 April 1993, n. 124, art. 6bis).

Option c

With respect to Option c, no special provision covers the case. The investment company is a separate entity, distinct in all respects from Roberto. Roberto's insolvency cannot endanger investors' rights in the investment company.

Luxembourg

Different authorisations are required for the activities enumerated. All these activities fall within the rules of the 1993 Law on the financial sector, as amended, in particular by the 1998 Law implementing the Investment Services Directive. Option a (individual management services) requires authorisation as an investment manager (*gérant de fortune*), under art. 24B. Option b requires authorisation as either a distributor of UCI (undertaking for collective investment) shares (art. 24D), or as a SICAV (*société d'investissement à capital variable*, which is a UCI organised as a corporate vehicle) or as a management company of an FCP (*fonds commun de placement*, which is a UCI organised on a contractual basis as an undivided ownership). Option c requires authorisation as investment manager. However, the supervisory authorities of the

[50] Miola, Briolini, in Campobasso, ed., *Commentario al testo unico della finanza*, I, 331 ff.

[51] Sub-funds of SICAVs are subject to the same regime pursuant to d. lgs. 24 February 1998, n. 58, art. 43.8; pension funds are governed by similar provisions as well: d. lgs. 21 April 1993, n. 124, art. 4.2, 4.6, 4ter.

Luxembourg financial markets are sometimes reluctant to accept investment vehicles which function in a manner similar to a SICAV but do not have the same control or restrictions on investment. All of these entities are subject to specific rules if insolvency results.

Option a

If Roberto SA acts as an investment manager, then art. 36 of the 1993 Law obliges him to take the necessary measures to prevent any commingling of assets or cash; in particular, to avoid any use of the assets held on behalf of the clients for his own account, except with the express agreement of the client. Article 36bis, applicable only to those professionals in the financial sector who manage third party funds (such as Roberto SA), requires Roberto SA to identify expressly all accounts and assets he manages for his clients. Roberto SA must deposit the assets of the clients with an authorised and officially controlled depository (generally a Luxembourg bank). In case of insolvency, according to art. 36bis (3), the assets of third parties (i.e. clients) are segregated from Roberto SA's assets and are outside the reach of Roberto SA's creditors.

Option b

The situation of investors participating in a collective investment scheme comes closest to the situation of an FCP, mentioned above. The law dated 20 December 2002 on UCIs (the '2002 Law')[52] regulates this type of UCI. The assets held by the FCP are managed by a management company and are deposited with an authorised depository (a Luxembourg bank). The clients hold shares representing their *pro rata* entitlement in the FCP, but are, legally speaking, in a situation of undivided ownership of the relevant assets, the FCP having no legal personality.

The insolvency of Roberto SA as a distributor of UCI shares does not affect the rights of the investors, who have proprietary shares of the FCP; nor does it affect the FCP as such. To the extent that Roberto SA holds money in transit for the subscription of shares in the FCP, the rules of art. 36bis, referred to under Option a, will apply and ensure the segregation of the investor's funds.

[52] This Law replaces the law dated 30 March 1988 on UCIs (the '1988 Law'). During a transitory period, UCIs existing prior to the coming into force of the 2002 Law remain governed by the 1988 Law.

If Roberto SA is the management company of the FCP, then his insolvency will normally cause the liquidation of the FCP. This procedure is subject to the control of the Commercial Court in Luxembourg and is carried out by court-appointed liquidators. The assets held by the FCP are realised according to the rules laid down by the law and the court (art. 80 of the 1988 Law and art. 104 of the 2002 Law) and all investors participate in the product of the realisation according to their *pro rata* interest represented by the shares they hold in the fund.

Option c

If one excludes the situation of private investment vehicles,[53] as explained above, then this situation can be compared to a SICAV. A SICAV is organised like a commercial company, and subject to the same rules, except where expressly provided otherwise by the 1988 or 2002 Laws. Investors hold shares in the SICAV, and the assets held on their behalf are legally owned by the SICAV, which is a legal entity. The assets must be deposited with an authorised depository (a Luxembourg bank). The situation of Roberto SA as investment manager or distributor of UCI shares is the same as above. In all of these cases of insolvency of any of the management professionals, the rights of the investors are protected by the specific rules of the laws on the financial sector (mostly the 1988/2002 and the 1993 Laws).

Netherlands

General investment in financial instruments

In all three situations, Roberto will fall under either the 1995 Act on the Supervision of the Securities Trade, or the Act on the Supervision of Collective Investment Schemes (ASCIS), or the 1992 Act on the Supervision of Credit Institutions. As a result of this, Roberto does not have ownership of the securities, does not have rights to clients' money in a bank account (see Case 1 under the sections titled *Investment in securities* and *The contractual agreement between John BV and Sam*), and has the obligation to keep his client's assets completely separate from his own assets. If Roberto becomes insolvent, this will not have any impact on the rights of the three clients. If Roberto is a member institution (which will have a corporate form) (see Case 1 under the section titled

[53] No specific protection would be afforded to the investors in such a case. They are shareholders of a company which would be put under general insolvency management: this means that they will be paid after all other creditors, preferred and general.

The Securities Giro Administration and Transfer Act), then Rebecca does not have anything to do with the insolvency of Roberto Company. The collective deposit does not form part of the patrimony of Roberto Company.

Option a

In Case 5, Roberto is a securities institution that falls under the ASST 1995. More specifically, Roberto is a limited company, and Simon's money and financial instruments will be given to a third party to be placed in accounts in the name of Simon. This corresponds to the situation discussed in Case 1 under the section titled *The contractual agreement between John BV and Sam*. The insolvency of Roberto has no impact on the assets owned by Simon. The investments stay in Simon's name with the third party.

Option b

Rebecca or the securities institution that she contracted with will keep the shares or the rights in the investment company or the investment fund. If Roberto is the securities institution, then the situation is the same as in Option a. If Roberto is the manager of the investment company or the investment fund, then his insolvency has no effect on the rights of Rebecca. The shares or rights are in the custody of an administrator. For information on regulation, see Case 9 under the section titled *Supervision*.

Option c

DEF BV will be an investment institution in the sense of the ASCIS (see Case 9). It is not likely that Roberto, as a director of the investment institution, is a broker for the shares in the investment institution. In any case, the personal insolvency of Roberto will have no influence on the ownership of the shares by Ruth.

Portugal

Portugal has implemented the EU Directives concerning financial services, namely Directives 98/646/EEC, 93/6/EEC and 93/22/EEC.

Professional management of investments is subject to the relevant provisions of the Banking Act (arts. 4.1.g and h, 6.f and 8.2) and of the Management Companies Act (Decree-Law 163/94) (see the introduction to the answer to Case 1), and should be performed by a company (*sociedade anónima*) under the supervision of the Central Bank. These laws implement the aforementioned Directives (see especially Directive 93/22/EEC, Annex, Section A. 3). In accordance with the European regime, the investment of Simon will not be affected by insolvency of Roberto SA. According to the Management Companies Act, art. 5, assets corresponding to Simon's investments must be deposited in a separate bank account in Simon's name, which is exempt from the claims of the creditors of Roberto SA even in the case of insolvency and/or bankruptcy.

The investment of Rebecca would also be fully protected from the creditors of Roberto SA in case of his insolvency and/or bankruptcy. It would be an investment fund (*fundo de investimento*) which could be open-ended (*aberto*) or closed-ended (*fechado*). Besides the Banking Law, investment funds are specially regulated by Decree-Law 276/94 of 2 November, which implements Directive 85/811/EEC on UCITS. In addition to open and closed funds, this law allows treasury funds (*fundos de tesouraria*) and funds of funds (*fundos de fundos*). Investment funds are autonomous patrimonies that belong jointly to the investors – unit holders – and are exempt from the creditors of the fund management company (*sociedade gestora de fundos de investimento*).

The management of assets in the interest of Ruth by Roberto through shares of a financial company, DEF Ltd, which holds investments chosen by Roberto is similar, but not identical to, a closed-ended investment fund. It is also similar to a SICAV (investment company with variable capital). As a closed-ended investment fund, the investments would be held by the fund, which is not a corporate body but an autonomous patrimony managed by a financial company, Roberto SA (*sociedade gestora do fundo de investimento*). SICAVs are not allowed in Portugal. In accordance with the Banking Act and the Management Companies Act, this alternative would not seem to be possible. If it were permitted, DEF Ltd would not be liable for the debts of Roberto and his bankruptcy would not cause any adverse consequence for his clients' investments.

Simon, Rebecca and Ruth would be equally protected and exempt from the insolvency of Roberto, or Roberto SA.

Scotland

Option a

This can be done either by means of agency or by means of trust. However, in practice the latter is likely (see Case 1). In either case, customers such as Simon are protected from Roberto's bankruptcy. In the case of agency, they are protected because they own the assets. In the case of trust, they are protected because the trust assets form a separate special patrimony that is not part of Roberto's general patrimony.

Option b

A pooled fund cannot easily be managed on the basis of agency. In practice, a pooled fund of this type will have to be a trust. Customers such as Rebecca are protected from Roberto's bankruptcy: see above. A pooled fund can be held in trust for different investors.[54] It is not necessary for the trust to have only one beneficiary. There is no limit to the number of beneficiaries that a trust may have.

Option c

If the assets are vested in a company that has a separate juristic personality, then the shares in that company belong to the shareholders, such as Ruth, and not to Roberto. The assets of the company itself belong to the company, as a person, and not to Roberto. So neither the shares in the company, nor the assets of the company, should be affected by Roberto's bankruptcy as a natural person.

Spain

Option a

This case involves individual portfolio management of securities, which is governed by the law regulating stock markets, *Ley 2471988, de 28 de julio, del Mercado de valores*, which has been amended several times. This law regulates investment service enterprises of which there are three types that vary in terms of the activities they are each allowed to carry out: (a) *sociedades de valores*, (b) *agencias de valores* and (c) *sociedades gestoras de carteras*.

The Spanish Minister of Finance must authorise an investment service company operating in Spain. They take the form of either the *Sociedad Anónima* or the *Sociedad de Responsabilidad limitada*. Investment service companies of other European Union countries can, however, operate in Spain.

[54] For pooled funds in practice see the English report for Case 9. The law and practice in Scotland on collective investment schemes are almost exactly the same as in England.

Bankruptcy procedures affecting investment service companies are regulated in art. 76bis of the law, which provides for a special procedure in which there is a clear intervention of the *Comisión Nacional del mercado de valores*, a public agency whose function is to control the stock markets. In order to protect investors from the investment company's bankruptcy, the law provides for the creation of a guarantee through a *fondo de garantia de inversiones*. All Spanish investment service companies are required to participate in these funds, which are structured as separate patrimonies and regulated in detail in art. 77 of the law. Investors who fail to recover directly from their investment service company can claim a refund from the guarantee fund to which their particular investment service company adheres. After paying out the guarantee, the guarantee fund is subrogated to the particular investor's claims.

Option b

Rebecca is a participant in an investment fund managed by Roberto. Spanish law, which contains a special rule on bankruptcy in art. 17.4 of the *Ley 46/1984, de 26 de diciembre, reguladora de las instituciones de inversión colectiva*,[55] regulates investment funds and investment companies.[56] The second paragraph of art. 17.4 clearly applies to the situation envisaged in Option b. It states that the fund's patrimony is not responsible for the debts of participants, managers or depositaries. Moreover, Spanish law protects the participants in investment funds by requiring managers to be legal persons. According to Spanish law, Roberto cannot manage a collective investment scheme in his personal capacity. The law also severely limits the investments that can be carried out through an investment fund.

The legal nature of the investment and pension fund is a highly controversial issue under Spanish law; however, it seems that they are both organised along the lines of co-ownership. The funds are owned by the participants and managed by an investment company that has all the powers of an owner, but is not to be considered the owner.[57]

[55] 'Los acreedores del fondo no podrán hacer efectivos sus créditos sobre el patrimonio de los partícipes cuya responsabilidad se limita a sus aportaciones. El patrimonio del fondo no responderá por las deudas de los partícipes, gestores o depositarios.'

[56] This law has been amended several times, partly in order to incorporate Directives 85/611/EEC, 93/6/EEC and 93/22/EEC.

[57] The law is quite twisted as far as defining the investment fund is concerned. Art. 1.2 reads as follows: 'Los fondos de inversión mobiliaria son patrimonios *pertenecientes* a una pluralidad de inversores, cuyo derecho de propiedad se representa mediante un certificado de participación, administrados por una Sociedad gestora a quien se *atribuyen las facultades de dominio sin ser propietaria* del Fondo . . . '

However, art. 17.4 is careful to limit the participant's responsibility to the fund's creditors to an amount equal to the investment. The investment fund is therefore clearly a separate patrimony.

Option c

Ruth is a shareholder of an investment company. Spanish law regulates these companies, along with the investment fund, in the law mentioned above. Investment companies take the form of a *Sociedad Anónima* and they are formed according to the legal rules generally applicable to these companies. These rules are supplemented by those requirements laid down in the *Ley reguladora de las instituciones de inversión colectiva*, the fulfilment of which renders the *Sociedad Anónima* into a *Sociedad de inversión colectiva*.[58]

By using the company structure, Ruth's money is clearly safe from Roberto's bankruptcy since the company holds the investments that are bought. The price to be paid, however, is the loss of flexibility since the structure of the *Sociedad de inversión colectiva* is quite rigid.

Sweden

Option a

Simon, who opted for a position separate from all other clients, seems above all to have ended up with a position which is separate from the manager Roberto's own position. Since Roberto received the money in the sole interest of Simon and was not entitled to risk the money as a loan to himself, Simon can extract the assets from the bankruptcy estate provided they have been held separate from Roberto's assets. The basis for such a judgement is either the Trust Money Act or s. 53 of the Commission Agency Act, which overlap in this situation (see the answer to Case 4). The Trust Money Act is directly applicable to money received on behalf of the mandatary, and applicable by analogy to other fungible assets received under the same conditions. The Commission Agency Act is applicable to all kinds of assets – fungible or not – received from the mandator with a commission to sell them, or to assets bought from a third party in the mandatary's name on behalf of the mandator.

[58] These requirements are basically that the corporate purpose must be exclusive, that the legal entity has to have Spanish nationality, and that the managing bodies have to be structured in a certain way.

Pursuant to s. 53 second paragraph of the Commission Agency Act, the mandator (commitent) immediately becomes the owner of goods that the mandatary (commissionist) has bought in his own name on behalf of the mandator. Whether it is bought on behalf of the mandatary or the mandator is decided by the mandatary's intention, no matter whether the mandatary had a mandate or not (i.e. acted as a *negotiorum gestor*). The third party (the seller) need not be informed of who is the intended owner.[59] The implication of the title's immediate passing from a third party to the mandator is that the title does not rest with the mandatary for some 'logical second' (as it does in some other legislations), and therefore a floating charge on all the mandatary's assets or a *Globalzession* of the commissionist's present and future assets does not attach to what he buys for a mandator.

An additional requirement for the mandator's right to separate what was bought for him is, of course, that the asset is individually distinguishable from the mandatary's own assets. In some other cases co-ownership may exist (see Case 4, Alternative 1). If the assets consist of dematerialised financial instruments, these are often registered in the name of the mandatary but in a special account, called an administrator's account (see Shares Account Act, *aktiekontolagen* 1989:827).

It might also be mentioned here that, pursuant to the Financial Enterprises Act, an investment manager must keep money (but not other assets) received from a client separate, which increases the probability that such money will be kept separate. As to other assets, 'only' the risk of embezzlement gives an incentive to see that the assets are individualised from the manager's own assets.

Option b

Rebecca, who opted for a pooled scheme, also has a right of *pro rata* separation under the same conditions as Simon, according to the Trust

[59] There is, however, one exception to this rule, invented in precedents by the Supreme Court and contrary to all general principles on commission agency. When real estate is bought (wholly or partly) on behalf of someone else, the real owner (in full or in part) is not protected against the creditors of the formal owner until the real owner's claim on the real estate is formalised by a transfer from the formal owner or by a judgment from a court. Likewise, a third party who buys the real estate from the formal owner or takes it as a pledge (mortgage) does not need to respect the non-formalised claim of the real owner even if the third party knew of it. See NJA 1984, 772 and NJA 1985, 97 and 615.

Money Act and, by analogy, according to cases dealt with under the Commission Agency Act.

In Sweden there is a statute on funds of financial instruments (*lagen om värdepappersfonder*, 1990:1114). It is applicable to funds that are created by capital supplied by the public and in which the investors have a share and where the fund is (to be) owned by the investors. According to the Act, companies must have authorisation to engage in these kinds of enterprises. That the fund is owned by the investors is mentioned in the statute, not as a consequence, but as a definition of the scope of its applicability. Consequently, it is later stipulated that the fund as such is not a legal person (not a *stiftelse*, see Case 4 Alternative 1 *in fine*). The fund company only owns what stems from its share capital and the fees paid by the investors. All this implies that the basic rules on separation in bankruptcy are to be found in the statutes mentioned in the preceding paragraph.

Option c

Ruth, who opted for shares of an investment company (of which Roberto was the chief executive officer), seems to have chosen a solution where the company is not one covered by the Financial Instruments Funds Act (mentioned above) but is an investment company in a traditional sense, where that company owns all the assets and the investors only have shares in the company as such. If this is the case, Ruth has to be satisfied with the shares. Roberto bought the shares on behalf of Ruth, presumably with the intention of making Ruth the owner, and, therefore, Ruth is the owner even if Roberto bought the shares in his own name, provided only that the shares are held separate from Roberto's own property. See s. 53 of the Commission Agency Act. The final outcome for Ruth, of course, will depend on the solvency of the share company.

Comparative remarks

Option a

In the majority of countries (Austria, Belgium, Denmark, England, Finland, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Scotland, Sweden), Simon is protected, often but not always via legislation implementing EU law. There is, in general, a duty to keep the client's assets separate from those of the manager. Where there is no possibility of priority if the assets are in the patrimony of the manager (e.g. Belgium, France, Luxembourg, the Netherlands), the manager is not permitted to hold the assets; and sometimes assets must be held separately even where such segregation is not necessarily required, as a matter of general law, in order for clients to have priority in insolvency (England). The legislation may require management to be carried on by a company. However, in some countries it appears that Simon is not protected, as the regulatory framework requiring segregation will not cover individual portfolio management (France, Spain).

In general, regulatory legislation, where it applies, often requires that the manager be a company. Also it often forms the basis of an investment protection scheme.

Option b

Here a common core has been generated by European legislation. A pooled investment like this must be under the regulations. The investor, Rebecca, is always protected. The legal implementation of the directives is variable. Sometimes the fund must have legal personality, and investors are stakeholders (e.g. Denmark, Luxembourg); in other cases, the investors own the underlying securities directly, by co-ownership (Austria, Belgium, England, Finland, Greece, Spain (majority view)). These possibilities are explored further in Case 9, 'Collective Investment Schemes'.

Option c

In this case, the investor, Ruth, is protected in every legal system. The separate legal personality of the corporation puts this beyond doubt. The ability of the corporate form to replicate so easily the bankruptcy effects of the trust must lead us to ask why companies are not used more widely as functional equivalents of the common law trust. Some possibilities include the publicity which the corporate form attracts, and the mandatory governance rules which may apply. In a wide sense, this includes the regulation of shareholder meeting and voting as well as the structure of the board of directors. It is also true that the corporate form often attracts different taxation treatment. As the answers to Case 9 demonstrate, however, it is increasingly common for the 'normal' rules of corporate law to be modified where a corporation functions as a vehicle for collective investment.

Case 6: Tracing

Case

The facts are as in Case 5, except as detailed below. The following alternatives occur:

Alternative 1

Without authority, Roberto uses all of the money in Simon's account (€1,000) to buy a painting. When Simon learns of this, the market value of the painting has risen to €2,000. Roberto is still solvent. Simon wants to terminate the relationship and take the painting. Can he do this?

Alternative 2

The facts are the same as in Alternative 1. However, before Simon learns of the transaction the painting is destroyed. It is insured for its market value. By the time Simon learns of this, Roberto is personally insolvent. Simon wants to terminate the relationship and take the insurance claim. Can he do this?

Alternative 3

Without authority, Roberto buys a painting with all of the money in Simon's account (€1,000) and €1,000 of his own money. By the time Simon learns of this, the market value of the painting has fallen to €1,000 and Roberto is personally insolvent. Simon wants to terminate the relationship and take the painting. Can he do this?

Alternative 4

Roberto has an unsecured overdraft facility (revolving loan facility/line of credit) with his bank, in his personal capacity. He borrows €100,000 from this facility and uses it to buy a piece of land in his personal capacity. Later, without authority, he uses all of the money in Simon's account (€100,000) to pay the debt he owes to the bank. By the time Simon learns of this, Roberto is personally insolvent. Simon wants to terminate the relationship and take the land. Can he do this?

Discussion

Austria

Alternative 1

As indicated in Case 5, Roberto would not be allowed to take over his client's money under Austrian law. The facts of the case imply a fiduciary relationship between Roberto and Simon, rather than a direct representation relationship.

Regarding the internal relationship, Simon can terminate the fiduciary relationship with immediate effect (s. 1020 ABGB) and claim damages (s. 1012 ABGB), since Roberto severely violated Simon's confidence when he invested his money without any kind of authorisation (s. 1020 ABGB). With respect to the external relationship, the purchase of the painting is legally valid. In other words, Roberto – as the fiduciary owner of Simon's money – becomes the 'formal' owner of the painting.

If Roberto bought the painting in the course of the management activities he carries out for Simon (in his capacity as mandator), Simon can ratify the unauthorised transaction (s. 1016 ABGB). This will give him a personal claim to have the painting transferred into his ownership. The same is true if Roberto bought the painting for his own benefit. Simon will be able to receive the painting upon ratification of the transaction that was effected by Roberto without authorisation. The mere intention with which Roberto acted does not affect Simon's rights to the painting. In both cases it was the money in Simon's account which was used, and in both cases Roberto acted in breach of the fiduciary contract. Thus, it is Simon's decision whether he wants the painting or not.

Alternative 2

Simon can certainly terminate the relationship with immediate effect (see Alternative 1).[1]

[1] Besides, the fiduciary relationship expires as soon as Roberto becomes insolvent (s. 1024 ABGB).

He would also be entitled to claim the painting (as in Alternative 1), if it still existed (and if he ratified the unauthorised transaction). According to the doctrine of subrogation, however, assets that replace the fiduciary assets while the fiduciary relationship is in operation are also considered to be fiduciary assets.[2] That is why Simon can take the insurance claim, which is deemed to replace the painting. Again, Simon's rights to the insurance indemnity do not depend on the intention with which Roberto carried out the transaction.

Simon has a right of separation according to s. 44 KO, since he is recognised as the 'material' owner of the fiduciary assets under Austrian law (see Case 4). His claim receives preferential treatment with respect to the other creditors.

Alternative 3

Simon can terminate the relationship with immediate effect (see above). With regard to the painting, Simon cannot just take the painting (after having ratified the unauthorised transaction), since he shares 50 per cent co-ownership with Roberto. The courts will decide whether Roberto or Simon receives the painting upon payment of half of its market value to the other party, or if it should be put up for public sale and the proceeds shared equally. Since Simon wants to receive the painting, it seems most probable that he will get it with priority over Roberto's creditors (s. 44 KO). Simon can claim additional damages for the loss he suffered from the drop in the market value of the painting (s. 1012 ABGB). This claim, however, will be without priority in the course of the insolvency proceedings.

Alternative 4

Simon can terminate the relationship with immediate effect. He cannot, however, take the land since Roberto made the purchase in his own capacity with his own money. There is no link between the purchase of the land and the business Roberto conducts for Simon within the fiduciary relationship. Nonetheless, Roberto will be held liable for breaching the fiduciary contract. The claim for damages, however, will be without priority.

[2] Friedmann, *Gutachten* 36. DJT (1931), 1024 ff.; Hämmerle, *Gutachten* 36. DJT (1931), 694 f.; Umlauft in *Apathy*, *Treuhandschaft* 36; Strasser in *Rummel*, *ABGB I* ^{3} § 1002 Rz 42l.

Belgium

Alternative 1

A distinction should be made between the issue of ratification of Roberto's actions, thereby making Simon the legally bound or entitled party, and the issue of Simon's ability to invoke ownership rights towards third parties, such as creditors of Roberto. With regard to the termination of the contract, Simon, as the mandator, is free to terminate the mandate at will.[3] To receive the painting, he will be required to ratify the transaction that was effected by Roberto without authorisation. Retroactive ratification of an act performed by a mandatary is legitimate, even after termination of the mandate.[4] For such ratification to be possible, it must be the case that Roberto purchased the painting in his capacity as mandatary, and not for his personal benefit. If it is proven by Roberto or his creditors that the purchase was not made on behalf of Simon, then the latter cannot ratify the transaction and instead is left with a personal claim for damages. Yet Simon can make the counter-argument that Roberto's use of his money is sufficient proof that the purchase was made in the performance of his mandate. If this argument is accepted, then ratification is possible. As a result, Simon acquires title to the painting and thus can rightfully claim the painting from Roberto.

Whether such a claim will be effective against third parties, such as creditors of Roberto, depends on the factual situation regarding the possession of Roberto. Article 2279 BCC, stating that possession of a movable is valid as a title of ownership, creates a rebuttable presumption of ownership for the person in possession of the asset. Any creditor in good faith[5] may presume that the person in possession (Roberto) is the owner. If a person other than the possessor (Simon) claims the property, then that person is required to rebut the presumption. Therefore, he is required to prove that the possession is not 'clean' but rather has defects, i.e. that the possession does not comply with the requirements of arts. 2228 and 2229 BCC and is merely a detention. The possession must be continuing, undisturbed, public and not dubious. If Roberto bought the painting as a mandatary, then he is not possessing as the owner but rather he is only in detention of the painting. If this

[3] Art. 2004 BCC.

[4] Art. 1998, paragraph 2, BCC; Court of Cassation, 15 December 1932, *Pasicrisie* 1933, I, 52.

[5] Not knowing that someone else is the owner of the movable asset.

can be established, the burden of proof being on Simon, then upon ratification the ownership of Simon must be accepted by Roberto's creditors in good faith.

If Roberto has become insolvent before ratification, then the mandate is automatically revoked.[6] Thus, all acts performed by Roberto on behalf of Simon after becoming insolvent are null and void. However, the nullity of such acts can only be invoked by the mandator or his creditors and not by the mandatary, his creditors or other parties.[7] Hence, Simon can still ratify the purchase and recover the painting as long as he can prove that the purchase was an act under the mandate and that Roberto had the painting in detention for the real owner, being Simon. Also, ratification must be quick since courts tend to protect the rights acquired by third parties in the time that lapses between the transaction itself and ratification by the mandator.[8]

Alternative 2

If the insurance policy is made on behalf of Simon, then obviously he will be allowed to take the money. If the policy is made in Roberto's name, then Simon may still be entitled to claim the insurance money, under the principle of real subrogation, in so far as he had rights of ownership on the painting itself (see Alternative 1). However, under Belgian law there is no general principle of real subrogation.[9] It is only in particular situations that the rights to asset *A* can be transferred by way of real subrogation as rights to asset *B*, on the basis that *B* is coming into the place of *A* and is taking over the function of *A*.

Assuming that Roberto bought the painting as a mandatary on behalf of Simon, giving Simon the ownership of the painting upon ratification (see above), Simon may directly claim the insurance money without facing competition from Roberto's creditors. The basis for this real subrogation may be found in art. 1303 BCC. This article states that if an asset is destroyed without the fault of the debtor, and the debtor has a right or a claim for damages regarding the asset (the insurance claim), then he must transfer this right to the creditor that has a claim on the asset. Another basis may be art. 1934 BCC, stating that a party

[6] Art. 2003 BCC.

[7] Tilleman, *Lastgeving*, 341 with references to other scholars.

[8] Court of Cassation, 6 February 1953, *Pasicrisie* 1953, I, 437; De Page, *Traité élémentaire du droit civil belge*, vol. V, no. 446.

[9] Court of Cassation, 12 December 1991, conclusion by Attorney-General Janssens de Bisthoven, *Pasicrisie* 1992, I, 287; E. Dirix, 'Zakelijke subrogatie', *Rechtskundig Weekblad* 1993–1994, 273–280.

who keeps an asset for an owner, who loses the asset without being at fault (by *vis maior*) and therefore receives a price or something else, is bound to return to the owner what he received. The last rationale that can underlie Simon's claim for the insurance money is found in an analogous application of art. 10 of the Mortgage Act, in combination with art. 58 of the Insurance Act of 25 June 1992.[10] According to this rule, the rights of a creditor with a mortgage on an immovable property are transferred to the insurance money received upon destruction of the property if such money is not used to rebuild the property.

Alternative 3

If it is undisputed that Roberto purchased half of the painting for himself and half of it as the mandatary on behalf of Simon, then the latter can ratify the purchase (see Alternative 1). It can then be argued that the purchase was made in joint names and that the painting is in joint ownership. If Roberto becomes insolvent, then Simon is entitled to half of the painting (or its value) as the joint owner, i.e. with preference over Roberto's creditors. He can also claim additional damages for the loss that resulted from the drop in the market value of the painting. The claim for damages will be without priority. Even the claim as joint owner for half the value of the painting will be difficult to make, taking into account art. 2279 BCC, which protects third parties in good faith (see Alternative 1). Since the painting is in Roberto's possession, third parties in good faith may consider this painting to be his property. The burden of proof of Roberto's joint ownership rests with Simon.

If Roberto bought the painting in his own name, simply using Simon's money, then Simon is not a joint owner. The painting is considered to be the property of Roberto and thus Simon is left with a personal claim for the money that was used. It seems that there is no legal basis, in this situation, to argue that Simon can be the owner of the painting by way of real subrogation, transferring his rights on the money to the painting.

Alternative 4

Simon can terminate the mandate (see Alternative 1), but he cannot claim the land. Simon has no connection with the land. Roberto bought the land in his own name and paid for it with his own money from the

[10] *Moniteur Belge* 20 August 1992.

loan facility. Simon's money was only used to pay back the loan. There can be no application of any real subrogation in Simon's favour.

If Simon gave the money as a loan to Roberto to allow him to pay the bank, and if Simon's loan is secured by a mortgage on the land, then Simon may seize the land in execution of his preferential mortgage right. Regardless of the mortgage, Simon can obviously seize the land if Roberto does not pay him back voluntarily, as an execution creditor.

Simon could also invoke personal subrogation to the rights of the bank, in application of art. 1251 para. 1 BCC. If the bank has a privilege or mortgage on the land securing the loan, then Simon can argue that the bank payment made with his money qualifies as his payment, as creditor of Roberto, to another secured creditor. This allows Simon to take over the position and securities of the discharged creditor. However, pursuant to art. 5 of the Mortgage Act, Simon can only claim this position towards third parties if the subrogation was registered in the margin of the land register.[11]

Denmark

Alternative 1

The question states that Roberto purchased the painting without Simon's authority. It follows that under the individual management services contract, either Roberto shall consult Simon before each transaction under the agreement, or Roberto may only use the money in Simon's account for specified purposes, which do not include the purchase of a painting.

Whether or not Roberto's behaviour constitutes a breach of agreement entitling Simon to terminate the relationship depends on the provisions of the agreement. In the absence of express provisions on breach, the fact that Roberto acted without authority is most probably going to lead a Danish judge to the conclusion that there is a material breach of agreement even if the investment is successful (future transactions carried out without authority may not prove to be so successful), and that Simon can therefore terminate the relationship *ex nunc*.

However, under Danish law, the fact that Roberto acted without authority does not imply that the purchase of the painting is an invalid transaction (as is the case, for instance, with fraudulent transactions)

[11] See A. Verbeke, *Vrijwillige zuivering niet absoluut risicoloos* (Notarius, 1996), 350–355. E.g. Commercial Tribunal of Ghent, 28 November 2000, *Bank en Financieel Recht* 2001, 188.

and that Simon must be entitled to take the painting. The fact that the painting is worth more than the money invested by Simon is not relevant, since the very purpose of the agreement was to make his investment grow. In principle, Roberto should also be remunerated for services rendered until the time of termination of the agreement.

Provided that Simon's money is actually kept separate in his account, and provided that this money is undisputedly used to purchase the painting, Simon can recover the painting even if Roberto becomes insolvent at the time of recovery.

Alternative 2

The assumptions made in Alternative 1, namely that Simon's money is actually kept separate in his account and that this money is undisputedly used to purchase the painting, hold here as well. As a result, Simon is able to recover the compensation paid by the insurance company from Roberto's estate as a substitute for the painting. Since the insolvency of Roberto most probably implies that the relationship is terminated, it is not necessary for Simon to terminate the agreement expressly on the grounds of Roberto's breach of agreement through the purchase of the painting.

Alternative 3

Again, the assumptions made in Alternative 1 hold here. As a result, Simon can recover the painting from Roberto's estate, provided that he pays the estate half of what the painting is worth at the time of recovery, that is, €500.

Alternative 4

Since Roberto's actions clearly constitute a breach of agreement and since Roberto becomes insolvent, Simon can terminate the relationship and claim back his money from the estate. However, since his money was not used to purchase the piece of land, Simon cannot claim the land from the estate.

England

Alternative 1

The money was trust property. Under English law, it follows that the traceable proceeds are also trust property, if the trust beneficiary so elects. This is so whether or not the trustee's purchase was authorised.[12] Simon may claim the painting as his own. If the trust were not a bare trust, entitling Simon to demand the trust property at any time, then he would have been able to claim the painting as trust property while at the same time seeking the appointment of a new trustee.

Within the principles of the law of agency, English law recognises the possibility of ratification of an unauthorised act, with the retroactive effect of conferring authority. However, a transaction cannot be ratified unless the agent, when entering into it, acted expressly on behalf of the principal.[13]

Alternative 2

It appears that indemnity insurance is treated as a traceable product, just as in the case of the sale of property. This is the position held in the United States and Canada,[14] although in England this position has been doubted.[15] In any event, Simon has a personal claim against Roberto for breach of trust.

Alternative 3

Simon may claim that the painting is trust property, to the extent of his contribution. This would mean that Roberto holds the painting in trust, such that one half of the painting is his and the other half is held for Simon. On this approach, Simon must bear his share of the fall in the market value and he would obtain trust property worth €500 (a 50 per cent interest in the painting). His personal claim against Roberto for breach of trust would permit recovery of the rest, but without any priority.

A better solution for Simon is to claim an equitable charge over the painting to secure his claim for breach of trust for the full amount of €1,000. An equitable charge is a real security interest that does not require possession of the charged property by the creditor. It may arise by operation of law, in which case no registration of the charge is required. In a case like this, Simon can claim that the whole painting is charged with the repayment of the breach of trust claim. The effect is that he has a secured claim for the full amount of his loss. In a case of

[12] *Foskett* v. *McKeown* [2001] 1 AC 102, [2000] 2 WLR 1299 (HL).

[13] *Keighley, Maxsted & Co.* v. *Durant* [1901] AC 240 (HL).

[14] *Beamer* v. *Beamer* 479 A.2d 485 (1984); *Busse* v. *Edmonton Grain & Hay Co.* [1932] 1 DLR 744 (Alberta CA).

[15] *Ellerman Lines Ltd* v. *Lancaster Maritime Co.* [1980] 2 Lloyd's Rep. 497.

misapplied trust property, the beneficiary may freely elect between saying that the traceable proceeds are held in trust, or saying that they are held subject to an equitable charge to secure a claim for breach of trust.[16]

Alternative 4

It is unclear whether the land is considered a traceable product in this case. It has been argued academically that it should,[17] but judicial opinion has been divided.[18] The academic argument is that although Roberto owned the money with which he purchased the land, because borrowed money belongs to the borrower, he then repaid the loan with misappropriated money. In an economic sense, therefore, the ultimate source of the purchase price for the land was the misappropriated money.

If, contrary to the facts given, the bank had a security interest in the land to secure the line of credit, then Simon could claim to be subrogated to that security interest.[19] This claim does not depend on proving that the asset in question was acquired with the plaintiff's money; i.e., this argument would work even if Roberto had dissipated all of the money borrowed from the bank, rather than using it to buy the land.[20] Also, this claim is available even in a case where the previous security interest has been formally discharged.[21]

Finland

Alternative 1

The rules concerning tracing are uncertain in Finnish law. If it is clear that Roberto was using Simon's money for a purpose that was outside the scope of the investment agreement, and that Roberto did not mean to buy the painting on Simon's account, then it is most likely that Simon

[16] *Foskett* v. *McKeown* [2001] 1 AC 102, [2000] 2 WLR 1299 (HL), *per* Lord Millett.

[17] L. D. Smith, 'Tracing into the Payment of a Debt' [1995] CLJ 290–305.

[18] Doubts were expressed in *Bishopsgate Investment Management Ltd* v. *Homan* [1995] Ch. 211 (CA). The judges in *Foskett* v. *McKeown* [1998] Ch. 265 (CA) expressed differing views. An appeal to the House of Lords was allowed ([2001] 1 AC 102, [2000] 2 WLR 1299), but it did not settle this matter.

[19] See, for example, *Boscawen* v. *Bajwa* [1996] 1 WLR 328 (CA).

[20] In civilian terms, this is personal subrogation, not real subrogation.

[21] As in *Boscawen*. It would not be available to a plaintiff who had simply made an unsecured loan and later discovered it was used to discharge a secured loan. See generally C. Mitchell, *The Law of Subrogation* (Oxford: Clarendon Press, 1994).

cannot get the painting. He is only entitled to terminate the investment mandate and claim damages. The result can be different if Roberto operated within the general scope of the investment agreement, with the aim to fulfil his liabilities, but exceeded his authority in some detail. Under those circumstances, Simon could probably choose to claim the painting. Simon can, in other words, ratify the acquisition, irrespective of Roberto's intervening insolvency.

The cases between these two extreme alternatives are especially uncertain. If the acquisition of the painting was clearly outside the scope of the investment agreement, but Roberto bought the painting intending to acquire it for Simon's account, then most likely Simon has the right to ratify the acquisition within a reasonable time. It is, however, unlikely that Simon can do this after Roberto becomes insolvent. The ratification is comparable to a new contract of acquisition, which should not give Simon a preferential right in relation to the general creditors. If Roberto was not clearly operating outside the scope of the investment agreement, then it is at least possible to conclude that neither Roberto nor his insolvency administrator can reject Simon's ratification, even though Roberto did not intend to buy the painting for Simon's account.

Alternative 2

Simon's rights depend, in the first place, on whether he can claim the painting itself. If Simon can claim the painting, then he is entitled to the insurance compensation. According to the Insurance Agreement Act of 28 June 1994/543, s. 62, i.e. if not otherwise originally agreed with the insurance company, the owner of the damaged good can normally claim compensation regardless of who contracted with the insurance company. The insolvency of the policyholder does not affect that right of the owner. Simon, however, loses his right to compensation if Roberto received and commingled the money before the beginning of his insolvency procedure. This is possible since the insurance company is entitled to pay the insurance compensation to the policyholder, unless the owner is mentioned in the insurance agreement or she has informed the company of her intention to claim compensation personally.

Alternative 3

It is necessary to consider first the rules discussed in Alternative 1. If Simon can, according to those rules, claim the painting, then he is considered to own half of the painting, while Roberto owns the other half. Then, the painting can be sold in the common interest of Simon and Roberto's creditors. The fall in value affects both of them equally, because both are considered to own half of the painting. Giving Simon sole ownership of the painting at the expense of Roberto's creditors cannot be justified by the wrongdoing of Roberto.

Alternative 4

Simon is not entitled to take the land. As the above answers demonstrate, tracing is, to some extent, acknowledged in Finnish law. The extent of this idea, in the absence of exact legislation and precedents, is unclear in detail; however, the limits seem to be rather narrow. Where the interests of third parties, e.g. creditors, are concerned, the limits are even narrower. In the previous cases, the question of tracing was simple in the sense that the same property directly changed from one form of appearance to another form. In this alternative, Simon's money was not originally used to buy the land in fulfilment of the investment agreement and, in fact, it was not originally used to buy the land at all. Under these circumstances, Simon cannot claim the land.

France

Alternative 1

Roberto bought the painting with Simon's money. The purpose of the acquisition was to invest Simon's money. The question that arises is whether it is possible to replace Simon's claim over the money transferred to Roberto with a claim over what replaced the money, i.e. the painting.

French law has several provisions providing for the substitution of one thing by another, i.e. real subrogation (*subrogation réelle*).[22] It is generally accepted by legal scholars that *subrogation réelle* is allowed in every situation in which the replacement of one thing by another permits the economic value of the first thing to be preserved, e.g. in this particular case the money.[23] French courts tend to extend the

[22] On *subrogation réelle*, see R. Demogue, 'Essai d'une théorie générale de la subrogation réelle', *Rev. crit. lég.* June 1901. 296; H. Capitant, 'Essai sur la subrogation réelle', *RTD civ.* 1919. 385; Lauriol, 'La subrogation réelle', thesis (Alger, 1934); V. Ranouil, *La subrogation réelle en droit civil français* (LGDJ, 1985).

[23] F. Terré and Ph. Simler, *Les biens*, 5th edn (Dalloz, 1998), No. 477: 'La subrogation réelle doit être admise toutes les fois qu'il s'agit de conserver à sa destination la valeur d'un

domain of *subrogation réelle*, interpreting loosely either the provisions of French law or the intentions of the parties.[24] In the present case, however, Roberto acts without authority, and French courts will not be able to hold that it was within the intention of the parties that the money be used to purchase such an asset, which is required for real subrogation. Thus, Simon does not have a right with respect to the painting.[25]

Alternative 2

When insured assets are destroyed, a real subrogation occurs and the insurance indemnity is deemed to replace the destroyed assets.[26] The same rationale that was developed under Alternative 1 applies here. In light of the fact that Simon is not entitled to claim the asset, he will also not be allowed to claim the insurance indemnity.

Alternative 3

In light of the fact that the painting was bought with both Roberto and Simon's money, Simon should not be able to argue that his money was replaced by the painting as a whole, since the value of each investment in the painting is taken into account at the time of the acquisition. Moreover, Roberto acted without authority and, as such, it will be difficult for Simon to demonstrate that the intention of the parties was that a real subrogation occur.[27] Therefore, Simon is not entitled to take the painting. However, Simon can always sue Roberto for payment of his investment. Once Simon obtains a judgment ordering Roberto to pay him the investment

bien soumis à affectation spéciale; le bien est alors envisagé plutôt dans sa valeur pécuniaire que dans son individualité matérielle, cette valeur premettant d'atteindre un certain but.' See also J. Carbonnier, *Les biens*, 16th edn (PUF, 1995), No. 25: 'Si l'argent du créancier a été employé à acquérir une valeur réelle, il serait rationnel et juste de reconnaître à un créancier un privliège de droit monétaire sur la valeur acquise. La subrogation réelle pourrait servir de base technique à la solution (. . .) ; la fonction de protection qu'elle exerce contre le risque d'insolvabilité serait étendue au risque monétaire.'

[24] Req. 5 January 1891, *S*. 1891. 1. 102; and Dijon 30 June 1894, *S*. 1894. 2. 185.

[25] See Terré and Simler, *Les biens*: 'Si le rapport juridique a pour objet un ou plusieurs biens déterminés, en cas de perte ou de vente du bien, le remplacement de celui-ci dans le rapport par un autre bien (le prix, une indemnité par exemple), c'est-à-dire la subrogation réelle, ne se produit que si un texte de loi l'a ordonné, ce qui laisse quand même à la volonté individuelle la possibilité de prévoir la subrogation, dès lors qu'elle ne présente pas un caractère illicite.'

[26] Com. 1 October 1989, *D*. 1986. 246, comment Cabrillac.

[27] See the discussion under Alternative 1 above.

debt, Simon can seize the asset in execution, unless he is paid by Roberto.

Alternative 4

Simon does not have a right to the land purchased by Roberto with Roberto's money. Simon does not have a right *in rem* permitting him to go after or trace the land (*droit de suite*). Simon may not avail himself of a real subrogation on the land: (a) Simon's money was not used to buy the land; a mere indirect effect is not sufficient to give rise to a right for Simon on the land itself; and (b) there was no intention of the parties to create a real subrogation, nor do any specific provisions of French law provide for real subrogation in that respect.[28] Roberto's action is a possible basis for Simon to request termination of their relationship. French courts do grant such termination, notwithstanding Roberto's insolvency.[29]

Germany

Alternative 1

Simon's right to terminate depends on the agreement and, if all else fails, on § 626 BGB (see Case 1, Alternative 1). His claim over the painting is based on § 667 BGB and it does not depend on whether Roberto had the authority to purchase the painting. According to § 687 para. 2 BGB, the mere fact that money in Simon's account was used indicates that the purchase should be seen as made on Simon's account.[30] Since Roberto is assumed to be solvent in Alternative 1, a question of priority does not arise.

Alternative 2

If it is supposed that the insurance contract is in Roberto's name but is paid out of money administered for Simon, then there is no doubt that Simon has the right to have transferred to him the claim against the insurance company (§ 667 BGB). It is not clear whether Simon is given priority over Roberto's general creditors. The fact pattern is such that the assets administered for Simon are kept separate (Case 5, Option a). Under the relevant case law, the principle of immediacy is nevertheless invoked (see introduction to the answer to Case 4). This means that Simon is denied priority with

[28] See discussion under Alternative 1 above.

[29] See F. Pérochon and R. Bonhomme, *Entreprises en difficultés, instruments de crédit et de paiement*, 3rd edn (LGDJ, 1997) No. 185.

[30] See above Case 3, Alternative 2; and BGH JZ 1980, 141 for sale of assets belonging to the principal.

respect to claims which Roberto holds for him.[31] The prevailing view in the literature is that claims for damages that represent an asset should be treated like the asset itself, if they are kept separate in the same way. Even under this rule, a positive outcome for Simon is doubtful in this case. The asset itself was bought by Roberto and did not come from Simon directly; therefore, according to numerous authors (and the case law), Simon is denied priority on the claim for the asset itself, before it was destroyed (see introduction to Case 4). The same holds true for the damage claim.

Alternative 3

Since Roberto bought the painting without authority he is surely liable to Simon for damages for breach of contract. If Simon is interested in the painting, then the only possible claim he can make under § 667 BGB is the transfer of a 50 per cent share in the ownership of the painting. This is considered to be a personal remedy. Even if Simon's money and the painting are kept separate, the problems raised by the principle of immediacy are as explained in Alternative 2 and in the introduction to Case 4. The solution is disputed.

Alternative 4

Simon is most likely not able to make the claim for the land. Roberto bought the land using his own money, and therefore it cannot be argued that he acquired the land, as § 667 BGB provides, 'in the course of conducting [his client's] business'. It would take a very ingenious court to hold that the needed link can be established at some later point in time by Roberto's decision to use Simon's money to repay the debt incurred to finance the acquisition of the land.

Greece

Alternative 1

Tracing is not generally allowed under Greek law unless a specific statutory provision explicitly recognises it with respect to a specific legal relationship.[32] The question whether Simon can take the

[31] In this sense, RGZ 94, 20 (21–25) and 305 (308); the question was left open in BGHZ 36, 329 (333).

[32] See Dimakou, in Georgiadis–Stathopoulos, § 947, no. 39. A. Georgiadis, *Property Law* (1991), I, 476; Doris, in Georgiadis–Stathopoulos, § 211; Simantiras, *General Principles of Civil Law*, 941; Papantoniou, *General Principles of Civil Law*, 204; Deliyannis, EEN, 1955, 908 ff.; AP 58/1975, NoB 23/1975.

painting should be answered under the legal framework governing representation (s. 211 CC). If Roberto acquired the painting in a personal capacity, then he became the owner of the painting, even if it was acquired with Simon's money. In such a case Simon can only claim his money back.

On the other hand, if Roberto bought the painting as a representative of Simon, the latter became the owner of the painting, since the contract concluded in his name produces an immediate effect for his benefit (s. 211 CC). As for the lack of Roberto's authority to buy the painting, s. 229 CC provides that the validity of a contract concluded in the name of another without any power to represent, depends on its subsequent approval by the represented person. Therefore, Simon can become the owner of the painting, provided that he grants subsequent approval of the contract concluded in his name. In such a case, Simon can claim the painting according to s. 1094 CC (acknowledgement of the ownership and restitution of the thing). Nevertheless, it can only be presumed that Roberto was acting as a direct representative of Simon if Roberto stated to the other contracting party that the contract is concluded in the name of Simon, or if it can be deduced from the circumstances that the contract was concluded in Simon's name (s. 211 CC *in fine*). In order to avoid misunderstandings, the Greek Civil Code contains a rule of interpretation stating that, if it is not possible to ascertain that a person acted in the name of another, it shall be considered that this person acted in his own name (s. 212 CC).

Alternative 2

See Alternative 1 for a more complete discussion. If Simon is the owner of the painting, then he can claim the insurance indemnity. If not, then the insurance claim belongs to the owner of the painting, i.e. Roberto. If Roberto became insolvent, then the insurance claim is subject to Roberto's creditors.

Alternative 3

See Alternative 1 for a more complete discussion. The ownership of the painting does not depend on who owned the money used to pay for the painting, but rather on whether Roberto acted as the direct representative of Simon, according to ss. 211 CC ff.

Alternative 4

See Alternative 1 for a more complete discussion. There is no doubt that Roberto did not act as a representative of Simon. Simon does not have any right over the land.

Ireland

Whether Simon can claim the €1,000 in the various alternatives depends on whether he can trace it in each case. Orthodox analyses of tracing are not entirely straightforward,[33] but it is now tolerably clear that tracing is a two-stage process by which Simon must first identify the €1,000 or its exchange product in Roberto's hands, and then make his claim to it.[34] The leading case is *Shanahan's Stamp Auctions* v. *Farrelly*.[35] Investors in a stamp investment scheme were to be grouped into syndicates to which blocks of stamps would be allocated, and when those stamps were auctioned, the investors would receive the proceeds of sale. The scheme was bogus; on its insolvency, Budd J held that the investors who had been grouped into syndicates had proprietary claims to those stamps allocated to them by the company, and that the investors who had not been grouped into syndicates could trace their money into and claim the unallocated stamps. More recently, in *In re Money Markets International*,[36] a customer instructed a stockbroker to purchase shares, and lodged the purchase money into the stockbroker's account in advance. Before the share purchase could be completed, the stockbroker was suspended from the Stock Exchange, and Laffoy J held that the customer could trace his purchase money into the stockbroker's account and claim it in full, notwithstanding subsequent dealings with the account before the stockbroker's suspension.

Alternative 1

Simon should be able trace his €1,000 into the painting and claim it.[37]

[33] See e.g. Delany, *Equity and the Law of Trusts in Ireland*, 2nd edn (Dublin: Round Hall Sweet & Maxwell, 2000), ch. 18; Keane, *Equity and the Law of Trusts in the Republic of Ireland* (London: Butterworths, 1988), ch. 20.

[34] See e.g. *Foskett* v. *McKeown* [2001] 1 AC 102 (HL) *per* Lord Millett; see generally Smith, *The Law of Tracing* (Oxford: Oxford University Press, 1997).

[35] [1962] IR 386 (HC; Budd J); see O'Dell, 'Tracing' (1999) 21 DULJ (ns) 131, 138, 142–144, 162, 167–168.

[36] [1999] 4 IR 267 (HC; Laffoy J); see O'Dell, 'The Use and Abuse of *Clayton's Case*' (2000) 22 DULJ (ns) 161.

[37] *Shanahan's Stamp Auctions* v. *Farrelly* [1962] IR 386, 428 *per* Budd J.

Alternative 2

Simon should be able trace his €1,000 into the painting and then into the chose in action (intangible claim) represented by the insurance claim.[38]

Alternative 3

If a person in a fiduciary position such as that which Roberto occupies with respect to Simon 'makes a purchase with mixed funds of his own and of the beneficiary [such as Simon here], the beneficiary is entitled to a charge to the extent of the trust money laid out in the purchase'.[39] Hence, Simon will have a charge on the picture to the value of €1,000.

Alternative 4

Although, as a matter of principle, the land should count as the traceable product of Simon's money, as the law now stands, Simon would probably not be able to trace through the overdraft and claim the land.[40]

Italy

Alternative 1

Simon is entitled to take the painting provided that he ratifies the unauthorised act (arts. 1711, 2032 CC).[41] If Simon ratifies the purchase of the painting, Roberto has to return the painting to him in accordance with the rules applicable to mandate, which allocate the property in the painting to Simon (see art. 1706 CC). Termination of the contract of mandate is possible despite ratification of the transaction because the acts accomplished by Roberto are a major violation of the contractual obligations under the contract of mandate.

[38] There seems to be no Irish authority on the point, and there is little guidance to be had from divided authorities elsewhere in the common law world. It is, however, unlikely that any rule which denies that the proceeds of the insurance claim are the traceable proceeds of Simon's 1,000 could survive the approach taken by Lord Millett in *Foskett* v. *McKeown* [2001] 1 AC 102 (HL).

[39] *Shanahan's Stamp Auctions* v. *Farrelly* [1962] IR 386, 428 *per* Budd J.

[40] *In re Ulster Land, Building and Investment Co., ex parte Fitzsimon* (1889–1890) 25 LR Ir 24 (Chatterton VC); *Carroll Group Distributors Ltd* v. *G. and J. F. Bourke Ltd* [1990] 1 IR 481 (HC) 486–487 *per* Murphy J; *PMPS* v. *PMPA* (HC, unreported, 27 June 1994, Murphy J).

[41] We assume at this stage that Roberto is still solvent. On the ratification of unauthorised acts: Santagata, *Del mandato. Art. 1710–1712* (1998), 107 ff.

Alternative 2

If Simon proves that Roberto used his money to purchase the painting (i.e. upon evidence of book entries), he is entitled to take the insurance claim after ratification of the transaction (cf. arts. 1711, 2032 CC). He can do so pursuant to art. 1705.2 CC: 'the mandator can, by substituting himself for the mandatary, exercise claims arising from the performance of the mandate ... '. This provision is enforceable even in the case of insolvency of the mandatary, provided that the mandate has a 'certain date' (*data certa*, an officially certified date) prior to the executing creditor's action, or prior to the declaration of insolvency, pursuant to the Italian bankruptcy law (see art. 1707 CC).[42] The fact that Roberto is insolvent poses a problem, however. In our case, ratification occurs after Roberto's insolvency. Though ratification operates with retroactive effect, the 'certain date' requirement of art. 1707 CC in our case is not met. This means that Simon's right to the claim ranks pari passu with other claims against the insolvent.

Alternatively, Simon could claim the insurance money without having to share it with other creditors if he established that the insurance claim is owed to him *ex lege* (cf. art. 2038 CC); or, on the basis of the original contract of mandate, documented by a writing bearing a certain date prior to insolvency (art. 1707 CC), on the basis that while the use of Simon's money to purchase the painting was unauthorised, nonetheless the purchase of the painting was itself within the powers conferred to Roberto. It does not appear, however, that these alternative solutions are available in practice.

Alternative 3

Simon has a claim for restitution of the €1,000 that Roberto used to buy the painting (art. 2041 CC). This is a personal claim. Therefore, it ranks pari passu with Roberto's other unsecured creditors' claims. On the basis of the reasoning mentioned above, under Alternative 1, Simon is entitled to take the painting. Since the painting was purchased with Simon's and Roberto's money, it is arguable that the painting is co-owned by them. Alternatively, one could hold that the painting belongs to Simon and that Roberto has a restitionary claim againt Simon for €1,000 (cf. art. 2042 CC). However, the fact that Roberto is

[42] For commentary: Santagata, *Del mandato*, 466 ff.; Luminoso, *Il mandato, la commissione, la spedizione*, 236 ff.; Jaeger, *La separazione del patrimonio fiduciario nel fallimento* (1968), 361 ff.

insolvent poses a problem, because the right to the painting can be asserted as a property right vis-à-vis Roberto's creditors only if the formal requirements set out in art. 1707 CC (certain date) are met. As mentioned above, under Alternative 2, lack of compliance with those requirements probably means that Simon's claim to the painting comes in pari passu with other creditors' rights.

Alternative 4

Simon is not entitled to obtain the land. He has a personal claim to the money that Roberto used to pay his debt to bank, but there is no relevant link between that payment and the acquisition of the land.

Luxembourg

Alternative 1

Roberto SA and Simon are assumed to have organised their relationship as a contract of mandate, subject to certain restrictions. Simon is entitled to terminate the relationship at any time, as explained under Case 1. In Alternative 1, the breach of the investment instructions is a good cause for termination. Upon termination, the mandatary must account to the mandator for all his actions, including the actions he carried out outside the realm of his authority. Simon is free to take the painting by ratifying the underlying transaction, as the mandator can do at any time. Alternatively, he can reclaim the money and ask for the transaction to be set aside, since it was carried out without authority. The fact that Roberto SA acted without authority does not affect Simon's right to claim the painting that was paid for with his money, if he ratifies the transaction. However, taking the painting, even in the absence of an express ratification, will be considered a tacit ratification and Simon will be contractually bound vis-à-vis the seller.

The ratification is conditional on the transaction being carried out on behalf of Simon, even if it is done without proper authority or in breach of the limits placed on the mandate. In other words, it must be possible to construe the transaction as being done for the benefit of Simon. If this is not the case, he will arguably only have a claim for recovery of the money misused.

Asserting such a claim against third parties, such as a buyer having bought the painting from Roberto SA, would however be difficult. Article 2279 CC establishes a presumption that a holder of a movable asset is the owner thereof. This presumption applies if the possession is without defect, i.e. if it was public, continuous and undisturbed. In that case, a third party acting in good faith (such as a buyer), particularly if he has acquired the painting from Roberto SA in a regular transaction in the normal course of business, will be able to rely on this presumption and fight off any claim for restitution by Simon (*revendication*).

Real subrogation is a theory with very limited application under Luxembourg law, and would most probably not apply here, especially given the fungible nature of the asset (money) which has been misappropriated.

Alternative 2

If Roberto SA insured the painting as Simon's agent, Simon can claim the benefit of the insurance payment. However, Simon is not bound to do so since Roberto SA acted without authority. Simon is entitled to terminate the relationship, and he can either reclaim the sums used for the acquisition of the painting by setting aside the unauthorised transaction, or he can claim the insurance payment, which will replace the painting by application of the concept of real subrogation (*subrogation réelle*). In case of Roberto SA's insolvency, this right should normally even allow payment in priority to other creditors, as neither the original asset (the painting) nor the subrogated asset have been the property of Roberto SA. If the insurance claim is discharged by a payment to Roberto SA, then Simon can only claim as a general creditor of Roberto SA, since the funds are commingled with Roberto SA's own funds. If Roberto SA is an investment manager regulated under the 1993 Law, then it is arguable that art. 36bis of that law applies, which should allow Simon to take the sums, because they would have to be accounted for separately.

As in Alternative 1, if Simon is not entitled to ratify the transaction, he will not be able to establish any right to the insurance claim.

Alternative 3

If Simon is entitled to ratify the transaction, then he will be a joint owner of the painting with Roberto SA. It will, however, be difficult to assert such a claim in practice. In principle, he should be entitled to claim 50 per cent of the sale price realised by the forced sale of the painting in the framework of the insolvency proceedings. In addition, he can make a claim for the €500 which was lost in the transaction; however, he will be treated as a general unsecured creditor in this regard. If Simon does not ratify the payment, then he has a claim for restitution of the €1,000 used by Roberto SA without authority; however, he will be treated as a general creditor in this regard as well. Alternatively, Simon may also try to claim the purchase price from the seller if he can show that the seller was aware, or should have been aware, of the lack of authority; he will then claim that the transaction can be set aside.

Alternative 4

Simon is not entitled to take the land in these circumstances. *Subrogation réelle* only applies in limited circumstances. He is left with a claim against Roberto SA who acted without authority and misappropriated the funds of the mandator.

Netherlands

Alternative 1

The possibility for a securities institution or a credit institution to use a client's money to buy a painting, which is obviously outside the power of attorney of the institution, is very remote. In practice, this will not happen. For the answers below, the facts of Case 6 should be changed such that Simon transferred money to a bank account of Roberto, with the explicit mandate that it should be invested in immovable property. In such a case, if Roberto buys a painting with the money, then the questions below are relevant.

Art. 110 Book 3 CC is applicable

If the manager is acting on behalf of Simon, the client, then the painting falls into Simon's patrimony without ever entering the patrimony of the manager, as a result of art. 110 Book 3 CC (direct acquisition of ownership by the mandator: see Case 1 under the section titled *The contract of mandate*). However, this direct acquisition of ownership will only take place if the mandatary 'implements the relationship' between the mandator and the mandatary. It is the mandator's responsibility to prove this, but it is not clear where to draw the line between actions that implement the relationship between the mandator and mandatary and actions that do not. The subjective intention of the mandatary is irrelevant. The fact that the mandatary used the money without authority can be a sign that the mandatary did not implement the relationship he has with the mandator. In such a case, property will not pass directly to the mandatary; rather, ownership will remain with the mandatary.

Another question that arises is how to terminate the relationship. It is a contract of mandate, and therefore Simon can terminate it at any time (see Case 1 under the sections titled *The contract of mandate* and *Investment in financial instruments; point a: termination*). If the manager is guilty of breach of contract, then the client can ask for (partial) rescission and damages (arts. 265 and 277, 278 Book 6 CC). As a result of rescission, the parties are freed from their obligations to the extent that they have not yet been fulfilled (art. 271 Book 6, first sentence). If the obligations have (partly) been fulfilled, then they must be undone (art. 271 Book 6, second sentence); if this is not possible, then the value of the performance must be repaid (art. 272 Book 6).

If the painting belongs to Simon as a result of art. 110 Book 3 CC, then since the painting increased in value, the only plausible damage is the damage caused by the rescission of the contract (time needed to look for another manager, missing market opportunities in that period, etc.).[43]

The insolvency of Roberto is not relevant to the ownership of the painting. Upon acquisition by Roberto, ownership passed to Simon without going through the patrimony of Roberto. The claim for damages does not have a preference in insolvency proceedings, and thus it is not likely that the claim will succeed.

Art. 110 Book 3 CC is not applicable

If art. 110 Book 3 CC (see Case 1 under the section titled *The contract of mandate*) is not applicable, then the painting falls into the patrimony of Roberto, the manager. In such a case, the same possibilities are available for terminating the contract as described in the previous section. The amount of damages will be equal to the difference between the value of the client's rights had the manager properly fulfilled his duties, and the value of the client's rights after rescission of the contract (art. 277 Book 3 CC). Thus, the profit that Roberto could have made if he had invested the €1,000 properly must be established.

[43] Mr C. Asser's handleiding tot de beoefening van het Nederlands burgerlijk recht, *Verbintenissenrecht*, deel 4-I, *De verbintenis in het algemeen*, A. S. Hartkamp (Zwolle: W. E. J. Tjeenk Willink, 2004), (Asser/Hartkamp 4-I 2004), nos. 409–423. Some ancillary costs, such as those of legal actions, can be awarded too. In the Netherlands, the amount of damages will be decided objectively, by calculating what would be the damage for a creditor in a similar position to the actual creditor. See R. Zwitser, 'Eén plus één is billijkheidshalve soms drie', *Nederlands Juristenblad* 1999/44 (10 December 1999), 2058–2063.

This sum, together with the original €1,000, must be paid as damages (apart from the damages for rescission of the contract: see the previous section). The client can ask the court for damages *in natura* instead of damages in money (art. 103 Book 6 CC). The court has the discretionary power to grant this form of damages. In such a case, the client can probably ask for the painting as a means of awarding damages. This is certainly possible if the client, Simon, also makes a claim in unjust enrichment (art. 212 Book 6 CC).[44]

If Roberto is insolvent, then the decision of the court to award money damages or damages *in natura* makes little difference. Either way, it is very unlikely that Simon will receive anything, since practice indicates that unsecured creditors are usually left empty-handed.

Alternative 2

As for the rescission of the contract, the result is the same as in Alternative 1, although as a result of the insolvency an award of damages will be of little use. Such a claim is not given any preference in the case of insolvency, and normally there is not much left for unsecured creditors.

Art. 110 Book 3 CC is applicable

If art. 110 Book 3 CC applies (see Case 1 under the section titled *The contract of mandate*), then the mandator is the legal owner of the painting from the moment the painting is delivered to the mandatary. With the exception of some special contracts such as usufruct (art. 213 sub 1 Book 3 CC), mortgage (hypothec) and pledge (art. 229 Book 3 CC), Dutch law has not yet dealt with the question of whether, in such circumstances, the mandator also has the right to the insurance claim. It is probable that some help can be derived from art. 420 Book 7 CC. This article grants the mandator the right to take over a claim against a third person in the case where the mandatary acts in breach of contract or where the mandatary falls into bankruptcy. The latter situation occurs in Alternative 2, and thus it is likely that the client, Simon, can ask the insurance company to pay him directly.

Art. 110 Book 3 CC is not applicable

Here it is assumed that art. 110 Book 3 CC does not apply because the mandatary acted without authority, although this is not easy to prove.

[44] Asser/Hartkamp 4-I 2004, nos. 410 and 411.

Usually, art. 110 Book 3 CC has a broad scope. Also, the fact that Roberto acted without authority is not *per se* a reason to exclude the effect of art. 110 Book 3. Assuming that art. 110 Book 3 does not work here because the parties excluded it and the mandator did not ratify the act of the mandatary,[45] then upon delivery the painting is the property of the mandatary. The insurance claim belongs to the mandatary as well. Simon, the mandator, can only claim damages for breach of contract. Art. 420 Book 7 may be helpful (see the previous section).

Alternative 3

Art. 110 Book 3 CC is applicable

The rule in art. 110 Book 3 applies regardless of the fact that Roberto used his own money as well. According to Dutch law, it does not matter where the money comes from if art. 110 Book 3 is applicable. The answer to the question of termination is the same as in Alternative 1. Rescission of the contract is possible. There are no damages except for those that are a result of rescission of the contract. The painting is Simon's as a consequence of art. 110 Book 3 CC.

Art. 110 Book 3 CC is not applicable

The client, Simon, has the right to damages resulting from rescission of the contract. See Alternative 1, under the section titled *Art. 110 Book 3 CC is not applicable*. This claim can be made in money or *in natura*, but either way, the claims do not have any form of preference in the insolvency of Roberto.

Alternative 4

Art. 110 Book 3 CC is not applicable since this case concerns a registered immovable, and since the sale was not made while implementing the contract between Roberto and Simon. Simon can terminate the relationship as a result of breach of contract (see Alternative 1). He can be awarded damages in the form of money or he can be awarded the land (see Alternative 1, under the section titled *Art. 110 Book 3 CC is not applicable*). However, these court decisions are not of much use since these claims do not carry any form of preference or priority.

[45] In the case of ratification, art. 110 would apply, if it was not excluded by agreement.

Portugal

Alternative 1

Portuguese law goes beyond Directive 93/22/EEC. The professional management of 'other assets' besides transferable securities (Banking Act, art. 4.i and j) is included in the area reserved to management companies, which is regulated by the Banking Act and the Management Companies Act. This enlarges considerably the area of application of the Management Companies Act. In accordance with art. 1.3 of this Act, Roberto SA must have a written mandate granted by Simon, stating the terms, conditions and degree of freedom of management.

Simon may terminate his relationship with Roberto whenever he wishes; however, if he does so before due time and without just cause (*justa causa*), he may have to pay compensation to Roberto SA, depending on the terms and conditions of the mandate and on the circumstances of the case at hand.

The origin of the money is irrelevant as far as ownership of the painting is concerned. This depends on the powers of the buyer, and on whose account the purchase was made. It is important to know whether the painting was bought for Simon or for someone else. If the purchase of the painting was made for the account of Simon, although contrary to the written terms of the mandate, and if the mandate includes representation, Simon is entitled to ratify Roberto SA's management if he so wishes (although he is not obliged to do so). This would allow him to claim restitution of the painting as his own property. If the mandate granted to Roberto SA is without representation and the painting was bought in the name of Roberto SA but for the account of Simon, Simon is entitled to demand that ownership of the painting be transferred to him and that the painting be handed over to him (art. 1181 CC). If the painting was *not* bought for Simon, but for Roberto SA or for a third person, Simon will have no right in the painting. He will have a claim for €1,000 (plus interest).

Alternative 2

Should the painting be destroyed in the meantime, Simon may choose between (a) not ratifying the purchase and demanding restitution of the funds (€1,000), or (b) ratifying the purchase and demanding compensation for its value from Roberto SA and/or the insurance company. As the destruction of the painting makes its restitution impossible, Simon might claim its insured value, in accordance with art. 794 CC.

The bankruptcy of Roberto SA raises an additional complication. Since it is a financial society, the insolvency of Roberto SA is not governed by the general provisions of the Bankruptcy Act (*CPEREF* – *Código dos Processo especiais de Recuperação da Empresa e da Falência*, Decree-Law 132/93 of 23 April), but by the special provisions of the Banking Act (arts. 139–153 and 198) concerning recovery (*saneamento e recuperação*), under the supervision of the Central Bank. Nevertheless, the general rules of the Bankruptcy Act apply where not contradicted by the special ones of the Banking Act. In accordance with art. 167.2 of the Bankruptcy Act, mandates, either with or without representation, are automatically terminated as a consequence of the judicial declaration of bankruptcy.

If the mandate granted by Simon to Roberto SA is with representation, Simon may ratify his management, by unilateral notice, and as a consequence of this ratification he will be entitled to the painting or, this being destroyed, to the insurance claim (art. 794 CC). In the case of mandate without representation, assets or rights acquired by Roberto SA as agent, which should be transferred to the principal, are exempt from the claims of creditors of the agent (art. 1184 CC). Therefore the bankruptcy of Roberto SA, although increasing the complexity of the case, does not affect Simon.

Alternative 3

The first question is whether Roberto SA, in buying the painting, did so half for his own account and half on Simon's behalf or, alternatively, wholly on Simon's behalf, though using his own funds to make the payment. In either case, Simon is not bound by Roberto SA's act; he can ratify it or not, as he deems fit.

As Roberto SA has become insolvent but not yet bankrupt, Simon may demand restitution of the €1,000, should he choose not to ratify the purchase. If Simon ratifies the purchase and the mandate is with representation, the painting (or half of it, depending on interpretation) belongs to him, and its restitution may be demanded (*rei vindicatio*).

In the case of mandate without representation, the painting belongs to Roberto SA until its ownership is conveyed to Simon. Simon may choose between ratifying the purchase and demanding the transfer of ownership of the painting, and not ratifying and demanding restitution of the funds. The transfer of ownership of the painting may be demanded through a special action of *execução específica* (art. 410 CC) (specific performance).

As Roberto SA is insolvent, he will become bankrupt as a consequence of the judicial proceedings brought by Simon. The court will issue a call to all his creditors, and the proceedings will be converted into bankruptcy proceedings. It is then extremely important to recall that the painting is protected from the claims of other creditors because either the mandate was with representation and it belonged to Simon, or the mandate was without representation and art. 1184 CC expressly exempts it from judicial seizure, provided that the mandate is contained in a document created prior to the date of the execution (see the introduction to the answer to Case 1).

Alternative 4

As Roberto SA is an investment firm and a financial society under the provision of the Banking Act and Management Companies Act (implementing Directive 93/22/EEC), this kind of situation is not very likely to happen. If the case may be interpreted as Roberto SA (a management company) buying an immovable for itself using a credit facility from a bank, and abusively withdrawing money from Simon's account to pay its debt to the bank; and that Simon only knew about this after Roberto SA became insolvent, the Portuguese solution is as follows.

The withdrawal of money from the account of Simon is abusive and illicit and, therefore, void. Article 6.5 of the Management Companies Act states that clients' accounts may only be debited (a) for the payment of the acquisition of securities (or other assets) within the limits of the administration, (b) for the payment of remuneration due by the clients, or (c) for transfer to other accounts of the same client. Simon may sue Roberto SA for recovery of the funds, but may not acquire the immovable. As long as there is no bankruptcy or liquidation proceedings pending against Roberto SA, Simon may file an *arresto* (a preliminary injunction of judicial seizure) against the immovable for the security of his claim (arts. 619–622 CC).

Scotland

The law in this area is by no means free from doubt.

Alternative 1

Roberto might have intended (a) to lend the money to himself, so that the painting was merely something he bought with the help of the loan, or (b) to buy the painting as a trust asset, or (c) to embezzle the money. All three possibilities involve breach of trust.

(a) A trustee is not permitted to lend money to himself (unless the trust provisions expressly permit such a loan).[46] If he does lend money to himself, he is under an obligation to repay the money immediately.[47] He is also under an obligation to pay interest for the period during which he has the money.[48]

If a trustee borrows money from a trust and invests it in a business of which he is a partner, then the rate of interest payable is the higher of (i) ordinary interest or (ii) the actual rate of return achieved by the use of the money.[49] But in such cases there does not seem to be any 'tracing'. If a trustee has bought an asset with the unlawful loan, the asset is, it seems, not deemed to be a trust asset.[50] Nor does the trustee seem to be liable to pay the trust any profit he may have made from the asset that was bought with the unauthorised loan.[51]

(b) If Roberto's intention was to buy the painting as a trust asset, then, on the principle of real subrogation, the thing that was purchased forms part of the trust estate, even though the purchase was contrary to the terms of the trust.[52] If a trustee makes an unauthorised purchase or investment, then the asset or investment ought to be realised, and the proceeds invested in an authorised way.[53] If the realisation achieves a profit, that profit belongs to the trust. If the sale achieves a loss, then the trustee is obliged to make good the loss.[54]

(c) If Roberto was simply embezzling the money, then probably the result is the same as in (b).[55]

Can Simon terminate the relationship? As has been said above,[56] the beneficiaries of a trust can demand that it be wound up. But this is true regardless of whether or not there has been a breach of trust.

[46] *Perston* v. *Perston's Trs* (1863) 1 M 245; Wilson/Duncan, para. 28–18. A trustee who unlawfully contracts with himself is said to be an *auctor in rem suam*.

[47] *Ritchie* v. *Ritchie's Trs* (1888) 15 R 1086.

[48] *Templeton* v. *Burgh of Ayr* 1912 1 SLT 421; Wilson/Duncan, para. 28–23.

[49] *Cochrane* v. *Black* (1855) 17 D 321; Wilson/Duncan, para. 28–23.

[50] *Ritchie* v. *Ritchie's Trs* (1888) 15 R 1086.

[51] But this point might be open to debate.

[52] *Grant* v. *Baillie* (1869) 8 M 77.

[53] *Grant* v. *Baillie* (1869) 8 M 77; *Ritchie* v. *Ritchie's Trs* (1888) 15 R 1086; Wilson/Duncan, para. 28–19.

[54] *Town & Country Bank* v. *Walker* (1904) 12 SLT 411. Wilson/Duncan, para. 28–05.

[55] Authority is lacking.

[56] See Case 1.

Alternative 2

If the painting is a trust asset, then the proceeds from the insurance are payable to Roberto in his capacity as trustee, i.e. they form part of the trust estate. This is because the insurance money is a *surrogatum* for the painting itself.[57] If the painting is not a trust asset, then the proceeds are not a trust asset.

Alternative 3

(a) If the €1,000 was taken as a loan, then the painting is owned by Roberto and not by the trust (see above). Roberto owes the trust €1,000 plus interest. In this case, the painting is irrelevant.

(b) If, however, Roberto bought the painting partly for the trust and partly for himself (which seems unlikely), then the painting is owned, *pro indiviso*, in equal shares both by Roberto and by Roberto in his capacity as a trustee. In such a case the trust owns something worth €500 and a loss results that is equal to €500. Roberto is obliged to compensate the trust for the loss. (But, of course, he is now insolvent.) There does not seem to be any basis for arguing that the trust has any rights in Roberto's share of the painting.

(c) If Roberto embezzled the money then the position is uncertain. It is suggested that the result would be as in (b).[58]

Alternative 4

Roberto wrongfully borrowed €100,000 from the trust and must repay it, with interest. (Of course, he is now insolvent.) The trust has no right to the land.

Spain

Alternative 1

Even if Roberto acts without authority, his conduct is not considered to be wrongful since it clearly benefits Simon (art. 1715 CC). Simon can

[57] *Surrogatum sapit naturum surrogati.*

[58] Cf. *Southern Cross Commodities Property Ltd* v. *Martin* 1991 SLT 83. But that was a case where directors had embezzled from a company, rather than trustees from a trust. The decision is controversial: see G. L. Gretton, 'Constructive Trusts' [1997] Edin. LR 281 and 408.

terminate the relationship when he pleases (arts. 1732 and 1733 CC),[59] and Roberto has to return to Simon anything that he received by virtue of their relationship (art. 1720 CC). Moreover, since Roberto bought the painting with Simon's money, Simon can claim the painting directly. This is based on both arts. 1717[60] and 1720[61] CC. Moreover, the Spanish Supreme Court established that in the case where the mandate is carried out *in nomine proprio* the rights acquired by the mandatary are only acquired by virtue of a provisional title.[62]

Alternative 2

Not only is Simon entitled to take any object purchased with the money transferred to Roberto, but, once the relationship is terminated, he can take over any right that Roberto has by virtue of their relationship (art. 1720 CC). If Roberto is declared insolvent, then Simon can have a preferential claim based on art. 908 of the Code of Commerce, because the amounts paid out by the insurance company relate to an object that clearly belonged to Simon; morevoer, the title Roberto holds is not irrevocable.

Alternative 3

Roberto did not follow Simon's instructions and instead invested the money in an unfavourable way (the painting's price was originally €2,000 and the market value fell to €1,000, which means that Simon's share of €1,000 is reduced to €500). Since this investment is not beneficial to Simon's interests and is not carried out according to Simon's instructions, Roberto's conduct is considered wrongful (arts. 1714 and 1715 CC). When the relationship is terminated, Simon is entitled to claim anything that Roberto received by virtue of their relationship (that is, the painting) (art. 1720 CC). Simon is also entitled to damages, especially since Roberto is a professional manager and the

[59] Spanish law allows irrevocable mandates (see the answer to Case 1), but it is assumed that the parties did not agree on that.

[60] Art. 1717 reads as follows: 'Cuando el mandatario obra en su propio nombre, el mandante no tiene acción contra las personas con quienes el mandatario ha contratado, ni éstas tampoco contra el mandante. En este caso el mandatario es el obligad directament a favor de la persona con quien ha contratado cmo si el asunto fura personal suyo. *Exceptúase el caso de que se trate de cosas del mandante*.'

[61] Art. 1720 establishes that 'todo mandatario está obligado a dar cuenta de sus operaciones y a abonar al mandante cuanto haya recibido en virtud del mandato, *aún cuando lo recibido no se debiera al segundo*'.

[62] For example, STS 22 May 1964, STS 15 May 1983.

Spanish Civil Code compels Spanish courts to take into account whether a mandate is carried out gratuitously, when determining the manager's responsibility (art. 1726 CC).

There is one particular fact that should not be neglected. Since Roberto bought the painting partly with his own money and partly with Simon's money, only 50 per cent of the painting belongs to him. Since the painting is an indivisible object, Simon has to compensate Roberto for €500 (art. 1062 CC). Simon's claim for damages is an unsecured claim and therefore it cannot be argued that a set-off is appropriate.

Alternative 4

In Alternative 4 Roberto used Simon's money for his personal needs. This is considered to be wrongful conduct. Roberto has to pay interest on the amount used, beginning from the day on which it was first taken (art. 1724 CC). Simon is therefore entitled to get back €100,000 plus interest and damages. Simon is, however, not entitled to claim the piece of land that, in fact, was not bought with his money but with the money the bank lent to Roberto.

Sweden

Alternative 1

There is no question that Simon may terminate the relationship without being obliged to compensate Roberto for loss of profit, because Roberto seriously breached the contract by using all the money for a non-authorised investment (see answer to Case 1, Alternative 1). The problem is whether Simon can lay his hands on the increase in value even if he chooses to terminate the mandate.

If Roberto bought the painting in Simon's name, Simon may ratify the purchase and hence be entitled to the purchase of the painting (s. 25 of the Contracts Act). One might ask whether this would prejudice his right to terminate the mandate without compensation to Roberto. I doubt that. The mandate was planned to be a lasting one, and by this transaction Roberto has demonstrated that he does not respect Simon's instructions. Therefore, we are faced with a fundamental anticipatory breach.

If Roberto bought the painting in his own name, Roberto's intention decides whether Roberto became the owner of the painting or Simon became the owner. This is not expressly declared in the relevant section of the Commission Agency Act (s. 53, pursuant to which the mandator immediately becomes the owner when the mandatary buys 'on his behalf'),[63] but it follows more evidently from s. 42. According to this section, a mandatary who buys financial instruments for himself when he had a mandate to buy such instruments for a mandator and later sells the same kind of instruments to the mandator, is obliged to give the mandator the price at which he bought himself, unless he can prove that he bought for some other person (another mandator, or himself). It should especially be noted that – when no other mandator was in action – the mandatary may prove that the first purchase was for himself, and then the mandator who had given a matching mandate does not become the owner at the time of the mandatary's purchase; instead, he becomes the owner when the mandatary sells to the mandator, which must be at the same price as was paid on the first purchase. This, however, is equivalent to a presumption that the purchase is intended to satisfy an existing mandate.[64] Thus, if Roberto cannot prove that he had himself in mind as owner, Simon immediately became the owner of the painting, and consequently the increase in value goes to him. Pursuant to s. 15, the mandator has a right to reject a purchase if the mandatary was negligent and fundamentally damaged the mandator's interest, or acted dishonestly. In this case, he will probably not make use of this right. Still, he ought to be entitled to terminate the lasting mandate because of the unauthorised behaviour (anticipatory breach).

If Roberto can prove that he bought with the intention himself to become the owner, Simon has no ground for a claim of ownership to the painting. He must be satisfied with a personal claim on Roberto to

[63] The purpose of s. 53 is above all to declare that the mandator, by immediately becoming the owner, is protected in relation to the general creditors of the mandatary (as would have been the case if the mandatary had bought in the name of the mandator). There is no 'logical second', in which charges on the mandatary's property in general can attach to goods purchased on the mandator's behalf, even if the mandatary used his own money. But the bankruptcy estate may exercise the mandatary's right to a lien on the goods for compensation of the expenses. Since the mandator has a right to reject (he need not ratify), he seems to be entitled to choose not to reject even if the mandatary has gone bankrupt. This is, among others, a good reason why a mandator should be entitled to ratify a contract made in the mandator's name but outside the authority, even if the mandatary is bankrupt when ratification takes place.

[64] It also follows from NJA 1937, 619 that the intention of the mandatary is decisive. In this Supreme Court case two different mandators each submitted that a bid at an auction was made on their behalf. The case was decided in accordance with the mandatary's intention.

account for the money he used. Swedish law has a very undeveloped concept of unjust enrichment, with only a few scattered sections in different statutes and also very few cases based on a general principle. Thus, it cannot be assumed that the fact that Roberto used Simon's money is a ground for Roberto's being obliged to account for the increase in value. An additional good reason for this assumption is that even if the painting had decreased in value, Roberto would still have been obliged to account for all the money he used.

Alternative 2

Pursuant to s. 54 of the Insurance Agreements Act (*lag om försäkringsavtal*, 1927:77), an insurance against destruction or other damage is presumed to be taken in the interest of an owner, a pledgee, or any other person who bears the risk of the goods. The favoured third party is privileged even if the person who took the insurance goes bankrupt, and it does not matter whether the insurance company was notified or otherwise knew of the third party's interest in the insured goods.[65] If Roberto acted to promote the interest of Simon, although without authority, and Simon either ratifies according to s. 25 of the Contracts Act or does not reject according to s. 15 of the Commission Agency Act – prior to or after bankruptcy has been declared – and thereby becomes or remains the owner (see Alternative 1), the provision would be applicable, and Simon would be able to collect the insurance money. If, on the other hand, Roberto acted with the intention to become the owner of the painting himself, he became the owner and bore the risk of the goods. Consequently, Simon would not be entitled to the insurance money under s. 54 of the Insurance Agreements Act.

It might be argued, based on the doctrine of *surrogation*, that Simon – even if Roberto bought on his own behalf – should be entitled to the insurance claim since Roberto embezzled Simon's money. However, this doctrine is assumed to be applicable only when there is no disruption of the chain, i.e. when one object has immediately been substituted by another object.[66] In this case Roberto had become owner of the painting,

[65] See e.g. NJA 1995, 197 and NJA 1996, 400. This might be somewhat surprising in a legal system where protection in bankruptcy and execution for acquired claims generally presuppose that *debitor cessus* was notified prior to the execution. But the requirement of notification does not apply to new claims created in favour of a third party as the first holder. See Walin, *Separationsrätt* (1975), and Håstad, *Sakrätt avseende lös egendom*, 6th edn (1996).

[66] See Håstad, *Sakrätt*, 166 ff., with references.

leaving Simon with only a personal claim, when the painting was destroyed. Unless the insurance for the painting was explicitly taken in Simon's interest, Simon will not have a claim on the insurance money.

Alternative 3

As discussed, Simon may terminate the relationship without having to compensate Roberto. The difference compared to Alternative 1 is that the painting was bought in equal shares with money from Simon and Roberto. It can be assumed that Roberto and Simon in this case became co-owners of the painting (and this is effective in bankruptcy). We can compare this with the Supreme Court case in NJA 1994, 506, where a person who had received a deposit of corn mingled it with corn of his own, with the result that a co-ownership existed in bankruptcy. The problem remains whether the decrease in value hits only Roberto's share or each party's share proportionately. In NJA 1994, 506, the Supreme Court wrote that the depositor had a right to separate the quantity he had deposited. In that case, however, the depository had deducted parts of the total deposit for his own use, and there was no evidence that the quantity of the total deposit had ever been lower than the quantity that the depositor wanted to separate. Therefore, it was natural to regard the deductions as withdrawals from the depository's contribution. The Court had no reason to pronounce its opinion regarding a case where, for instance, rats had eaten half of the total deposit. Since we are starting with a co-ownership, market changes and other casual events should be distributed proportionately.

Alternative 4

Here Roberto borrowed €100,000 to buy real estate for himself, and later he used Simon's money to pay his debt to the lender.

Since Roberto did not buy the real estate for Simon, and there is no direct link between the purchase and the embezzlement, Simon has no better right to the estate than any ordinary creditor of Roberto.

Comparative remarks

These cases bring out some sharp distinctions. Interestingly, they are not necessarily between the laws of continental Europe and those of other European jurisdictions. The cases present a policy decision requiring the balancing of the interests of the defrauded client against the general creditors of the manager. Some countries, both trust and non-trust, favour the client; others, again both trust and non-trust, favour the creditors.

Termination of the relationship is universally available following misappropriation of client funds.

Alternative 1

The crucial question here is whether Simon's rights depend on the intention or capacity in which Roberto acted. Many systems will allow Simon to have the painting only if Roberto bought it for him (Belgium, Finland, France, Greece, the Netherlands, Scotland, Sweden). Under general principles, so long as Roberto bought it for Simon, even without authority, Simon may take it via ratification. But in these systems, if Roberto acted for himself, this is conclusive and Simon has no right to the painting, but only a claim for damages. The dividing line is drawn in different ways. In Belgium, Greece and Scotland, it appears to be a matter which Roberto decides. In Finland and the Netherlands, it is a more objective question whether Roberto was acting within the relationship.

In other systems, Roberto's capacity or intention is treated as immaterial (Austria, England, Germany, Ireland, Italy, Luxembourg, Portugal, Spain). Denmark appears to follow this solution if the purchase was merely unauthorised, but not if it was fraudulent. Italy adds a formal requirement of proof that the contract of mandate was established before Roberto's bankruptcy.

Alternative 2

Those systems that allow a claim to the painting will generally allow a claim to the insurance proceeds (interestingly, the position in England and Ireland is unclear). Some of those countries which would not allow Simon to have the painting note a special rule for insurance proceeds, such that a right over an asset will generate a right to an insurance claim for the loss of that asset (Belgium, France).

The insolvency of Roberto brings out differences in the effects of the solution in Alternative 1. In Germany, Simon can have the painting, and the insurance proceeds, but only in the sense that he has a personal claim to a transfer; there will be no priority in insolvency. The same is true in the Netherlands (where art. 110, Book 3 CC does not lead to a direct transfer into Simon's patrimony). Some other systems understand the effect by making ratification available even for an unauthorised purchase (Italy, Luxembourg, Portugal, Spain). This theory will also deny bankruptcy protection, if ratification is made impossible after the manager's bankruptcy. Other systems contemplate priority for the client, either because there is a right of separation even if the painting or insurance claim belong to Roberto (Austria), or because Simon's trust interest does not depend on ratification (England, Ireland), or because ratification can occur after insolvency (Portugal, Italy).

Alternative 3

In most countries the fact that Roberto's money is used does not substantially change the solution from the previous cases with the exception that the claim, when admitted, is limited to a 50 per cent share over the painting. So even if that co-ownership is allowed, there is an unsecured claim for the rest of the loss. In England and Ireland, the claim can be secured by an equitable charge over the painting, which gives the trust beneficiary a secured claim so far as the proceeds have any realisable value.

Alternative 4

Leaving aside the possibility (mentioned in the Portuguese report) that the land was bought on Simon's behalf, every country except England and Ireland views the purchase here as unrelated to the client's money and denies any possibility of a special claim to the land. As the English report explains, the possibility of 'backwards tracing' through the payment of a debt awaits final resolution in that jurisdiction; this is also the case in Ireland.

Case 7: Choice of law

Case

Jane manages property in the interest of her client, Monica. The property is located in your country, where both Monica and Jane live and are domiciled. In their agreement they introduce a clause stating that their relationship is a trust governed by Jersey law. Litigation arises between them. Jane claims the invalidity of the trust provision of the arrangement, and claims that local law should govern the relationship. What is the result?

Discussion

Austria

Austria has not ratified the Hague Convention on the Law Applicable to Trusts and on their Recognition. Since both of the parties live and are domiciled in Austria, and the property is located there as well, the proposed relationship does not include any foreign element; this precludes the application of the Austrian conflicts law (IPRG).[1] Therefore, the validity of the 'choice of law clause' between Jane and Monica is governed by the general rules of Austrian law.

Due to the contractual autonomy of the parties, the clause is legally valid and Jersey law governs the trust or fiduciary relationship. This, however, is only true as far as the default part of Austrian law is concerned; the parties cannot 'contract out' of the application of

[1] *BG über das internationale Privatrecht*, BGBl 1978/304 idF BGBl I 2000/135.

mandatory provisions of Austrian law. As a result, contractual autonomy permits the applicability of Jersey law regarding the contractual part of the trust, whereas the proprietary or real aspects of the relationship follow the *lex rei sitae*, which is Austrian law in this case.[2]

Belgium

If litigation regarding a trust governed by foreign law arises before a Belgian court, then the court applies the Belgian rules of private international law. Trusts have been excluded from the application of the Rome Convention of 1980 on the law applicable to contractual obligations. A Belgian court therefore has to turn to the general principles of Belgian private international law in order to determine the extent to which the choice of Jersey law must be respected. Furthermore, Belgium signed but did not ratify the Hague Trusts Convention.[3]

Bringing trusts under the conflict rules governing contracts makes it possible to recognise the trust to some extent. Indeed, under Belgian private international law, the theory of contractual autonomy is dominant. Unless the contract is purely internal and does not lead to any conflict of law, all contacts being with a single country,[4] the parties may agree to whatever they wish, and may freely choose the applicable law (*lex contractus*).[5] The opposing theory of objective contacts (*théorie de rattachement objecti*) requires sufficient contact between the contract and the law that has been chosen. This theory has been refuted by the highest courts: the law of any state can be designated as long as the choice of law is ‘reasonable’.[6]

The theory of contractual autonomy, however, is not always applied. There are at least three exceptions. An important first exception is for

[2] See Mänhardt/Posch, *Internationales Privatrecht. Privatrechtsvergleichung. Einheitsprivatrecht*^{2} (1999), 24 ff.; Schwimann, *Internationales Privatrecht*^{3} (2001), 32 ff., 105.

[3] In anticipation of its ratification, the relevance of the Trusts Convention for current Belgian law is based upon art. 18 of the Vienna Convention on the Law of Treaties, according to which a signatory of a treaty should abstain from any act that would undermine the objective and principles of the treaty.

[4] G. Van Hecke and K. Lenaerts, *Internationaal privaatrecht*, *APR*, 2nd edn (1989), 325, no. 694.

[5] Court of Cassation, 24 February 1938, *Pasicrisie* 1938, I, 66; A. Verbeke, ‘Rechtskeuze en internationale contractsvrijheid’, in A. Verbeke, J. Verstraete and L. Weyts, eds., *Facetten van ondernemingsrecht. Liber amicorum Prof. Bouckaert* (Leuven: UPL, 2000), 584–585.

[6] R. Van der Elst, ‘L’autonomie de la volonté en droit international privé français et belge’, in *Liber Amicorum Baron Louis Frédéricq* (1966), 982; Van Hecke and Lenaerts, *International privaatrecht*, 325–326, no. 695.

questions of form and capacity. The law of the place where the contract is concluded (*locus regit actum*) governs the formal aspects of contracts. The law of the personal status (nationality) of the contracting parties governs their legal capacity. A second exception involves the proprietary or real aspects of the trust, which are governed by the law of the state where the immovable property is situated (*lex rei sitae*). Thirdly, Belgian rules of international public order always prevail over the law chosen by the contract. Legal scholars agree that the concept of a foreign trust, itself, is not contrary to international public order and that the will of the parties should be respected to the greatest extent possible.[7] While there seems to be a consensus that the concept of a foreign trust is not itself contrary to international public order – unlike the creation of a trust under Belgian law, which is not possible – there is greater uncertainty as to the extent to which a foreign trust can be executed in Belgium. A foreign trust may indeed encounter a large number of rules that belong to international public order, such as the protection of creditors in the case of insolvency and the protection of third parties acting in good faith. Belgian law will also govern imperative rules of family law regarding marriage, succession (forced heirship or *legitim*) and minors.

To conclude, a trust under Jersey law can be created in Belgium as long as there is no fraud involved. Furthermore, the situation may not be exclusively internal to Belgium. In Case 7 the choice of Jersey law would probably not be recognised since there is no link to any country other than Belgium. If there were some international element, making the choice of law valid, then the foreign trust would be given the fullest effect possible; however, for a number of aspects, Belgian law would still prevail.[8] The ratification of the Trusts Convention would bring more certainty to this issue.

Denmark

The 1980 Choice of Law Convention (the Rome Convention) was enacted into Danish law by the Choice of Law Act (Act No. 188 of 9 May 1984). According to art. 1(1), the Convention applies to contractual

[7] Although there is some uncertainty as to whether an exception is to be made for foreign trusts which have been created in Belgium for the sole purpose of tax avoidance. Some share the French opinion that this would constitute fraud – *fraude à la loi* – and that the contract as a whole should be governed by domestic law.

[8] I. Peeters and A. Verbeke, 'Kwaliteitsrekening en trust', in *Inzake kwaliteit* (Antwerp: Kluwer, 1999), 137–161.

obligations in all situations in which a choice between the laws of several countries is to be made.

In accordance with art. 3(1) of the Convention, Danish law recognises that the parties to an international contract are free to choose which law governs the contract. Full contractual freedom is, however, limited to (genuine) international contractual relationships, i.e. contractual relationships with a real geographical connection to more than one legal system.

Where important circumstances at the time of conclusion of the contract (other than the choice of law agreement itself) are connected to only one country, the parties are not free to set aside the mandatory rules of that country (cf. art. 3(3) of the Convention). Since the only thing connecting the agreement between Jane and Monica with a country other than Denmark is the choice of law clause itself, mandatory Danish rules apply despite the choice of law clause. Examples of such mandatory rules are Danish consumer, health and employment protection rules. Certain mandatory rules will apply even if the agreement is a genuine international agreement, e.g. the Danish competition rules, which apply whenever an agreement has effects on the Danish market. Furthermore, the choice of law clause does not exclude the application of the General Clause in s. 36 of the 1917 Contracts Act, mentioned in the introduction to the answer to Case 1 above. Indeed, the choice of law clause itself may be set aside under the General Clause if deemed unfair.

However, as a point of departure, the Danish court must respect the choice of law clause and therefore disregard non-mandatory Danish rules and instead use the material rules of Jersey law to solve the dispute. Only if a rule of the foreign legal system is (manifestly) incompatible with fundamental Danish legal principles, will it be disregarded under the *ordre public* principle.

The question does not state on which grounds litigation arises between Monica and Jane. By its art. 2(f), the Rome Convention does not cover disputes over whether the principal is bound by the actions of his agent. If the litigation concerns such a dispute, then the general choice of law principles of Danish international private law apply, since the 1978 Hague Convention has not yet been ratified by Denmark. According to art. 2(g), the common law trust is excluded from the scope of the Convention. Since the trust institution is unknown in Denmark, this provision does not exclude an agreement like the one between Monica and Jane from the scope of the Convention.

England

Much, but not all, of the Hague Convention on the Law Applicable to Trusts and on their Recognition is incorporated into English law by the Recognition of Trusts Act 1987. For the purposes of private international law, Jersey is a separate jurisdiction from England and Wales. The Recognition of Trusts Act 1987 does not take advantage of the possibility offered by the Convention (art. 24) to exclude the operation of the Convention with respect to conflicts of laws occurring between jurisdictions within a larger state. Hence the Convention's rules apply to this situation.

As concerns choice of law, the Convention clearly starts from a position of settlor autonomy. The paramountcy of settlor autonomy was upheld in the first English decision interpreting the Convention. In *Re Barton*,[9] a testator chose English law to govern a will trust. The testator was domiciled in Texas at the time of his death. The court held that the choice of law was effective, even though this allowed the beneficiaries to terminate the trust under the principle of *Saunders* v. *Vautier*, a principle which does not exist in the law of Texas.[10] This was a strong decision in favour of the effectiveness of an express choice of law clause, since it was clearly not the wish of the settlor that the trust should be capable of early termination. The court rejected an argument that art. 15 prevented the operation of *Saunders* v. *Vautier*.

The choice of Jersey law is therefore effective, unless some basis can be found in the Convention for overriding the primary principle of settlor autonomy. In order to determine whether that is the case, it would be necessary to have more information regarding the effect of the choice of Jersey law in this case. For example, if the terms of the trust would be permissible under English law, then probably the choice of Jersey law will be enforced by the English courts. If, however, Jersey law was chosen in order to avoid some rule of English law, more analysis would be needed. For example, a purpose trust is one in which there is no person with the status of trust beneficiary; the trustee holds the trust assets to be applied for a purpose. Jersey law permits a trust under

[9] [2002] EWHC 264, [2002] WTLR 469. This was a decision of Lawrence Collins J, the general editor of *Dicey and Morris on the Conflict of Laws*, 13th edn (London: Sweet & Maxwell, 2000). He also decided *Chellaram* v. *Chellaram (No.2)* [2002] 3 ALL ER 17, although this case was not primarily concerned with the Convention.

[10] The principle of *Saunders* v. *Vautier* is explained in the English response to Case 1, Alternative 1.

which the property is devoted to such an impersonal purpose, even if that purpose is totally private. The orthodox understanding of English law is that the only purpose trusts which are permitted are charitable trusts, which always have an element of public benefit; subject to some obscure exceptions, it is not possible to create a non-charitable purpose trust.[11] The parties might therefore have chosen Jersey law in order to create just such a trust.

For many states the most important provision for this situation could be art. 13 of the Hague Convention. That is, one could argue that non-charitable purpose trusts are a 'category of trust' which English law does not permit, and therefore art. 13 means that the English court would not be required to recognise the choice of Jersey law which was made in order to create such a trust. For some reason, however, art. 13 has not been incorporated into English law. The effect of this is further discussed below.

If the choice of Jersey law was made in order to evade the application of some rule of English law which is in the list of matters in art. 15 of the Convention, or which is analogous to it, then that article would of course permit the application of the English rule in question. This seems unlikely, as does any relevance of art. 16. Probably the only basis, therefore, on which the choice of Jersey law might be invalid is public policy, as provided in the Convention's art. 18.[12] Again, however, this probably requires us to know exactly what the parties are achieving by choosing Jersey law. One commentary says that under art. 18, an English court would invalidate a choice of a foreign legal system, if that choice was aimed at creating a non-charitable purpose trust of property in England.[13] On the other hand, the main goal of the Convention is to permit settlor autonomy in the choice of law, and so it would not make sense to invoke art. 18 too lightly. Most commentators seem to agree

[11] That is, most commentators think that legislation would be required (as in Jersey and some other jurisdicitons) to permit non-charitable purpose trusts. There is, however, some debate about this issue: see, for example, D. Hayton, 'Developing the Obligation Characteristic of the Trust' (2001) 117 LQR 96; in response, P. Matthews, 'From Obligation to Property, and Back Again?', in Hayton, ed., *Extending the Boundaries of Trusts and Similar Ring-Fenced Funds* (London: Kluwer, 2002), 203. The most thorough argument that English law does permit such trusts is in P. Baxendale-Walker, *Purpose Trusts* (London: Butterworths, 1999).

[12] See J. Harris, *The Hague Trusts Convention: Scope, Application and Preliminary Issues* (Oxford: Hart, 2002), 390–396.

[13] D. J. Hayton, *Hayton and Marshall: Commentary and Cases on the Law of Trusts and Equitable Remedies*, 11th edn (London: Sweet and Maxwell, 2001), at 1041.

that art. 18 should be invoked only in fairly extreme circumstances. It is a strong thing to say that a foreign norm is 'manifestly incompatible' with public policy.[14] One author, combining this approach to art. 18 with the English decision not to enact art. 13, concludes that 'the Recognition of Trusts Act 1987 appears to have the surprising effect of authorising an English settlor in an otherwise wholly domestic context to create a trust unknown or unauthorised in English domestic law, by the simple expedient of choosing a foreign law to govern it. That would drive a coach and horses through the traditional doctrinal limitations of English trust law.'[15]

If the choice of a foreign legal system was made in order to evade the English rules against perpetuities, which represent public policy decisions about the ability to tie up wealth indefinitely, there might be a stronger case for the application of art. 18.[16]

It is therefore difficult to say, in the abstract, whether the choice of Jersey law would be upheld by an English court. There has been very little judicial interpretation of the Recognition of Trusts Act 1987, and the commentators are somewhat divided. Moreover, the effect of the choice of Jersey law would be a crucial factor in the English court's decision as to whether or not it was effective.

Finland

The agreement is, in general, valid as far as it concerns the contractual relationship between Jane and Monica. However, since the agreement seems to have connections only to Finland, mandatory Finnish law applies. Mandatory provisions concerning contractual relations between

[14] J. Mowbray et al., *Lewin on Trusts*, 17th edn (London: Sweet & Maxwell, 2000), 297–298; Harris, *Hague Trusts Convention*, 390–393; J. Kessler, *Drafting Trusts and Will Trusts*, 6th edn (London: Sweet & Maxwell, 2002), 346, n. 15.

[15] Harris, *Hague Trusts Convention*, 343. Compare the Italian answer to this case.

[16] In English law, a charitable trust may have a perpetual duration, but other trusts may not. Other rules against perpetuities limit the amount of time during which income generated by trust property can be accumulated, and the amount of time during which a beneficiary's interest can remain uncertain ('contingent'): see especially the Perpetuities and Accumulations Act 1964, and also the Law of Property Act 1925, s. 164; Trustee Act 1925, s. 31. The Canadian common law jurisdiction of Manitoba has abolished the common law rules against perpetuities (Perpetuities and Accumulations Act, CCSM c. P33), as have a number of states in the United States. This permits trusts of perpetual duration and the indefinite accumulation of income into capital. In the Canadian civil law jurisdiction of Quebec, non-charitable purpose trusts can be perpetual (Civil Code of Quebec, art. 1273).

the parties of an investment agreement are, however, very rare, especially if the agreement is not within the scope of application of the Consumer Protection Act of 20 January 1978/38. If Jane is an entrepreneur and Monica is a consumer, i.e. she has made the agreement essentially for purposes other than business, then the Consumer Protection Act normally applies. Finnish law concerning legal status of third parties, e.g. the general creditors, applies because the property is situated in Finland. Thus, if either Jane or Monica becomes insolvent, then the rights of creditors are decided according to Finnish law.

France

French courts may authorise Monica and Jane to have their agreement governed by the law of Jersey provided that (a) their agreement has an international character,[17] and (b) public policy is not violated. French courts tend to recognise the effects of Anglo-American trusts that have been validly created, even though France does not have a direct equivalent to the trust, by translating the trust into the French category which has the most similar characteristics.[18] In Case 7, the parties and the property do not have any link with Jersey. Rather, they all seem to be linked solely to France. Therefore, it is likely that French courts will decide that the relationship should be governed by French law, i.e. that the choice of law provision provided for in Jane and Monica's agreement is void.

France has not ratified the Hague Convention on the Law Applicable to Trusts and on their Recognition. The French government announced that it would not ratify it until the French legal system adopted a trust-like device. To this effect, the French government proposed to the National Assembly a bill to introduce the *fiducie* under French law. However, the French Parliament has not approved the Bill on *fiducie*, nor even debated it, mainly because of tax evasion concerns, and, to a lesser extent, because of issues regarding the legal compatibility of the *fiducie* with the French legal system.[19]

[17] Paris, 30 November 1972, *RCDIP* 1974, 723; *Clunet* 1973. 390, comment Oppetit. Y. Loussouarn and P. Bourel, *Droit international privé*, 6th edn (Dalloz, 2000), No. 375; B. Audit, *Droit international privé*, 3rd edn (Economica, 2000), No. 169. In this case, the trust was assimilated to a contract.

[18] See e.g. Paris, 10 January 1970, *Epoux Courtois* c. *Consort de Ganay*, JDI, 1973, 207, annotation by Y. Loussouarn, RCDIP 1971, 518, annotation by Droz.

[19] On the draft bill to introduce the *fiducie*, see, among others, Grimaldi, 'La fiducie'. A new bill (No. 178) was introduced into the Senate on 8 February 2005.

Germany

Germany has not ratified the Hague Convention on the Law Applicable to Trusts and on their Recognition. Accordingly, the general rules of German conflict law are applicable. The results following from these rules do not differ substantially from what would occur under the Hague Convention. In other words, Jersey law governs all contractual aspects of the relationship of the parties. However, all matters relating to the transfer of title to the property, to security interests in the property, to the protection of creditors in matters of insolvency, and in other respects to the protection of third parties acting in good faith, are governed by the *lex rei sitae*, i.e. German law (see art. 11 lit. d [second sentence] and art. 15 of the Hague Convention).[20]

Greece

Greek courts use the method of 'acclimatisation' to resolve litigation problems that arise from the Anglo-Saxon institution of trust. This involves applying to the relevant trust issue the most appropriate domestic legal institution.[21]

It should be noted that Greece has signed the Hague Trusts Convention of 1 July 1985, which, however, has not yet been ratified.[22] Greece has ratified the EEC Convention of 1980 on the Law Applicable to Contractual Obligations. The EEC Convention recognises the autonomy of the contractual parties to choose the governing law of a contract, irrespective of whether the chosen law is that of an EEC Member State (s. 3 EEC Convention, s. 25, § 1(a) CC). Therefore, to the extent that under Greek law (*lex fori*) the agreement is a contract of mandate (this preliminary question is answered according to the *lex fori*: see the introduction to the answer to Case 1),[23] the contracting parties are entitled to choose the law governing their contractual relationship. The provisions

[20] And in detail Czermak, *Der express trust im internationalen Privatrecht* (1986); Kötz, 'The Hague Convention on the Law Applicable to Trusts and their Recognition', in D. Hayton, ed., Modern International Developments in Trust Law (1999), 37–44.

[21] See AP 862/1983, NoB 32/1984, 476; MPA 7960/1981, Hellin.Dni 23/1982, 42 (the legal framework applicable to the executor of a testament has been applied to a trustee); MFPA 14150/1963, NoB 12/1964, 52 (the beneficiary of a trust has been assimilated to the beneficiary of a usufruct). See also AP 1286/1977, NoB 26/1978, 1046; Ef.A 8301/1989, EEN, 1990, 299; FEf.A 4479/1972, NoB 21/1973, 1521.

[22] See Deliyanni–Dimitrakou, *Trust and Fiducia*, 357–359.

[23] MFPA 14150/1963, NoB 12/1964, 52; FEf.A 4479/1972, NoB 21/1973, 1521; AP 1286/1977, NoB 26/1978, 1046.

of a foreign law are only inapplicable if they are contrary to *bonos mores* or to public policy (*ordre public*) (s. 33 CC and s. 16 EEC Convention).

Nevertheless, the management of property has also *in rem* effects (acquisition of ownership, protection of ownership, possession over property etc.). With respect to these effects, the management of property falls within the sphere of property rules governed by the *lex rei sitae* (s. 27 CC).[24]

As a result, a Greek court will apply Greek property law with respect to the *in rem* effects of the legal relationship between Jane and Monica. On the other hand, Greek courts will apply the laws of Jersey with respect to other legal rights and obligations, deriving from the management of property, subject to the limits set by *bonos mores* and Greek public policy (in particular, rules related to taxation, or compulsory rules related to hereditary succession, etc.). Subject to these limits, the claim of invalidity would not succeed.[25]

IRELAND

Ireland has not (yet) implemented the Hague Convention on the Law Applicable to Trusts and their Recognition. The common law rules unhelpfully distinguish between trusts of movables and trusts of immovables.[26]

If the property managed by Jane in Monica's interest is personal property, and thus a movable, then the trust is governed by its proper law.[27] The settlor of the trust can select this proper law,[28] as occurred here. Hence, the relationship will be governed by the law as chosen in the trust deed, the law of Jersey (notwithstanding that Monica and Jane are domiciled in Ireland, and whether or not the property is situated in Ireland, Jersey, or elsewhere).

If, as seems much more likely, the property managed by Jane is real property, and thus an immovable, questions of validity of the trust are referred to the *lex situs* of the property,[29] though questions of

[24] Ad hoc: P. Kozyris, in Kerameus–Kozyris, *Introduction to Greek Law* (1993), 304. See also Paraskevopoulos, 'Trust – Trustee and Sale of an Immovable Situated in Greece', NoB, 1981, 425.

[25] Ad hoc: Ef.A 8301/1989, EEN, 1990, 229; MPA 7960/1981, Hellin.Dni 23/1982, 42; FEf.A 4479/1972, NoB 21/1973, 1521; AP 1286/1977, NoB 26/1978, 1046; MFPA 14150/1963, NoB 12/1964, 52.

[26] Binchy, *Irish Conflicts of Law* (Dublin: Butterworths, 1988), 506–507.

[27] *In re Cloncurry's Estate* [1932] IR 687; *Revenue Commissioners* v. *Pelly* [1940] IR 122; *In re Cuff Knox* (1961) 98 ILTR 141; cf. *Cripps Warburg* v. *Cologne Investment Co. Ltd* [1980] IR 321.

[28] *Revenue Commissioners* v. *Pelly* [1940] IR 122, 128 *per* O'Byrne J, upholding such a choice of law where the trust was created by contract.

[29] Binchy, *Irish Conflicts of Law*, 512–513.

construction of such trusts are determined in accordance with the law intended by the settlor, which need not be the *lex situs*.[30] The leading case is probably *Cripps Warburg* v. *Cologne Investment Co. Ltd*.[31] A borrower had failed to repay a loan; on the plaintiff-lender's action for repayment and interest, D'Arcy J in the High Court held that the contract of loan was governed by its proper law, which on the facts was English law. However, the loan was secured by way of mortgage over a hotel for the purchase of which the loan had been taken out; the plaintiff instituted a parallel mortgage suit, and D'Arcy J held that Irish law was applicable to this action, as it concerned Irish immovables. Thus, on Jane's claim to the validity of the trust, an Irish court would apply Irish law, on the basis that this is the place where the property is situated; though on any questions of construction and enforcement, an Irish court would apply the law as chosen in the trust deed.

Italy

The Hague Convention on the Law Applicable to Trusts and on their Recognition has been in force in Italy since 1 January 1992. Since then, the question raised by Case 7 has been widely debated among legal authors, and there are several judicial decisions on the point.[32] In the present case, the content of the legal instrument creating the trust is not described; we assume that the property (e.g. a villa) was validly transferred to Jane. It is not clear whether the case raises other issues besides that of the validity of the choice of law clause that is being challenged. The answer to the case must therefore deal first and foremost with the

[30] Ibid., 513, citing, inter alia, *Studd* v. *Cook* (1883) 8 App. Cas. 577; *Philipson-Stow* v. *IRC* [1961] AC 727 (HL) 761.

[31] [1980] IR 321 (though strictly speaking not a case of trust, it nevertheless illustrates by analogy how the *lex situs* would apply as between Jane and Monica on the question of the validity of the trust and how other conflicts of law rules could apply in respect of other issues).

[32] The Italian contributions on the point published in the last decade or so are very numerous. For abundant citations, as well as for critical discussion of the Italian judicial decisions, see Lupoi, *I trust nel diritto civile* (2004), 263 ff., 334 ff. (illustration of the Italian experience with respect to purely internal trusts). Two surveys of the Italian developments are of special interest: Braun, 'I trust interni' Riv. dir. civ., 2000, I, 573 ff.; Braun, 'La giurisprudenza italiana sul trust', in Dogliotti, Braun, eds., *Il trust nel diritto delle persone e della famiglia* (2003). Each year, the journal *Trust e attività fiduciarie* publishes the Italian bibliography on trusts. For updates concerning Italian cases on trusts, see also the website www.il-trust-in-italia.it, which is maintained by the association 'Il trust in Italia'.

validity of a choice of law clause in favour of the foreign law pursuant to the Hague Convention on trusts in the context outlined above.

Article 6 of the Convention provides that: 'A trust shall be governed by the law chosen by the settlor.' This provision does not subordinate party autonomy in the choice of the applicable law to the existence of connecting factors that would establish the international character of the legal relationship governed by the foreign law chosen by the settlor.[33] Hence the choice in favour of the foreign law is valid even though the trust is wholly located in Italy. In other words, the fact that the significant elements of the trust (apart from the choice of Jersey law as the applicable law) are all connected to Italy does not *per se* entail the invalidity of the trust provision of the agreement between Jane and Monica. This conclusion was first advanced in Italy by Lupoi's seminal contributions on the topic and it is now widely shared by the Italian literature on trusts.[34] True, art. 13 of the Convention provides that: 'No State shall be bound to recognize a trust the significant elements of which, except for the choice of the applicable law, the place of administration and the habitual residence of the trustee, are more closely connected with States which do not have the institution of the trust or the category of trust involved.' This article confirms that the choice of law clause is not invalid merely because the relevant connecting factors are all pointing to a country 'which does not have the institution of a trust or the category of trust involved'. Furthermore, art. 13 does not require the non-recognition of the trust in such a case; it merely allows it. But why should non-recognition follow if the trust in question does not manifestly collide with public policy (art. 18 of the Convention), nor with laws of immediate application (art. 16), nor with the mandatory forum laws concerning the matters listed in art. 15 of the Convention? If the trust does not run contrary to any of those provisions, art. 13 must be only a tool of last resort, which could be used to deny recognition of the trust when its effects are nonetheless repugnant in the

[33] See von Overbeck, 'Explanatory Report', in Hague Conference on Private International Law, *Proceedings of the Fifteenth Session*, II (1985), 383–385.

[34] Cf. Lupoi, 'Il trust nell'ordinamento giuridico italiano dopo la Convenzione dell'Aja del 1985', Vita not., 1992, 964 ff., 978 ff. For a full statement of the same opinion, see Lupoi, *Trusts: A Comparative Study* (2000), 348 ff. Most recently: Lupoi, *I trusts nel diritto civile* (*2004*), 258, 263 ff. In the same sense, see the literature cited below, n. 42; Gambaro, 'Trust', in *Digesto, sezione civile*, XIX, 4th edn (1999), 449, 466 ff.; Gambaro, 'Noterella in tema di trascrizione degli acquisti immmobiliari del *trustee* ai sensi della XV Convenzione dell'Aia', Riv. dir. civ., 2002, II, 257 ff.

light of the place where the trust assets are located or of the objects of the trust and the places where they are to be fulfilled.[35]

The most recent court case upholding the choice of the foreign law to govern a trust connected only with Italy is the *Tribunale di Bologna* judgment of 1 October 2003.[36] In this case, the settlor, who was resident in San Marino, created a trust over immovables situated in Italy. One of the trust beneficiaries was resident in San Marino. The trust instrument (written in Italian) contained a choice of law clause in favour of English law. The *Tribunale di Bologna* held that the trust was validly created and that the circumstance that the settlor and one of the beneficiaries were San Marino residents was irrelevant;[37] the Court stated that the decision would have been the same had they been Italian residents. Previous decisions to the same effect authorise the registration of trust instruments in the land register (or in other public registers).[38]

Though the great majority of scholars and court decisions recognise the free choice of law of the settlor under the Convention and opt for recognition of the trusts, some authors and very few court decisions oppose the prevailing trend.[39] The main argument against it is that the Convention is an international instrument and therefore it should not apply if the trust does not have objective connections with foreign jurisdictions apart from those which are declared irrelevant by art. 13

[35] See Lupoi, *Trusts: A Comparative Study*, 357 ff.. See also Lupoi, *I trust nel diritto civile*, 67 ff.; Carbone, 'Trust interno e legge straniera', in Dogliotti, Braun, *Il trust nel diritto delle persone e della famiglia*, 25 ff., at 33 ff.

[36] T&AT, 2004, 67; Corr. giur., 2004, 65, with critical annotation by V. Mariconda, 'Contrastanti decisioni sul trust interno: nuovi interventi a favore ma sono nettamente prevalenti gli argomenti contro l'ammissibilità', Corr. giur., 2004, 76 ff.

[37] This judgment cites Gambaro, 'Noterella', 265, to make clear that the Convention should be interpreted in the light of the policy in favour of trusts adopted by Italy when it ratified the Convention.

[38] In favour of the registration of trust instruments in the Italian land registers in contexts identical or similar to that of the present case, see: Trib. Parma, 21 October 2003 (decree), Foro. it., 2004, I, 1295; Trib. Verona, 8 January 2003, T&AT, 2003, 409; Trib. Milano, 8 October 2002, T&AT, 2003, 270; Trib. Pisa, 22 December 2001, T&AT, 2002, 241; Trib. Bologna, 18 April 2000, T&AT, 2000, 372; Trib. Chieti, 10 March 2000, T&AT, 2000, 372. The academic debate over these developments is covered by Lupoi, *I trust nel diritto civile*, 261 (with reference to the articles of Gazzoni, who is critical on the point, and to Gambaro and others who have replied to him).

[39] The following decisions hold that the trust instrument not be registered in the land register: Trib. Belluno, 25 September 2002, Foro it., 2003, I, 637; T&AT, 2003, 255 (this decision was rendered with respect to the area of Belluno, where land registers are organised in accordance with the Austrian model); Trib. S. M. Capua a Vetere, 5 May 1999; Riv. dir. int. priv. proc., 1999, 1019; T&AT, 2000, 251; Riv. dir. impresa, 2000, 117, n. Pascucci.

of the Convention.[40] A similar argument is that the choice of the foreign law in such a case is abusive and therefore ineffective.[41] Both arguments have been rejected because they are incompatible with art. 6 of the Convention. Indeed, they both turn optional non-recognition of the trust into mandatory non-recognition, contrary to the legislative history of art. 13 of the Convention.[42] Full party autonomy under the Convention with respect to trusts wholly located in Italy is also opposed because the order giving effect to the Convention in Italian law should produce minimum effects, i.e. effects which exclude the recognition of trusts falling under art. 13.[43] This position is once more contrary to the express text of art. 13 and to its legislative history.

On the facts of the Case, it does not appear that the trust of Case 7 produces effects that run contrary to the mandatory rules preserved by art. 15 of the Convention, to public policy, or laws of immediate application, or that there are reasons to deny recognition of the trust pursuant to art. 13 of the Convention. In this context, the choice of a foreign law to regulate the trust is valid and the trust shall be recognised.

Luxembourg

Luxembourg ratified the Hague Convention on the Recognition of Trusts dated 1 July 1985 by a law dated 27 July 2003 on trusts and fiduciary contracts, which came into force in September 2003 (the ‘2003 Law’).

[40] See Contaldi, *Il trust nel diritto internazionale privato italiano* (2001); Broggini, ‘Il trust nel diritto internazionale privato’, in Beneveneti, ed., *I trusts in Italia oggi* (1996), 11; Fumagalli, ‘La Convenzione dell’Aja sul trust e il diritto internazionale privato’, Dir. comm. int., 1992, 533, 560–562.

[41] Broggini, ‘Trust e fiducia nel diritto internazionale privato’, Europa e dir. priv., 1998, 399–411. See also Castronovo, ‘Il trust e “sostiene Lupoi”’, ibid., 450. Other arguments against free choice of law in cases falling under art. 13 of the Convention are based on Italian law. Thus, it is argued that asset segregation cannot be the by-product of the settlor’s choice in favour of the foreign law if the trust is connected only with Italy because Italian law does not allow asset segregation by an expression of private will (see e.g. Castronovo, ibid., 448–449; Trib. Belluno, 25 September 2002, Foro it., 2003, I, 637; T&AT, 2003, 255). The reply to this and to similar arguments is that the Convention derogates from Italian law on these points. See Gambaro, ‘Noterella’, 263, and Trib. Verona, 8 January 2003, T&AT, 2003, 409.

[42] Carbone, ‘Trust interno e legge straniera’, in Dogliotti, Braun, *Il trust nel diritto delle persone e della famiglia*, 25; Luzzatto, ‘“Legge applicabile” e “riconoscimento” di trusts secondo la Convenzione de L’Aja del 1 luglio 1985’, Riv. dir. int. priv. proc., 1999, 5; Carbone, ‘Autonomia privata, scelta della legge regolatrice del trust e riconoscimento dei suoi effetti nella Convenzione dell’Aja del 1985’, ibid., 773.

[43] Contaldi, *Il trust nel diritto internazionale privato italiano* (2001), 123.

As the ratification of the Hague Convention is so recent at the date of writing this report, it is not yet possible to tell how Luxembourg courts will interpret the text of the Convention.

It may, however, be interesting to consider their position prior to the ratification: Luxembourg courts did not take the approach of recharacterising trusts in order to bring them within the categories known to Luxembourg law. It was held that 'as the *lex situs* of assets alone governs the rights *in rem* that can bear on those assets, a trust, a concept unknown under Luxembourg law, cannot be created on assets located in Luxembourg'.[44] However, the same decision held that Luxembourg courts recognise trusts created by foreigners abroad (in a country which recognises the trust concept), in conformity with the locally applicable laws, without trying to recharacterise them as a Luxembourg legal institution; such recognition, however, does not entail the recognition and enforcement of any rights *in rem*, which would otherwise be excluded under Luxembourg law (such as tracing remedies for beneficiaries). The decision is rather open as to the criteria for the recognition of trusts; however, it appears that both real elements (location of the assets of the trust) and personal elements (domicile of the founders, the trustees, beneficiaries, etc.) come into play.

On the basis of the pre-Convention case law, since Jane and Monica are both domiciled and living in Luxembourg and since the assets of the trust are presumably in Luxembourg, the Luxembourg courts would normally refuse the characterisation of their relationship as a Jersey trust. There would be two main reasons for this. First, given that the agreement does not have any international character, the application of a foreign law would not bind the Luxembourg court. Even if the parties are in principle allowed to subject their agreement to a foreign law, they are not allowed thereby to exclude the mandatory local rules of the place to which the subject matter is exclusively connected. This approach is supported by the Rome Convention on the law applicable to contractual obligations (even though trusts are excluded therefrom). Without even considering issues related to contracts made by consumers, Jersey law has no connecting factors with the relationship, which is purely related to Luxembourg. Therefore Luxemburg courts would be entitled to give effect to mandatory provisions of Luxembourg law, and even, although this is not certain, given the 'alien' nature of a trust, recharacterise the relationship into a Luxembourg law agreement, such

[44] CA Luxembourg, 22.5.1996, Bull. Droit et Banque, no. 26, 47–56, obs. Lp. Kinsch.

as a mandate. Second, the application of Jersey law implies the recognition of the creation of rights *in rem* on assets in Luxembourg, which is excluded by the general principle of *lex rei situ*, as applied by the abovementioned case law. Even assuming Luxembourg courts would recognise the contractual relationship as such, i.e. on the basis of the terms of the agreement purporting to create the trust, they would not give effect to any elements of the trust relationship which would be contrary to mandatory principles of Luxembourg law, in particular with respect to the creation of rights *in rem*. For the purpose of determining which mandatory principles are potentially at issue, a Luxembourg court would normally compare the relationship to an equivalent institution under Luxembourg law, such as, for instance, a mandate.

Under the rules established by the Hague Convention (assuming the trust under consideration would be within its material scope), the choice of Jersey law would in principle be recognised to govern the validity, effects, construction and administration of the trust (arts. 6 and 8). Article 2 of the 2003 Law provides that, for the purpose of implementing the Hague Convention, and with respect to assets subject to a trust located in Luxembourg, the legal position of the trustee is determined by reference to that of an owner (*propriétaire*), without prejudice to the principle of segregation of assets if applicable.

The recognition of the choice of law would be subject to the limitations established by the Convention itself, in particular the following articles.

Under art. 13, a Luxembourg court would not be obliged to recognise a trust whose significant elements (other than the chosen law, the place of management and the usual residence of the trustee) are linked more closely to a state whose law does not know the institution of the trust. In the present scenario, the closest connection would be Luxembourg. While Luxembourg law does not have a trust institution identical to the common law trust, it may be difficult for a court to use this argument given that Luxembourg has the institution of *fiducie*, which, on the basis of the 2003 Law, comes under the definition of trust contained in art. 2 of the Hague Convention.[45]

Article 15 contains a list of matters for which the application of the mandatory rules of the law that would apply on the basis of common rules of private international law is preserved (including transfer of

[45] Doc. Parl. no. 4721, 3: the legislator does however recognise that while the *fiducie* benefits from recognition on the basis of the Hague Convention, there remain substantive differences between both institutions.

property and *in rem* security, protection of creditors in case of an insolvency and protection of *bona fide* third parties). If one of the mandatory laws of Luxembourg law (applicable, for instance, as *lex rei sitae*, or as personal law of either Jane or Monica) would be in contradiction with Jersey law governing the trust, the Luxembourg courts would be entitled to (and would probably) apply the mandatory provisions of Luxembourg law.

Article 16 preserves the application of internationally mandatory laws (*lois d'application immédiate*). Again, the impact of that provision would depend on the actual question to be resolved.

Article 18 contains the general exception of public order, i.e. the provisions of the Convention can be discarded if their application is manifestly contrary to public order.

In summary, the ratification of the Hague Convention has given Luxembourg law a framework for the recognition of trusts, even though its prior position did already allow the recognition of trusts in certain circumstances.

On the facts of the case though, where there is no connecting element to Jersey other than the chosen governing law, the effect of such choice of law is likely to be limited in practice by the application of mandatory provisions of Luxembourg law to which most other connecting factors appear to turn, under one of the above headings.

Netherlands

The Netherlands is party to the Hague Trusts Convention (HTC). Art. 6 allows for a choice of law. No special connection with the chosen law is necessary. Article 11 HTC obliges recognition of the trust. However, art. 13 permits the recognising country to withhold recognition if the significant elements of the trust are more closely connected with states that do not have the institution of the trust; in deciding whether this test is satisfied, the court is to disregard, among other factors, any express choice of applicable law. In this case, the trustee, the beneficiary and the assets are situated in the Netherlands. It is likely that a Dutch court will not recognise the trust. However, it is unclear what position the persons involved will take.[46] In this case the 'trustee' (Jane) will most certainly be regarded as the legal owner of the assets if those

[46] See on art. 13: M. E. Koppenol-Laforce, *Het Haagse Trustverdrag* (Deventer: Kluwer, 1997), 144–151; M. E. Koppenol-Laforce, *The Trust, the Hague Trusts Convention and Civil Law Countries* vol. 3, no. 1 (Notarius International, 1998), 27–40, 35–36; M. E. Koppenol-Laforce,

assets were registered in her name at that time. The 'beneficiary' (Monica) only has contractual rights against Jane. It is possible that the relationship is requalified as a contract of mandate, and therefore the Dutch Civil Code rules on those contracts are applicable (see Case 1). Whether Jersey trust law can play a role is doubtful unless there are certain rules in Jersey trust law that can be applied in a contract of mandate relationship and which are not against mandatory Dutch law. In such a situation the trust qualification is ignored and the relationship is seen as purely contractual. In the Netherlands, the Rome Convention on the Law applicable to Contractual Obligations will be applied. Article 3 sub 3 permits a choice of law in a purely national situation such as this, but this choice cannot set aside mandatory law of that national state. If it is a contract of mandate, Monica can terminate the contract whenever she wants and on termination Jane has to transfer back the property. Should Jane become insolvent before any transfer, the property will most certainly fall into her bankrupt estate without Monica having any preference whatsoever on the property or on financial compensation over other creditors of Jane in the bankruptcy.

Portugal

Portugal is not party to the Convention Concerning the Law Applicable to Trusts and to their Recognition of 1 July 1985.

The Rome Convention on Private International Law is not applicable to trusts (art. 1.2.g). Thus, in keeping with the Portuguese system of private international law, the trust must be the object of an operation of *dépeçage* and governed, as far as proprietary or real aspects are concerned, by *lex rei sitae* (art. 46 CC). In the contractual part, it should

'De inpassing van de family trust in het Nederlandse civiele recht', in *De inpassing van de family trust in het Nederlandse civiele en fiscale recht, preadvies voor Vereniging voor Belastingwetenschap, Geschriften Vereniging voor Belastingwetenschap* no. 201, 1–67 (Deventer: Kluwer, 1999), 31–33; and D. J. Hayton, S. C. J. J. Kortmann and H. L. E. Verhagen, eds., *Principles of European Trust Law* (Kluwer Law International – W. E. J. Tjeenk Willink, 1999), 198 (Dutch report). A. Dyer, in 'International Recognition and Adaptation of Trusts: The Influence of the Hague Convention' (1999) 32 Vand. J. Trans. L. 989, pp. 1017–18, discusses a decision of the Dutch Supreme Court (HR 18 November 1998, case no. 31,756) in which it was decided that art. 13 should be given a narrow reading. The court decided not to apply art. 13, and recognised a trust for which Jersey law was designated as the governing law, even though the settlor was in the Netherlands and the trust deed was executed in England. In this case, unlike in Case 7, the trustee was a Jersey trust company; on the other hand, art. 13 also directs the court to ignore the place of administration of the trust, and the habitual residence of the trustee, as significant elements for the purpose of applying art. 13.

be governed by the law stipulated by the parties, though this is limited to a law whose applicability reflects a serious interest of the contracting parties or is linked to one of the elements of the contract that could be considered relevant in the field of private international law (art. 41 CC). Should no law have been stipulated, the law of the usual abode of the declarer is applicable to unilateral acts. In the case of bilateral contracts, the applicable law is the law of the usual abode common to the parties, if any; or, in the case of bargains without a consideration, the law of the usual abode of the party conferring the benefit. In other contracts, the law of the place where the contract was executed governs.

Thus, Portuguese law will govern questions of ownership. With regard to the obligations binding on Monica and Jane, the law of Jersey may be accepted provided that there is a substantial link with the arrangement, or that it corresponds to a serious interest of one or more of the parties; if not, the obligations between Monica and Jane will also be governed by Portuguese law, as the law of their common usual abode (domicile) and of the place where the deal was executed.

Scotland

The Recognition of Trusts Act 1987 applies in Scotland as it does in England, and gives effect to the Hague Convention on the Recognition of Trusts.[47] Scotland and England are foreign to each other for purposes of private international law, and the 1987 Act applies as between the different legal systems of the United Kingdom. However, Jersey is not part of the United Kingdom. The 1987 Act provides the rules for Scots private international law not only in relation to other states that have adopted the Convention, but in relation to all other states.[48] Thus, as far as Scots private international law is concerned, the 1987 Act applies in relation to Jersey, and that is so whether or not Jersey private international law has accepted the Convention. Whether Jersey private international law would recognise this trust is a separate question, which will not be addressed here.

The Convention provides that a truster is free to choose the proper law of the trust.[49] However, 'where the law chosen ... does not

[47] For a full discussion from a Scottish standpoint, see A. E. Anton, *Private International Law*, 2nd edn (1990), chapter 25. See also Wilson/Duncan, para. 17–1 to 17–12, and R. D. Lesie, 'Private International Law' in *The Laws of Scotland: The Stair Memorial Encyclopedia*, vol. 17, paras. 334–338.

[48] Anton, *Private International Law*, 630.

[49] Art. 6.

provide for trusts or the category of trust involved, the choice shall not be effective', in which case the applicable law is the legal system 'most closely connected' with the trust.[50] Hence it is relevant to know whether Jersey law 'provides for trusts or the category of trust involved'. The expression 'the law chosen' seems to refer to the internal law, not to the private international law, of the chosen legal system, since it is provided that in the Convention 'the word "law" means the rules of law in force in a state other than its rules of conflict of laws'.[51] It is understood that Jersey legislation forbids a Jersey trust to own immovables in Jersey but has no rule forbidding ownership of immovables elsewhere.[52] If that rule is to be categorised as a rule of Jersey's internal law then it follows that the choice of law is effectual. If it is to be categorised as a rule of Jersey's 'rules of conflicts of laws' then the choice of law is ineffectual. On the assumption that the former view is correct, the choice of law is valid. If, however, the choice of Jersey law were to fail, then Scots law would be the legal system 'most closely connected' with the trust, in which case the trust would be valid anyway.

Article 18 of the Convention allows a choice of law to be deemed invalid if the choice contravenes public policy. The possibility of denying recognition of a choice of law (whether in relation to trusts or in relation to other matters) on the ground that the choice is abusive is one of considerable importance but remains largely untested in the Scottish courts. In practice it is unlikely that the choice of Jersey law would be invalidated on the ground that it was abusive.

It should be added that the conveyance of the assets to the trustee would take effect regardless of which legal system governs the trust, and would even take effect if the trust were void. The reason is that the assets are in Scotland, and Scots property law adopts the principle of abstraction,[53] so that the invalidity of the *causa* of a transfer does not mean that the transfer itself is invalid.[54] If the *causa* is void then the

[50] Arts. 6 and 7. Art. 7 has a list of factors to be taken into account in determining which legal system is the one that is the 'most closely connected' with the trust.

[51] Art. 17.

[52] Trusts (Jersey) Law 1984. See Maurizio Lupoi, *Trust Laws of the World* (1996), vol. I; Paul Matthews and T. C. Sowden, *The Jersey Law of Trusts*, 3rd edn (1994). The Jersey Law Commission has recommended the extension of trusts to immovables in Jersey: http://www.lawcomm.gov.je/.

[53] There are some qualifications to this statement, but it is correct in general.

[54] Art. 15(1)(d) indicates that Scots law will govern 'the transfer of title to property' of Scottish assets.

result may be (depending on the circumstances) that the law of unjustified enrichment obliges the transferee to effect a retransfer.[55]

Spain

The factual situation admits two variations, depending on whether the trust is domestic or international. *Variant a* involves a purely domestic situation in which there is no foreign element, since the trustee is located in Spain. In such a case, the administration of the trust is carried out in Spain, and Monica and Jane are Spanish nationals. It is clear that this situation does not allow for the possibility of foreign law, since this option arises only if there is a foreign element to the relationship. However, this must be qualified. Spanish law analyses the factual situation depicted above in contractual terms. From this viewpoint there is no theoretical difficulty in accepting that the relationship is, in fact, conducted under the terms of Jersey law in so far as no Spanish *ius cogens* rules are affected. Spanish contract law is governed by the principle of party autonomy. Therefore, there is no obstacle to the parties' incorporating Jersey rules in their contract instead of resorting to, for example, standard clauses. The only limit imposed, as in other domestic contracts, is by Spanish *ius cogens* rules that are especially likely to affect the situation of third parties. The fact that the parties call their creation a trust is therefore irrelevant (except in so far as it helps to interpret what the parties really want). The choice of law clause is invalid and local law governs the situation. However, the agreement is conducted under the terms of Jersey law in so far as no Spanish *ius cogens* rules are affected.

If the trustee is located outside the jurisdiction, or if the trust is administered abroad or if Monica is a foreign national, then, in principle, there is a foreign element present (*variant b*). However, it is still questionable whether this foreign element is relevant such that it renders the trust international. Since Spain has not ratified the Hague Convention and there is no case law on this issue, one can only try to predict a possible answer according to Spanish rules of private international law.[56]

[55] An alternative procedure is an 'action of reduction', but this, if successful, operates *ex nunc* and not *ex tunc*, so its effect is similar to a voluntary retransfer.

[56] Literature on the private international law aspects of the trust is very scarce and recent. See the work by Cristina González Beilfuss which has already been cited; M. Checa Martínez, *El trust angloamericano en el Derecho español* (Madrid: McGraw Hill, 1998).

In order to decide whether the situation is international, it is necessary to consider all the facts of the case rather than one aspect in isolation. If the factual situation is that of an artificially internationalised situation, then it is our opinion that the choice of Jersey law is not permitted. The case is solved as described above.[57]

If, however, the relationship is genuinely international, then it is necessary to address the question of characterisation in order to determine whether Spanish private international law allows the choice of the applicable law. In this respect, it is necessary to conduct the difficult exercise of characterising an unknown institution. Since Spanish law does not recognise the trust institution as such, Spanish private international law rules that determine the applicable law of a trust do not exist. Therefore, characterisation operates using the so-called theory of equivalence, that is, by determining which Spanish institution is the functional equivalent of the trust. In the case of trusts, because of the very different functions they fulfil, it has been convincingly argued that the functional equivalent of the trust cannot be determined in general for all trusts, but only on a case-by-case basis for each individual trust.

In our opinion, a management scheme like the one depicted calls for a contractual characterisation. At first glance, this involves the application of Spanish private international law rules for contracts. There is, however, a problem regarding these rules, since they are laid down in the Rome Convention on the law applicable to contractual obligations, which excludes trusts in art. 1.2(g). Therefore, one must resort to the rules laid down in art. 10.5 CC that are only applicable to those 'contracts' not covered by the Rome Convention.

Article 10.5 CC poses some problems in so far as it limits the possibilities for choosing the applicable law to those foreign laws bearing a connection to the case at hand. The choice of Jersey law may therefore not be upheld if Jersey law is unconnected to the case, although one must acknowledge that this requirement is very easily circumvented, especially if one bears in mind that according to art. 10.5 CC, 'any connection' (*alguna conexión*) suffices. If, however, the parties creating the management scheme are not properly advised of this rule and Jersey law is completely unconnected to the case, then the choice of Jersey law

[57] In fact this would be the result of applying the general theory of *fraude à la loi*. See, for a similar solution, art. 3.3 of the Rome Convention on the law applicable to contractual obligations.

may be considered void. Article 10.5 CC lays down subsidiary rules that apply the law of the common nationality of the parties, or, if there is no such common nationality, then the rules apply the law of the common habitual residence, and finally the law of the place where the agreement took place. The applicable law may therefore be one that the parties did not at all expect. However, it may be argued that Jersey law can still play the role depicted above, that is, that it is applicable as a manifestation of party autonomy with only the limitation of the *ius cogens* rules of the applicable law. If this case comes before the Spanish court, then internationally imperative rules of Spanish law (that is, those rules of Spanish law that apply regardless of the applicable law) must be taken into account.

General private international law reasoning supports this solution. Considering the difficulties Spanish courts face in dealing with choice of law cases, we would like to point out that, depending on the circumstances of the case, it is not unlikely that a court might declare the choice of law clause void while applying the *lex fori*, since the homeward trend is still very strong in practice.

Sweden

It seems that the choice of law would be binding between the parties. For some years there was a statute in force declaring that mandatory rules to the benefit of a commercial agent could not be circumvented by reference to foreign law, but this rule was recently abolished in the Commercial Agency Act. Therefore, no general principle can be said to exist that mandatory rules may not be set aside by references to foreign law. Of course, *ordre public* would set a limit. Furthermore, there has been some discussion as to whether the law chosen must have some natural connection to the parties or the property affected, but this view is said to be difficult to uphold in so far as the parties would have been able to achieve the same result by transforming the reference to a foreign law to a substantive clause which created the same effect under the national law.[58]

If, however, Monica (the client) went bankrupt, it should be noted that Jane and Monica could not have made a substantive agreement in favour of Jane or any third party, binding on Monica's general creditors, that would have been better than the otherwise applicable law, since

[58] See Karlgren, *Internationell privat- och processrätt*.

the agreement deals with assets located in Sweden. Therefore, Swedish law would probably disregard their choice of law in case of Monica's bankruptcy, at least if the assets were not located in Jersey when the trust was set up. This would be in line with the general principle that the *lex rei sitae* is applicable in proprietary matters.

Comparative remarks

Amongst countries that have ratified the Hague Convention (Italy, Luxembourg, the Netherlands, Scotland and England) the situation is not uniform. Scotland and England recognise the choice with the limitations set out in the Convention (see e.g. arts. 15 and 16 on mandatory laws and art. 18 on 'public policy'). Italy takes the same approach, even though the trust is not recognised as a legal form of general application in that jurisdiction. The Netherlands, on the other hand, would probably deny recognition largely as a result of insufficient contact with the forum, relying on art. 13, which provides that a trust need not be recognised if its only substantial connections are to a non-trust jurisdiction. In Luxembourg, the exception to the choice of law clause based on art. 13 of the Convention will probably fail to impress the court, because Luxembourg has the institution of *fiducie*, which, on the basis of the 2003 Law, comes under the definition of trust contained in art. 2 of the Hague Convention.

Amongst the other countries, there is some diversity of approaches to the question of party autonomy in choosing the applicable law, although functionally there is probably not much variation. There is some difference as to whether the autonomy to choose a foreign legal system is limited by a requirement of some objectively substantial connection to that system. Where this is required (France, Portugal, Spain), the choice of law clause will be completely disregarded. Where it is not required (Austria, Belgium, Denmark,[59] Finland, Germany, Greece, Sweden), the choice of law clause is valid, but subject to certain limits. The most frequently mentioned limit, of course, is public policy or public order. Most reporters also mention that the real (or 'proprietary') aspects of the relationship will be governed by the *lex rei sitae*. Similarly, the rights of creditors and of third parties in good faith are not to be

[59] The Danish reporter notes that, although a substantial connection is not required for validity of the choice of law clause, fewer Danish rules will apply in a mandatory way where such a connection is present.

affected by the choice of law (e.g. Germany, Finland, Sweden). The Irish reporter observes that the validity of any trust of Irish immovable property is always governed by Irish law, but even in this case a different legal system may be chosen to govern the ongoing trust. The Belgian reporter also mentions rules as to form and party capacity.

Special part

Case 8: Pension funds

Case

A pension fund for employees of a company, that provides a specified benefit upon retirement, has been running for several years. Both the employer and the employees make contributions to the fund. The managers of the fund are of the opinion that there is a surplus of funds as a result of successful investments.

a. Can the employer suspend making contributions?
b. To whom does the surplus belong?

Discussion

AUSTRIA

An employees' pension fund that provides a specified benefit upon retirement, several years after the employer and the employee have made contributions to the fund, is not a 'pension fund' according to the Austrian Investment Fund Act. However, Austrian private law recognises alternative concepts that meet the requirements described in Case 8. These alternatives are based on a specific statute called the *Betriebspensionsgesetz* (BPG).[1] There are basically three pension fund schemes under s. 2 BPG.[2]

The first scheme is called *Pensionskasse* (s. 2 Z 1 BPG). This pension scheme is an insurance solution that allows the employer to organise the insurance entity. The insurance entity has its own legal personality

[1] BGBl 1990/282.

[2] Schwarz/Löschnigg, *Arbeitsrecht*^{8} (2000), 353 ff.; Floretta/Spielbüchler/Strasser, *Arbeitsrecht*^{4} (1998), 242 ff.

based on a specific statute, the *Pensionskassengesetz* (PKG). Both the employer and the employee pay contributions to the insurance entity on behalf of the employee. The employees can claim benefits upon retirement, regardless of whether they still have an employment contract with the same employer.

The second pension fund scheme is a direct promise pension (*direkte Leistungszusage*) (s. 2 Z 2 BPG). In this direct claim pension scheme, the employer is obliged to provide a benefit to the employee upon retirement if the employee worked for the employer for more than five years. Whether the employee still has an employment contract with the same employer upon retirement is not relevant.

The third possible pension fund scheme is a life insurance scheme (s. 2 Z 3 BPG). The employer pays insurance premiums on behalf of the employees according to an insurance contract between the insurance company and the employer. The employees can claim the benefits upon retirement regardless of whether they are still employed by the same company.

The described pension fund schemes are based on individual or collective contracts between the employer and the employees. The parties are free to agree upon their own terms for most elements of pension fund schemes, especially with regard to the question whether the contributions or the pensions to be paid are fixed (contribution orientation or outcome orientation). The BPG ensures that pensions accumulated over the years are irrevocable, although it is possible to modify the direct promise pension, taking into consideration the economic situation of the company. In the case of a direct promise pension (s. 2 Z 2 BPG), the employer itself is required to create accruals and reserves, according to actuarial mathematics, to be able to satisfy the expected claims of the employees. The accruals must be secured by bond or investment fund deposits.

In addition to the pension fund schemes based on the BPG, there is a special type of pension investment fund according to the Austrian Investment Fund Act. Pension funds (PIF) are special Austrian investment funds that are not allowed to distribute their profits to the certificate holders before they retire. Certificate holders can only be the following investors: (a) insurance companies, (b) *pensionskassen* (s. 2 Z 1 BPG) as described above, and (c) individuals. Individuals are only allowed to hold PIF certificates if an irrevocable repayment plan is signed. When the individual retires, the pension is paid by way of annuity.

Belgium

Pension plans and benefits are divided into three categories. The first is the basic legal pension plan, which functions according to the principle of repartition (pay as you go). The second is the supplementary pension plan linked with a professional activity, which is based on the principle of capitalisation. Here, there are group insurance policies and pension funds, with defined benefits or defined contributions. Third, there are individual supplementary pension plans, including private life insurance and individual pension investment funds (regulated in the Act of 4 December 1990 and enjoying specific tax benefits).

At the end of 1998, the capitalised assets in the second category were approximately 15 per cent of the Belgian gross national product, which is far below the European average of about 40 per cent.[3] In this category the group insurance system is dominant (about 65 per cent), which is the opposite of most other European countries where pension funds are dominant. The degree of participation is limited to 31 per cent of the active population, as opposed to 90 per cent in the Netherlands and 50 per cent in the UK. The assets in the third category, at the end of 1998, were also around 15 per cent of the gross national product. Here, pension investment funds clearly dominate (70 per cent) over individual life insurance.

It is quite clear that pension funds have been successful and have gained increased importance in the Belgian financial sector. Their legal status can largely be found in the Royal Decree of 14 May 1985 and the more recent Decree of 7 May 2000. In accordance with this legislation, pension funds are organised within a separate corporate entity, which has legal personality and is considered to be the owner of the funds. The corporate forms which have been made available are the non-profit association and the mutual insurance company. Other schemes, either corporate or fiduciary, are not permitted.

Guaranteeing a specified benefit upon retirement is rather unusual for Belgian pension funds; unofficial estimates are that less than 10 per cent of the funds make such a commitment. For those who do, however, specific rules apply. The Royal Decree of 7 May 2000 was an attempt to bring the legal status of funds providing a specified benefit closer to that of insurance companies. For example, the Decree now

[3] All data based on *Verslag aanvullende pensioenen en ICB's*, Memorandum of the Belgische Vereniging van de Instellingen voor Collectieve Belegging, 15–17.

applies similar rules to these pension funds regarding solvency, accountability and pricing.[4]

A basic principle is that the assets of the pension fund cannot be reclaimed by the employer or re-enter his patrimony. Regardless of how well the fund is doing, the employer cannot transfer any of its funds or assets to himself or his company. The profits made by the fund belong to the fund itself. Although the Royal Decree of 2000 continues to sanction this principle, in exceptional situations such as liquidation, bankruptcy or mass lay-offs, it has allowed the assets of the pension fund to be used to pay employees or to be used for other purposes, provided that there remain sufficient funds to guarantee the fund's obligations. The distribution of the assets is then managed under supervision on behalf of the employees and trade unions.[5] If the pension fund itself must be liquidated, then its assets are distributed among employees and possibly the employer in accordance with the regulations of the pension fund and the by-laws of its corporate entity.

A second principle inherent to the system of pension funds is the principle of solidarity. Hence, both employer and employee must make contributions to support the fund. In the case of insolvency, however, the deficit is to be borne by the employer alone. If, on the other hand, the fund does very well, the employer is free to declare a 'contribution holiday' and suspend contributions on his behalf for a limited period of time, provided that this is in accordance with the pension fund regulations. Following the rule that the assets of the fund cannot re-enter his patrimony, the employer cannot claim the surplus that belongs to the fund itself, making the fund grow continuously. Employees cannot claim the surplus either, as they are only entitled to their guaranteed benefit. The surplus may, however, be distributed amongst the employees through an amendment of the pension fund regulations raising the specified benefits.

In the last few years, the Belgian legislator has shown an increasing awareness of the need to stimulate the use of pension plans further and has made significant efforts in this respect. This is illustrated by the recent regulation of pension plans for self-employed professionals, who will now – as of 1 January 2004 – enjoy a tax deduction of up to 7 per cent of their annual income for financial contributions to a pension plan.[6]

[4] See Report to the King accompanying the Royal Decree of 7 May 2000, paragraph 3.

[5] Art. 18 Royal Decree 7 May 2000.

[6] See arts. 41–82 of the Miscellaneous Act of 24 December 2002, *Moniteur Belge* 31 December 2002.

On 28 April 2003, the law of social plans was enacted, aiming at democratising the second category of pension benefits, by bringing it to a larger group of people. The plan may be created by a single company, or for a sector, or a branch.[7]

Denmark

In Denmark, most occupational pension schemes are regulated in collective agreements entered into by Danish labour market organisations. Some occupational pension schemes are, however, regulated in individual employment contracts. The employer has the choice of establishing a separate pension foundation, designed only for its own employees, or joining a pension fund. In both cases, the Pensions Fund Act (Consolidation Act No. 159 of 8 March 2001) is applicable. Separate pension foundations are not very common in Denmark, since most Danish companies are SMEs (small and medium-sized enterprises), for which it is not worthwhile to establish and administer a separate pension foundation.

According to the Act, the constitution of the pension fund shall contain rules on the calculation and allocation of any surplus to members. Rules covering any deficit shall also be included. Notification of these rules must be given to the Danish Financial Supervisory Authority. According to the Act, the Authority ensures the transparency of the rules and ensures that the rules lead to a 'reasonable' allocation of surplus. In general, the employer must satisfy any deficit.

a. Can the employer suspend making contributions?

Whether the employer can suspend making contributions depends on the agreement between the employer and the employee and on the bylaws of the pension fund. The rules of most Danish pension schemes oblige the employer to make continuous contributions of a fixed amount and therefore the employer cannot suspend contributions. However, some pension schemes do not entitle the employee to a continuous contribution from the employer; rather, they entitle the employee to receive a pension of a fixed amount at the time of

[7] See *Moniteur Belge* 15 May 2003 and erratum 26 May 2003. At the Council of Ministers of 28 March 2003 several Royal Decrees implementing the Act were approved in draft. The new system for independent workers had already been enacted as part of the Miscellaneous Act of 24 December 2002. Drafts of Royal Decrees were approved at the Council of 4 April 2003.

retirement. In this case, the by-laws of the pension fund may entitle the employer to a contribution holiday, if the pension scheme shows a surplus.

b. To whom does the surplus belong?

To whom the surplus belongs depends on the by-laws of the pension fund; however, according to the Pension Funds Act, the allocation of any surplus must be 'reasonable'. If the employer has guaranteed any deficit, then it may be considered reasonable for the employer to benefit from the surplus, or for the employer to be granted a contribution holiday in the case of a surplus.

England

Trusts have traditionally played an important role in pension arrangements. Following the misappropriation of pension funds by Robert Maxwell, there was some concern that this should be changed. However, the Pensions Law Reform Committee recommended that the trust vehicle should still be used.[8] The Committee's recommendations led to the Pensions Act 1995.

A surplus can only arise in a 'defined benefit' pension scheme, like the one in this question. 'Defined contribution' or 'money purchase' pension schemes have become more popular since the introduction of the Pensions Act 1995 since they do not place any risks on the employer of needing to top up a pension fund which is not performing well. Such schemes are, however, more risky for employees.

A defined benefit scheme can generate a surplus. This has led to a great deal of litigation, mainly in relation to the two issues raised by this question. Under the general common law, there is no simple answer, because the outcome will turn on the provisions of the particular scheme.[9] The position is clearer in England now under the Pensions Act 1995.

[8] It is, however, modified and controlled by legislation. The investment provisions of the Trustee Act 2000 do not apply to pension fund trustees; the delegation provisions apply only in a restricted way (Trustee Act 2000, s. 36). In particular, trustees of pension funds may not delegate to an agent their investment functions, nor may the pension fund employer act as an agent for any function. Note also that by s. 33 of the Pensions Act 1995, it is not possible for the terms of a pension trust to exclude liability of the trustees for negligence regarding their investment functions.

[9] See e.g. *Re Courage Group's Pension Schemes* [1987] 1 WLR 495; *Schmidt* v. *Air Products Canada Ltd* [1994] 2 SCR 611, 115 DLR (4th) 631; *Air Jamaica Ltd* v. *Charlton* [1999] 1 WLR 1399 (PC, Jamaica); *Monsanto Canada Inc.* v. *Ontario (Superintendent of Financial Services)* [2004] 3 SCR 152, 242 DLR (4th) 193.

(a) Can the employer suspend making contributions?

The Act requires periodical actuarial evaluation of the pension fund. If there is a shortfall, the employer must rectify it. If there is a surplus, the employer will be allowed a 'contribution holiday'. The position was recently clarified in relation to surpluses in *National Grid Co. plc* v. *Mayes*.[10] Under the terms of the plan, in the event of a surplus the employers 'shall make arrangements, certified by the actuary as reasonable, to deal with the surplus'; but no amendment could be made 'making any of the moneys of the Scheme payable to any of the Employers'. This condition against payment to the employer used to be required by the Inland Revenue for its approval of a scheme, which is required in order to attract the most favourable tax treatment.[11] When a surplus was actuarially certified, the employers dealt with part of it by increasing benefits for employees (including giving the employees a contribution holiday). As to the rest of the surplus, the employers' proposed arrangement was that they would treat some of their contribution obligations as discharged without payment. The House of Lords held that this was acceptable, even though the economic effect of a discharge of a debt is the same as that of a payment to the employers. The House held that the purpose of the clause barring payment was to prevent an employer from having access to funds that had already been exempted from normal taxation. This purpose would not be infringed by allowing the employer to take a contribution holiday.[12]

(b) To whom does the surplus belong?

If the surplus can be eliminated through a contribution holiday, then the question to whom it belongs is less pressing. Such a surplus may

[10] [2001] 1 WLR 864, [2001] 2 All ER 417 (HL). Much of this decision also demonstrates the extent to which it is difficult to formulate general principles; the precise terms of any particular plan can be determinative.

[11] In short, income tax is not paid by employer or employees on contributions; and the gains in the fund are not taxed (though income tax is paid when benefits are taken). The rule against employer withdrawals was required when the pension fund in *National Grid Co. plc* v. *Mayes* was established. Under the current law, a plan may allow payments to the employer out of the pension fund, but if there is a power to make such payments, it must be held not by the employer but by the pension trustees (Pensions Act 1995, s. 37). This ensures that any payment to the employer cannot be made without regard to the interests of the employees, because the trustees are restrained by the Pensions Act 1995, s. 37(4), which requires that the power be exercised in the interests of the members.

[12] The holding in *Schmidt* v. *Air Products Canada Ltd* [1994] 2 SCR 611, 115 DLR (4th) 631 was broadly similar on the issue of an employer's contribution holiday.

appear, however, when a scheme is being wound up. A well-drawn document will deal with the question of how the surplus should be dealt with, but prior to the Pensions Act 1995 much litigation was generated in cases where the terms of the trust did not clearly deal with this matter.[13] It was impossible to extract any general rule, since the outcome of each case depended on an interpretation of the terms of the particular trust. The Pensions Act 1995 deals separately with a surplus during an ongoing scheme, and one which must be dealt with when the scheme is being wound up. A power to transfer assets to the employer before the scheme is wound up must be controlled by the trustees, and may be used only if they are satisfied that it is in the interests of the beneficiaries and that benefits under the scheme have been indexed against inflation.[14] In the case of a scheme being wound up, surplus assets can be returned to the employer even if the trust document expressly prohibits any transfer to the employer (which used to be required for favourable fiscal treatment). Here again, the benefits must first be indexed.[15] If, however, the trust deed provides for the surplus to be used for the benefit of employees, this will be effective.

Finland

According to Finnish pension legislation, a certain level of pension provision is obligatory. There are three alternative ways for a private employer to organise the obligatory pension for its employees. The employer can (a) make an insurance contract with a specially licensed insurance company, (b) establish a pension foundation, or (c) join a pension fund.[16]

[13] A recent and startling example relates to two pension funds for bus drivers and other workers in the National Bus Company. When it was privatised in 1986, there was a surplus of £120 million, which was transferred to the government. Eventually there was a settlement in which the government paid £356 million (including thirteen years' interest) to pension trustees for the benefit of some 50,000 former employees (*The Times*, 16 June 1999).

[14] Pensions Act 1995, s. 37. In other words, if the trust deed gives this power to the employer, it is overridden to that extent (although in this case the employer must consent to the exercise of the power by the trustees).

[15] Pensions Act 1995, ss. 76 (distribution to employer permitted by the trust), 77 (distribution to employer prohibited by the trust). Although s. 77 allows a surplus to be returned to an employer where the pension is being wound up, even though the terms of the trust forbid this, in such a case the benefits must not only be indexed, but they must be augmented to the limit permitted by tax law.

[16] In certain branches where short work relations are typical, the employer must, normally, join a pension fund meant for employees of his or her branch. The use of alternative (a) or (b) requires, in these cases, permission granted by the authorities. See

According to the law, the employer and the employees administer jointly both the pension foundation and the pension fund, although the employer is considered to have a stronger position in the pension foundation than in the pension fund.[17] With regard to details, the administration of the pension foundation and fund is determined by their respective by-laws. Clearly, the most important way to organise employee pensions is to take out pension insurance; however, the roles of the pension foundation and pension fund are not irrelevant.

Pensions are financed both by employers and employees. The authorities annually determine the employee's share of the cost of the obligatory pension, according to a formula laid down by legislation.[18] This payment is deducted from the salary by the employer and then used to finance the employee's pension according to the system chosen by the employer. In the case of a pension that exceeds the required minimum level, the employee's share of the cost can be determined by the contract between the employer and the employee, or by the by-laws of the pension foundation or fund. The legal default rule is that an employee is liable to pay, at most, half of the extra expenses.[19]

When the employer uses insurance in order to organise the obligatory pensions of its employees, it must pay an insurance premium, which is determined by the authorities on the grounds of a formula given in the legislation. The premium is equal to a certain percentage of the salary of each employee. If the employer has chosen to organise the pensions of its employees by means of a pension foundation or a pension fund, then the employer is liable to pay the foundation or fund an amount such that the solvency and solidity of the foundation or fund are secured

the Act on Pension for Employees in Short Work Relationships of 9 February 1962/134, ss. 2 and 3. Similar kinds of pension funds also take care of (a) artists and certain comparable groups of employees, if they are working in short employment relations (see the Act on Pension of Artists and Employees belonging to Certain Special Groups of 26 July 1985/662, s. 2) and (b) seamen (see the Act on Pension of Seamen of 26 January 1956/73, s. 2). These pension funds are, thus, meant for the whole or a part of an employment sector, and not only for employees of one or a few employers. These funds are administered in much the same way as the licensed pension insurance companies, and they seem to fall outside the frame of Case 8. Hereinafter, they are not taken into consideration in this text.

[17] See the Pension Foundation Act of 29 December 1995/1774, s. 17 and the Insurance Fund Act of 27 November 1992/1164, s. 25.

[18] See the Employees Pension Act of 8 July 1961/395, s. 12 b. The benefits of the obligatory pension are defined by the law and they depend, roughly speaking, on the salary which the employee has earned during the last years before his or her retirement and on the total duration of his employment relationships.

[19] See the Employees Pension Act, s. 11.

according to certain actuarial criteria determined in the legislation and by the authorities.[20]

a. Can the employer suspend making contributions?
If the economic situation of the foundation or fund fulfils the criteria determined by the legislation and authorities, then the employer can suspend making contributions.

b. To whom does the surplus belong?
In the same way that the employer is liable to take care of the financial deficit of the foundation or fund, the employer is, on the other hand, entitled to the surplus if the assets of the foundation or fund permanently exceed the level defined in the legislation and by the authorities.[21] If the foundation or fund is dissolved, e.g. due to the fact that the employer stopped running its business or due to the provisions of the by-laws, then the rights of the employees to their future pensions must, in general, be secured by obtaining insurance from a specially licensed insurance company.[22] The possible surplus will, thereafter, be paid back to the employer or used in the way determined by the by-laws of the foundation or fund.[23] As long as the foundation or fund has taken care of the obligatory pensions of the employees, the default rule is that the surplus belongs to the employer.[24]

France

French law provides for a series of schemes in the nature of pension plans.

The first is the basic pension plan, which functions according to the contributory principle (*répartition*). Such pensions are paid by social security institutions, which are public legal entities governed by administrative law. Social security contributions are mandatory for both the employer and the employee throughout the period of work. The French Government maintains traditional contributory pension schemes

[20] See the Pension Foundation Act, s. 45.
[21] See the Pension Foundation Act, s. 45 and the Insurance Fund Act, s. 83 a. As far as a pension fund is granting only pensions exceeding the legal minimum standard and the surplus of the fund is produced by payments of the employees, the employer is not entitled to it.
[22] See the Pension Foundation Act, s. 88 and the Insurance Fund Act, s. 122.
[23] See the Pension Foundation Act, s. 88 and the Insurance Fund Act, s. 120.
[24] See the Pension Foundation Act, s. 88 and the Insurance Fund Act, s. 83 a.

(*retraites par répartition*), as opposed to capitalised schemes, mainly for political reasons. Recent debate on pension policy led to legislative changes, which maintain the principle of contributory pension schemes: the Act of 24 July 2003 (*loi portant réforme des retraites*) confirmed this principle and extended (with some exceptions) the duration of contributions required for employees to be entitled to receive a full pension.

The second is the supplementary pension plan linked with a professional activity, which is based on the principle of capitalisation. French companies may put in place a number of savings schemes available to their employees. A report released in 2000 proposed the implementation of employee savings funds that would block employee contributions to the funds for up to fifteen years, the effect of which could be – to some extent – similar to pension funds. An Act of 19 February 2001 aims to implement, to some extent, the suggestions of this report. This Act created a new type of employee fund called the *plan partenarial d'épargne salariale volontaire*, whose characteristics include blocking employee contributions for a ten-year period, and which may be a tool for employees to obtain additional funds at the time of their retirement. The Act of 24 July 2003 modified the *plan partenarial d'épargne salariale volontaire* into a *plan partenarial d'épargne salariale volontaire pour la retraite*, i.e an employee savings fund dedicated to pensions. The main difference between these two schemes is that the former blocked employee contributions for a ten-year period whereas the latter blocks the amounts until the employee's retirement (unless specific circumstances are met). Both of these plans (i) are created pursuant to collective agreements among unions and the employer (or, in some instances, a series of employers), (ii) provide for employer contributions, in addition to those of the employees, along with tax and social charges advantages, and (iii) invest contributions in collective investment schemes.

The third type of plan is the individual supplementary pension plan, which includes life insurance as well as the *plan d'épargne individuelle*, created by the Act of 24 July 2003, which is in substance a special type of insurance agreement benefiting employees.

Finally, a French pension funds regime was established by the Act of 25 March 1997 (the 'Pension Fund Act'): a so-called *fonds d'épargne retraite* would have permitted the creation of capitalised pension funds. No implementing decrees of the Pension Fund Act were ever published. The French Government announced in 1998 its intention to abrogate the Pension Fund Act, and did have Parliament abrogate it by an Act of 17 February 2002 (*loi de modernisation sociale*).

a. Can the employer suspend making contributions?
With respect to the basic social security pensions, the employer cannot suspend making contributions. With respect to a supplementary pension plan linked to a professional activity, the employer is bound by the terms and conditions of the plan itself. With respect to the special type of insurance agreement, the employer makes no contributions.

b. To whom does the surplus belong?
With respect to the basic social security pensions, the surplus belongs to the particular social security institution. With respect to a supplementary pension plan linked to a professional activity, the employer may not claim the surplus. It belongs to the employees. Retiring employees are entitled to a life annuity (*rente viagère acquise à titre onéreux*), or to direct transfer of the capital, depending on the terms of the said plan. With respect to life insurance, the surplus belongs to the insurer, unless otherwise provided for in the life insurance agreement. The employee will benefit from a life annuity (*rente viagère*).

Germany

In Germany, pensions of employees (outside the social security system) are based on a specific Statute, the *Gesetz zur Verbesserung der betrieblichen Altersversorgung* of 12 December 1974.[25] There are four schemes under § 1 of the Statute. The *Unterstützungskasse* (para. 4) is characterised by the fact that the employee does not have a claim; it has almost become obsolete since the Supreme Court has held that in the area of labour law, consistent behaviour of the employer can nevertheless be binding on the employer.[26] The *Direktzusage* (para. 1) is a direct claim against the employer. The *Direktversicherung* and the *Pensionskasse* (paras. 2 and 3) are insurance solutions; the only difference between the two schemes is that in one case the employer himself organises the insurance entity, which in this case also has its own legal personality. Therefore, for the purposes of the questions asked in Case 8, it is necessary to distinguish between a direct claim scheme (para. 1) and an insurance scheme (paras. 2 and 3). A genuine trust scheme for pension funds has been proposed for the three schemes;

[25] BetrAVG, *Bundesgesetzblatt* part I, 2998, *Bundesgesetzblatt* part III/FNA 800–22.

[26] BAG AP nos. 1, 3 and 6 zu § 242 BGB *Ruhegehalt – Unterstützungskassen* and AP nos. 3 and 17 zu § 1 BetrAVG *Unterstützungskassen*.

it is called the *Finanzmarktförderungsgesetz* (see Case 1, Alternative 1) but it has not yet been enacted. For tax reasons, pension schemes aside from those under the Statute are essentially non-existent.

Party autonomy exists for a significant part of the drafting of the scheme, especially for the question of whether it is the contributions or the eventual pensions which are to be fixed (contribution or outcome orientation). The majority are of the latter type[27] and only in this respect are the questions raised of any importance. The risks related to this scheme led to a considerable drop in the promising of company pensions. In this scheme a fixed sum can be promised (static type), or, more commonly, the promise can be adjusted periodically (dynamic type). There is, however, a statutory duty to consider the adaptation of the pension every three years, taking into account the economic situation of the company (see § 16 BetrAVG).

If the pension promised is paid by the employer himself (direct promise scheme, § 1 para. 1 BetrAVG), then he must create reserves which, according to actuarial mathematics, are necessary to satisfy foreseen claims (see § 253 para. 1 HGB). The reserves, and the increased value of investments made, clearly belong to the employer (the company). According to German law, the protection of the employee is secured by a mutual insurance scheme similar to the deposit-guarantee schemes used by commercial banks. In the employer's balance sheet, pension investments must be recorded at their purchase price (§§ 253 para. 1 [1], 255 HGB). Successful investments by the employer are not directly related to one liability or the other. Therefore, even if the increase in value of the investments leads to a re-evaluation of these investments under §§ 249, 253 ff. HGB, then this increase is only the sum of the assets in the balance sheet. New assets, however, acquired at higher prices (new investments in a changing portfolio) will show these increases in value in the balance sheet. This surplus can certainly be used as a reserve, and it reduces the amount of reserves needed in the future.

Under the insurance scheme (paras. 2 and 3), both employees and employers can be obliged to contribute. According to German life insurance law, premiums are calculated in a conservative way. Therefore, the presence of a surplus is considered to be normal. The surplus share of each life insurance policy is attributed to the policy (at least for the part that is not withheld by the insurance company).

[27] See *Münchener Handbuch Arbeitsrecht*/Ahrend/Förster, vol. 1, § 102 para. 59.

Such a surplus, however, does not reduce the obligation to pay premiums. Since the employer normally promises the employee a certain pension, the surplus must be distributed. Under static schemes, where the employer promises only a certain sum, the surplus is not used for the benefit of the employee (derived by argument from § 16 para. 3 no. 2 BetrAVG). If the surplus is fully used for the benefit of the employee, then the duty to consider adaptation every three years is fully satisfied (§ 16 para. 2 BetrAVG). The scheme is considered to be dynamic.

Greece

In Greece pensions are paid by social security institutions, which are legal entities of public law, after a certain age limit has been reached and after a certain period of work has been completed. Social security contributions are mandatory for both the employer and the employee throughout the period of work. The state often commits itself to make complementary contributions to the social security institutions.[28] Suspension of contributions is not possible for the employer. Any surplus belongs to the particular social security institution, which is liable to pay the pension.

On the other hand, private insurance schemes are often utilised in Greece by several employers as complementary pension plans for their retired personnel. Each private scheme is regulated by an agreement concluded between an insurance company and the employer, providing for the latter to make contributions in favour of its employees. These private schemes are not mandatory for the employer, who may terminate the scheme according to the terms of the particular insurance agreement. Furthermore, any surplus belongs either to the employer or to the employee, depending on the terms of the particular agreement.

Pension policy is currently under reform in Greece. The recent debate on pension policy led to legislative changes towards a system of private pensions, which is complementary to the public social security system.[29] L.3029/2002 provides for the right of employers and/or employees to establish by private agreement legal entities of private law (Funds of Professional Insurance) in order to provide complementary pensions and other benefits in kind or in cash (e.g. medical assistance, indemnities in case of accident or disease, etc.) to those employees who have opted to participate in the Funds. The Funds are supervised by the

[28] Kremalis, ‘Social Insurance Law’, in Kerameus–Kozyris, *Introduction to Greek Law*, 262–263.

[29] Ibid., 258.

Minister of Work and Social Security. Adherence to the Fund is not mandatory for either the employees or the employer, unless the latter undertook to establish the relevant Fund. The Funds operate according to the principles of capitalisation, i.e. they invest any contribution paid by the employers and/or employees in movable and/or immovable assets, and the board of the Fund manages such assets. L.3029/2002 provides for restrictions regarding the management of the assets belonging to each Fund. Furthermore, the by-laws of the Fund should determine in particular the amount of contributions to be paid by the employers and/or the employees, the methods of readjustment of those contributions, the amount of pensions and of any other benefits, and the methods of readjustment of those pensions and benefits.

As a result, there are no generally applicable principles of Greek law with respect to the questions raised in Case 8, such issues being treated on a case-by-case basis according to the terms of the by-laws of each particular Fund.

However, the complementary private pensions system described above has not yet come into effect, as a number of tax issues are still unresolved.

Ireland

a. Can the employer suspend making contributions?

The employer will, of course, be able to suspend contributions if the pension trust expressly provides for this. If it does not, two positions arise. First, a pension trust document cannot be varied without an express power of amendment.[30] In such a case, if the trust does not allow for an employer to suspend contributions, then it cannot be amended to achieve this outcome. However, second, as a general rule, most modern pension trust documentation will usually provide that it may be amended or varied.[31] Where this occurs, the general law requires that any material alteration in its terms must be notified to the members of the pension scheme within six months.[32] In such a case,

[30] *Re Miller* [1897] 1 IR 290; *Re Johnson's Settlement* [1944] IR 529; unless, of course, the rule in *Saunders* v. *Vautier* can apply (see Case 1, Alternative 1, above), but 'in all but the smallest pension schemes, this would present practical difficulties' (see Finucane and Buggy, *Irish Pensions Law and Practice* (Dublin: Oak Tree Press, 1996), 66, para. 3.10 n. 15).

[31] Finucane and Buggy, *Irish Pensions Law*, 152, para. 5.26.

[32] The Occupational Pension Schemes (Disclosure of Information) Regulations, 1991; SI No. 215 of 1991 requires that such notice be provided within six months; and if the pension terms form part of the contract of employment, s. 5(1) of the Terms of

if the trust does not allow for an employer to suspend contributions, it can be amended to achieve this outcome.

b. To whom does the surplus belong?

The question of ownership of a surplus in a pension trust,[33] especially on a winding-up, will turn on the terms of the pension trust deed,[34] which will often allow that surplus to augment pension benefits.[35] Thereafter, any 'ultimate surplus after augmentation of benefits . . . is repayable to the Principal Employer'.[36]

Italy

In Italy, pension funds law has been reformed several times over the last decade or so.[37] Before these changes, the legal form of private pension schemes was usually that of a fund established as a separate patrimony, or as an unincorporated association (art. 36 CC) or foundation (cf. art. 39 CC). The fund was often formally vested in the employer (arts. 2114–2117 CC). These older funds still provide pension benefits to about 600,000 members, under the umbrella of the above-mentioned reforms, in certain sectors of the market with higher than average wages (banks, insurance companies, corporate managers, etc.).

Today, pension funds are set up as unincorporated associations, or as incorporated associations or foundations; if they are established for an entire sector of the workforce (e.g. for workers in the steel industry) they must have legal personality (d. lgs. 21 April 1993, n. 124, art. 4.1, 4.4). The fund is normally managed by institutions specialised in asset-management activities under a contract with the fund (d. lgs. 124/1993,

Employment (Information) Act, 1994, then such notice should be provided within one month.

[33] Finucane and Buggy, *Irish Pensions Law*, 546–550, paras. 17.29–17.35.

[34] See, e.g., *Irish Pensions Trust* v. *First National Bank of Chicago* (HC, unreported, 15 February 1989, Murphy J).

[35] Finucane and Buggy, *Irish Pensions Law*, 547, para. 17.31.

[36] Ibid., 547–548, para. 17.31.

[37] The fundamental text is the d. lgs. 21 April 1993, n. 124, *Disciplina delle forme pensionistiche complementari*, as amended. The main pension funds regulator, i.e. the *Commissione di vigilanza sui fondi pensione* ('Covip'), published a consolidate version of it on its website: www.covip.it. For general data and analysis of the Italian pension system, see: the *Report on National Strategies for Future Pension Systems (Italy 2002)*, available on the website of the European Commission: http://www.europa.eu.int/comm/employment_social/soc-prot/pensions/it_pensionreport_en.pdf; Gabrielli, Vallacqua, *The Italian Pension System: Present Structure and Prospects* (2003); Pension Forum, ed., *Rapporto sulla previdenza complementare 2003* (2004). For more detailed commentary, see: Tursi, *La previdenza complementare nel sistema italiano di sicurezza sociale* (2001); Bessone, *Previdenza complementare* (2000).

arts. 6, 6bis, 6ter). The fund assets can neither be diverted from the purpose for which the fund was established, nor seized by the creditors of the manager. As for collective investment schemes described in Case 9, the fund assets must be kept in the custody of a bank (d. lgs. 124/1993, art. 6bis).

These new schemes are commonly known as 'closed funds' because they are established by collective agreements that cover only those workers in the category for which the agreement was negotiated (d. lgs. 124/1993, art. 3). In June 2002 there were forty-two closed funds with about 1,050,000 members. On the other hand, 'open' pension funds are joined by all categories of workers who cannot join a 'closed' pension fund, such as self-employed workers (d. lgs. 124/1993, art. 9). Open pension funds are established by the same asset-management institutions that manage closed funds. These funds do not have legal personality, nor are they independent decision-making bodies, but they offer the same basic safeguards set up for closed funds: their assets can neither be diverted from the purpose for which the fund was established, nor seized by the creditors of the manager. In June 2002 there were over 100 open funds, covering about 300,000 members.

Most Italian pension funds are defined contributions funds. Actually, closed pension funds can now only be established as defined contributions schemes (d. lgs. 124/1993, art. 2.2). Payment of the defined benefit is guaranteed by insurance coverage (d. lgs. 124/1993, art. 6.3).

Lacking specific precedents, it is submitted that the issues raised by the present case should be analysed as follows.

a. Can the employer suspend making contributions?

The fund is established, in most cases, by way of contract. If its duration is indeterminate, the employer can withdraw from it with a unilateral declaration, on the basis of the general principle of law which does not allow perpetual obligations. This declaration will terminate the employer's obligation to contribute to the fund, but it cannot affect the vested rights of the other contributors to it.[38] If the fund is for a fixed term, the employer cannot withdraw from it before the expiry of the term. In either case, suspension of the contribution by a unilateral act of the employer seems to be problematic, unless the power to suspend contribution was agreed upon when the fund was established. If such power was not expressly reserved, it could possibly be grounded on the

[38] Cass., 1 July 1998, n. 6427, Mass. giur. lav., 1998, 557, n. Molteni.

principle that unforeseen events which disturb the economy of the contract can lead to its termination, unless a modification is more appropriate. But this equitable principle operates only if the risks against which the employer is reacting are not typically associated with the contract in question.[39] This is a strong limitation to the application of the principle.

b. To whom does the surplus belong?

Employers' contributions to pension funds are considered part of employees' deferred remuneration, though the link between the supplementary pension benefit and the other components of their remuneration does not work for all purposes and in all respects.[40] If the fund is funded by the employer, he cannot claim the surplus, because this would undermine the pension promise. It should also be mentioned that an express statutory provision declares that the pension fund assets are owned by the pension fund (d. lgs. 124/1993, art. 4ter). This formula, which is not crystal-clear, means that the capitalised contributions to the fund (and the surplus, if any) are not owned by the employer, nor by the present members of the scheme either. It could therefore be argued that no one is presently entitled to the pension fund surplus. With respect to funds that are transferred to an insurance company, which guarantees defined benefits, the conclusion is different, however. These funds are owned by the insurance company. The fund surplus belongs to the insurer as well, by analogy to the legal regime applicable to life insurance funds, though the pension funds legislation is not explicit on the precise point.

LUXEMBOURG

In 1999, Luxembourg adopted two major pieces of legislation that for the first time provide a legal basis for complementary pension plans and pension funds. The laws are dated 8 June 1999. They include a law on

[39] Cf. Art. 1467 CC: 'In contracts for continuous or periodic performance or for deferred performance, if extraordinary and unforeseeable events make the performance of one of the parties excessively onerous, the party who owes such performance can demand dissolution of the contract, with the effects set forth in article 1458. Dissolution cannot be demanded if the supervening onerousness is part of the normal risk of the contract. A party against whom dissolution is demanded can avoid it by offering to modify equitably the conditions of the contract.'

[40] This has been affirmed by several decisions. See e.g. Cass., 1 February 1997, n. 974; Cass., 19 May 1995, n. 5505.

complementary pension plans and a law creating pension funds under the form of a sepcav (*société d'épargne-pension à capital variable*) or of an assep (*association d'épargne-pension*). Prior to this date, any complementary pension plan was subject to private, contractual arrangements.

It is assumed that the employees' pension fund adopts the form of a complementary pension plan, i.e. a sepcav or an assep, or an entity (*fond de pension*) regulated by the Insurance Commissioner (*Commissariat aux Assurances*). A sepcav has a legal personality separate from the employer and the employees. An assep is a co-ownership of assets without legal personality. Both the sepcav and the assep are subject to strict control by the CSSF (*Commission de Surveillance du Secteur Financier*), that is, the supervisory authority of the Luxembourg financial sector. The third type of pension plan is subject to the control of the *Commissariat aux Assurances*, which is the supervisory authority of the insurance sector.

The above-mentioned laws do not expressly provide for the situation of a fund that generates a surplus due to the investment of assets already financed by the contributions. Rather, the laws are mainly concerned with the situation of deficits between the anticipated liabilities and the assets of the fund (according to an actuarial calculation defined by the law).

However, it is likely that the individual fund addressed this issue in the *règlement de pension* (pension regulation), which every sepcav and assep is obliged to adopt. In particular, art. 60 of the 1999 Law on sepcavs and asseps requires the determination of the duties of the contributors, the financing plan, and certain other regulations regarding the contributions to be made.

On the basis of general legal principles, and in the absence of any specific regulations (which must be approved by the CSSF), it is arguable that the surplus does not suspend the employer's obligation to contribute according to the obligations he has undertaken, and that the surplus belongs to the fund.

Netherlands

General

Different structures are available for employee pension plans. The regulations on pensions are found in the *Pensioen- en Spaarfondsenwet* (Pension and Savings Funds Act; PSW) (latest version Stbl. 2000, 256). Article 2 PSW obliges every employer who promises a pension to his employees, to choose for the implementation of this promise one of the possibilities that are offered by the PSW. The employer may join a general company pension fund, he may institute a business pension fund in connection with his business, or he may conclude a contract with an insurance company or give his employees the means to conclude the contract with the insurance company by themselves.

In the Netherlands a frequently used vehicle for a company pension fund is the foundation. The assets that form the pension fund are held by the foundation. The title to the assets stands in the name of the foundation. If the pension is secured by way of an insurance contract with an insurer, then the employees have a personal claim against the insurer for their pension money. In such a case, contributions cannot be suspended and there is no possibility of a surplus.

The foundation as manager of the pension fund

a. Can the employer suspend making contributions?

The general opinion in the Netherlands is that the employer has the right to profit from the surplus. One way for the employer to benefit from the profit is by the suspension of contributions. However, this possibility is controversial. Other possibilities have been suggested as well. Some argue that the 'beneficiaries' of the fund should profit from the surplus.

b. To whom does the surplus belong?

Formally, the surplus belongs to the foundation since the foundation has full title to the fund. However, the structure of the fund, the by-laws, and the contractual arrangement between employees and employer are all relevant in determining to whom the surplus belongs, irrespective of who is the legal owner of the fund. It is often argued that the surplus should flow back to the employer, since it is the employer who has to supplement the fund if it falls short of the amount that is required to meet the pension liabilities. However, the final conclusion regarding this point depends on the arrangements in the contract. Parties can conclude a new contract and agree that the surplus will be used to increase the benefits payable to the employees.

It is also possible to look at the situation from an economic perspective. On this view, the individual employee or the collective of employees (including the ones that already receive their pensions and those with rights that are dormant) are the ones to whom the surplus should flow. This flow can take the form of shorter working hours, opportunities to take courses, sabbatical leave, and so on.

Some of the surplus arguably belongs to the fiscal authorities, since it now appears that too much pension premium was deducted from the profits of the company. This is the subject of an ongoing debate.[41]

PORTUGAL

In Portugal, there are basically two main state pensions systems that cover the whole of the population: one for civil servants (*Caixa Nacional de Pensões*) and another for those who are not employed by the state (*Sistema de Segurança Social*). In the future, there will be a single general system of social security.

Beside the state system, there is a private system, based on pension funds connected to insurance companies. As a result of collective labour negotiation, private pensions may complement the basic social security system, as is the case for employees of banks. Apart from this, anyone may voluntarily complement any other pension plan through several private pension funds (PPRs – *Planos de Poupança-Reforma*) managed in connection with insurance companies. This is becoming increasingly popular as it provides fiscal advantages.

In accordance with the Pension Funds Act 1999 (Decree-Law 475/99 of 9 November), pension funds are 'assets solely allocated to one or more pension plans' and their assets are allocated only to the beneficiaries through compliance with a pension plan. The contents of pension plans must be previously approved by the insurance control entity – the Insurance Institute of Portugal (*Instituto dos Seguros de Portugal* – ISP). There is total separation of assets between the fund and its members, participants and beneficiaries. Pension funds, like investment funds, are autonomous patrimonies that are managed by special pension funds management companies – *Sociedades Gestoras de Fundos de Pensões*. Pension funds and their management companies are subject to the supervision of the ISP, the entity that exercises general supervision over the insurance industry.

In accordance with the Pension Funds Act 1999, pension plans may be closed (which is the case for employer–employee funds) or open (these

[41] PMC de Lange, 'De eigendom van vermogensoverschotten van pensioenfondsen', *Sociaal Recht* 2000–11, 342–346. J. B. Kuné, 'De eigendom van en de zeggenschap over pensioenvermogen; een bijdrage tot de discussie', *Tijdschrift voor Pensioenvraagstukken*, April 1999, no. 2, 47–50. See, for older literature in English: L. Mok et al., eds., *International Handbook on Pensions Law and Similar Employee Benefits* (London, 1989), chapter III: 'Surplus reversion: recapture of assets'.

funds are free to the public); they may be defined benefit (contribution is variable in order to obtain a defined benefit), defined contribution (benefit is variable) or mixed. They may also be *contributivos* (employer and employee contribute) or *não contributivos* (only the employer contributes). Closed (employer–employee) pension funds may be defined benefit, defined contribution or mixed; open funds must be defined contribution.

Each pension plan must be approved by the ISP and can only be altered with its approval. Each defined benefit (or mixed) plan must have an actuarial plan, and an individual actuary must be appointed to control its accuracy.

Surplus is dealt with in art. 28 of the Pension Funds Act 1999. If there is a surplus for five consecutive years in a defined benefit pension plan, the surplus may be returned to the employer (*associado*) under the supervision and control of the ISP, after considering the circumstances from which the surplus arose, and taking into account the interests of participants and beneficiaries (employees). The ISP shall not allow the return of a surplus if it was a direct or indirect consequence of an alteration of the pension plan, or of a drastic reduction in the number of participants. The amount and the terms of the return are defined by the ISP. In Case 8, the pension plan is defined benefit and the contribution is variable; a contribution holiday might be proposed to the ISP in case of surplus. Surplus clauses may be included in pension plans.

Scotland

The law and practice are the same as in England.

Spain

Pension funds are regulated by special legal provisions (*Ley 8/1987, de regulación de los planes y fondos de pensiones* and *Real Decreto 1307/1988*), which have been amended on several occasions. As with investment funds, the Spanish legislator has opted for a *bewind* type of structure, in which the funds are nominally owned by participants, who participate only to the extent of their contribution.

Pension funds are the instruments to carry out pension plans. The law recognises three types of pension plans: (a) pension plans promoted by employers for the benefit of employees (*sistema de empleo*), (b) pension plans created by associations or trade unions for their associates (*sistema asociado*), and (c) individual pension plans (*sistema individual*) which are promoted by banks or other financial institutions, and are open to the public in general. The law also distinguishes between defined benefit plans (*plan de prestación definida*), defined contribution pension schemes and mixed schemes.

The situation described is that of a *sistema de empleo* with a defined benefit, since otherwise a surplus could not arise. Whether in this case the employer can suspend his contributions mainly depends on the pension plan itself. If the pension plan contemplates this possibility, then difficulty will not arise; if, on the other hand, it is an unexpected situation not provided for in the plan, then the managers have to turn to the *Comisión de Control del plan* in order to receive instructions. This body is formed by representatives of the employer, of the employees and of third party beneficiaries. Since the law stipulates that the employees have a majority vote in that body, it is more likely that they will suspend their contributions rather than the employer's contributions. As mentioned above, all the funds of the plan belong to the participants; in other words, the surplus belongs to them.

Sweden

Normally, pensions in Sweden for privately employed persons, in addition to the basic level provided by the state to all citizens, are regulated in collective agreements between the employer and the union of the employees. Premiums are deducted from the wages or paid in addition to the wages to a jointly run insurance company. Both the employers and the employees are represented in the company's board. If the management of the fund has been successful and the company thus was overconsolidated, the company has a choice between stopping or decreasing the contributions from the employer, returning part of the assets to the employer, or increasing the pensions to the employees. In the 1990s this situation occurred. There was some legal discussion whether the surplus in a joint insurance company (*Alecta*) should benefit the employers or the employees. In the end a decision was taken by the board that the surplus should be returned to the employers in proportion to their payments, provided that they were still employers. A reason for this decision seems to have been that, pursuant to s. 1 of a statute on safeguarding pension promises (*lag om tryggande av pensionsutfästelser*, 1967:531), an employer is responsible for his pension promise even if the employer has paid premiums to a fund (a legal entity, *stiftelse*, with the purpose to pay out the pension).

Thus, according to the interpretation that the parties on the labour market reached in the actual case, the surplus belongs to the employer, but since the surplus was returned to the employer there was no suspension of contributions.

In the statute on funds (*stiftelselagen*, 1994:1220), there are some special provisions on collective agreement funds (*kollektivavtalsstiftelser*): see ch. 11 ss. 3 and 4. If the premiums are paid to such a fund instead of an insurance company, the by-laws of the fund decide how a surplus should be treated.

Comparative remarks

Due to historical, social and economic diversity, wide differences exist throughout Europe with regard to the existence and importance of employment pension funds, outside of the state-sponsored social security system. In Belgium, they are increasingly important, while in Greece, they are plainly unknown and individual plans are required. Many countries have recent legislation, such as France, Italy, and Luxembourg, but the state's commitment to this kind of investment is variable, as the French report shows. In other countries, such as Austria, England, Finland, Germany, the Netherlands and Spain, they seem to be an established part of the employment landscape.

The answers show the multiplicity of legal forms that may be used to generate the desired economic effects. Some reports (Austria, Finland, Germany, Greece, Italy, the Netherlands, Sweden) mention the possibility of using third party insurance. Here any overfunding is for the benefit of the insurer, and the employer's contributions are required as a matter of contract law. Some of these reports (Austria and Germany) also mention the possibility that the employer promises the pension, maintaining funded reserves to secure the obligation; here the surplus clearly belongs to the employer and the question of a contribution holiday does not really arise.

The difficulties raised by the case arise when the fund is a separate patrimony from the employer, but at the same time, unlike a third party insurer, it is not fully independent. Again, there are many forms. There may be a foundation (Denmark, Finland, Italy, the Netherlands) or an incorporated association (Italy), or a *sui generis* entity with legal personality (Austria, Belgium, Germany, Luxembourg). There may also be a separate patrimony without legal personality, like an unincorporated association (Italy, Luxembourg), a fund (Portugal) or a trust (England, Ireland, Scotland). Whether or not the fund has personality, it may be true that any surplus belongs to it (Luxembourg, Portugal, Sweden), but if the stakeholders are the employer and the employees, the substantial question must still be answered as to which of these will be the ultimate beneficiary. Some countries (Belgium, Denmark, the Netherlands, Sweden) indicate a preference for party autonomy, observing that the solution will always be found in the terms of the particular plan. In the absence of a solution here, some (Finland, the Netherlands) suggest that it will be the employer, on the reasoning that it has taken the risk of having to make higher contributions if the fund was underfunded, and therefore it should benefit from a surplus. Others (Italy, Spain) suggest that the surplus belongs to the employees. Denmark, England, Ireland and Scotland suggest a mixed view, with party autonomy playing a role that is limited by certain mandatory rules.

Case 9: Collective investment schemes

Case

A financial services company wishes to launch a collective investment scheme. It hopes to choose a vehicle that will allow the free transfer of the interests of investors, and which will permit the rules governing the scheme to be changed where necessary.

What options are available to it?

Discussion

Austria

Austrian private law recognises one type of collective investment scheme, namely, investment funds that fall under the Austrian Investment Fund Act (InvFG).[1] Austrian investment funds are open-ended funds that work on the principle of risk diversification and lend themselves to an open clientele. It is also possible to create special funds that only have a limited number of investors. All types of Austrian investment funds allow for changes of terms and conditions and for changes of investors, although there is no secondary market for trading the investment fund 'certificates'. Under the Austrian Investment Fund Act, the investors have the right of redemption.[2]

A change of the terms and conditions of an investment fund, under s. 22(3) InvFG, does not require the consent of the investors, but it must

[1] BGBl 1993/532.

[2] Weber, *Das Investmentfondsgesetz* (1998) 25 ff.; Heidinger, *Das neue Investmentfondsrecht* (1998) 27 ff.

be made in their interest, must be approved by the supervisory board and must be published. Section 22(3) InvFG deals only with the public law of the modification.

Different supervision schemes apply for Austrian investment funds. Supervision under the InvFG includes a bank supervisor, a supervisory board, an investment company (a special bank) and the depository bank. The investment company manages the fund and makes the investment decisions. The depository bank acts according to the investment decisions of the investment company and therefore buys and sells shares, bonds, etc. The supervisory board then approves the investment decisions of the investment company and the reports and financial statements of the investment fund. The bank supervisor of the investment company also approves the reports and financial statements of the investment fund.

The rules of the InvFG, for the investment company, are considered as *leges speciales* with respect to the general rules for banks in the Austrian *Bankwesengesetz* (BWG).[3] The regulations in the InvFG for permitted investment decisions are also oriented towards solvency and liquidity.

The supervision of banks applies to schemes falling under the InvFG, since the investment company and the depository bank fall under the definition of a credit institution (s. 1 BWG). Supervision under this statute is mainly concerned with solvency and liquidity issues.

Belgium

Belgium has implemented the European Directive on Undertakings for Collective Investment in Transferable Securities, as amended in 1988, through Book III of the Act of 4 December 1990. Two of the three forms suggested in the European Directive are now available in Belgium: (a) common funds, and (b) investment companies. Unit trusts cannot be created under Belgian law.

Specifically, the Act provides for four different collective investment schemes, two in corporate form and two in the form of a common fund. Both forms can be organised with fixed or variable capital. Thus, the financial markets can opt for an open-ended common fund, a closed-ended common fund, an open-ended investment company[4] and a closed-ended investment company.[5] The open-ended variants allow

[3] BGBl 1993/532.

[4] 'BEVAK' (Dutch) or 'SICAV' (French).

[5] 'BEVEK' (Dutch) or 'SICAF' (French). See art. 108 Act of 4 December 1990.

investors to step out at any time and request the redemption of their shares. Closed-ended investment companies and funds do not allow redemption on demand;[6] on the other hand, they do not have to pursue a strategy of spreading the risks to the same extent as the open-ended forms.[7] All four forms must have as their sole purpose the collective investment for the single benefit of their shareholders and/or participants. All assets must be deposited with a registered depository, which takes the form of a management company.

The rules governing an investment company are largely contained in its by-laws. The by-laws can be changed in accordance with the applicable provisions of general company law. The rules governing investment funds are contained in the contract and the management regulations of each fund. These by-laws or regulations cannot be amended without the approval of the Commission for Banking and Finance and of the general assembly of its investors. The general assembly can validly decide if the investors that are present represent at least 50 per cent of the shares in circulation. If this is not the case, then the general assembly must reconvene at a later date; it can then make a decision regardless of the number of investors that are present.[8]

The government has entrusted the Commission for Banking and Finance with the supervision of collective investment funds and collective investment companies. New investment funds and companies may only commence their activities after the Commission has approved the fund or company, approved its regulations or by-laws, and agreed with the appointment of the depository. Preliminary approval of the Commission is also required for (a) every amendment of the regulations or by-laws, (b) every change of management company or depository, and (c) every possible change in the controlling participation in the management company.

Denmark

As mentioned above in Case 5, collective investment in transferable securities is regulated by the UCITS and Non-UCITS Act. The Act contains rules on the organisation, approval and supervision of UCITS and Non-UCITS. UCITS and Non-UCITS must be organised in the form of associations with a capital of at least DKK 10 million.

[6] Art. 116 Act of 4 December 1990.

[7] Open-ended funds and companies may not invest in real estate and high-risk (venture) capital; art. 110, 116 and 122 Act of 4 December 1990.

[8] Art. 113 Act of 4 December 1990.

The articles of association are subject to the approval of the Danish Financial Supervisory Authority, and the latter must also approve changes to the articles of association. There is no specific regulation on other forms of collective investment schemes. Such investment schemes may therefore take on the corporate forms available to other undertakings.

UCITS and Non-UCITS are subject to the supervision of the Danish Financial Supervisory Authority, an institution under the responsibility of the Minister for Economic Affairs. Other forms of collective investment schemes are subject to the supervision that applies to the corporate form chosen.

England

There are broadly two systems used for such schemes in English law, the unit trust and the investment trust.[9] In a unit trust, units have a value set by the manager (according to a formula) and the manager is obliged to buy back units when investors want to redeem them. Investors are trust beneficiaries, and a trustee holds the underlying investments. Investors, therefore, have a direct beneficial interest in the underlying investments.

The investment trust, confusingly, is not a trust at all. Investors are shareholders in a corporation, which holds the underlying investments. The investors have no direct interest in the underlying investments. Moreover, they cannot sell their investment back to the manager; rather, the shares in the corporation are publicly traded on the stock exchange.[10] The effect is that the scheme is ‘closed-ended’ in the sense that the assets in the pool are fixed (unless the company issues new shares). The unit trust is potentially (and in practice usually) ‘open-ended’ such that new investors can add their funds at any time, acquiring units and enlarging the pool. This difference was blurred by the creation, in 1997, of the ‘open-ended investment company’.[11] This is a company (hence a legal person) with a variable share capital, which can issue and redeem new shares routinely.[12]

[9] This discussion omits the case in which the scheme will not be marketed to the public. That would permit other possibilities, such as the limited partnership.

[10] The Companies Acts 1985 and 1989 do permit a company to buy shares in itself in certain circumstances, but this is subject to many restrictions.

[11] The open-ended corporate form has long been the usual legal framework in North America, where it is possible to purchase and redeem fractions of shares in such a company so that transactions can be measured in exact units of currency.

[12] This new legal form was created by the Open-Ended Investment Companies (Investment Companies with Variable Capital) Regulations 1996, SI 1996/2827, made

As far as changing the rules governing the scheme is concerned, this would be possible in any of these cases. For the unit trust and the open-ended investment company, there are detailed rules governing meetings of investors and how they may change the rules of the scheme.[13] Changes require the approval of the Financial Services Authority.[14] In the investment trust, the making of changes to the company's constitution would be governed by company law; a change to the corporate constitution would require shareholder approval. There is no direct regulation by the FSA in this case (but see the next section). In all cases, a three-quarters majority is required to approve the change.[15]

In the case of a unit trust or an open-ended investment company, the scheme will be subject to Part XVII of the Financial Services and Markets Act 2000 (FSMA).[16] This provides some detailed rules for unit trusts,[17] and authorises the regulations for open-ended investment companies.[18] With regard to unit trusts, their trustees may not be exempt from liability for negligence under the terms of the trust.[19] Moreover, the trustee must be a separate entity from the manager

under the European Communities Act 1972, s. 2(2), which provides a general parliamentary authority to implement European legislation by secondary legislation (regulations). Any regulations made under the authority of that Act can only implement the European legislation; the Act does not authorise regulations which go beyond the European legislation. For this reason, the 1996 regulations could only go so far as the terms of the UCITS Directive. In practice this meant that an open-ended investment company (OEIC) could only have as its objective 'collective investment in transferable securities of capital raised from the public'. It could not invest in immovables or some kinds of derivatives. See Kam Fan Sin, *The Legal Nature of the Unit Trust* (Oxford: Clarendon Press, 1997), 44. This changed in late 2001 with the coming into force of the Open-Ended Investment Companies Regulations 2001, SI 2001/1228; because these were made under ss. 262 and 428 of the Financial Services and Markets Act 2000 (FSMA), they can go further than the Directive.

[13] These are in section 11.4 of the FSA rules for collective investment schemes, called CIS 11.4 in the terminology of the FSA. The current version is available on the FSA website, www.fsa.gov.uk.

[14] For unit trusts: FSMA, s. 251; for open-ended investment companies: Open-Ended Investment Companies Regulations 2001, SI 2001/1228, reg. 21.

[15] This is required by CIS 11.4 for a unit trust or an open-ended investment company. For an investment trust, the rules are in the Companies Act 1985, ss. 4, 9, 378.

[16] It is possible to set up private schemes outside the regulations, but not only can they not be marketed to the public, they also attract adverse fiscal treatment.

[17] Chapter III of Part XVII.

[18] Chapter IV of Part XVII, under which the Open-Ended Investment Companies Regulations 2001, SI 2001/1228, were passed.

[19] FMSA 2000, s. 253. By its s. 37, the provisions of the Trustee Act 2000 governing permissible investments and delegation do not apply to trustees of unit trusts.

who chooses the investments, and both must be corporations.[20] The FSMA also authorises the enactment of 'trust scheme rules',[21] and the power to make trust scheme rules extends to open-ended investment companies.[22] The rules are very detailed, covering the constitution of the scheme, its prospectus, how the scheme may invest, how investments must be held, permissible fees, and many other things.[23] The regulations governing permissible investments now permit funds that invest in land and in high-risk investments like futures and options.[24]

There are other FSA regulations that apply more generally. Anyone conducting investment management business must be authorised by the FSA, which includes an enquiry whether they are a 'fit and proper' person.[25] Other rules regulate the conduct of all aspects of the business, including the promotion of investment opportunities, accepting customers, and the handling of customers' assets.[26]

The situation is slightly different for investment trusts. Shares of these companies are not products regulated under the FSMA. The internal workings of the company are therefore not subject to FSA scrutiny. In particular, the directors of the company (who may be the ones who choose the investments) do not need to be authorised as 'fit and proper persons' by the FSA.[27] There are no required qualifications for someone

[20] FMSA 2000, ss. 242–243. Although an open-ended investment company is a legal person like an investment trust, it holds the underlying investments in a manner similar to the manager of a unit trust: that is, there must be a separate legal entity which holds them as depository (Open-Ended Investment Companies Regulations 2001, SI 2001/1228, reg. 5).

[21] Section 247.

[22] Open-Ended Investment Companies Regulations 2001, SI 2001/1228, reg. 6.

[23] In the language of the FSA, this part of its rules is called CIS. There is also a newer set of rules for collective investment schemes called COLL which may be chosen by new schemes. The current version of all FSA rules can be found on the FSA website, www.fsa.gov.uk.

[24] See CIS 2.1.4, and note 12.

[25] The standards to be applied are set out in Schedule 6 to the FSMA and implemented by the part of the FSA rules called FIT which are available on their website, www.fsa.gov.uk.

[26] Among the most important are the Conduct of Business Rules, which the FSA calls COB. The current version is available on the website, www.fsa.gov.uk. COB 10 contains some special rules for collective investment schemes. Also important are the general Principles for Businesses, called PRIN by the FSA.

[27] If, as is more common, the directors appoint a manager (probably another company) to choose the investments, this manager must be approved by the FSA as a 'fit and proper person' to perform this function.

to be a company director.[28] Internal workings of the company are instead governed by the Companies Acts 1985 and 1989. Shareholders will be entitled to vote at annual meetings for the directors and on other matters properly raised at the meeting.[29] They will also have available to them the various remedies which company law grants to shareholders. Such a company will have the status of 'investment company',[30] but the only effect of this is that the company is not liable for capital gains tax (since investors will pay this tax on their own gains).[31] If (as is likely) the shares of the company are traded on the London Stock Exchange, the entities, including investment rules for that body have to be respected. There are some rules that are particular to investment listing trusts. The company must disclose, in its annual reports, the ten largest investments in its portfolio. The board of directors must act independently of any investment manager, and a majority of the directors must be unconnected to the manager.[32]

On the other hand, the marketing of shares in an investment company is an activity that is subject to FSA regulation. Persons engaging in this activity must be approved, and the marketing must comply with FSA standards.[33]

Finland

Collective investment schemes are usually organised according to the Investment Funds Act of 1 January 1999/48.[34] These funds consist of pooled securities and/or derivatives, which the investors own *pro rata*.[35] A management company makes decisions concerning the investments,

[28] The company's constitution may impose a requirement to be a shareholder (Companies Act 1985, s. 291); also, a person aged seventy or over may not be a director of a publicly traded company, unless this is expressly permitted by the company's constitution, or approved by the shareholders with particular attention drawn to the director's age (ibid. s. 293). A person may be disqualified from acting as a director for misconduct as a director (Company Directors Disqualification Act 1986).

[29] Open-ended investment companies are not subject to the Companies Acts, but they must also have annual general meetings, at which directors are elected: Open-Ended Investment Companies Regulations 2001, SI 2001/1228, reg. 37.

[30] Companies Act 1985, s. 266.

[31] The same exemption applies to open-ended investment companies, and to the trustee of a unit trust.

[32] The FSA serves as the UK Listing Authority and in that role promulgates the Listing Rules, which are available on the FSA website, www.fsa.gov.uk; see especially chapter 21.

[33] See, in particular, the Conduct of Business Rules and the Principles for Businesses, above, note 26.

[34] See also Case 5 above.

[35] See Investment Funds Act, s. 25.

and a depository company implements those decisions and safeguards the invested property. Investment funds are the most appropriate vehicles for the purpose described in Case 9; and, in the case of private investors, they are practically the only ones used.

Investors in investment funds can freely transfer their interests or, for example, use them as security. According to the Investment Funds Act, the rules of an investment scheme can be changed. The changes need to be approved by the authority (Financial Supervision or Council of State) at the request of the management company.[36] The investors must be informed of the changes and, if they do not accept the changes, they have a period of one month to redeem their investment.[37]

One particularly regulated means for collective investments is the real property fund, which is governed by the new Real Property Funds Act. In this case the fund property consists primarily of real property owned by a specially licensed public limited company. Members of the public who invest acquire shares of this company. The shares can be freely transferred unless otherwise provided in the by-laws of the company, within the framework of the Companies Act. Changes in the rules of the investment scheme need to be approved by the Financial Supervision at the request of the company, as in the case of an ordinary investment fund.[38] The investors have, however, no absolute right to redeem their shares. That right depends on the by-laws and decisions of the company and on the general prerequisites of redemption defined in the Companies Act.

One option, which is sometimes used in venture capital investments, involves the establishment of a limited partnership. The investors become partners with limited liability, and without any significant opportunity to be involved in the investment decisions, which are made by an investment manager or an investment company. According to the Unlimited and Limited Partnerships Act of 29 April 1988/389, Ch. 1 s. 4, a partner cannot transfer his rights in the partnership without the consent of the other partners, and every change made in the by-laws of the partnership requires the consent of all of the partners. Both these provisions can, however, be displaced by the by-laws

[36] See Investment Funds Act, s. 43.

[37] The rules of the investment fund can restrict the investors' right to redeem their investment, if the fund is not within the scope of Directives 85/611/EEC and 88/220/EEC: see Investment Funds Act, s. 88.

[38] See the Real Property Funds Act, s. 14.

of the partnership. Therefore, the investments can be transferable and changes in the by-laws can be made, for instance, by voting in a similar way to a company with limited shares.[39] In spite of these legal possibilities, partnerships used in venture capital investments are usually meant only for a limited number of major investors.

It is also possible to establish an ordinary company with limited shares, which has investment as its business activity. This kind of company is governed by the normal rules concerning companies with limited shares.

Management companies and depository companies taking care of investment funds must be licensed by the Council of State, which can also cancel the licence if its terms are not fulfilled.[40] The current supervision is overseen by the Financial Supervision, which also supervises banks and other lending institutions. The same authority ratifies the rules of investment funds, if the fund is governed by Directives 85/611/EEC and 88/220/EEC. Otherwise, the ratification must be obtained from the Council of State.

Limited partnerships, which carry on venture capital activities on an equity basis, are not under any special supervision by the authorities. Memberships in these partnerships are not publicly traded, nor are they commonly offered to the public in other ways.

France

Two options are available to a financial institution that wishes to launch a collective investment scheme. It can create either a *société d'investissement à capital variable* (a 'SICAV') or a *fonds commun de placement* (an 'FCP').[41] Both of these are commonly established by banks, and are very frequently used by companies and individuals as a convenient way to invest.

A SICAV is a limited liability corporation whose sole purpose is to manage a security portfolio.[42] The SICAV issues shares to investors.

[39] See T. Wilhelmsson and N. Jääskinen, *Avoimet yhtiöt ja kommandiittiyhtiöt* (Helsinki: Lakimiesliiton Kustannus, 2001), 74–80.

[40] See the Investment Funds Act, ss. 5, 117 and 125.

[41] A third alternative would be to create an investment corporation with a fixed stock capital (*société d'investissement*). Investment corporations with a fixed stock capital are regulated by arts. 6 ff. of the 2 November 1945 Ordinance, and are limited liability corporations whose sole purpose is to manage a security portfolio. In practice, investment corporations with a fixed stock capital are very rarely used.

[42] Art. L. 214–15 para. 1 C. mon. et fin.

These shares are freely transferable to other investors. Also, these shares may be listed, under certain conditions, on a stock exchange. An investor may request any SICAV to buy back the shares it has issued at any time,[43] unless the SICAV decides temporarily to suspend the buy-back (a) in accordance with the terms and conditions of the SICAV's by-laws, (b) if exceptional circumstances occur, and (c) if it is in the interest of the shareholders of the SICAV that buy-backs be temporarily suspended.[44] Therefore, the investor's interests in a SICAV are freely transferable. In practice, investors rarely use the secondary market to transfer their interests in a SICAV, and prefer to ask the SICAV to redeem their investment.

To create a SICAV, the financial institution will need to obtain the approval of the AMF (Financial Markets Authority) to set up a limited liability company (*société anonyme*) with a minimum capital stock of €8 million.[45]

Its chairman and board of directors will manage the SICAV, as in any other corporation of this type. However, managers of a SICAV will have to comply with special rules of ethical conduct applying to mutual funds. The assets of the SICAV will be held by a depository.[46] The depository will, inter alia, have to control the SICAV's management actions. The by-laws (*statuts*) of the SICAV can be amended by the shareholders of the SICAV. A quorum of shareholders is not required to hold a shareholders' meeting.[47] In the light of the fact that investors rarely, if ever, attend SICAV shareholders' meetings, it will be fairly easy for the financial service company to control the shareholders' meeting with a nominal amount of capital stock, and, therefore, to cause the SICAV's *statuts* to be amended. Fundamental changes, such as amalgamations or breakups, do however require the approval of the AMF.

An FCP is a co-ownership (*copropriété*) of securities.[48] Stocks (*parts*) that are issued by an FCP are freely transferable, and any holder of *parts* may request the FCP to buy back such stock at its liquidated value pursuant to the terms and conditions of the FCP's internal regulations,[49] unless the management of the FCP decides temporarily to suspend the buy-backs

[43] Art. L. 214–15 para. 2 C. mon. et fin. However, a SICAV may not buy back shares if its capital stock falls below €4 million (art. 411–14 GRAMF).

[44] Art. L. 214–19 C. mon. et fin.

[45] Art. 7 of Decree no. 89–624 of 6 September 1989.

[46] Art. L. 214–16 para. 1 C. mon. et fin.

[47] Art. L. 214–17.3 C. mon. et fin.

[48] Art. L. 214–20 para. 1 C. mon. et fin.

[49] However, an FCP may not buy back stock if its assets fall below €300,000 (art. 411–14 GRAMF).

(a) in accordance with the terms and conditions of the FCP internal regulations, (b) if exceptional circumstances occur, or (c) if it is in the interest of the holders of stocks that buy-backs be temporarily suspended.[50] In practice, investors ask the FCP to buy back the stock, and investors rarely use secondary offerings to sell or purchase interests in an FCP. An FCP is created jointly by a commercial corporation[51] (which is in charge of the management), and by a limited liability company which acts as the depository[52] (and which holds the assets of the FCP).[53]

The AMF must give its approval to the creation of any FCP. Internal regulations, which are functionally equivalent to the by-laws of a corporation, will need to be prepared jointly by both entities creating the FCP, and will need to be approved by the AMF. The internal regulations will provide, inter alia, for the conditions of subscription to the stock of the FCP and for the principal guidelines on the way that the assets of the FCP will be invested.

There is a debate as to whether or not internal regulations may be amended without the approval of the investors, with the sole agreement of the manager and of the depository and the approval of the AMF. Some argue that a sufficient notice of the modification of the terms and conditions of the internal regulations should be sufficient.[54] However, in the light of the fact that investors are deemed to accept the internal regulations existing at the time of their investment, it is possible that French courts would refuse to let a change of an internal regulation be effective against an investor, without his consent. There is, however, no significant case law on this issue.

Both SICAVs and FCPs are subject to similar supervision regimes. First of all, the auditors supervise the accounts of the scheme and have to certify them. Secondly, the AMF may proceed with any investigations or inquiries into the scheme. Finally, the depository must control the way in which the assets are managed.

[50] Art. L. 214–30 C. mon. et fin.

[51] The minimum initial capital stock must generally be at least €400,000: art. 8 of Decree no. 89–624 of 6 September 1989.

[52] The depository must, apart from limited exceptions, be an insurance company or a bank.

[53] Art. L. 214–24 C. mon. et fin.

[54] S. Mambrini, gen. ed., *Dictionnaire Permanent Epargne et Produits Financiers* (Montrouge: Editions Législatives, loose leaf), v° OPCVM, No. 132.2 *in fine*.

Germany

Under German law, there are three principal types of collective investment schemes based on risk diversification: (a) the type regulated by the Investment Funds Statute (KAGG, see Case 5, Option c), (b) a public company type, and (c) Investment Clubs which are normally organised as non-trading partnerships under §§ 705 ff. BGB. The last two schemes do not fall under the Statute (see § 6 para. 1 [2] and § 1 para. 3 KAGG). The Statute, however, covers virtually all kinds of investment instruments, so extending the ambit of application of the UCITS Directive. It can, therefore, be chosen for virtually any investment field (see Case 5, Option c for more detail).

The Investment Club scheme[55] does not readily allow the substitution of investors (the trading of 'shares') or of terms and conditions. In the law of non-trading partnerships, the principle of unanimity applies to both questions. Even though there are exceptions to this principle, taxation concerns will render unattractive any such scheme which is open to many investors. The two other schemes, the statutory scheme (complying with the KAGG) and the company scheme, also work on the principle of risk diversification. They lend themselves to an open and public investor clientele. The main difference between them is that under the German Code on Public Limited Companies,[56] the open-ended principle is not permissible. It is contrary to §§ 57, 58 V, 71, 71a AktG to repurchase shares from investors. Therefore, the two schemes offer two alternatives. Under the KAGG, the investor has a right of redemption in all instances (§§ 7a, 11 para. 2, 25h, 26 and 34 KAGG; open-ended principle), but no secondary markets exist for trading the 'shares'. Note that in this case only the contractual or indenture type is possible (alternatives 1 and 2 of art. 1 para. 3 UCITS Directive; § 6 para. 1 [2] KAGG). In a public limited company scheme, no redemption right can be granted. There are secondary markets, however, which may not be very well developed for all schemes. In this latter scheme, a change of terms is considered to be a normal change of the corporation's constitution, which requires a three-quarters majority under §§ 179 ff. AktG. A change of terms under § 15 para. 2 [1] KAGG does not require the consent of the investors, but it must be in their interest and approved by the supervisory authority. Section 15 para. 2 [1] KAGG deals only with the public law side of the modification.

[55] For this latter type, see *Bundesaufsichtsamt für das Kreditwesen*, letter of 21.9.1998, Az. VII 4 – 71.51 – 142/98.

[56] Aktiengesetz of 6.9.1965, *Bundesgesetzblatt* 1965 part I, 1089; AktG.

With respect to the consent of the investors, a modification may be allowed pursuant to an amendment clause, which can be found in the by-laws of virtually all investment funds. These clauses are scrutinised by the courts on the basis of the Unfair Contract Terms Statute (AGBG).[57]

Three supervision schemes apply in parallel (and this has often been criticised). The prudential supervision over banks applies to schemes falling under the KAGG, since the Investment Company in the scheme and also the depository bank fall under the definition of a credit institution (see § 1 para. 1 nos. 5 and 6 *Gesetz über das Kreditwesen* of 11.7.1985).[58] Supervision under this statute is mainly concerned with solvency and liquidity questions, and is based on the scheme of the European directives on solvency ratio, own funds and capital adequacy. This type of supervision arguably applies also to the company scheme since economically (although perhaps not technically) these companies administer a portfolio for others, namely, their shareholders.[59]

Supervision on the basis of the KAGG applies only to those entities falling under the statute, not the company scheme. The rules are considered as *leges speciales* with respect to the KWG. With heavy regulation for investment decisions, this statute also has a solvency and liquidity oriented scope and embodies a rather conservative approach. There are, however, rules that do not have this scope, such as the rule that investments may not be made for entrepreneurial purposes. There are also rules concerned with the investor relationship, mainly disclosure rules. Thus, in many respects the supervision in the KAGG goes far beyond the one in the KWG. The KWG, nevertheless, has its importance in terms of ratios. In this respect, German law closely follows the UCITS Directive (with only very few stricter rules, and virtually no shortcomings in transposition). A more detailed description of the 'German' model is therefore not needed.

The code of conduct contained in arts. 10 and 11 of the Investment Services Directive, transposed in §§ 31–34a *Wertpapierhandelsgesetz*, arguably also applies since § 2 para. 3 no. 6 WpHG uses the same terms as § 1 para. 1a no. 3 KWG to define its ambit of application (see references above).

[57] See BGHZ 89, 206 (211) and BGH VersR 1971, 1116 (1117). *Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen* (*AGB-Gesetz*) of 9.12.1976, *Bundesgesetzblatt* 1976 part I, 3317, AGBG.

[58] KWG, *Bundesgesetzblatt* 1985 part I, 1472, 1473 and now 1997 part I, 2518 and 1998 part I, 2776, 2777.

[59] See § 1 para. 1a no. 3 KWG; disputed.

Greece

L.1969/91, which implemented into Greek law EEC Directive 86/611 as amended, recognises only two types of collective investment schemes: mutual funds and investment companies.[60] Mutual funds are open-ended funds, while investment companies are closed-ended funds.

Investment companies are independent legal persons under the legal form of *Société Anonyme*. Investors hold share capital and they pool their contributions for creating, through the investment company, a portfolio of investment instruments, which is managed on their account. Investment companies must be listed on the Athens Stock Exchange (s. 8 of L.1969/1991; see also s. 2 § 1 of EEC Directive 85/611).

On the other hand, mutual funds are not independent legal persons. They are portfolios of investment instruments. From a legal point of view, mutual funds constitute an undivided joint right over the underlying securities (see s. 785 CC).[61] Investors are joint owners of the securities and they also have joint liability for any indebtedness related to the mutual fund (ss. 17 § 1 and 18 § 1 of L.1969/1991). The interests of investors in the mutual funds are divided into units.

Shares of investment companies are freely transferable. On the other hand, the holder cannot sell the units of a mutual fund to another investor. They may only be redeemed and cancelled by the company which manages the fund (see Case 5).

With regard to the possibility of changing, where necessary, the rules governing the scheme, essentially the rules related to the investment policy, these two schemes do not provide for the same possibilities.

As far as the mutual funds are concerned, the holders of the units do not have any right to change the rules governing the scheme, nor even to influence the investment policy followed by the investment manager. Although the latter is considered to be a mandatary of the investors, the CC rules relating to the contract of mandate are not applicable, in particular those rules associated with the limits set in the mandate (s. 717 CC) or with the revocation of the mandate (s. 724 CC).[62] The

[60] Deliyanni-Dimitrakou, *Trust and Fiducia*, 313; Karathanasis and Psomadakis, *Mutual Funds* (1992), 14–16; Katsoulas, *Capital Market and Management of Mutual Funds* (1994), 26–27.

[61] Deliyanni-Dimitrakou, *Trust and Fiducia*, 316.

[62] Pampoukis, *Undertakings for Collective Investments in Transferable Securities* (1992), 82–83.

investment manager enjoys a broad, irrevocable and exclusive investment power over the scheme. Unit holders who do not agree with the particular investment policy of the fund can only apply for the redemption of their units.[63] The limits set for the investment manager are those determined by the law (L.1969/91) and the statutes of the fund, which should be approved by the Capital Market Commission (see below) and be publicly available. The investors cannot amend the statutes of the fund.

On the other hand, investment companies are subject to the provisions of L.1969/91 and to their statutes. Moreover, since investment companies are companies limited by shares (*Sociétés Anonymes*), they are also governed by L.2190/20, which is generally applicable to *Sociétés Anonymes*. This Act authorises, in particular, the shareholders to amend the company's statutes by a resolution taken in a shareholders' meeting. Such a resolution may therefore modify the statutory rules governing the scheme, in particular its investment policy.[64] Thus, only investment companies fulfil the two requirements set in Case 9.

As far as supervision is concerned, L.1969/91 is applicable when an investment company has its statutory seat in Greece. Investment companies must be companies limited by shares (*Sociétés Anonyme*). As mentioned above, they should also be listed on the Athens Stock Exchange.

The establishment of an investment company requires a licence provided by the Capital Market Commission, which is a Public Authority supervised by the Ministry of Finance, which is entitled to control the organisation of the company, its technical and financial capacity, and the credibility and the experience of its managers, particularly with a view to the appropriate management of the entrusted assets. Furthermore, the Capital Market Commission is authorised continuously to control the management of the company; in particular, the compliance with any compulsory rules relating to the investment policy of the scheme and the disclosure of information to the investors. The Capital Market Commission is also empowered to take disciplinary proceedings against investment companies and/or their officers, if they do not comply with their specific legal and/or statutory obligations.[65]

[63] Deliyanni–Dimitrakou, *Trust and Fiducia*, 317–318.

[64] Katsoulas, *Capital Market*, 69.

[65] Deliyanni–Dimitrakou, *Trust and Fiducia*, 317; Pampoukis, *Undertakings*, 74 ff.

Ireland

The Investment Services Directive 93/22/EEC requires that any firm providing investment services be authorised by the Central Bank and Financial Services Authority of Ireland (CBFSAI).[66] Assuming authorisation, collective investment schemes in Ireland[67] can take a myriad of different forms, but two predominant structures can be identified. In the first of these, which has a separate legal personality, the scheme assets are owned by a company in which investors are issued a share representing their investment (the open-ended investment company). In the second, where the establishment of the scheme does not create a separate legal personality, the scheme assets are held on behalf of investors, whose proportionate holdings are represented by a unit, by a trustee (the unit trust). The share or unit gives the investor the right to participate in the profits or income which arise from the scheme's investment activities. Management and custody of the assets will be separate in both cases.[68]

The most popular forms include: UCITS (undertakings for collective investment in transferable securities which conform to the requirements of the UCITS Directive[69] which, as well as imposing structural requirements, also, at present, limits investment strategies); unit trusts; investment limited partnerships; and collective investment companies.[70] All of these structures are regulated by the CBFSAI and are subject to specific requirements with respect to their authorisation/organisation (directors, trustees, managers and custodians are subject to particular requirements, for example) and

[66] The Directive has been implemented in Ireland partly by the Stock Exchange Act, 1995 and partly by the Investment Intermediaries Act, 1995: see generally McHugh, *Regulation of Investment Capital Markets* (Dublin: Blackhall Publishing, 1999), chapter 2; see also p. 154, note 186 above.

[67] See generally Foy, *The Capital Markets. Irish and International Laws and Regulations* (Dublin: Round Hall Sweet & Maxwell, 1998), 190–202, 288–372.

[68] The trustees or board of directors responsible for overseeing the fund will be responsible for ensuring compliance by the fund with its legal requirements. Foy, *Capital Markets*, 303. Trustee liability for breach can arise where a trustee breaches the obligations set out in the UCITS Regulations and Unit Trusts Act, 1994 (see below). There is some doubt as to whether more general trustee obligations apply under the investment company or partnership regime (see below). Ibid., 347.

[69] Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, OJ L375/3 (1985).

[70] Foy, *Capital Markets*, 190.

information disclosure in particular.[71] The trust deed, memorandum and articles of association, or partnership agreement, as appropriate, will set out the fund's operating rules.

UCITS are subject to the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations 1985. They may only take the form of an open-ended scheme. In an open-ended scheme, units are issued continuously, or at short intervals, at a price related to current net asset value[72] and may be redeemed by unit-holders on request, again at current net asset value, or at a price related to it. Specifically, UCITS may take the form of a unit trust, an open-ended investment company with variable capital or an open-ended investment company with fixed capital.

Collective investment companies (CICs) are governed by Part XIII of the Companies Act, 1990 which allows for the establishment of collective investment schemes with a corporate structure which are not subject to the investment restrictions of the UCITS regime and permits such companies to easily repurchase their share capital. Collective investment companies invest only in immovable property. Under s. 252(2), shares in the CIC must, at the request of the shareholder, be purchased by the company directly or indirectly out of company assets. By virtue of s. 80 of the IIA, CICs under Part XIII may also be constituted as closed-ended companies. In closed-ended schemes, restrictions apply to the redemption of the units (here, the shares) representing the capital of the scheme.[73]

Unit trusts[74] are governed by the Unit Trusts Act, 1990. Unit trusts may be constituted as open-ended schemes or closed-ended schemes.

Investment limited partnerships are governed by the Investment Limited Partnership Act, 1994. These structures take the form of

[71] The regulatory conditions which the CBFSAI may impose under the relevant statutes are set out in the UCITS Series of Notices and, for schemes other than UCITS, the NU Series of Notices.

[72] Current net asset value is the current market value of the scheme's portfolio, divided by the number of units outstanding.

[73] The manager of the scheme is not obliged to buy back the original investment by the subscriber (who holds a share in the company which owns the fund assets). As a result, liquidity can only be provided by the investor selling on the open market and, depending on market forces of supply and demand, the price obtained may not relate to the value the share represents of the assets held in the trust.

[74] A unit trust is constituted by a trust deed which is made between a management company and a trustee/custodian. The trust deed will set out the rules of the scheme and unit holders' rights. Foy, *Capital Markets*, 294.

partnerships which invest in property. Unlike the traditional partnership structure, limited liability protection is available for the limited partners.[75] The assets of the partnership must be safeguarded by a separate custodian. Custodians are subject to the obligations set out in the Investment Limited Partnership Act, 1994.

Italy

The collective investment scheme of Case 9 is regulated by the d. lgs. 24 February 1998, n. 58, *Testo unico delle disposizioni in materia di intermediazione finanziaria* and by other norms that implement in Italy the relevant EC directives on collective undertakings in transferable securities and regulate other collective investment schemes as well. These secondary norms are for the greatest part contained in regulations adopted by Consob – the main financial services regulatory body – and by the Bank of Italy.

'Collective Investment Schemes' (*Organismi di investimento collettivo del risparmio*) under the d. lgs. 24 February 1998, n. 58, art. 1.1, lett. m, include both common funds (*fondi comuni di investimento*) managed by a management company, and investment companies with variable capital, i.e. open-ended investment companies (*società di investimento a capitale variabile*, SICAV).

The d. lgs. 58/1998, art. 1.1, lett. n, also defines the management of savings as a pool (*gestione collettiva del risparmio*). This consists of: (i) the promotion, creation and organisation of investment funds and the management of relations with the holders of their shares; (ii) the management of collective investment schemes, assets, on one's own account, or on the account of third parties, through investment in financial instruments, loans or other movable or immovable assets.

The Italian companies authorised to manage pools of assets are the investment management companies (*società di gestione del risparmio*) regulated by the same source (d. lgs. 58/1998, arts. 34–35), as well as by Consob and Bank of Italy regulations.[76]

As mentioned above in answer to Case 5, an investment management company can manage (inter alia): (a) investment funds, consisting of

[75] A general and limited partners scheme applies. General partners remain personally liable for partnership obligations; see generally Twomey, *Partnership Law in Ireland* (Dublin: Butterworths, 2000).

[76] See especially: Consob Regulation, 1 July 1998, n. 11522; the Bank of Italy Regulation, 1 July 1998.

segregated assets (*patrimonio autonomo*) managed as a pool, subdivided into shares, held by a plurality of investors (d. lgs. 58/1998, arts. 36–40); (b) investment companies with variable capital (SICAV), the sole object of which is the collective investment in pools of assets through the offer of their shares to the public (d. lgs. 58/1998, arts. 43–50).

With regard to the question posed, i.e. the selection of a vehicle that allows the free transfer of the investors' interests, both options (i.e. investment funds and SICAV) are in principle appropriate, though the legal structure of these vehicles is obviously different. The investment funds are conceived as pools of assets. The legal nature of the relationship linking each investor to the fund is disputed; the theories proposed to conceptualise it oscillate between co-ownership and fiduciary ownership, which in this case reflects the model provided by unit trust vehicles operating in anglophone jurisdictions.[77] On the other hand, the legal position of the investors in a SICAV corresponds to that of a shareholder in a company and is no more problematic than the latter one.[78]

The fund certificates are all of equal value and with equal rights; they are issued as registered or bearer certificates, as the investor requires (d. lgs. 58/1998, art. 38.8). The Bank of Italy, after consultation with Consob, regulates their features and initial par value. The rules of each fund, which further specify their features, are approved by the Bank of Italy after consultation with Consob (d. lgs. 58/1998, arts. 36.3, 39).

SICAV shares are bearer shares or registered shares. The articles of association may: (a) limit the issue of registered shares; (b) restrict the transferability of registered shares (d. lgs. 58/1998, art. 45). Accordingly, the free transfer of their shares may be subject to restrictions.

Holders of open-ended investment funds certificates and of SICAV shares have the right to redeem their shares in the invested assets. This explains why there is no secondary market for them.

Changes of the rules of the collective investment scheme follow different procedures for investment funds and SICAV.

The investment fund rules are changed by the management company. They are subject to approval by the Bank of Italy, which is granted if they meet certain requirements set out in the d. lgs. 58/1998, arts. 36–37. Since the management company must act in the interests of the

[77] Cf. Costi, Enriques, *Il mercato mobiliare* (2004), 437 ff.; Lener, 'La circolazione del modello del trust nel diritto continentale del mercato mobiliare', Riv. soc., 1989, 1050 ff.

[78] Costi, Enriques, *Il mercato mobiliare*, 421 ff.

investors and of the integrity of the market, the proposed changes must conform to these two basic criteria.

Changes in the articles of association of the SICAV are voted for by the shareholders' meeting of the investment company, which is validly constituted without a quorum. They are also subject to approval by the Bank of Italy (d. lgs. 58/1998, art. 47).

The actual pattern of collective investment schemes marketing in Italy is such that investment funds are far more popular than SICAV in Italy. This preference is mostly due to the fact that investment funds have been on the market for a longer period and are more familiar to the non-sophisticated investor.

Luxembourg

Luxembourg has a variety of collective investment schemes organised under specific legislation. The first is the Law dated 30 March 1988 on undertakings for collective investment, as amended (the '1988 Law'), which is the basis for the very successful Luxembourg investment funds, organised mainly under the form of an FCP (*fonds commun de placement*) or of a SICAV (*société d'investissement à capital variable*). This Law has been completely restated by a Law dated 20 December 2002 implementing, in particular, the most recent European Directives (UCITS III) (the 'UCI Law'). The main provisions of the 1988 Law have, however, been continued. In addition, other forms, corporate or otherwise, may also be adopted. UCIs are divided into two categories: (a) Part I UCITS, which are subject to Part I of the UCI Law, representing the implementation of the European UCITS Directives, and (b) Part II UCIs, which for various reasons are excluded by the Law from Part I, and which may have an investment policy wider than the one permitted under the Directives (e.g. real estate funds, leveraged funds, etc.).

The second is the Law dated 19 July 1991 on undertakings for collective investment whose shares are not intended to be placed with the public at large (institutional investment funds). The third is the Law dated 8 June 1999, creating the pension funds, under the form of either sepcavs or asseps (see Case 8).

If the objective of the financial services company is the free transfer of the interests of the investor, i.e. the possibility of subscription and redemption of the shares or the free transfer of the shares on the secondary market, as well as a possible change of the rules of the scheme at any time, either a SICAV or an FCP organised under the UCI Law should be considered.

A SICAV is a Luxembourg public limited company, whose sole purpose is the investment of its assets in securities or certain other eligible assets in order to spread the investment risks and share profits among shareholders. The shares are intended to be marketed publicly, through either a public or a private placement. The articles of incorporation indicate that the amount of the corporate share capital will at all times be equal to the net asset value (NAV) of the SICAV, which establishes an exception to the general principles of company law. A SICAV must have a custodian bank established in Luxembourg.

An FCP is a collective mass of securities and other eligible assets, composed and managed according to the principle of spreading the risks, on behalf of collective owners who are liable only up to their individual investment and whose rights are represented by shares intended to be marketed to the public by a private or public placement. An FCP generally must have a custodian bank established in Luxembourg. In addition, as the FCP is an undivided mass of assets without legal personality, it must have a management company that acts in its own name but on behalf of the FCP. The FCP is governed by its management regulations.

Both the shares of a SICAV and the units of an FCP are in principle freely transferable,[79] and may even be listed on a stock exchange. The investors generally have the right to request redemption of their shares or units at regular intervals. While this right of redemption is required in order for a SICAV or an FCP to qualify as a Part I UCITS (i.e. an open-ended investment fund, subject to the UCITS Directives), the right of redemption may be limited or even excluded in the case of Part II UCIs (closed-ended funds). In addition, even in the case of Part I UCITS, the redemption can be suspended by the board of directors or the management company in specific circumstances, generally provided for in the articles or the management regulations, as well as in certain cases provided for by the UCI Law.

Both the FCP and SICAV are subject to supervision by the CSSF, whose main objective is the protection of the interests of the investors. The control starts at the creation of the investment scheme; the SICAV or FCP must be authorised by the CSSF. This implies the approval of the statutory documents, and of the custodian bank (which in either case

[79] Subject to any specific limitations contained in the articles of association; these are sometimes related to investment restrictions.

must generally be a Luxembourg bank) and, in the case of an FCP, the management company. The directors of the SICAV/FCP, as well as of the custodian bank and of the management company (in the case of an FCP) are also subject to approval on the basis of their honour and professional experience. Once the approval is obtained, the SICAV or FCP is registered on a list held by the CSSF and published in the official journal.

Changes of the statutory documents and of the directors must be approved by the CSSF. In the case of corporate forms, such as the SICAV, changes are made by normal corporate procedures, including a vote of the shareholders. For the FCP, unitholders do not have the position of shareholders. Changes to the constitutional documents, in particular the management regulations, are therefore made by the management company, subject to approval by the CSSF (and, where provided for in the management regulations, the custodian bank). The management regulations will sometimes (mainly in small funds) provide for the consent of the unitholders. In order to protect the unitholders in the case of substantive changes, the CSSF may require the management company to give them advance notice of the changes, either by way of circular letter or by publication of a press notice. In certain cases, it may also require the management company to allow the investors to redeem their units free of charge prior to the change.

The investment policy of the SICAV or FCP must be approved by the CSSF, and must correspond to the criteria and limits laid down in the UCI Law and the CSSF Circulars. Auditors control the application of the investment policy in practice, as does the CSSF. The custodian also has a certain control function with respect to the activities of the investment fund. This role is wider in the case of an FCP, where the custodian controls the calculation of the NAV and ensures compliance by the management company with the investment restrictions. The custodian acts in the exclusive interest of the investors and is liable to them for any wrongdoings.

Netherlands

In the Netherlands, the Act on the Supervision of Collective Investment Schemes (ASCIS)[80] regulates the offering of rights of participation in investment institutions. Further rules on these investment institutions are laid down in the Decree on the Supervision of Collective Investment Schemes (DSCIS).[81] Apart from some statutory exceptions and general

[80] *Wet Toezicht Beleggingsinstellingen.*

[81] *Besluit toezicht beleggingsinstellingen.*

exemptions, it is forbidden to solicit participation in an unlicensed investment institution (art. 4(1) ASCIS). Licences are granted by the Authority for Financial Markets (AFM), which also supervises the licensed institutions (together with the Dutch Central Bank which exercises prudential (financial) supervision).[82]

The ASCIS defines an investment institution in two ways. It may be an investment company or an investment fund. Article 1(a) ASCIS describes an investment company as 'the legal entity which solicits or has obtained moneys or other goods for collective investment in order to have the participants share in the proceeds of the investments'. In practice, this will be a public company with variable capital. Such a company has the legal obligation to have its shares listed on an official exchange.[83] Article 1(b) ASCIS describes an investment fund as 'a property which has not been incorporated into a legal entity in which moneys or other goods which have been solicited or obtained for collective investments have been or are included in order to have the participants share in the proceeds of the investments'.[84] These definitions show that the main difference between the two vehicles is that an investment company is a legal entity whereas the investment fund is not. In practice investment funds are quite often structured in such a way that the manager and/or the custodian are legal entities. Some writers suggest that the distinction must also, or even mainly, be found in the fact that an investment company is the legal and beneficial owner of the assets that are acquired as investments. If the legal person is not the beneficial owner of the investment assets (the entity holds the investments for the benefit of the participants), then it will be characterised as an investment fund.[85]

[82] *Security Transactions in Europe* (loose leaf edition) (The Netherlands: CCH Editions Limited, 1997); Niels R. van de Vijver, *Securities Regulation in the Netherlands*, 2nd edn (Deventer: Kluwer Law and Taxation, 2000), 49–54; N. V. Ponsen and P. Klemann, *Beleggingsinstellingen nader belicht* (Deventer: Kluwer 2000); C. M. Grundmann-van de Krol 2004, 196–238; C. M. Grundmann-van de Krol, 'Effectenhandel', in F. H. J. Mijnssen et al., eds., *Geldige Effecten, Capita selecta recht van effecten- en geldverkeer*, (Amsterdam, 1999), 49–58, 55–58.

[83] Art. 76a Book 2 CC.

[84] An investment *fund* under Dutch law will have a contractual base. Grundmann-van de Krol 2004, 87.

[85] S. Perrick, 'Het beleggingsfonds en de stichting', *Stichting & Vereniging* 1993, 118–119; S. Perrick, 'Capita selecta beleggingsinstellingen', in Schaafsma, ed., *Ontwikkelingen in het effectenverkeersrecht* (Deventer: Kluwer 1996), 34–35.

An investment institution, which performs activities such as described above, in or from the Netherlands outside a restricted circle of investors, is required to have a licence from the AFM. An institution is acting in or from the Netherlands if the legal person has its (statutory) seat in the Netherlands, irrespective of the country where investments are solicited, or if the legal person is domiciled outside the Netherlands but is active on the Dutch market.[86] The Dutch Supreme Court has clarified the meaning of a closed circle:[87] if, before the issuing of the securities, there is a relationship between the investment institution and the participants such that those participants can reasonably have knowledge of the particularities of the issuing investment institution and of the issued securities, then one can speak of a restricted circle.[88] The licence requirement does not apply to investment institutions that are seated in another EEA Member State and hold a UCITS licence, nor does it apply to individuals not acting in their profession or business who offer shares in an investment institution.

Such an investment institution must satisfy certain basic requirements, such as necessary expertise and reliability, financial safeguards, administrative requirements and the information that is provided to the public.[89] Investment institutions can be open-ended or closed-ended. For investment funds and UCITS some extra requirements must be fulfilled.

If an investment institution asks for moneys or other assets exclusively from professional investors, or if the participations are exclusively offered to professional investors, then no licence is required. Professional investors are also obliged to comply with these selling restrictions.

[86] Explanatory report to the Act on the Supervision of Collective Investment Schemes, Second Chamber 1988–1989, 21 127, no. 3, 15. See, for the implications of offering securities on the Internet, the policy document no. 99–003 of the Netherlands Authority for the Financial Markets (http://www.afm.nl/) (English version available).

[87] HR 17 December 1996, JOR 1997/7 note Grundmann-van de Krol, NJ 1998, 21 note Knigge. See also the policy document no. 98–001 of the Netherlands Authority for the Financial Markets (http://www.autoriteit-fm.nl/) (English version available). See Grundmann-van de Krol, 'Effectenhandel', 50, nn. 93 and 94 for more references. Draft legislation (Second Chamber 2002–2003, 28 998) to change the Act on the Supervision of Investment Institutions is pending. One of the changes is to abolish the restricted circle criterion in art. 4 ASCIS and art. 3 ASST 1995.

[88] See also the definition of a restricted circle as used in the ASST 1995.

[89] Art. 5 sub 1 ASCIS.

An investment fund must have a custodian and a manager, and the two must be completely separate from each other. The funds must also be separate, but it is not quite clear whether the ASCIS aims at a factual separation or a separation with property effect. Since the ASCIS does not give any further rules on how to effect the separation in practice, it is generally thought that a factual separation is intended (the Draft Legislation ASCIS (see footnotes) provides such rules). This means that either the custodian or the manager has legal title to the assets, but they need each other to dispose of the assets. It is possible to agree on a structure in which the investors are the legal owners of the assets. This is not a smart structure in cases where there are assets other than movable assets. In those cases the investors can transfer their share in the investment fund to someone else, but the rules for such a transfer are the same as the rules for the transfer of the underlying asset. So, if the investment fund has invested in real estate, an investor who wants to transfer his share must comply with the rules on transfers of real estate. In practice, only a very small number of investment funds are structured in such a way that the investors have joint legal title. In most cases, the manager or the custodian has the legal title to the assets, which leaves the investors with a personal claim against the legal owner.[90]

Collective investment (UCITS)

A Dutch UCITS is an investment institution (a company or a fund) with the following characteristics:

- It has as its exclusive statutory or contractual purpose the investment in securities with the principal goal of risk spreading;
- The units are bought back on demand of the investor, directly or indirectly; and
- The seat, or if it concerns an investment fund, the seat of the manager, is present in the Netherlands.[91]

[90] Grundmann-van de Krol 2004, 88 and 211; K. Frielink, 'Wat is een beleggingsfonds in de zin van de wet toezicht beleggingsinstellingen?', in S. C. J. J. Kortmann et al., eds., *Onderneming en effecten* (Deventer: W. E. J. Tjeenk Willink, 1998), 293–304; K. Frielink, 'Beleg 5 May 1996, 150; M. E. Klom/5 May 1996, 150; M. E. Klompé and H. W. R. Weststrate, 'Beleggingsfondsen; eigendomsverhoudingen en afgescheiden vermogen', De NV 74/ 3 March 1996, 81–85; Perrick, 'Capita selecta beleggingsinstellingen', 31–47; Perrick, 'Het beleggingsfonds en de stichting', 117–120.

[91] Art. 6 sub 1 ASCIS.

On top of the general requirements listed above, a Dutch UCITS must also comply with other requirements. The main office of the UCITS-investment company, or the main office of the manager, in the case of an investment fund, must be in the Netherlands. The activities of the manager of the UCITS-investment fund must be limited to the management of investment institutions. The UCITS may not perform any activities other than investment in securities with the principal goal of risk spreading, and it must pursue an open-ended policy. The assets must be given in custody with a custodian that is independent of the UCITS.[92] The custodian of the UCITS must have its seat in an EU or EEA Member State and a place of business in the Netherlands.[93]

It follows from the EC Directive on units for collective investment in transferable securities (UCITS) (Directive 85/611/EC, OJ 1985, L 375/3) that UCITS from other Member States must be recognised in the Netherlands, just as Dutch UCITS have to be recognised in other Member States. This Directive has been implemented in the Investment Institutions Act. Moreover, investment institutions that are subject to adequate supervision in their home countries can be granted dispensation from a large number of licence and supervision requirements.

The Minister of Finance has been appointed as supervisory organ in the ASST 1995 and the ASCIS. For the ASCIS and the ASST 1995, the supervisory task in the field of prudential supervision (solidity of the institutions, being supervision over the capital requirements and other financial requirements) has been delegated to the *Pensioen- en verzekeringskamer* (Pension and Insurance Supervision Institution or PISI) and the Dutch Central Bank (DCB).[94] The conduct-of-business-related aspects have been delegated to the Authority for the Financial Markets.[95] The DCB supervises whether the licensed institution keeps up with the

[92] Under certain circumstances a deviation of this requirement is possible. See art. 9 ASCIS.

[93] Art. 6 sub 2-6 ASCIS.

[94] *De Nederlandsche Bank*. On 30 October 2004, the Pension and Insurance Supervision Institution merged into the Dutch Central Bank. See www.dnb.nl.

[95] Next to the DCB, PISI and the AFM there also exists the Council of Financial Supervisors (CFS). This Council coordinates the policy and rules in the fields that cover more than one specific sector (today many insurance companies are also investors and are offering investments to consumers, so they are supervised by all three authorities). The CFS structures the cooperation of the three authorities. The division of the supervision by subject rather than by institution was effected on 1 September 2002. In the ASCIS one has to read AFM where DCB is mentioned. See www.afm.nl. However, this is not the end of the changes in supervision. Draft legislation for other changes (Second Chamber 2002–2003 and 2003–2004, 28 122, nos. 1–20) is pending.

financial requirements. The AFM supervises all other aspects and will grant licences. With regard to the investment institution, the AFM and the DCB have the right in their respective supervision fields to ask for information,[96] to give directions,[97] and to give a warning.[98] The AFM and the DCB have to consult each other before they use one of these rights. The AFM, after consultation with the DCB, may appoint a silent administrator if the investment institution is in a phase that compromises the adequate functioning of the institution.[99] Both the AFM and the DCB may order the institution to pay a penalty or an administrative fine for violations in their respective fields of supervision.[100] The ultimate remedy is the withdrawal of the licence by the AFM. The supervisory institutions also have the right and the obligation to exchange information, even with foreign supervisory institutions, and to work together.[101] In practice the AFM is the supervisory authority. The role of the DCB is very limited for all practical purposes.

The most suitable option will be a public company (*Naamloze vennootschap*) with variable capital which has to be listed on the stock exchange.

Portugal

The advisable solution is to set up an investment fund. The basic regulations governing investment funds are set out in Decree-Law 276/94 of 2 November, amended by Decree-Law 308/95 of 20 November and Decree-Law 323/97 of 26 November, which transposes into Portuguese law Directive 85/611/EEC of 20 December 1985.[102]

This law did not admit variable capital companies like SICAVs, but continued to accept the distinction between *open* and *closed-ended* funds. Open funds are those in which units are issued in a variable number; new investors receive new units and are entitled to redeem their units. Closed funds issue a fixed number of units which are transferable to new investors.

Under Portuguese law, an investment fund is an autonomous patrimony with no legal personality that is managed by a management

[96] Art. 19 ASCIS. [97] Art. 21 ASCIS. [98] Art. 25 ASCIS. [99] Art. 22 ASCIS.

[100] This possibility was introduced by law on 1 January 2000.

[101] Art. 27, 27a and 27b ASCIS.

[102] See M. J. Tomé, *Fundos de Investimento Mobiliários Abertos* (Coimbra, 1997) (the same article is published in *Estudos de Homenagem ao Banco de Portugal*, (Lisbon, 1998), 51–182); Tomé, 'Notas sobre Aspectos Financeiros e Civis dos Fundos de Investimento Mobiliário Abertos', in *Direito dos Valores Mobiliários*, I (1999), 9–62; A. Veiga, *Fundos de Investimento Mobiliário e Imobiliário. Regime Jurídico* (Coimbra, 1999).

company. In the fund the interests of the investors are expressed in units represented by certificates. The fund's management rules and the rights of the investors are set out in the *management regulations*, which can only be modified with the authorisation of the Securities Market Commission (CMVM).

There are various types of fund, both securities and real estate, with greater or lesser risk. Portuguese law comprises UCITS, non-UCITS, guaranteed funds, stock index funds, treasury funds, funds of funds and groups of funds.

Investment funds are subject to Securities Market Commission (CMVM) supervision, although investment management companies are supervised by the Central Bank (Banco de Portugal). The securities market authority has the powers to authorise the constitution of the fund, its accountancy rules and the use of financial instruments to manage its assets, such as derivatives and repos. There are several Regulations issued by the CMVM concerning investment funds.[103]

Scotland

The law and practice are the same as in England.

Spain

The options available for a collective investment scheme have already been mentioned in the answer to Case 5. They include the investment fund (*fondo de inversión*) and the investment company or *sociedad de inversión* as regulated in a special law which has already been mentioned (*Ley 46/84, de las instituciones de inversión colectiva*).

The investment fund is probably the instrument that would be chosen by a financial services company. The fund is divided into nominative shares that are freely negotiable. The rules governing the scheme are established in the *Reglamento de Gestión del Fondo* which is part of the contract creating the fund. It can be changed subject to the approval of the *Comisión Nacional del Mercado de Valores*, a public agency in charge of supervising and inspecting the Spanish stock markets and the activities of all the participants in those markets. Any change of the rules must be communicated to the participants. If the change is substantial and touches on fundamental aspects like, for example, the

[103] Available at www.cmvm.pt.

policies on investment or distribution of benefits, then the participant who so wishes can force the fund to buy his share at the price it had on the day the change was approved. The control of the funds takes the form of reports which have to be provided to the participants periodically and which are supervised by the *Comisión Nacional del Mercado de Valores*.

Investment companies are regular companies that take the form of a *Sociedad Anónima*. The statutes of the company contain the rules governing the scheme. Any change of these rules requires a change of the statutes, which has to be approved in a general assembly of shareholders and is subject to severe limitations that make this option most likely unattractive for a financial services company wishing to launch a collective investment scheme. The supervision mechanisms are, on the one hand, the ordinary supervision mechanisms of the *Sociedad Anónima*. On the other hand, the company statutes have to provide for a commission of shareholders in charge of the control and auditing of the company. Investment companies must also provide shareholders with periodic reports, and are under the supervision of the *Comisión Nacional del Mercado de Valores*. The *sociedad de inversión* is therefore an instrument that is especially subject to control.

Sweden

A financial company, wishing to launch a collective investment scheme which allows free transfer of investors' interests and permits the rules governing the scheme to be changed where necessary, would in Sweden act as a fund company (*fondbolag*) and set up a fund for financial instruments (*värdepappersfond*). The fund is owned by the investors (s. 1 Financial Instruments Funds Act 1990:1114, *lag om värdepappersfonder*) in proportion to their investments (s. 30). The fund is not a legal entity; it cannot own rights and debts, and the assets as such cannot be seized for anyone's debt (s. 8); on the other hand, the creditors of the investors may of course execute against the investor's share as such. The company represents the investors, acting in its own name (s. 12). The fund company shall cooperate with an institute of deposit (*förvaringsinstitut*, normally a bank) (s. 14). The shares shall be of equal value (s. 30). It shall be possible for the investors (or their creditors) to redeem their shares from the fund company (ss. 2 and 32).

The rules of the fund may be changed, but only with the approval of the Finance Inspection Board (*Finansinspektionen*).

Comparative remarks

This case perhaps most clearly shows that, given flexible legal rules, the same economic results can be achieved no matter what the legal form may be. It also covers ground which is very heavily influenced by European legislation, on the regulatory side.

Leaving out forms that are not suitable for public offering (such as various kinds of partnership), the leading trend is to have two models available: a common fund and a corporate form. Such alternatives can be found in Belgium, England, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Scotland and Spain. Only the fund form is mentioned in the reports for Austria, Denmark, Finland, Portugal and Sweden. The corporate form is often modified in this context to have a variable capital, allowing for an open-ended fund, even though this is not permitted by general company law. This can be seen in England, France, Ireland, Italy, Luxembourg, the Netherlands and Scotland. The possible use of the more normal corporate form, with a non-variable capital, is mentioned in England, Germany, Greece and Scotland. Belgium, England and Ireland allow for all possibilities, which may also all be available in some other countries: open- and closed-ended funds, in both the common fund and the investment company vehicle.

In open-ended forms, including most funds and some companies, the normal mode of liquidation for the investor is a redemption transaction with the fund. The investment is not technically transferred, but is readily converted into money. True transferability is required with the closed-ended corporate form.

All vehicles organised in corporate form allow amendments in accordance with general company law or under different provisions. On the other hand, investment funds and unit trusts may sometimes alter the rules without having to seek the consent of the participants to the scheme. In all cases, this is subject to close regulation pursuant to the UCITS Directive.

Case 10: Multiple debenture holders

Case

A company, XYZ Ltd, wishes to raise money in the financial markets. It is willing and able to give real security to secure the debt. The transaction must be structured so that XYZ Ltd can issue secured debt instruments to multiple investors, in such a way that each investor holds the same kind of real security over the same assets, and so that the enforcement of the security will be practicable. How can these goals be realised?

Discussion

Austria

There exists in Austrian law an old statute which governs the transaction. This is the *Gesetz vom 24. April 1874 betreffend die gemeinsame Vertretung der Rechte der Besitzer von auf Inhaber lautenden oder durch Indossament übertragbaren Teilschuldverschreibungen und die bücherliche Behandlung der für solche Teilschuldverschreibungen eingeräumten Hypothekarrechte*.[1] This statute deals with *Teilschuldverschreibungen*. These are bonds negotiable on the capital market, issued by the company in situations like those of Case 10.

Such bonds can be secured by a mortgage on the immovable property of the company issuing the bonds. The statute enacts special provisions for such a security. The mortgage is created by presenting a mortgage deed to the court responsible for the land register. This document deed

[1] RGBl 1874/49, last modified by BGBl 1991/10.

has to be drawn up by the company issuing the bonds. The individual bondholder is not registered in the land register. Only the total amount for which the bonds are issued, the number of bonds issued and the dates at which they are to be paid are registered. By purchasing a bond the purchaser also acquires a share of the mortgage. If necessary, a curator (*Kurator*) can be appointed by the court to take care of the interests of the individual bondholders.

Belgium

Belgian civil law does not provide for a general security over all of the assets of a company. The closest alternative is the establishment of a right of pledge on the business of the issuer whereby the 'business' includes goodwill, movables, contractual rights, intellectual property, stock-in-trade up to a maximum of 50 per cent, and all other assets that serve the business. Immovable property is not included. A pledge of immovables is never used;[2] here, a mortgage is required. Business pledges can only be issued to the benefit of banking institutions, not to ordinary creditors.

Companies wishing to issue secured debt instruments to debt investors will find an acceptable (although rarely used) alternative in the issuance of mortgage debentures. Belgian company law offers the possibility to issue such debentures, with mortgage cover, to multiple investors.[3] The mortgage should be taken on one or more immovable assets of the company and must be registered in the land register on behalf of the current and future debenture holders. Exceptionally, the mortgage registration does not mention the creditors or debenture holders but only the debt instruments themselves. Hence, each single debenture incorporates the right to a proportional part of the security in the case of the insolvency of the debtor. The practical enforcement of the security is organised through the creation of a general assembly of debenture holders, which nominates a mandatary, authorised to represent the creditors.[4] This nomination is not valid without the approval of the President of the local Court of First Instance.

Companies wishing to offer security other than mortgages must request the preliminary approval of the general assembly of debenture

[2] Arts. 2085–2091 BCC.

[3] Art. 493 of the Company Code (previously art. 97 Company Act).

[4] Arts. 495 and 568 of the Company Code.

holders to attach other security to the debt. The assembly may also decide to require certain assets to be deposited with a depository.

Denmark

As a point of departure, it is not possible under Danish law to have a whole undertaking as security; according to the Registration Act, s. 47a, no one may mortgage everything he owns or acquires in the future, and, according to s. 47b, a mortgage on personal property may not be given in the case of unspecified objects. Consequently, the floating charge or company charge known in other legal systems is prohibited in Denmark, primarily based on considerations of a socially oriented nature.

However, if you have a mortgage on real property, from which a business is carried on, then the mortgage covers the whole of the working plant (cf. the Registration Act, s. 37). This provision covers instances where an enterprise carries on a business from premises of its own. It is even possible to have a mortgage on a working plant if the business is carried out in rented premises (cf. s. 47b(2) of the Act).

The Danish business world has made various attempts to get around the prohibition on company charges. One model is to isolate the relevant assets (stocks, claims, etc.) by founding a subsidiary, transferring ownership of the assets to the subsidiary, and giving the shares of the subsidiary to the investor (usually a bank) as security. However, this model is less suitable in a situation where there are a large number of investors.

It must be concluded that Danish law does not actually seem to offer a practical solution to meet the requirements of XYZ Ltd. The investors may, of course, each secure their individual loans by taking specific assets as security.

England

English law allows the creation of a security interest over a shifting class of assets. Most commercial secured lending is secured by an 'equitable charge', in which the debtor may remain in possession of the property.[5] Such a charge may be 'fixed', meaning that the debtor is not at liberty to dispose of the charged property in the ordinary course of his business,

[5] Other devices exist. A statutorily modified mortgage (that is, conveyance by way of security which leaves the debtor in possession) is commonly used for immovable property. The charge, however, can be used for any kind of property. The registration requirements are complicated. See generally L. D. Smith, 'Security', in P. B. H. Birks, ed., *English Private Law* (Oxford: Oxford University Press, 2000), ch. 5.

or 'floating', where such liberty exists.[6] It is the floating charge which is normally used when the goal is to create a security interest in all of the assets of the debtor, as they exist from time to time.

Where there will be a large number of creditors, and especially where it is desirable to make the debt obligations freely transferable on the capital markets, the trust is used, because the existence of a single representative for creditors facilitates the administration of the security. All of the assets of XYZ Ltd can be charged to the trustee. He holds the security interest for the benefit of the creditors, in the proportions of their contributions to the loan. There is no limit to the number of creditors who can participate. Their interests can be freely transferable on an investment market. These transfers will be transfers of a debt, along with the beneficial interest in a corresponding part of the security interest, the whole of which is held by the trustee throughout. Public marketing will attract regulation under the Financial Services and Markets Act 2000 (see the answer to Case 9).

The trustee may or may not be one of the creditors. In this kind of transaction it is common to have provisions by which the creditors can vote to make decisions regarding steps to be taken relating to the security. Such steps are taken by the trustee on behalf of all the creditors.[7]

The trust can also be used where there are multiple creditors whose interests are successive, rather than concurrent. This is common in project finance, where different lenders may finance different phases of the project. Again, there is no need for multiple security transactions since the trustee holds the security interest throughout.

Finland

The most comprehensive real security is called an enterprise charge. The security right of the creditor comprises, in this case, practically all business property of the company with the exception of immovable property. Such property must be mortgaged separately. In both cases, the charge is registered by the authorities and the security right is definitively established by placing the certificate of registration in the possession of the creditor.

If there are a lot of creditors, as supposed in Case 10, then it is not, of course, practicable to leave the security in their joint possession; nor is it

[6] See *Agnew* v. *Commissioners of Inland Revenue* [2001] 2 AC 710 (PC, NZ); note however *National Westminster Bank plc* v. *Spectrum Plus Ltd*, [2004] 3 WLR 503, which has been appealed to the House of Lords.

[7] The trust deed may not excuse the trustee from liability for negligence: Companies Act 1985, s. 192.

necessary. The same real security can be given *pari passu* to multiple investors by leaving the certificate of registration, or some other security, in the care of a neutral third party, which is informed of the arrangement. The neutrality means that the third party must be formally independent in his relation to the company giving the security. The requirement of neutrality is, however, not especially onerous. So, it is probably acceptable for the third party to be a subsidiary of company XYZ.[8] On the other hand, it is unlikely that an employee of company XYZ will act as a third party taking care of the interests of the debenture holders. If the certificates, or other securities, are appropriately placed in the possession of a third party, then every investor can have an equal security right in the insolvency of XYZ Ltd. It is irrelevant whether the third party is a natural person or a company, e.g. a bank or other credit institution.[9]

A mere notice to the third party of the security rights of the creditors is, according to the law, sufficient to perfect the security.[10] It is not necessary that the third party promises to take care of the interests of the creditors. Such a duty, at least at a minimal level, is imposed by law. This means, for example, that the third party must not, after notification, give the security back to the debtor but rather to the creditors. In practice, however, there would be a relatively detailed contract of mandate specifying the rights and duties of the third party in taking care of the interests of the investors. If this contract was made between XYZ Ltd and the third party, then it is not certain under which circumstances the contract *in favorem tertii* can be changed by the original parties without hearing the debenture holders. To avoid this kind of uncertainty, the contract between XYZ Ltd and the third party can be incorporated in the debenture documents.

Security arrangements described in this question are not common in Finland.[11] The security offered to investors under these kinds of

[8] This kind of arrangement seems to be accepted, for instance, in Supreme Court decision KKO 1982 II 59. See also E. Havansi, *Esinevakuusoikeudet* (Helsinki: Lakimiesliiton Kustannus, 1992), 149.

[9] The use of a notary or some other officials in their capacity as authorities is not possible according to Finnish legislation.

[10] See the Commerce Code Ch. 10 s. 1.

[11] So-called syndicated loans, which are also used in Finland for financing of major companies, seem to fall outside the scope of Case 10, because the goal of company XYZ was to raise money in the financial markets, not to take a loan from the banks. In syndicated loans, it is, moreover, uncommon in Finland to take a real security from the debtor. In syndicated loan agreements, there is usually a choice of law clause stating that the agreement is governed by English law. The central figure in these arrangements is the 'agent bank'.

circumstances is rather a bank guarantee or something similar. Real securities are then given to the guarantor as a counter security. In this way, the various problems concerning the administration of real securities held in common can be avoided.

France

A French company (the 'Issuer') may issue secured debt instruments to multiple investors. The Issuer could grant, for example, either a pledge on its business (*nantissement de fonds de commerce*) or a mortgage (*hypothèque*) on its immovables. The Issuer may guarantee debt instruments by security interests that are granted either (a) before the issuance,[12] or (b) after the issuance of the debt instrument.[13]

Unless otherwise provided by the by-laws (*statuts*) of the Issuer,[14] the general ordinary assembly of the shareholders of the Issuer has the power to authorise that security interests be granted by the Issuer's representative in favour of holders of debt instruments issued by the Issuer.[15]

The Issuer's representative is allowed to proceed with all of the formalities needed to render the security interest opposable to third parties, e.g. registering a mortgage (*hypothèque*). The Issuer's representative is responsible for renewing any registration of a security interest.[16]

The holders of the debt instruments are deemed to have retroactively accepted the security interest by their subscription to the debt instrument.[17] Holders of the same kind of debt instruments issued by an Issuer are deemed to be part of a group called a *masse*, which has a legal personality.[18] The security interests granted by the Issuer are granted for the benefit of the *masse*.[19] The *masse* will elect a representative, who has full power to act in favour of the holders of the debt instruments.

Security interests in favour of holders of debt instruments may be granted after the issuance of the debt instruments.[20] In this case, the representative of the *masse* accepts the security interest granted by the Issuer in favour of the holders of the debt instrument.

[12] Art. L. 228-77 C. com.

[13] Art. L. 228-81 C. com.

[14] G. Ripert and R. Roblot, *Traité de droit commercial*, t. I, 17th edn, by M. Germain and L. Vogel (LGDJ, 1998), No. 1814.

[15] Art. L. 225-100 para. 4 C. com.

[16] Art. 236 of the 23 March 1967 Decree.

[17] Art. L. 228-77 C. com.

[18] Art. L. 228-46 para. 1 C. com.

[19] The representatives are designated by the bondholders at a bondholder meeting, or in the debenture agreement if the bonds are publicly offered.

[20] Art. L. 228-81 C. com.

Germany

The scheme normally chosen under German law for these situations is the trust for debenture holders. Procuring direct security rights in land for every investor is impossible, as a result of the requirement of registration. Collective schemes influencing the rights of debenture holders are partly regulated in the *Schuldverschreibungsgesetz* of 1899.[21] This statute, however, deals only with bonds denominated in DM/euros and only with a limited number of topics, mainly majority vote in default cases. Security rights are not dealt with. Therefore, the scheme is based on standard contract terms. The problem most disputed under German law arises from the fact that the terms have to be specified on the bonds themselves and that they are first drafted in an agreement between the issuing company and the lead bank of the syndicate (or the issuing banks), to which the trustee may also be party. The terms in this agreement are therefore individually bargained for between these parties. It has therefore been argued that whenever the issuing banks are the first debenture holders (firm commitment underwriting), the terms are not subject to control under the Unfair Contract Terms Statute (AGBG). The majority view is less technical. It emphasises that even in cases of firm commitment underwriting, the purpose of the deal is to place the bonds with the public at large, and for the public at large the terms clearly constitute standard terms not bargained for.[22] Accepting this, it is then considered a fundamental principle to treat all debenture holders equally and any deviation is void under § 9 para. 2 AGBG. The enforcement of the security is the trustee's task, and is not more complicated than the enforcement of any security in land by an individual security holder.

Greece

Such objectives may be realised in Greece through the issuance of secured bonds by a company. L.3156/2003 provides that any bonds issued and disposed to multiple investors may be secured through a real security interest. The real security interest may be raised over

[21] *Gesetz betreffend die gemeinsamen Rechte der Besitzer von Schuldverschreibungen* of 4.12.1899, *Reichsgesetzblatt*, 691, *Bundesgesetzblatt* part III, 4134–1, SchVG.

[22] See, among others, Hopt, 'Änderungen von Anleihebedingungen – Schuldverschreibungsgesetz, § 796 BGB und AGBG', *Festschrift for Steindorff* (1990), 341 (372); Kümpel, *Bank- und Kapitalmarktrecht* (1995), para. 11.69, 11.70; v. Randow, 'Anleihebedingungen und Anwendbarkeit des AGB-Gesetzes', ZBB 1994, 23 (28, 29 and 31); and Stucke, *Rechte der Gläubiger bei DM-Auslandsanleihen* (1988), 261 ff.

movable assets (in particular, claims towards third parties, shares, etc.) or over an immovable asset. The real security is constituted by agreement executed between the security interest provider (who may be the issuing company or any third party, if the assets belongs to such third party) and the bondholders' representative. L.3156/2003 provides that,[23] in case of a real secured bond, the appointment of a bondholders' representative, which may be a credit institution or a company providing investment services and which will manage the real security for and on behalf of any bondholders, is mandatory. Furthermore, if the real security should be registered in a public registry or mortgage record, etc., in order to become effective, such registration should be made in the name of the bondholders' representative along with a statement mentioning that such real security is given in favour of the bondholders in order for them to secure their bonds. Such real security interest is a separate property held by the bondholders' representative for and on behalf of any and all bondholders and it cannot be claimed by the creditors of such bondholders' representative. On the other hand, the rights of the bondholders over the security are indivisible until the enforcement of it, which is made by the bondholders' representative in its name and on behalf of the bondholders.

Ireland

The trust as outlined in the English report would also be the most appropriate solution as a matter of Irish law.[24]

Italy

There are several ways to structure the transaction. The company may issue bonds secured by the creation of a real right over immovables (hypothec) or other company assets. These are in practice financial assets that are pledged as security for the repayment of the loan. The usual formalities for the constitution of a hypothec over an immovable are greatly simplified if the hypothec secures bearer or order bonds (cf. arts. 2831, 2839, 2845 CC). The hypothec is entered in the land

[23] S. 3 of L.3156/2003.

[24] Common law and equitable principles apply *mutatis mutandis*. As to statutory provisions, s. 93 of the Companies Act, 1963 precludes exempting trustees for debenture holders from liability for negligence, in much the same way as s. 192 of the Companies Act 1985 does in England.

register in the name of the debtor for the whole mass of bondholders. The annotation mentions the name of the joint representative of bondholders. Notifications and communications concerning the hypothec are addressed to the joint representative of bondholders, or to a curator who is nominated for this purpose.

The joint representative, who may or may not be one of the creditors,[25] is appointed by the meeting of bondholders. This meeting also has authority to decide certain other matters specified by the law, including modifications of terms of the loan (cf. art. 2415 CC). If not appointed by the bondholders' meeting, the joint representative is appointed by the court upon request of one or more bondholders, or of the directors of the company. He remains in office for a period of three years and can be re-elected. The joint representative attends to the implementation of the decisions of the bondholders' meeting and protects their common interests in relations with the company. He has the right to attend shareholders' meetings. For the protection of common interests, he represents bondholders in all judicial proceedings (art. 2418 CC). Individual actions by bondholders are not barred by this regime, unless such actions are incompatible with the resolutions of bondholders' meetings (art. 2419 CC).

With the reform of Italian company law which entered into force in 2004, companies may also raise money by issuing financial instruments that are secured by those assets of the company which are allocated to the particular business opportunity being financed by the money borrowed against those instruments (see arts. 2247bis – 2247decies CC on *patrimoni destinati ad uno specifico affare*).[26] This regime provides the functional equivalent of the establishment of a new entity, without its formal features. The assets are a distinct patrimony by appropriation, that is immune from the claims of the company's other creditors. Income generated by this patrimony is subject to the same regime. The resolution creating such patrimony shall specify which assets are comprised in the distinct patrimony. If the patrimony includes

[25] For commentary, see Campobasso, 'Obbligazioni di società', *Digesto, sezione commerciale*, X, 4th edn (1994), 280. The entry into force of the new Italian company law in 2004 does not change the basic features of the regime described in the text. See Galgano, *Il nuovo diritto societario* (2003), 391 ff.

[26] Iamiceli, *Unità e separazione dei patrimoni* (2003); Di Sabato, 'Sui patrimoni dedicati nella riforma societaria', Società, 2002, 665–666; Ferro Luzzi, 'La disciplina dei patrimoni separati', Riv. soc., 2002, 129; Inzitari, 'I patrimoni destinati ad uno specifico affare', *Società*, 2003, 299.

immovables or registered movables, annotations in the appropriate registers must be made. As for the other assets, the creation of the security shall be made known to the public by consultation of the register of business enterprises (arts. 2188 ff. CC). The resolution creating the security (art. 2247bis, 2247decies CC) is inscribed in such a register (art. 2247quater). The value of such patrimonies cannot exceed 10 per cent of the net value of the company assets (art. 2247bis CC). Under these new provisions, creditors of the company hold meetings regulated by the law. They are collectively represented by a joint representative, as described above. The creditors whose rights are secured by the creation of such a patrimony can exercise their individual rights only in so far as they are compatible with the powers of their joint representative and with the resolutions adopted by the creditors' meetings (cf. art. 2247octies CC).

Last, but not least, the issue of bonds may also be secured by transferring the assets securing the loan to an Italian trustee. The transaction, in this case, is governed by a foreign law, on the basis of art. 6 of the Hague Convention on the law applicable to trusts and on their recognition.[27]

Luxembourg

A Luxembourg company can issue bonds (*obligations*) pursuant to arts. 76 ff. of the Law dated 10 August 1915 on commercial companies, as amended.[28] The holders of the bonds will form a group of creditors (*masse*) organised pursuant to arts. 85 to 94–5 of the Company Law. The *masse* will be represented by a representative of bondholders (*représentant des obligataires*). The representative can be appointed either at the outset of the issue, by the company, or during the life of the issue, either by the company or by the commercial court, at the request of the bondholders or any interested third party. The representative is entitled to hold and register security on behalf of the bondholders, and to act for them in the case of the insolvency of the issuer. This is a statutory exception to the principle that security interests are usually accessory and so can only be held by the creditor of the debt secured.

[27] See Italian answer to Case 7. On one such operation: Trib. Milano (decree), 27 December 1996, Società, 1997, 858 ff., comment by Lener and Bisogni; D'Orio, 'Un trust a garanzia di un prestito obbligazionario. Percorsi e tendenze nella dottrina sui trusts', Giur. comm., 1998, I, 235.

[28] Assuming it has a corporate form which allows such issue, i.e. mainly a *société anonyme* or a *société en commandite par actions*.

In terms of security interests over whole businesses, there is no equivalent to a 'floating charge' under Luxembourg law. On the basis of the principle that security interests created over assets located in Luxembourg must comply with the mandatory principles of Luxembourg law (*lex rei sitae*), a Luxembourg company would not be able to create an English law floating charge over its assets located in Luxembourg. As a partial equivalent, a company may however create a pledge over its business as a going concern (*gage sur fonds de commerce*), which is regulated by a 1935 Grand-Ducal Decree. The Decree provides precisely which assets of the business are covered by that form of security, as well as rules on registration and enforcement. Two limitations restrict the use of this mechanism in practice: (i) only specially authorised banks and breweries are entitled to receive such pledges, and only a few banks have applied for authorisation to do so, and (ii) only operating industrial and commercial companies can have a *fonds de commerce* in the sense of the Decree, which excludes finance companies or special-purpose entities.

A debtor may obviously also grant security interests over specific assets, such as bank accounts, portfolios of securities or receivables, and immovable property, using in each case the specific security interest provided by Luxembourg law or the relevant *lex situs*. By properly structuring the security interest over assets like portfolios of securities, it is possible to create a mechanism similar to a floating charge over a group of assets (i.e. allowing substitution of assets). In this respect, it should be noted that, by a law dated 1 August 2001, Luxembourg has created the possibility to use a transfer of ownership for security purposes in a variety of circumstances.[29]

In respect of assets located in other countries, the issuer may grant security under local law, and will need to comply with local mandatory rules. Where applicable, the recent EU initiatives (such as Council Regulation 1346/2000/EC on insolvency proceedings, Directive 98/26/EC on the finality of payments or Directive 2002/47/EC on collateral financial arrangements) provide legal certainty under the conditions set out therein for the recognition of such security interests in case of insolvency of the issuer.

The provisions on the representation of bondholders are not compulsory for Luxembourg companies. According to art. 94–6 of the Company

[29] S. Jacoby, 'Quelques réflexions au sujet de la loi du 1er août 2001 relative au transfert de propriété à titre de garantie', *Annales du droit luxembourgeois*, 2001, 237–265.

Law, Luxembourg companies which submit their issue of bonds to a foreign law may disapply the relevant provisions, and in practice bonds or notes are often governed by English or New York law. In this case, questions of bondholder representation, including the question of holding security for the changing group of bondholders, would be subject to the governing law of the bonds (subject to compliance with mandatory principles of the *lex situs*, such as the accessory nature of the security interest).

Specific issues may arise in respect of Luxembourg security interests created in support of bonds or notes issued under a foreign governing law, where the security is held by a third party, such as a security trustee. Luxembourg security interests are mostly accessory in nature, and so cannot exist in the absence of a secured obligation. Difficulties may therefore arise where the third party holding the security interest as trustee does not itself have a claim against the issuer. Practitioners increasingly seek to overcome these difficulties by using a so-called parallel debt mechanism: the issuer will covenant to pay the sum of all secured obligations alternatively to the secured creditors and the security trustee, the obligation owing to the security trustee being parallel to the one owed to the secured creditors. A pending bill (no. 5251, for the implementation of Directive 2002/47/EC on financial collateral arrangements) currently proposes to allow security interests to be granted directly to a person acting on behalf of the beneficiaries of the collateral arrangement (such as a security trustee), even if such person is not the creditor of the secured obligations, thereby making recourse to a parallel-debt mechanism unnecessary.

There are further possibilities entailing recourse to specific mechanisms and some additional structuring:

i. A first possibility for XYZ SA is to use the intermediation of a mortgage bank (*banque d'émission de lettres de gage*), created by a Law dated 21 November 1997, as amended. Such banks may grant loans to companies or individuals, and take security on underlying immovable property. In order to refinance themselves, the banks issue so-called mortgage bonds (*lettres de gage hypothécaires*). The bearers of those mortgage bonds are entitled to a preferential payment out of the underlying assets, i.e. the claims against the debtor companies which are secured by the real security taken by the bank.[30]

[30] S. Jacoby, *Les banques d'émission de lettres de gage* (Crédit Européen, 1998).

ii. A second possibility is the use of the fiduciary contract, as organised by the law (the '2003 Law') dated 27 July 2003 on trusts and fiduciary contracts. A fiduciary contract is an agreement which transfers title over patrimonial rights (fiduciary assets) to a fiduciary, which must be a qualifying institution, and creates for that institution a certain number of restrictions or instructions on the use of the fiduciary assets (fiduciary obligations). The fiduciary will be the creditor and also the secured party, and will exercise the rights to the underlying security interest. The use of the fiduciary contract as a security mechanism has been expressly recognised by art. 8 of the 2003 Law.

Netherlands

In the Netherlands, the raising of money in the financial markets on the security of the general business can be done by way of *trusthypotheek*. This mortgage can only encompass registered assets. Where movables are destined to serve immovables for some period in time, they can be pledged to secure the same claim as that for which the mortgage was granted (think of machines in a factory). It can be agreed that the execution of all these assets shall take place according to the rules on the execution of mortgages (art. 254 Book 3 CC). A general floating charge is not possible under Dutch law. The company XYZ BV will raise money in the market by issuing bonds. As security for repayment, a mortgage will be taken out on the assets of the company. The mortgagee will be someone other than the bondholders. Usually, the mortgagee will be a company. Under Dutch law several problems must be solved.

The first problem is that the security is an accessory right, which means that it can only be held by the mortgagee as security for a claim held by the mortgagee. The problem arises because the claims are held by the bondholders. There are three ways to solve the problem by creating a claim held by the mortgagee. The claim can be created by having the mortgagee act as a surety; by creating a parallel debt; or by active severalty. The disadvantage of the surety is that the mortgagee must first pay the bondholders before he can have recourse to the securities. In the second structure, the mortgagee and the company contractually agree that the mortgagee has a claim against the company for the same amount as the bondholders can claim from the company. The principle of freedom of contract permits this structure. However, it is sometimes remarked that such a contract does not create an independent claim of the mortgagee against the company, so that in practice it is the same as the third solution – the active severalty. In that situation the parties involved agree that next to the bondholders, the mortgagee has the right to claim the moneys due under the bond, for which claim the mortgage can be given. Between the mortgagee and the bondholders it is agreed that the bondholders are exclusively entitled to the moneys. In Dutch practice it is sometimes said that this structure does not work. If only one of the creditors has the right to the moneys (the bondholders), the other one (the representative) will have no more than the right to collect the moneys and will not have an independent claim on the debtor (the company). The mortgagee cannot get a mortgage in such a case. However, this has not prevented Dutch practice from using this method in securitisations.

The second problem is that it is not clear on what legal basis the mortgagee is acting on behalf of the bondholders. In fact, it can be a *fiducia cum amico* contract, an Anglo-American trust, a special form of representation/mandate, or a special form of *bewind* (administration). The first two options are usually dismissed. The first is dismissed because it gives the bondholders no more than personal rights against the mortgagee. The second is dismissed because it cannot, under Dutch law, be a true Anglo-American trust. The other two options can be used to explain why the trustee can act on behalf of the bondholders.

Another problem is that the mortgage is granted before the bondholders are known. If it is accepted that, at the moment the mortgage deed is registered, the mortgage and the bondholders are still a future event, then this problem can be solved. The moment at which the bonds are issued is the moment at which the mortgage becomes validly created. Article 260 Book 3 CC grants retrospective effect to the mortgage from the day on which the mortgage was registered.[31]

To summarise, the most common structure for large projects with many bondholders is one in which ownership of the securities is vested in the person (mostly a company) that will deal with the security for the group of bondholders. The agency structure is less suitable for this.

Portugal

XYZ Ltd may issue bonds and place the issue on the market. There are several possible alternatives as far as the securities to be issued are

[31] A. Thiele, *Collective Security Arrangements* (PhD Nijmegen University) (Deventer: Kluwer 2003), 27–107, with many references.

concerned. These include commercial paper (Decree-Law 181/92 of 22 August), with a term of up to one year or two at the outside, or cash bonds (Decree-Law 408/91 of 17 October), with terms of more than two years (these can only be issued by investment companies, leasing companies, factoring companies and hire-purchase companies, which are all credit institutions). For longer terms, XYZ Ltd, may issue ordinary bonds.

Decree-Law 125/90 of 16 April authorises financial institutions, such as banks and other corporate bodies rendering financial services, to issue a special type of bonds – *obrigações hipotecárias* or mortgage bonds – that are secured by mortgage on immovables, payment of which (principal and interest) is privileged and has priority over common creditors. The issue of *obrigações hipotecárias* is reserved to financial institutions authorised to finance the construction or acquisition of immovables, and is strictly controlled by the Bank of Portugal, mainly with regard to the value of the real assets securing the bonds. XYZ Ltd may issue *obrigações hipotecárias* if it is a financial institution specialising in the financing of construction or acquisition of immovables.

Scotland

The law and practice are, in general, the same as in England. Since a security is an accessory right, it may not be possible for the trustee to hold the security right unless he also holds the secured debt (a definite conclusion on this point would be difficult to arrive at, because of uncertainty as to the precise scope of the accessory principle). Hence, it is advisable that the bonds should be worded so that the debt is payable either to the bondholder or to the trustee.

The security that is used is, in practice, most likely a ‘floating charge’. This is similar to the English floating charge. It is a security which is capable of affecting the whole of the assets of the debtor company, both movable and immovable, and both real and personal. When the company acquires an asset, the asset automatically comes under the charge without the need for any new juridical act. When the company disposes of an asset, the asset ceases to be affected by the charge without the need for any juridical act. Thus, the charge is not a real right. However, an event called ‘attachment’ can convert the charge into a real right. It then becomes a real right of security over all the assets of the company, as they exist at the time of the attachment. The ranking rules are complex. The charge has to be publicly registered at the time when it is first created. The fact of attachment must also be publicly registered.

Spain

In order to achieve the described goals, XYZ Ltd can issue *obligaciones* (debts or debenture bonds) which are equal, negotiable and transferable titles linked to a loan. Another possibility is the *pagarés de empresa* (commercial papers). These papers are issued individually, and each title corresponds to a different loan contract, which is why they seem a less adequate vehicle than the *obligaciones* for the present purpose.

Since 1995, Spanish law has restricted the issuing of *obligaciones* to one type of company, namely the *Sociedad Anónima*.[32] This is, therefore, the first condition XYZ Ltd has to fulfil. The contract for issuing the bonds is not subject to a previous administrative authorisation, but there are certain formalities to be followed.[33] First, there is a need for the approval of the General Assembly of shareholders; directors cannot decide to issue bonds on their own. Secondly, the decision has to be communicated together with certain documents to the *Comisión nacional del mercado de valores* (CNMV) and it has to be taken in a public document, registered in the Commercial Register and made public in the Register's official bulletin. An essential requisite imposed by law is the constitution of the *sindicato de obligacionistas*, a body without legal personality, to protect the interests of the debenture bondholders, whose costs are met by the issuer corporation. It is also necessary to name a *comisario* as a representative and manager of the *sindicato de obligacionistas* who is in charge of the relationship between the issuer corporation and the body representing the bondholders.

The bonds can be ordinary or secured; and security can be personal or real. Securities are enumerated by the law in a non-exhaustive list (art. 284.1 *Ley de Sociedades Anónimas)*. Real securities, for example, include the mortgage on movables or immovables, and the pledge of securities (which have to be deposited in a bank). If these securities are offered, then there is no subjection to the quantitative limitations that the law imposes on debenture bonds (arts. 284.2, 282 and 289). The security can be established either at the moment of issuing the bonds or afterwards.

[32] The Spanish law on *sociedades de responsabilidad limitada* (limited companies) excludes the issuing of *obligaciones* (art. 9 and *Disposición Adicional* 3^{a}, Law of 23 March 1995) for these legal entities and for almost all other civil and commercial corporations, as well as for individuals.

[33] These formalities are laid down in arts. 282–310 of the Law regulating *Sociedades Anónimas* (RD 1564/1989 of 24 December), in arts. 25 and following of the Law regulating the stock markets, in arts. 8 and following of RD 291/1991 of 27 March and in arts. 310–319 of the Regulation on the Commercial Registry.

The law establishes special requirements on bonds backed by real security. It is necessary to issue a public document, which has to fulfil the conditions of art. 154 of the *Ley hipotecaria*, and to register the guaranteed debenture bonds in both the Register of Property and the Commercial Register.[34] In any case, the same security must cover all bonds issued (it is not possible to secure some bonds with a mortgage on movables and other bonds with a hypothec on immovables). The *Comisario* of the *Sindicato de Obligacionistas* is the person with the faculty of accepting or rejecting the real security offered by XYZ.

In any case, those holding secured bonds can also realise their debts on all other goods, rights or shares owned by the company (art. 284.3 LSA), which means that the company is answerable for the debt not only with the security, but also with all its patrimony. Secured debts do, however, receive preferential treatment, and earlier issues prevail over later ones (art. 288.1 LSA).

As far as the rights of investors are concerned, they can claim the stipulated interests and the lent capital once the agreed time period lapses. If XYZ does not fulfil its obligations or if there is a delay of more than six months, then the *Comisario* can execute on the securities. A previous decision of the assembly of bondholders is, however, necessary.

Sweden

In principle, a company which wishes to raise money in the financial markets against real security could administer the transactions itself and offer the lenders security in, for instance, the changing assets of the company (*företagsinteckning*, a floating charge which is registered on the company and attaches to 45 per cent of the value of all assets),[35] since the collateral in such a case need not be transferred into the possession of the lenders (although a negotiable instrument representing the collateral shall be transferred into the creditors' possession). In the loan agreement it could be stipulated that the lenders should have equal rights in the security.

A more practical way to structure the transaction is to make use of a bank as an intermediary. The bank could either try to find investors for

[34] Art. 310.5 of the Regulation of the Commercial Register.

[35] The legislation was amended in spring 2003. Earlier the charge attached to (100 per cent value in) all assets with the total exception of some assets, such as real estate, negotiable instruments and cash.

the whole sum, or it could also guarantee the loan. Normally the bank continuously represents the investors and has some authority to agree to changed conditions. If a security is offered which requires transfer of possession in order to be protected against the general creditors of the borrower, the bank may receive and hold the security on behalf of the lenders collectively. Thus, individual lenders may not be entitled to liquidate the security, which is in harmony with the general rule on co-ownership (here co-pledgeeship) that disposition over the co-owned property requires unanimity.[36] The bank is acting in a fiduciary capacity, and the lenders are of course protected in their right to the security if the bank were to go bankrupt. It does not matter whether the involvement of the bank was known when the lenders extended their credit or whether the bank appeared later, as a *negotiorum gestor* for the lenders, appointed by the borrower but acting in the interest of the lenders.

Comparative remarks

The first issue raised by the case is whether creditors can obtain a security over the general assets of the issuing company. This is possible in England, Ireland, Scotland and Sweden by means of a registered charge. In Austria, Denmark, Greece, the Netherlands and Portugal, a security over a shifting class of assets is simply unknown. In other countries it is possible, in respect of movables (Belgium, for bank creditors only, Finland, France and Germany). In Luxembourg, such a security is restricted both to certain debtors and to certain creditors. Recent changes to the law in Italy allow financial instruments to be issued for the benefit of a particular dedicated patrimony within the larger patrimony of the debtor; in this case, the creditors have an exclusive security claim over the assets in that dedicated patrimony.

A second problem regards the position of the security holder who acts in the interests of the creditors. In England, Ireland, Scotland and Germany this is a trustee; the investors or creditors are beneficiaries of a trust. Italian law permits the same structure, through the choice of a foreign governing law under the Hague Convention. In Luxembourg, the security holder may act under a fiduciary contract, or (in respect of immovables) under special legislation for mortgage banks. In France, the creditors constitute a body that has legal personality and that is

[36] The problems regarding such collective loans are discussed by Lennander, *Panthavares skyldigheter vid pantavtal om lös egendom*, (1977).

represented by a representative who has all the power to act in favour of the creditors. A similar pattern of representation is followed in Belgium, Italy, the Netherlands and Spain (and possibly in Austria as well, though the *Kurator* is also assimilated to a trustee), though the investors are not always considered as a body with legal personality. The representative may be identified as a mandatary which represents the investors (Belgium, Spain, Italy), but this raises the issue of whether the investors directly hold real security, or rather might be exposed to the risk of insolvency of the mandatary. The Belgian report mentions that the naming of the mandatary requires court approval. The Dutch report mentions other possibilities for understanding the relationship (*fiducia cum amico*, trust, *bewind*).

The Dutch, Luxembourg and Scots reports mention problems generated by the accessory nature of the security right held by the trustee or mandatary: it can only have the ability to enforce the whole security right if it is owed the whole debt. This does not seem to cause as many problems in practice as in theory.

Case 11: Securitisation

Case

A company, ABC Ltd, lends money on the security of mortgages/hypothecs on immovables. It now wishes to raise money in the financial markets. It wants to use its portfolio of secured loans as security for the transaction. The goals will be that ABC Ltd will not itself become liable on the transaction, and moreover that investors will not be adversely affected by any subsequent insolvency of ABC Ltd. How can the transaction be structured so as to isolate the portfolio of secured loans from the general business of ABC Ltd?

Discussion

Austria

There are only a few articles on securitisation in the Austrian literature,[1] and no court decision at all. The following remarks therefore have only a preliminary character.

In principle, Austrian law provides all the legal instruments required to structure securitisation transactions. First, it will be necessary to set up a new company, a special purpose vehicle (SPV). In a second step, ABC Ltd shall transfer its secured loans to the SPV. In exchange for them, the SPV shall pay a certain sum to ABC Ltd. To raise the money necessary for this payment, the SPV shall issue bonds to investors. If those

[1] Heinrich, 'Securitisation – ein innovatives Finanzierungsinstrument', *Finanz-Journal* 1995, 215; Oppitz, 'Austria', in Baums/Wymeersch, *Asset-backed Securitisation in Europe* (1996) 14; Trettnak, 'Forderungsverbriefung nach US-amerikanischem und österreichischem Recht', ÖBA (= Austrian Bank Archive) (2003) 397 ff.

investors are the only creditors of the SPV, then the security of the claims assigned to the SPV will also secure the investors' claims. As there is no direct relationship between the investors and ABC Ltd, this company will not be liable for the SPV's debts towards the bondholders.

Although Austrian law provides the basic instruments to structure such an operation, there are a number of practical problems which cast serious doubts on its feasibility under Austrian law. First, there is a problem with respect to fees (*Gebühren*). If a claim is assigned, a fee of 0.8 per cent of it has to be paid. If the claim is secured by a mortgage, it will be necessary to register the transfer of the security in the land register. This registration requires the payment of further fees. If the number of claims assigned is large, the costs of the assignments will be considerable.

Other problems may arise with respect to the SPV, if it is organised as a subsidiary company of ABC Ltd, so that ABC Ltd is a shareholder of the SPV. In this case, ABC Ltd may become liable for the SPV's debts if the value of the loans transferred to the SPV is less than the price paid by the SPV for them. According to Austrian law, a company must not pay out the company's capital to the shareholders (*Verbot der Einlagenrückgewähr*). If assets are sold by a shareholder to the company in exchange for more than the actual value of the assets sold, the transaction could involve ABC Ltd's liability for the SPV's debts in accordance with the said principle.

Belgium

Belgium has amended the Act of 4 December 1990 (see footnote 45 in the answer to Case 1) in order to create the legal possibility to refinance loans by transforming debts into securities.[2] An institution for debt investment serves as a special purpose vehicle to which the secured debt is transferred and which can be structured as an investment fund – without legal personality – or as an investment company – with legal personality.[3] The transfer of secured debts was facilitated in 1994 through an amendment of art. 1690 CC. The transfer can be invoked against *third parties* without formalities; in order to be able

[2] For details on all legislative interventions and a clear comment on securitisation in Belgium, see I. Peeters, 'Overdracht van schuldvorderingen en effectisering', in *Zekerheden, beslag- en faillissementsrecht in de notariële praktijk* (Bruges: Die Keure, 1998), 287–369.

[3] Art. 119bis–119nonies Act of 4 December 1990.

to invoke the transfer against the *debtor*, a simple and informal notification is sufficient.[4]

The loans constitute the assets of the special purpose vehicle but continue to be serviced by the originator. An administrator – in the form of a corporate entity – supervises the originator and exercises the rights attached to the debt. In the case of insolvency of the originator, its creditors have no claim to the secured debts since these belong to the institution for debt investment or its investors.

Denmark

If ABC Ltd is a mortgage-credit institute as defined in the Real Property Mortgage-Credit Act (Consolidation Act No. 768 of 28 August 2001), then the rules of the Act apply. Only mortgage-credit institutions may issue property bonds. Mortgage-credit institutions are subject to the Danish Financial Supervisory Authority's approval, which is conditional on the mortgage-credit institution having a share capital of a minimum of DKK 150 million. It is assumed that ABC Ltd is not a mortgage-credit institute as defined by the Act.

The concept of SPVs (special purpose vehicles) is unknown in Danish law. ABC Ltd may found a separate subsidiary in a corporate form that shall have as its purpose the borrowing of money from third parties. ABC Ltd may then transfer the right to receive payments on the secured loans to the subsidiary, which may in turn transfer the right to receive payments to the investors as security.

However, there is a risk that the whole arrangement will be disregarded if the subsidiary becomes insolvent, and that consequently ABC Ltd will become liable towards the investors in accordance with the theory on *hæftelsesgennembrud* ('lifting the corporate veil'), bearing in mind that the real purpose of the arrangement is to put fresh capital into the parent company. Correspondingly, if ABC Ltd becomes insolvent, then there is a risk that the assets of the subsidiary will be considered part of the insolvent estate.

Whether or not the arrangement is disregarded depends on how well the administrative and economic affairs of the two companies have been kept separate through separate accounts, separate bookkeeping,

[4] See e.g. A. Verbeke, 'Vormvrije cessie en bezitloos pand op schuldvorderingen', *Tijdschrift voor Notarissen* 1995, 2–43; E. Dirix, I. Peeters, G. Van Haegenborgh and A. Verbeke, *Overdracht en inpandgeving van schuldvorderingen* (Antwerp: Kluwer, 1995).

etc., and to some extent also whether or not the arrangement is considered to be motivated by sound commercial reasons.

England

The portfolio of secured loans must generally be transferred to another entity, which is called a special purpose vehicle (SPV). The SPV is usually a company, but it may be a trust. Money can then be raised by the SPV against the security of the portfolio, and this allows the SPV to pay ABC Ltd for the loans. This ensures that even if ABC Ltd fails, then the lenders to the SPV remain unaffected, and similarly ABC Ltd is not liable on the transaction between the lenders and the SPV. Commonly, the SPV creates a security interest (charge) on all of its assets in favour of those to whom it owes obligations, such as those who have invested and those who have provided credit to facilitate the transaction.[5]

If the debtors of the loans in the portfolio continue to pay ABC Ltd, then it holds those payments on trust for the SPV. This is common in any transaction in which loans are assigned. It may be important because ABC Ltd may not want to publicise the transaction, or it may not want customers and potential customers to know that ABC Ltd will be assigning its portfolio of loans to another entity. Thus all of the 'servicing' of the loans can continue to be performed by ABC Ltd. If ABC Ltd acts properly in setting up a segregated account, then the SPV (and therefore the lenders to it) would not be affected by the insolvency of ABC Ltd.

The trust is also used where the assets transferred to the SPV are not easy to identify separately, due to the nature of those assets or the bookkeeping systems used by ABC Ltd. In such cases, there can be transfers of generic pools of assets to an SPV as trustee, holding the whole pool in undivided shares for different lenders based on the level of their contributions. A trust is very often used for loans where there has been an agreed price for a pool of loans, but at the same time it is not known in advance exactly how much income the loans will yield. Here they may be transferred to a trustee, which will hold the loans on trust for the SPV and the originator, ABC Ltd, in undivided shares. If the loans yield any surplus above the price that the SPV was required to pay, this will be held on trust for ABC Ltd. The two possibilities mentioned in this

[5] This charge will usually be held by a trustee for all creditors, as discussed in Case 10: E. Ferran, *Mortgage Securitisation* (London: Butterworths, 1992), 66–67. See also R. Goode, *Commercial Law*, 3rd edn (London: LexisNexis UK, 2004), at 147–148.

paragraph are frequently combined into a 'master trust' structure, with a third party trustee to whom additional blocks of loans can be transferred by ABC Ltd from time to time as they arise. This is common, for example, in securitisation of credit card debts. It means that a single structure can be employed for a long period of time.[6]

Depending on the goals of the transaction, it may be important that the SPV is not a corporate affiliate of ABC Ltd. If the SPV is merely a subsidiary of ABC Ltd, then the transaction will not effectively remove the assets from the balance sheet of ABC Ltd. If they are fully independent, then ABC Ltd disposes of its loan portfolio and instead acquires cash. This may be important for many businesses and especially banks, as it may affect their reserve requirements (loans require reserves, but cash does not). Accordingly, it used to be common for ABC Ltd (or some other party) to hold the shares of the SPV as a trustee on charitable trusts. This meant that ABC Ltd had no beneficial interest in the shares and so the accounts of the two companies were not consolidated. The terms of the trust would restrict the trustees' ability to transfer the shares. It is now more common for the shares of the SPV to be held on a non-charitable purpose trust created in another jurisdiction, such as Jersey.[7]

Sometimes the accounting aspects are not crucial. It may be that ABC Ltd is not concerned about the accounting issues, but only desires to achieve the economic effects of the transaction. For example, by isolating the portfolio of assets in the SPV, so that the credit risk of ABC Ltd is no longer relevant in the pricing of bonds secured by the portfolio, it may be that the offering of bonds will achieve a higher credit rating than ABC Ltd could itself obtain. In this situation, the parties may consider a 'synthetic securitisation'.[8] In this transaction, the underlying

[6] This arrangement could amount to a collective investment scheme attracting regulation by the FSA. Securitisation of any kind is likely to attract prudential regulation by the FSA if the originator's activities are regulated.

[7] A purpose trust is one in which there is no person with the status of trust beneficiary; the trustee holds the trust assets to be applied for a purpose. In English law, subject to some obscure exceptions, the orthodox view is that the only purposes which are valid are charitable (public) purposes. There is, however, some debate about this issue: see, for example, D. Hayton, 'Developing the Obligation Characteristic of the Trust' (2001) 117 LQR 96; in response, P. Matthews, 'From Obligation to Property, and Back Again?', in Hayton, ed., *Extending the Boundaries of Trusts and Similar Ring-Fenced Funds* (London: Kluwer, 2002), 203; see also P. Baxendale-Walker, *Purpose Trusts* (London: Butterworths, 1999). Non-charitable purpose trusts are permitted by the law of Jersey and of some other jurisdictions.

[8] See E. Uwaifo, 'Key Issues in Structuring a Synthetic Securitisation Transaction – A European Perspective' [2001] *Journal of International Banking Law* 98.

assets (portfolio of loans in this case) are not actually transferred to the SPV. Instead, through the use of derivatives such as credit default swaps, the same economic effect is achieved. This can also be helpful where for some reason, such as legal obstacles, it is difficult to effect a transfer of the underlying assets to the SPV.

Finland

ABC Ltd can safeguard its own position by transferring the loans along with the connected security rights, without recourse in the case of nonpayment. In this case, ABC Ltd does not, normally, become liable on the transaction.[9] In order effectively to protect the investors from the negative effects of ABC's subsequent insolvency, additional arrangements are, however, required.

The transfer of loans, and the security rights connected to them, is not valid against the creditors of the transferor without certain additional actions that produce publicity. The appropriate action depends on the type of loan document.

If the loan is to be paid (a) to the holder of the promissory note (bearer note), or (b) to a named creditor or a person named by him or her (order note), then the note must not be left in the possession of the transferor, i.e. ABC Ltd. Instead, the note must be given into the possession of the transferee or a third party, which must be informed about the transfer either by the transferor or by the transferee.[10] Only banks and comparable financial institutions are relieved of that obligation: transferred bearer and order notes can be lodged with them.[11]

If the loan is to be paid to the original creditor, which means that there is only a simple promissory note, then the debtor must be informed of the transfer.[12] The notice to the debtor must make it clear that there

[9] Cases of fraud and similar can, presumably, be overlooked here.

[10] See the Promissory Notes Act, s. 22. The third party must be informed about the transfer so that he or she knows who is entitled to dispose of the note. Any commitment of the third party not to give the note to anyone other than the transferee is not needed. A mere notice of the transfer creates an obligation on the third party not to give the note to anyone else but the transferee.

[11] See the Promissory Notes Act, s. 22. This provision was enacted 31.7.1947 and it is, to some extent, unclear as to which kind of financial institutions it is applicable at present.

[12] See the Promissory Notes Act s. 31. In these cases, there is no bearer note, order note or other negotiable document which would facilitate the transfer or other legal dispositions. Even a simple note is, of course, normally handed over to the transferee or similar, but the notice to the debtor cannot be replaced by the delivery of that kind of

has been a transfer and that only the transferee is, upon this, entitled to dispose of the loan. It is not certain whether it is possible to order the debtor to make his payments to the original creditor until otherwise provided by the transferee. Most likely, this kind of arrangement is not possible but it would make the whole transfer invalid in the case of the insolvency of the transferee.

The delivery of the mortgage documents or other securities to the transferee is most likely not necessary in order to protect the transferee in the case of the insolvency of the transferor. This is provided, however, that the actions to make the transfer of the loan effective in the insolvency of the transferor are appropriately performed. The transferee can very well be a SPV, i.e. a partnership or company specially built for this purpose. Even a subsidiary of ABC Ltd is probably acceptable.[13]

Even if the portfolio of secured loans is effectively separated from the general business of ABC Ltd acting in the way described above, the problem of establishing a security right in favour of the investors remains. Only if the investors have a security right will they be protected in the possible subsequent insolvency of the transferee, which is the general idea of the asset-backed securities. Therefore, the loans with their securities must be pledged or assigned in security purposes to the investors. In order to establish such a security right, one is bound to use a third party, e.g. another SPV. The rules applicable to establishing security rights in favour of the investors have already been discussed above in the answer to the Case 10. One can, of course, move the loan and security documents directly from the possession of the original creditor to the possession of the third party administering the securities on behalf of the investors. Accordingly, one can notify the debtors of the transfer and of the security arrangements at the same time. Nevertheless, the formalities in establishing a security right in favour of the investors cannot be evaded, e.g. by using a trust arrangement.

Securitisation is not a common means of finance in Finland if it is understood in the regular way, with the loans being used as the investors' security. The first arrangements of this type were made, presumably, in the 1990s. The reasons for the limited use of securitisation are, on the one hand, the strong position of banks as financiers and the legal complexity

document. It is maybe worth stressing that the use of a simple note does not, as such, prevent the creditor from transferring the loan; it only means that the loan is not negotiable. If it is intended that the creditor shall not be entitled to transfer the loan, there should be a separate clause of that content in the loan agreement.

[13] See the report to Case 10.

of the transfer, and, on the other hand, the security arrangements. There has been an attempt to solve the latter problems, at least once in a while, using an SPV registered in an Anglo-Saxon country. This solution can, however, cause choice of law problems in the potential insolvency of the transferee. One solution to the inconveniences connected with the securitisation of asset-backed loans is included in the Mortgage Credit Bank Act of 23 December 1999/1240. The mortgage credit bank can establish security rights in favour of investors by a mere entry in its own register. That makes it possible for the mortgage credit bank to use the loans and their securities as real security for its own investors. The mortgage bank needs a special licence and its activities are supervised by the Financial Supervision. The bank must, for example, notify the Financial Supervision monthly of the investments and their securities.

France

A French securitisation regulation implemented in 1988[14] created a new French legal entity known as a *fonds commun de créance* (an 'FCC'), which is a limited-purpose investment vehicle. This new legal entity is a fund[15] that does not have a legal personality.[16] Since 1988, French companies have used FCCs extensively as refinancing tools. An FCC must, by law, have as its sole purpose the acquisition of receivables and the issuance of securities representing such receivables.[17]

Three parties are involved in the establishment and management of an FCC. The first is the fund's sponsor, which is the entity whose assets are transferred to the FCC. The second party is the fund's manager, which must be a corporate entity approved by the French *Commission des opérations de bourse*,[18] with its sole purpose being the management of FCCs. The third party is the fund's depository which must be a French credit establishment or any other French establishment approved by the French Ministry of Economy,[19] and which acts as depository of the assets of the FCC.

ABC Ltd's receivables can therefore be used as a tool to raise money in the financial markets. An FCC can be created. The FCC receives the

[14] Art. L. 214 – 43 ff. C. mon. et fin.

[15] Technically, the FCC is, by law, deemed to be a joint-ownership (*copropriété*) of receivables.

[16] Art. L. 214 – 43 para. 2 C. mon. et fin.

[17] Art. L. 214 – 43 para. 1 C. mon. et fin.

[18] Art. L. 214 – 43 para. 2 C. mon. et fin., and French Securities and Exchange Commission Regulation 94–01.

[19] Art. L. 214 – 48 – II C. mon. et fin.

portfolio of secured loans from ABC Ltd. The portfolio of secured loans is then separated from ABC Ltd's own estate.[20] Next, the FCC issues securities representing the portfolio of secured loans and, if it so decides, it can place them through a public offering provided that French public offering procedures are followed. The manager of the FCC can also make the application for the listing of securities issued by the FCC. Holders of the securities issued by the FCC may sell them and place them through secondary offerings.

Germany

The business in asset-backed securities is still developing in Germany. The framework, especially in business tax law, is held to be disadvantageous. Proposals to open the provisions of the Statute on Investment Funds (KAGG, see Case 5, Option c) for the originator do not seem to reflect the problems that originators encountered with these structures in the USA.[21] There is a clear intention in the banking business and by the banking supervision authorities to enhance the fiscal and supervisory framework and to develop this field of business. A clear expression of this will is to be seen in *Rundschreiben 4/97 des Bundesaufsichtsamts für das Kreditwesen*, '*Veräußerung von Kundenforderungen im Rahmen von Asset-Backed Securities-Transaktionen durch deutsche Kreditinstitute*,' AZ I 3–21–3/95 of 18.3.1997. It is normally assumed that contractual claims of at least €50 million must be securitised in order to make the transaction profitable.

In principle, there is little dispute over the civil law instruments that can be used to isolate the secured loans from the general business of ABC Ltd. It is necessary to transfer the assets irrevocably and validly to a 'special purpose vehicle' (this term is used also in German literature). The vehicle holds the assets for the benefit of the investors with whom the money is to be raised in the financial markets. The assignment of loans, like any contractual claim, must be based on a sales contract between the originator (in this case ABC Ltd) and the special purpose vehicle, and the transfer proper is governed by §§ 398 ff. BGB. Problems exist with the rules on the accuracy of denomination of the contractual claim that are assigned. It is possible to assign claims created in the

[20] See Th. Bonneau, 'Fonds communs de placement, de créances et droit civil', *RTD civ*. 1991. 1, Nos. 45 ff.

[21] See the monographs of Gehring, *Asset-backed Securities im amerikanischen und im deutschen Recht* (1998); Gögler, *Asset-backed Securities* (1995).

future, but at the moment they come into being it has to be possible to deduce from the deed of assignment itself whether they are included or not. Under German law, claims cannot be assigned if this is excluded between the creditor, ABC Ltd, and his debtors in the portfolio of secured loans (*pactum de non cedendo*, § 399 BGB). In the majority of cases (approximately 65 per cent), small and medium-sized enterprises are especially likely to accept such restrictions in their agreements with their debtors. Moreover, various types of claims are normally already assigned, especially with respect to claims arising from the sale of goods, which the originator himself received on a credit basis (assignment to the supplier, *verlängerter Eigentumsvorbehalt*). One more restriction can be found in rules on professional secrecy, which virtually exclude banks as originators. In general, claims arising from a contract, which the originator himself has not yet discharged, are considered to be dangerous since the breach of duty by the originator also affects the claim assigned (§ 404 BGB). The assignment of mortgaged loans is subject to additional formalities (§§ 1117, 1154, 1192 BGB). Loans to consumers do not seem apt for the transaction as a result of the risks that an application of the Consumer Credit Statute[22] engenders. Part of this risk is the consumer's right to give notice under the new § 609a BGB. This rule, however, does not contain the same right in the case of commercial credits unless the interest rate is variable.

There are various options available as to how intensively the contractual claims should be 'reserved' for the special purpose vehicle and the investors. With regard to the originator's relationship with the debtor, if it should be excluded that the payments to the originator have a discharging effect with respect to the special purpose vehicle and the investors, then the debtor has to be informed. An interest of the originator not to disclose the assignment can be respected in part if the assignment is not disclosed immediately, although the special purpose vehicle must have the right to disclose the assignment in due course, especially if payment difficulties arise for the originator. One can also use a trust account held by the originator for the benefit of the special purpose vehicle (for priority questions with respect to these accounts, see Case 4). As far as the creditors of the originator are concerned, an assignment without disclosure to the public is sufficient to guarantee

[22] *Gesetz über Verbraucherkredite, zur Änderung der Zivilprozeßordnung und anderer Gesetze* of 17.12.1990, *Bundesgesetzblatt* 1990 part I, 2840, VerbrKrG.

priority for the special purpose vehicle and the investors as long as the claim assigned is still existing (not yet discharged).

The special purpose vehicle cannot be organised as a trading partnership (mandatory unlimited liability for all partners) or as a non-trading partnership (virtually mandatory unlimited liability and the business will be held to fall under §§ 1 ff. HGB). Therefore, the form chosen is that of a limited partnership (*Kommanditgesellschaft*, §§ 161 ff. HGB) or limited company. The limited partnership has a trustee for the huge number of partners who are not personally liable (otherwise registration is required for every partner). This so-called *(kupierte) Publikums-Kommanditgesellschaft* has proven to have two major disadvantages: secondary markets for the shares are highly underdeveloped and the position of the partners can be weak since there is, in principle, party autonomy for the charter and the scrutiny of the charter is based only on the Unfair Contract Terms Statute (AGBG, see above). The private limited company and the cooperative society, therefore, seem to be the forms favoured by German law, although similar disadvantages exist. The originator should have less than 20 per cent of the shares (see § 271 HGB).[23]

Greece

In Greece, the legal framework for private securitisation transactions has been established recently. L.3156/2003 provides for the possibility of Greek commercial entities (originators) securitising their commercial claims to raise funds in the capital market. The transaction is structured through the issuance of a bond by a special purpose vehicle (purchaser), which, if incorporated in Greece, must be a company. According to L.3156/2003 (s. 14 § 13), the purchaser may also be a company incorporated outside Greece.

The transaction is basically structured as follows: the purchaser acquires the portfolio of secured debt from the originator by an assignment, the provisions of ss. 441 CC (assignment) and 513 CC (sale) being applicable *mutatis mutandis*. The purchase agreement should be registered in a public registry. The assignment becomes effective as of the registration date, without any further notification to any debtor being required. In terms of ownership, L.3156/2003 provides that such a

[23] For the risks of an application of the *Kreditwesengesetz*, see Gehring, *Asset-backed Securities*, 159–162.

portfolio is segregated from the property of both the issuing company and the originator, being an off-balance sheet transaction for the latter. Furthermore, a floating charge is created by law over all the assets of the purchaser in favour of any bondholder.[24]

Even though the private securitisation law is so recent, it is expected that a considerable number of such off-balance sheet transactions will take place in Greece, mainly due to the tax advantages provided by the said law.

Ireland

The law and practice are the same as in England.

Italy

The d. lgs. of 30 April 1999, n. 130, *Disposizioni sulla cartolarizzazione dei crediti* (on the securitisation of receivables) applies to Case 11. This law governs securitisation transactions involving the assignment of existing or future monetary claims, which are identifiable as a pool (*blocco*), consisting of a plurality of claims.[25] Since the entry into force of this law, the Italian market for asset-backed securities offered to the public has developed strongly, ranking second in Europe after the UK market.

In a securitisation transaction, ownership of a portfolio of claims is transferred from the originator company (the 'Originator') to a special purpose vehicle ('SPV'). Under the Italian law, the SPV is a company that has as its sole corporate activity the undertaking of securitisation transactions. This vehicle must be registered as a financial intermediary in the special register of financial companies held by the Bank of Italy. To finance the acquisition of the portfolio of claims, the SPV shall issue instruments of indebtness, which are to all purposes financial

[24] S. 10 § 18 L.5156/2003.

[25] Troiano, *Le operazioni di cartolarizzazione* (2003); Fauceglia, *La cartolarizzazione dei crediti. Commento alla legge nr. 130 del 1999* (Turin, 2002); Pardolesi, ed., *La cartolarizzazione dei crediti in Italia* (Milan, 1999); Rucellai, 'La cartolarizzazione dei crediti in Italia a due anni dall'entrata in vigore della L. 30 aprile, 1999, n. 130', Giur. comm., 2001, I, 392; Maffei Alberti, ed., 'Commentario', *Le nuove leggi civili commentate*, 2000, 997. In English see: Flora, Saffirio, Salvatori di Wiesenhoff, 'The Italian Law on Securitization Transactions: Accounting and Tax Issues', *European Taxation*, 2002, 429; see also the brochure by Freshfields, Bruckhaus, Deringer, *Securitisation in Italy*, June 2002 (with annexed English translation of d. lgs. 130/1999), available at the website: freshfields.com/practice/finance/publications/pdfs/3457.pdf. Securitisation of receivable is sometimes also carried out under d. lgs. 21 February 1991, n. 52, *Disciplina della cessione dei crediti di impresa*. In this case, however, the operation does not produce asset segregation, hence it is not discussed here.

instruments. Under d. lgs. 130/1999, the SPV shall apply the sums paid by the assigned debtors exclusively to satisfy rights pertaining to the securitised debts (as well as to cover costs related to the transaction). Furthermore, the claims relating to each transaction shall constitute assets segregated for all purposes (*patrimonio separato a tutti gli effetti*) from the assets of the company and from the assets relating to other transactions. No creditor other than the holders of the instruments issued to finance the acquisition of the portfolio of securitised claims shall be able to commence proceedings in relation to each pool of the above-mentioned debts.

The assignment of the claims under d. lgs. 130/1999 is regulated by the Italian banking law, art. 58.[26] According to it, the assignment is effective vis-à-vis the assigned debtor, the originator and third party creditors by way of publication in the Italian Official Gazette. This publication produces a number of effects. The most important of them in relation to the issues raised by the present case is that the benefit of any guarantee or security interest pertaining to the assigned claims will be automatically transferred to the SPV with the same priority originally securing the assigned claims. In the context of the securitisation of portfolios of loans secured by a hypothec, this feature is crucial. The administrative and fiscal costs of registering the security interest of the assignee in accordance with the general provisions of law (which would otherwise be applicable) would create a very serious obstacle to the transaction.

ABC will assign the portfolio of secured loans to the SPV without recourse, hence it will not be liable vis-à-vis the investors if the portfolio of claims assigned to the SPV fails to perform as expected (subject to any guarantees being provided in favour of the investors). This pool of assets shall consequently be isolated from the general business of ABC Ltd; but under d. lgs. 130/1999 the same pool of assets shall also be isolated from the general business of the SPV and from risks associated with other securitisation transactions. This means that the investors will know exactly where their money goes and will run only the risks associated with the specific transaction in which they participate.

Luxembourg

The Law dated 22 March 2004 on securitisation establishes a comprehensive legal and tax framework for securitisation entities established in

[26] D. lgs. 1 September 1993, n. 385, *Testo unico delle leggi in materia bancaria e creditizia.*

Luxembourg. The Law is non-compulsory, and securitisation operations may still be carried out outside of that framework as they were before.

Securitisation entities may take the form of either a corporate entity (securitisation company) or a securitisation fund. The latter has no legal personality and is managed and legally represented by a management company. To come within the scope of the Law, a securitisation entity must assume or acquire risks (either by itself or through an acquisition entity) and issue securities whose return and/or value reflects these risks. Securitised risks can relate to any type of assets, such as claims, movable or immovable assets, but can also include liabilities of third parties, or liabilities which are inherent in some or all of the activities of third parties. This allows for whole-business securitisations. The law provides for great flexibility in terms of the methods by which to acquire such risks (ranging from acquisition, guarantees or limited recourse loans to credit derivatives). Securitisation entities are subject to licence requirements and supervision by the CSSF if they issue securities to the public on a continuous basis. Securitisation entities may also be set up in the form of multi-compartment vehicles, the 2004 Law ensuring specifically that there is segregation between each of the compartments.

The Law has also introduced the possibility of appointing fiduciary representatives, who can perform a wide range of functions on behalf of the investors and creditors of the securitisation vehicle; in particular, they can perform functions akin to those of a note or security trustee. They must have their registered office in Luxembourg, must limit their activities to acting as fiduciary representative, and must obtain a licence from the Minister in charge of the CSSF.

If ABC Ltd opted for a securitisation under the 2004 Law, it would transfer its portfolio of secured loans to a securitisation entity, which would then issue either debt or equity securities. The claims become the property of the securitisation entity immediately upon the agreement of the parties, and such transfer is enforceable against third parties without any further formalities.

ABC Ltd may nevertheless remain in charge of the administration and recovery of the claims and, unless notified to the contrary, third party debtors validly discharge their debts by paying to ABC Ltd. Future claims arising from current or future contracts can be transferred to the securitisation entity as long as the claim is identifiable, either at the time of its creation or at any other agreed time. Such a transfer of a future claim cannot take place until after the claim is created; however, once the claim is created, the transfer is enforceable against third parties as of the time of the transfer agreement (i.e. retroactively), notwithstanding any insolvency proceedings started against the transferor.

In the event ABC Ltd becomes insolvent, the securitisation entity can notify the transfer to the third party debtors, thereby obliging them to pay to the securitisation entity or to any successor servicer it would appoint. The transfer of future claims would remain enforceable. In addition, the securitisation entity has the right to claim any payments received by ABC Ltd on its behalf prior to the opening of the insolvency proceedings, notwithstanding any claims of insolvency officials or the rights of other creditors.

The 2004 Law also provides a safe legal basis for other mechanisms generally used in international securitisation structures to achieve segregation and 'bankruptcy-remoteness'. Thus the 2004 Law specifically provides for the validity and enforceability of subordination or limited recourse clauses, even in the case of insolvency proceedings affecting the securitisation entity. It also declares valid non-petition clauses, i.e. clauses whereby creditors of the securitisation entity covenant not to start enforcement or insolvency proceedings; and it provides for the inadmissibility of any action started in violation of such a provision.

As an alternative to the 2004 Law, ABC Ltd could use a Luxembourg incorporated special purpose vehicle (SPV) outside the 2004 Law, which would then not benefit from certain of the features described above. Another possibility traditionally used for securitisation purposes prior to the 2004 Law is the fiduciary contract (see the Luxembourg answer to Case 10), whereby claims are transferred on a fiduciary basis to a credit institution or other authorised professional, where the claims are held in a segregated fiduciary estate. Finally, ABC Ltd could also consider establishing a mortgage bank (see the Luxembourg answer to Case 10).

Netherlands

General

Usually the transaction is structured using a special purpose vehicle (SPV).[27] ABC Ltd, the Originator, transfers (it can be a legal and economic transfer, but also for the time being a purely economic transfer) the portfolio of secured loans to the SPV for a price that is equal to, or

[27] A. Thiele, *Collective Security Arrangements* (PhD Nijmegen University) (Deventer: Kluwer, 2003), 27–107, with many references; F. G. B. de Graaf, A. R. T. van IJlzinga Veenstra, H. L. E. Verhagen, 'The Netherlands', in T. Baums and E. Wymeersch, eds., *Asset-backed Securitization in Europe* (London: Kluwer, 1996), 143–198.

slightly less than, the value of the portfolio. It is assumed that the loan agreements do not prevent such a transfer. Furthermore, the formalities that have to be fulfilled in order to effect a valid transfer depend on the law applicable to the loan agreements. A third aspect involves the issue of whether the securities for the loans can also be transferred to the SPV. Usually the SPV does not have recourse against the Originator for credit risk on the underlying debts. The SPV has been founded for this sole purpose and has legal personality. The fact that the SPV has a limited statutory purpose diminishes the risk of bankruptcy of the SPV. The SPV must not have any connection with the Originator, otherwise the results of the SPV will appear in the consolidated balance sheet of the Originator.[28] A method that is frequently used in the Netherlands is that the shares of the SPV are transferred to a foundation, which has been founded specifically for this purpose. This foundation issues non-cancellable certificates to the Originator. Usually the SPV is administrated by a trust company. This is a company whose business is to be the statutory director of other companies, and to provide them with administrative services (including acting as a postal address) and possibly also legal or financial services.[29]

The SPV raises money to pay for the transfer by issuing securities such as debentures, medium-term notes or commercial paper.[30] These debt securities must be secured. This is accomplished by giving security to a security trustee (another company or foundation founded especially for this purpose)[31] that acts for the investors. Usually the SPV does not service the loans itself since it is a large administrative burden for which the SPV has no capacity. Also, the Originator wants to continue

[28] Dutch banks are heavily involved in securitisation transactions. In many cases they concern transfers of claims which were held by banks (the banks were the originator). Dutch banks also frequently have another role, such as servicer or credit enhancer. This was the reason for the Dutch Central Bank issuing a memorandum (25 September 1997). This memorandum contains the policy of the Dutch Central Bank relating to legal supervision and business economics for banks involved in securitisation transactions. See W. Ruys, 'Beleid van De Nederlandse Bank inzake securitisation en toezicht', *Bedrijfsjuridische Berichten* 1998/7, 82–84.

[29] This follows from the recently adopted *Wet Toezicht Trustkantoren* (Act on Supervision of Trust Companies), which came into force on 1 March 2004. This Act regulates the trust companies.

[30] Pass-through certificates or pay-through certificates.

[31] See M. V. Polak and A. I. M. van Mierlo, *Verstrekking van zekerheden aan internationale syndicaten* (Amsterdam, 1998), 23. Here the same problems as those which have been described in Case 10 must be solved. The security trustee must become a creditor itself, otherwise it cannot get the securities.

its relationship with the debtors of the transferred debts. The servicing is arranged under an agency agreement between the SPV and the Originator. Of course, this agreement is made in such a way that the insolvency of the Originator does not have any effects on the SPV, which is the legal owner of the secured loans. A back-up service is always provided, which takes over if the Originator falls into bankruptcy. This practice is still at an early stage in the Netherlands. However, some problems can be pointed out.

Transfer of the secured loans and other claims

Sale and assignment of the loans and claims

The claims (receivables) must be transferred in accordance with art. 94 Book 3 CC. This article demands a written instrument of assignment between the Originator and the SPV and notification in any manner whatsoever to the debtors of the assignment (the original borrowers). It is only after both these requirements are fulfilled that the title to the claims passes to the SPV. This procedure of notification can be cumbersome. In Dutch practice, some solutions have been advanced to minimise the risks that are involved with a delay in notifying the debtors of the assignment.[32] In such a situation, the notification of the debtor is postponed until the occurrence of a specific situation. As a consequence, it is only on the occurrence of such a situation that the title to the loan is transferred to the SPV. Of course, the SPV wants some guarantee that the Originator will fulfil its transfer duties. It is not possible to create a security that actually guarantees the transfer. The only thing that can be secured is the payment of damages for non-performance by the Originator. This can be done by a silent pledge on the loans that are eventually to be transferred from the Originator to the SPV.[33]

Transfer of security

Under Dutch law, security rights attached to a receivable (in this case a loan) are automatically transferred together with the receivable. In nearly all situations, the security is seen as an accessory right to the underlying debt. This creates the same problems as described in Case 10. The security

[32] New legislation (First Chamber 2003–2004, 28 878; came into force on 1 October 2004) permits claims to be transferred, with the effect that they fall into the patrimony of the transferee, without the necessity to inform the debtor of the claim.

[33] See further de Graaf et al., 'The Netherlands', 160–161 and 165. With credit enhancement and liquidity support for the SPV, the creditors of the SPV can get some extra security.

trustee must be a creditor in his own right; otherwise it is not possible for him to get a security right. The same methods are available here. The security trustee can act as a surety, a parallel debt can be created by contract, or the lenders and the security trustee can agree to active severalty.

In Case 11, it is not clear in what way the loans are secured. If they are secured by a mortgage on real estate, then it is necessary – or, at least, it is wise – to make a note of the assignment in the public registrar where the immovables are registered.[34]

The applicable rules for a Dutch SPV

The Dutch SPV must be structured in such a way that it avoids applicability of the Act on the Supervision of the Securities Trade 1995[35] and of the Act on Supervision of Credit Institutions 1992.[36]

Act on Supervision of the Securities Trade 1995

The SPV does not want to have to abide by the prospectus requirements and the continuous reporting requirements as they are laid down in the mentioned Act. According to the definition of this Act, the SPV falls under it. However, exemptions are available. Exemption from the prospectus requirements takes place if: (a) the securities are subject to a 'professionals only' selling restriction, (b) this is mentioned in the offer, etc., and (c) the Netherlands Authority for Financial Markets has been notified in advance.[37]

If the securities issued by the SPV have a denomination equal to or in excess of €45,378.02 or an equivalent in foreign money, then the SPV does not have to fulfil either the prospectus requirements or the reporting requirements.[38]

[34] See further ibid., 164, and W. Ruys, 'Securitisation en bankhypotheken: problemen en mogelijke oplossingen', in Kortmann et al., eds., *Onderneming en effecten* (Deventer: W. E. J. Tjeenk Willink, 1998), 511–524.

[35] *Wet Toezicht Effectenverkeer*. This law implements the several EC Directives in this field, such as 93/22/EEC of 10 May 1993 and 93/6/EEC of 15 March 1993.

[36] *Wet Toezicht Kredietwezen* 1992, implementing EC Directive 89/627/EEC of 12 December 1988.

[37] Art. 2 Exemption Regulation ASST 1995. Exemption Regulation of 25 March 1992 (as amended) (*Vrijstellingsregeling Wet Toezicht Effectenverkeer*). See, for further requirements which are not directly relevant to the case, de Graaf et al., 'The Netherlands', 185; K. W. H. Broekhuizen, 'Securitisation: generieke vrijstelling voor de "spv"onder de Wet toezicht kredietwezen 1992', *Bedrijfsjuridische Berichten* 1997/19, 173–176.

[38] Art. 4 juncto art. 10 Exemption Regulation.

Act on the Supervision of Credit Institutions 1992

A credit institution is defined as an institution (in the broadest sense) that engages in the business of receiving repayable funds (whether or not for a certain period) and granting loans or making investments for its own account.[39] In the Netherlands, such an institution must have a banking licence from the Dutch Central bank. The activities of the SPV fall within this definition, so that the SPV qualifies as a credit institution except when an exemption is granted to the SPV. In order for the SPV to be able to benefit from the available exemptions, the requirements as laid down in the Ministerial Regulation of 4 February 1993[40] must be fulfilled. The first possibility is that the SPV funds itself from professional market parties exclusively by way of loans or debt securities that have an original maturity of at least two years.[41] The second possibility, as laid down in the newest version of the Ministerial Regulation of 1997, does not require an original maturity of two years; instead, it requires that the funding be done by issuing debt securities that have a rating.[42] Also, the assets that are transferred from the Originator to the SPV stem from a previously defined and homogeneous group of assets of the Originator. The requirement that the funding must be raised among professional market parties still stands.[43] A denomination exceeding 1,000,000 Dutch Guilders or the foreign equivalent automatically qualifies the SPV's debt securities as being exclusively for professionals, and thus no selling restriction is needed.

Portugal

A new law of securitisation of receivables (*titularização de créditos*) was published in 1999 (Decree-Law 453/99 of 5 November). Under this law, the assignment of receivables for securitisation may be made by the state and other public corporate bodies, financial institutions, insurance companies, pension funds and their managing companies, and other corporate bodies whose accounts for the past three years have

[39] Art. 1 sub 1 under a ASCI. De Graaf et al., 'The Netherlands', 186.

[40] Stcr. 1993, 29, as amended by Stcr. 1995, 177; 1996, 166 and 1997, 133.

[41] Art. 2 sub a SCI Act Ministerial Regulation.

[42] Given by a rating company that has been accepted by the Dutch Central Bank, such as Moody's Investor Service, Standard & Poor's Rating Services, Japan Credit Rating Agency, etc. A full list of companies is available from the Dutch Central Bank.

[43] The securities may never end up in the hands of the public. At any time the funding must be from professional parties. See the circular letter of the Dutch Central Bank of 14 August 1997. See also HR 15 December 1995, NJ 1996, 653 (Barings) note Perrick.

been audited by an accountant registered at the Securities Market Commission (CMVM).[44]

Portuguese law recognises both pass-through and pay-though securitisation schemes. In fact, the receivables may be assigned to securitisation funds (*fundos de titularização*) and/or to securitisation companies (*sociedades de titularização*). These are the sole special purpose vehicles permitted. The Securitisation Act does not allow trusts as a structure for special purpose vehicles.[45]

Securitisation funds are autonomous patrimonies which are exempt from the creditors of the fund's manager. Their legal framework is very similar to the investment funds regime. These funds are divided into units (*unidades de titularização*) and belong jointly to the unit holders. The securitisation funds have no legal personality, and are managed by specialised management companies. The issued units may be negotiated on the stock market. Portuguese law requires the existence of a depository, which is in charge of collecting payments of capital and interest in respect of the assigned receivables.

Securitisation companies are financial companies (*sociedades financeiras*) limited by shares (therefore it should be ABC SA) and may only carry on securitisation activity. Securitisation companies can only finance their activity through the issue of bonds. The securitisation activity is controlled by the CMVM.

ABC SA (Ltd) may raise money by assigning its portfolio of receivables to a securitisation fund or to a securitisation company. In principle, the assignment is effective as to debtors upon notification by registered letter, but notification is not necessary when the assignment is made by financial institutions, insurance companies, pension funds or their management entities.

Securitised credits are effected with priority to serve as a guarantee to owners of securitised bonds and do not answer for the debts of ABC SA (Ltd) until total payment of capital and interest. Investors in units and the portfolio of receivables securitised are separated from the business of ABC Ltd and are not affected by its bankruptcy. To confirm the bankruptcy-remoteness of this sort of financial technique, the

[44] See generally P. Câmara, *A Operação de Titularização* (1999), forthcoming edition by Banco de Portugal, and available at http://www.fd.ul.pt/licenciatura/dvm.htm.

[45] Implicitly criticising the legislative choice: see M. J. Tomé, and D. L. De Campos, *A Propriedade Fiduciária (Trust)* (1999), 14–15, 308–311; D. L. De Campos, 'A Titularização de Créditos (Securitização)', in *Revista Brasileira de Direito Comparado*, no. 17 (1999), 113–119 (118).

assignment must be unconditional and effective (a true sale) (art. 4.4 Securitisation Act). Therefore, promises of future assignments cannot be used under securitisation schemes. Moreover, the intervention of a rating agency is compulsory when securities issued on the basis of securitisation are offered to the public.[46]

However, the separation of assets within the securitisation company is not absolute. In fact, Portuguese law does not recognise the limited recourse principle, as the proceeds of the sale of the general assets of the securitisation company can also be used to pay the owners of securitised bonds (art. 601 CC).

Scotland

The law and practice are the same as in England, subject to the following. In practice, transfers are done by one of the following two methods. According to the first method, the 'mortgage portfolio' is completely transferred from ABC to the SPV, with notification (called 'intimation') to the borrowers and registration of the transfers in the Land Register of Scotland. If this happens, the borrowers make future payments to the SPV rather than ABC. According to the second method, there is no notification to the borrowers and the transfers are not registered in the Land Register of Scotland. In this case, the law still considers ABC to be the creditor of the borrowers and the security rights to be vested exclusively in ABC.[47] The borrowers continue to make payments to ABC. The contract between ABC and the SPV obliges ABC to 'turn over' all such payments to the SPV, as soon as they are received. If ABC were to become insolvent, then the mortgage portfolio would still be vested in ABC and thus available, in general, to its creditors. Hence, this second method is risky for the SPV. The SPV can protect its position, to some extent, by taking security. It may be the case that the contract between ABC and the SPV contains a clause whereby ABC declares that it holds

[46] Regarding the concept of public offering of securities under Portuguese law, see arts. 109 and 110 of the Securities Code; see also A. Ferreira, *O Direito dos Valores Mobiliários* (Lisbon, 1997), 273–291; P. Câmara, 'Emissão e subscrição de valores mobiliários', in AA.VV., *Direito dos Valores Mobiliários* (Lisbon, 1997), 215–218; Câmara, *A Oferta de Valores Mobiliários Realizada Através da* Internet', in *Cadernos do Mercado de Valores Mobiliários*, no. 1 (1997), 29–31; Câmara, *A Operação de Titularização*, 20.

[47] In Scots law, a security right in land cannot be transferred (ceded) without a new entry in the Land Register of Scotland. Moreover, notification to a debtor is (subject to exceptions) necessary to complete the transfer. Until notification, the claim remains in the patrimony of the transferor (cedent).

the mortgage portfolio in trust for the SPV. If such a clause is effective, then the SPV is, in principle, protected against ABC's insolvency. However, it is not certain whether such a clause is valid. It is arguable that this is not a *bona fide* use of the trust. Authority is conflicting on this matter.[48]

Spain

The vehicle to attain these goals in Spanish law is the *titulización* or securitisation, which is essentially regulated in arts. 5 and 6 of Law 19 dated 7 July 1992, which is supplemented by Circular 2, dated 16 March 1994 and developed in RD 926 dated 15 May 1998.[49]

Securitisation funds or FTHs function as special purpose vehicles (SPVs). RD 926/198 literally states that they follow the fiduciary model of special patrimonies without legal personality, which means that they are conceived as a *patrimoine d'affectation*, that is a patrimony linked to a purpose and separated, with regard to its composition and responsibilities (art. 5.1 of Law 19/1992), from the patrimonies of all other persons related to it.

The position of the actors explains the functioning of this financial instrument. A financial company like ABC Ltd is offering loans, which are guaranteed with a mortgage. Its credits are partially ceded to the FTH in a way that differs from the ordinary cession of credits as regulated in the Civil (arts. 1526 and 1878) and Commercial Codes (arts. 347 and 348). This special cession is done through the *participaciones hipotecarias*, which are a genuine type of value through which a percentage of the credit and not the mortgage itself is ceded. The cessor-issuer (ABC) remains the title-holder of the secured credit, which it is supposed to manage and make effective if necessary. In order to favour the free circulation of titles, the cession does not have to be notified to the debtor.

[48] There is no authority on this exact situation. But in similar types of case conflicting decisions exist. See, in particular, *Export Credit Guarantee Dept* v. *Turner* 1979 SC 286, 1981 SLT 286, *Tay Valley Joinery Ltd* v. *CF Financial Services Ltd* 1987 SLT 207, 1987 SCLR 117. See also *dicta* from the Court in *Clark Taylor & Co Ltd* v. *Quality Site Development (Edinburgh) Ltd* 1981 SC 111, 1981 SLT 308.

[49] The 1992 Law regulates Investment Corporations and Investment Funds on Immovables and Securitisation Funds (FTH). The circular contains a model issued by the CNMV on the constitution of FTH. RD 926/1998 regulates securitisation funds *on all kinds of assets* (not only securitisation on mortgages) and their managing companies.

The Securitisation Fund or FTH acquires these assets. The fund is created precisely in order to reinvest them and raise money through the issuing of new bonds. The company managing the FTH is a necessary actor since the fund lacks legal personality. The company is in charge of the management and legal representation of the fund (art. 5.2 Law 19/1992). It acquires the *participaciones hipotecarias* and issues the *bonos de titulización*. These bonds can only be negotiated in an official or organised market in Spain, and can only be represented digitally (arts. 5.8 and 5.9 Law 19/1992). The managing company must be a *Sociedad Anónima* and fulfil certain additional requirements, including authorisation by the Ministry of Economy, registration in the Commercial Register and in a special Register, attaining a capital of at least 150 million pesetas, etc.[50] The managing companies are legally characterised as companies managing third party interests and, according to art. 6.1 Law 19/1992 and art. 12.1 RD 926/1998, they are to represent and defend the interests of those holding the bonds.

Last, the bondholders, who in practice tend to be institutional or professional investors (investment or pension funds), have the right to claim the stipulated interest in addition to the restitution of the lent capital, once the stipulated time periods elapse. They have no direct relationship with the hypothecary debtor or the lending company. They would not be affected by ABC's subsequent insolvency since the fund is a separate patrimony.

Securitisation, as accepted by Spanish law, should be the normal means to attain the goals set forth in Case 11. Current practice dictates, however, that it is still not used very often; this use is increasing very quickly and growth has been spectacular in the last few years.[51]

[50] These requirements are laid down in detail in arts. 12–20 of RD 926/1998.

[51] A report by the Contact Group of the Consulting Bank Committee points out that there are different levels of development of securitisation in Europe: Spain is, like France, in an intermediary position between a group of countries with a lower rate of development, like Sweden, Ireland and Belgium, and behind the United Kingdom which has a very rapid development and growth. For the future one can predict a more rapid development in Spain because managing companies have been redefined by RD 936/1998, which also allows securitisation of assets or values (*activos*) other than mortgage credits. In fact, the issues of securitisation (on mortgage credits) increased by 65 per cent in Spain between 1998 and 1999. Fifteen issues were registered, for a global value of €6.8 billion. Of this amount, 79 per cent was invested in the national market. To obtain a global idea, these are the numbers, in millions of euros, in the late 1990s: 129 in 1995, 1,293 in 1996, 239 in 1997, 3,245 in 1998 and 5,269 in 1999 (CNMV Report, 47). The dynamism in the housing market has had a great impact on securitisation.

Sweden

The point of departure is that a company (the originator), maybe a bank, has a portfolio of secured loans (normally to persons who have mortgaged their immovables) but wants to transfer the portfolio from its own balance sheet against cash. The portfolio is transferred to a special purpose vehicle (SPV), which raises the purchase money by issuing bonds on the capital market. The transferor shall administer the loans in relation to the mortgagors and must normally issue some guarantees in favour of the SPV concerning the portfolio, or buy corresponding insurance protection, in order to improve the possibilities for the SPV (directly or indirectly by a subsidiary company) to raise money at a low interest rate. The transferor does not want any liability towards the buyers of the bonds. On the other hand, the transferor is often expected to repurchase the portfolio and discharge the bonds when the bonds fall due.

Such securitisation was previously not economical if the SPV was a Swedish company, since the demands on capitalisation were the same for the SPV as for the originator. Only a few securitisations were executed, and then with SPVs located in Jersey. In 2001 a couple of amendments were made in the legislation to facilitate securitisation with Swedish entities as the SPV.[52]

The first amendment concerns the demands on capitalisation for the SPV. If a company or some similar legal entity conducts a business which consists of acquiring claims on a few occasions and the financial means are not currently supplied by the public, such a legal entity is exempted from having the permits which are otherwise necessary for its activity (ch. 1 s. 3, *lagen 1992:1610 om finansieringsverksamhet*).

The second amendment is of a private law nature, but it also affects questions of accounting, demands on capitalisation, and tax. The amendment concerns the problem whether the portfolio previously owned by the originator is transferred to the SPV in such a way that the SPV would be safeguarded if the originator were to go bankrupt. Otherwise it would be impossible or at least expensive (connected with a high interest rate) to issue the SPV bonds on the capital market.

[52] See NJA II 2001, 45 ff. and, prior to the government's bill, the paper by Gregow 24 May 1994 issued by the Government's Department of Finance (*Finansdepartementet*), Nydrén, 'Om kreditrisker och juridiska risker vid s.k. värdepapperinsering', *Svensk Juristtidning* 1995, 221 ff., and Månsson and ANDERSSON, 'Värdepapperisering – Securitisation', *Norstedts Juridik* 1995.

The claims on the mortgagors are normally materialised in negotiable instruments. A transfer of these requires, in principle, a transfer of possession no matter whether true ownership or fiduciary ownership be transferred, or the instruments are to be pledged only (ss. 10 and 22 of Promissory Notes Act 1936:81, *skuldebrevslag*). But such a transfer of possession would be inconvenient in the case of securitisation, since the originator normally is supposed to administer the mortgaged loans. In s. 22 of the Promissory Notes Act there was already an exception when the transferor is a bank or an institute dealing with financial instruments. In these cases a sale of a negotiable instrument is binding on the creditors of the bank or the institute even if the instrument remains with the transferor as a deposit. The legislation in 2001 broadened the exception to cover also capital market enterprises (*kreditmarknadsföretag*).

In the government's bill concerning s. 22 of the Promissory Notes Act it is said that this section covers not only sales but also pledges. This is a mistake, however. It is evident that the original exception (in 1936) to the requirement of transfer of possession was restricted to sales, and probably only true sales. Since the courts are bound only by the black letter text in the legislation and not by statements in the bills, it is important whether a securitisation in an actual case should be characterised as a true sale or a security transaction. This highlights the implications of a guarantee issued by the originator, to repurchase the portfolio if the transferred debts are not paid. Whether such a guarantee will give ground for a characterisation as a security transfer outside the exception in s. 22 is not solved in precedents.[53]

If the claims on the debtors are not negotiable but book claims (receivables), a transfer of the claims – no matter whether it is a true sale or a pledge – is (with the exception that the transfer is a part of a sale of a whole enterprise) protected against the transferor's creditors only if the debtors are informed of the transfer (notified) (see s. 31 Promissory Notes Act). The amendments in the legislation in 2001 to facilitate securitisation did not deal with such debt. Consequently, the debtors must be informed either by the originator or by the SPV when

[53] The same issue could previously occur in the context of avoidance in bankruptcy, where it was easier to attack security transactions than real sales, when the transaction was perfected only within a three-month period prior to bankruptcy (see e.g. NJA 1977, 20). This legislation has now also been amended. Nor is it possible to avoid a security perfected after the credit was extended and shortly prior to bankruptcy, if the perfection of the security was delayed in the ordinary course of business (ch. 4 s. 12 Bankruptcy Act).

receivables are sold to the SPV, if the SPV wants protection against the originator's insolvency.

A true transfer of possession or its equivalent notification implies, pursuant to precedents concerning areas other than securitisation, that the transferor no longer has any access to the negotiable instruments or the book claim and no longer is entitled to collect the debt from the borrowers, at least not in its own interest (see e.g. NJA 1949, 164, NJA 1972, 246, and NJA 1975, 635). As the originator is supposed to administer the debt relations with the mortgagors, it could be said that the originator actually has access to the claims. In a more recent Supreme Court case, NJA 1995, 367, it was accepted, however, that a lessor (transferor) could continue to administer leases for a transferee, and thereby collect rents from the lessees on behalf of the transferee, without destroying the transferee's right of separation in the lessor's bankruptcy. This problem is not dealt with in the recent amendments to s. 22 of the Promissory Notes Act, but it may be assumed that the ruling from 1995 will be upheld also in the context of securitisation.

Comparative remarks

Many reports note recent legislation aimed at facilitating this increasingly important kind of transaction (France, Greece, Italy, Luxembourg, Portugal, Spain). This is frequently aimed at removing obstacles imposed by the general law. These obstacles often arise in relation to the transfer of loans, whether because they are unascertained, or unmatured, or because of requirements of notice to the debtor. Some reports (Italy, the Netherlands) also mention obstacles related to the transfer of security interests which secure the loans in question. Often the legislative solution is confined to the securitisation of a particular kind of asset, such as receivables, which may hamper the future development of the transactional structure. Other legislation is drawn much more widely (e.g. Luxembourg).

The structure used to reach the results set forth in Case 11 is the transfer to a special purpose vehicle (SPV). This device is mentioned by that name in Austria, Belgium, England, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Scotland, Spain and Sweden; in Luxembourg it is called a securitisation entity. The SPV does not always have legal personality (Belgium, Luxembourg, the Netherlands and Portugal mention both possibilities; in France and Spain, the SPV is a fund without personality). Where it does not have personality, then any transfer of security rights may require a structure like that addressed in Case 10, with some person holding the security for the investors (see the Netherlands report). In other jurisdictions, it is likely to be an ordinary company.

In jurisdictions where there is no enabling legislation, the reports indicate that the general law requirements for the transfer of loans may make the transaction difficult (Austria, Germany, the Netherlands), especially if the parties hope to accomplish the transaction without notifying the debtors. Under Scots law this may jeopardise the transaction. In other countries, the non-notification of the debtors may be accomplished through a trust (England) or through special bank accounts such as those addressed in Case 4 (Germany). Another possibility which can solve difficulties surrounding the transfer of the assets to the SPV is the synthetic securitisation (mentioned in the English report), which replicates the effect of a transfer through contractual arrangements.

PART III · CONCLUSIONS

Conclusions

MICHELE GRAZIADEI, UGO MATTEI AND LIONEL SMITH

1 Some difficulties

The second part of this volume collects reports that are the outcome of the discussion of eleven hypothetical cases.

In searching for the relevant law, all the respondents have characterised in one way or another the legal relationships between the parties, even when the questions posed did not require them to do so. It appears that, in principle, a number of general options are usually available (both across and within the legal systems under consideration) to analyse the relevant transactions. At this level of the investigation, concepts and names are important. They frame the ways each case is discussed. Here we find a rich variety of approaches to the cases, though the options available are, of course, not unlimited.

The reports above, however, also show that the labels attached to the facts do not necessarily provide the ultimate key to know what operative rules will govern each case. It would be wrong to assume that categories and names at this point do not count any more; they still play a role in explaining the outcome of the case. Nonetheless, the country reports cover issues more closely related to the circumstances of each case than they would have done if simply engaged in the discussion of the main features of mandate, fiducia, trust, etc., and they spell out answers that focus on the facts outlined in the case descriptions. Possibly, some degree of speculation is at times involved in the national answers because those facts do not necessarily fit easily within any familiar pattern. Informed guesswork is acceptable, however, if the question posed is addressed for the first time, or has been seldom addressed, or invites an answer dependent upon some elements not fully set out in the questionnaire. Furthermore, the law on a certain point may be developing in new directions, or may be simply contradictory. It would be foolish to think that all legal problems can be addressed with the same degree of confidence across the European space. Having noted this limitation of our work, which is also a first result of the enquiry, we turn to its substance by addressing first the general part of the questionnaire (Cases 1–7), and then the special part (Cases 8–11).

2 Comparative remarks on the general part

The general part of the questionnaire deals with fact situations in which two persons agree that a certain activity, or a certain act, will be carried out by one of them in the interest of the other. The facts as described may involve the transfer of property to the party undertaking to carry out the activity in question, or to accomplish certain acts, in the interest of the other party. This factual pattern has been analysed in different ways by national respondents. Most reports from continental Europe hold that the parties involved in the transaction entered into a contract. Some reports maintain that the relationship between the parties originates from the grant of a power of attorney, which may also be considered as a contractual arrangement, or as a legal relationship of a different kind. Reports from English-speaking jurisdictions, on the other hand, hold that the relationship between the parties is a trust. 'Trust', in these reports, is a legal category distinct from 'contract', as well as from 'agency', though the Scottish report notes that the trust in Case 1 is 'functionally similar to agency'.[1] Although these categories are analytically distinct, they can overlap: a trust can be created pursuant to a contract, and an agent can hold property as a trustee. Indeed, to unite all three categories, an agent may hold property as a trustee while the whole relationship between agent and principal is governed by a contract. In the light of the relevant facts, several reports from jurisdictions of continental Europe (e.g. Germany, Italy and Spain) consider that the parties have reached an agreement that is fiduciary in nature, that is a 'trust', if English terminology has an international dimension, besides the national one.[2] Yet, as we have noticed, the legal form in question is still a contract under those national laws. On the other hand, under English law (but Irish and Scots law join on this point) the fiduciary obligations of the manager are usually conceptualised as distinct from the manager's contractual obligations.

[1] Above, Case 1.

[2] Above, Case 1.

The time is ripe to ask what 'contract' and 'trust' mean in this context. Let us start from the first notion. To be sure, the agreement between the parties in our cases creates obligations. Yet there are aspects of their legal relationship that are not purely obligatory. The manager has the power either to act as a representative or, lacking that power, to dispose of and acquire assets he must account for. The notions of contract developed in continental Europe are wide enough that the second kind of relationship just mentioned is often placed in the same conceptual box ('contract') as contracts performing economic exchanges, like sales. It is well known that all continental legal systems include donative transactions as well within the domain of contract, albeit they obviously do not consist of economic exchange.[3] Here, yet another facet of the complex notion of contract is on stage: i.e. contract as a grant of power to act in the best interest of another, coupled with corresponding obligations. But though, in the history of European private law, the power to represent another has been inextricably associated with the notion of contract for a very long time, the generalisation is no longer unconditionally true. We owe to nineteenth-century German legal thinking the view prevailing today in most European countries, which keeps the two concepts separate, or at least tends to do so.[4] The conceptual innovation introduced by German legal science, however, did not disturb the legal categories handed down by the Romanistic tradition to deal with cases where the party undertaking to act on behalf of another does not purport to act in a purely representative capacity. Hence, transactions of the latter kind – like commission or mandate – are still firmly within the scope of the general notion of contract prevailing in civilian jurisdictions. On the other hand, if compared with the broad notions of contract developed in other European jurisdictions, contract is a narrow legal category under English law, inasmuch as gratuitous agency is not a contract under

[3] Several valuable comparative works address the point: Hugh B. Beale, Arthur Hartkamp, Hein Kötz, Denis Tallon, eds., *Contract Law* (Oxford and Portland, 2002), 1 ff.; James Gordley, ed., *The Enforceability of Promises in European Contract Law* (Cambridge, 2001), 1 ff., 337 ff.; Rodolfo Sacco, 'Formation of Contracts', in Arthur Hartkamp, Martijn W. Hesselink, Ewoud Hondius, Carla Joustra, Edgar du Perron, eds., *Towards a European Civil Code*, 2nd rev. edn (Nijmegen, The Hague, London, Boston, 1998), 191 ff.; Hein Kötz, *European Contract Law* (Oxford, 1997), 3 ff., 52 ff.; Arthur Taylor von Mehren, 'The Formation of Contracts', in *International Encyclopedia of Comparative Law*, VII, ch. 9 (Tübingen, Dordrecht, Boston, Lancaster, 1992); John P. Dawson, *Gifts and Promises: Continental and American Law Compared* (New Haven, Conn., 1980).

[4] See on this point the literature cited in chapter 2, 'A Short Note on Terminology', above, pp. 45 ff.

English law, though the relationship between principal and agent is consensual. In a comparative study like this, that narrow concept of contract is, above all, an invitation to explore whether the broader notions of contract prevailing in continental Europe are really as uniform as they look; it appears that they are not, as we will see below.

In the same vein, the scope and the analytical value of 'trust' as a legal category comes under scrutiny in the light of our comparative enquiry. Is 'trust', like 'contract' in continental Europe, one of those wide-ranging legal categories that promise more analytical value than they actually deliver? In England, the field of trusts is regularly divided into subtopics, as every student of trust law learns. The classification of trusts into express, resulting and constructive trusts and the dichotomy between private trusts and charitable trusts are the first aid kit with which to approach the subject. Regrettably, these partitions are of little help for our purposes: they do not cast light on what is specific to the commercial context. In our questionnaire, trustees hold property for the benefit of the beneficiary, but the crucial fact is that the property in question is not the settlor's gift to the beneficiary. The springboard of trust here is neither unselfish motive, nor the intention to transfer wealth without recompense. It is rather the search for return on investment, as well as the intention to carry out transactions allocating the risk of insolvency of the manager under terms that are just the reverse of those featuring in the debtor–creditor relationship. The trustee too is not acting out of generosity. In our cases he is normally a professional, rendering a service for remuneration. There is a contractual element at work throughout all the cases considered above, in several senses. First, the parties reach an agreement for an economic exchange: work for remuneration. Second, the scope and the level of the duty that trustees owe to beneficiaries can be negotiated or varied within the boundaries set by mandatory provisions of law. The obligational sides of the relationship are aptly described by the language of contract. The notion of trust emerging from our cases thus evokes the contractual dimensions of the relationship, alongside its proprietary ones. However, having in mind the common law of contract, it is fit to observe that this is an area of the law 'where the common law techniques of strict interpretation of contract, and reluctance to imply terms which the parties did not choose to make express, are modified by different techniques'.[5]

[5] F. M. B. Reynolds, *Bowstead and Reynolds on Agency*, 17th edn, with the assistance of Michele Graziadei (London, 2001), § 6–033.

To better locate the emergence of a common core of European private law in our field of study we must next focus on the operative rules applicable to the facts of each case.

First of all, whether the transaction between the parties is classified as a contract under the various national laws or not, all the country reports point out that the manager should steer clear of transactions tainted by the pursuit of personal profit over and above agreed remuneration, or by conflict of interests. Whether the transaction is considered contractual or not, the manager is not entitled to appropriate gains that he could reap by exploiting the position he holds qua manager. The pursuit of personal advantage over the care of the client's interests is generally not allowed. In this respect, the relationship between the parties is clearly different from other relationships that, in all European legal systems, squarely fall within the field of contracts. The fact that 'contract' is the label applied to the relationship between the parties in continental legal systems is not without consequences, however. It is trite law that trust beneficiaries under English law are entitled to trustees' gains obtained in violation of their duties. But 'contract' does not always ring the same bell in continental Europe. As a general label, on both sides of the Channel, it mostly denotes exchange, self-interested action and management of one's own affairs. Hence, in most European countries where the relationship between the parties is classified under the heading of contract, the violation of the no-conflict rule and no-profit rules does not trigger a remedy imposing, on its face, disgorgement of the defendant's gain as a matter of course. In contract cases, the rule of thumb is that the plaintiff's loss, not the defendant's gain, is the measure of redress.[6] This is why most reports from continental Europe approach Case 3 like yet another case in which the aggrieved party is entitled to contractual damages.[7] Only at a deeper level of analysis, the laws of several European jurisdictions counter this approach by welcoming the idea that the plaintiff's claim for 'damages' actually extends to restitution of the defendant's gain.[8] We now begin to see the tip of an iceberg. Transactions like those discussed in the general part of the questionnaire can be disentangled from the general notion of contract

[6] On the general rule, in comparative perspective, see Guenter Treitel, 'Remedies for Breach of Contracts', in *International Encyclopedia of Comparative Law*, VIII, ch. 16, paras. 42 ff.

[7] Most, but not all: see especially the German contribution to Case 3.

[8] For an instructive comparative discussion of the general problem, see Beale et al., *Contract Law*, 855 ff.

based on the idea of exchange. The seeds of the critique of that dominant notion (and of a clearer differentiation of the contractual field) are scattered. To look for the golden thread which unites them, one can turn to the action of account.[9] This is the typical remedy that paves the way to a gain-based claim against the unfaithful manager under the civil codes. Interestingly, the same procedure is available under English law, where the relationship between the parties is not purely contractual, but is a trust or some other fiduciary relationship involving the entrustment of property (e.g. partners). It is interesting to observe that in English law, the idea of accounting has been extended, under the term 'accounting of profits', in order to provide a gain-based remedy for some forms of wrongful conduct outside the fiduciary sphere. This has long been the case, for example, for infringement of intellectual property rights, and a more recent development extends this to some breaches of contract.[10] Our work also shows that what counts as conflict of interest and as wrongful profit varies across legal systems, though agreement on both points is more common than disagreement, at least in the case discussed above. In jurisdictions where 'trust' is an institution of general application, borderline cases of conflict of interest and illicit profit are apparently treated with more severity. But there are significant variations among them as well: Scots law, contrary to English law, does not strip the trustee of the gain obtained by violating the no-conflicts rule, if that gain could have never been acquired by the trust.[11]

A second important point is that transactions vitiated by conflict of interest can, in most cases, be attacked by the aggrieved party if, in very general terms, the third party dealing with the manager was aware of the conflict in question. Whether under the national laws the relationship between the manager and the client falls in the domain of contract, or whether it falls in other domains, like trust for England, Scotland and Ireland, the possibility of avoiding the relevant transaction, or of recovering what was transferred to the third party, or of getting compensation, depends upon a multiplicity of factors that combine to render those categorical distinctions largely irrelevant. The panoply of variations that must be taken into account to get a full view of the European landscape are largely a function of what is considered 'awareness of the conflict' at the national level, and of the allocation of the burden of proof related to this element. One further point is, however, sufficiently

[9] See the comparative remarks on Case 3.

[10] *Attorney-General* v. *Blake* [2001] AC 268 (HL).

[11] See the comparative remarks on Case 3.

clear. Where trusts play a primary role in transactions concerning land, like in England and in Scotland, the manager's power to convey good title is safeguarded by statute. Thanks to those statutory rules, acquisition of title to land held under a trust in England (in most cases) and in Scotland (always) will go through without paying any regard to the transferee's actual or constructive knowledge of the conflict of interest situation. The costs of uncertainty on the point for society would be simply too high to let private parties look after it. The same economic reasoning in the area of company law suggested the removal of certain limitations on the powers of company directors throughout Europe.[12] It is tempting to argue that the far-reaching tracing rules of English, Irish and Scots law are, in a sense, the opposite sides of the same coin: the greater power of disposition the manager has, the more important it is to protect the client's claims to the exchange product of the transaction.

The search for a common core of European private law uncovers more common ground when the issue is the protection of clients' assets from the claims of the manager's personal creditors. 'Clients' assets' is a convenient expression to side-step the problem of clarifying the precise relationship between client and manager with respect to assets entrusted by the client to the manager. Once more, when English, Irish and Scottish lawyers examine this issue, the rules preventing trustees' personal creditors from satisfying their claims out of trust assets appear as an obvious corollary of the trustee's legal position. True, the word 'trust', powerful as it is, has no magic virtue. The question whether the parties entered into a creditor–debtor relationship, or a trust relationship, is still a question of fact, absent statutory regulation of the relationship between the parties. Hence, that question is addressed by conducting a factual enquiry. Evidence that the transferor did not intend to let the transferee have free hands with the assets will point to the conclusion that the relationship was one of trust, not of debtor and creditor. Is the same factual element relevant in other European legal systems, where the parties are always thought to be bound by a contract? Here is an aspect of contract law that is seldom mentioned: in many jurisdictions of continental Europe, property transferred to the manager for a specific purpose will not be available to its

[12] Council Directive 68/151/EEC, art. 9. Note, however, that this directive does not harmonise the national rules applicable to directors' transations in conflict of interest: *Cooperatieve Rabobank 'Vecht en Plassengebied' BA* v. *Erik Aarnoud Minderhoud* [1997] ECR I-7211.

creditors (Cases 4, 5, 6). This outcome is clearly at odds with the idea that ownership is an all-or-nothing affair. Continental legal systems show a variety of approaches when faced with the problem of describing the precise legal status of property transferred to the manager for a specific purpose. Some openly admit that the legal status of that property does not conform to the model set out in the definitional provisions of the civil codes on ownership.[13] A different notion of ownership is emerging here. It may be named by commentators or judges with the help of expressions like 'economic ownership', 'fiduciary ownership', etc., though the language of the civil codes does not warrant them. Other legal systems do not recognise in clear terms the possibility of different forms of ownership within the same legal system.[14] Nonetheless, the tension between the classical civil law notion of ownership, that is the right to use, enjoy and dispose of things to the fullest, and the special features of ownership under the circumstances described above, is still there. To pick a specific example, in France clients transferring money to an estate agent to carry out the transaction with the third party may still be owners of that money on some views of the facts (clients' money!). Yet those clients are owners of that money no more (and no less) than the beneficiaries of the trust imposed on it in the same circumstances by the English law. To anticipate points related to the special part of the questionnaire, the same remark applies to the legal condition of assets managed by a company operating a *fonds commun de placement*, by a unit trust, etc. To recognise this simple fact would not be a bold innovation. It does not take an iconoclast in love with English-style trusts to notice that nineteenth-century legal writers (wholly innocent of modern heresies) could do so without difficulty, even in the land of the *code civil*.[15]

The general tendency to deny to the manager's personal creditors access to clients' assets is, however, qualified in many ways across Europe, especially if that asset is money, as in Case 4. In some jurisdic-

[13] Some of the best-known instances of the classical model mentioned in the text are provided by art. 544 of the French Civil Code and by § 903 of the BGB.

[14] France is probably the country where there is more reluctance to acknowledge the limitations of the language of the civil code in this respect. But even in France there is no absolute ban on experiments with heterodox concepts of ownership: Gauthier Blanluet, *Essai sur la notion de propriété économique en droit privé français: recherches au confluent du droit fiscal et du droit civil* (Paris, 1999).

[15] Emmanuel Delamarre and Gustave Le Poitvin, *Traité du contrat de commission*, II (Paris, 1841), 652 ff., at 655 (the commission agent has 'le titre', his client has 'l'utilité, la dominité de l'objet acquis').

tions (England, Ireland, Scotland), clients' claims to money held on their behalf will enjoy priority over the competing claims of the manager's general creditors, irrespective of whether the money ended up in designated accounts. In other jurisdictions the priority to which clients are entitled vis-à-vis other claimants may be defeated, or is strongly at risk, if the money is not held in designated accounts. A small number of countries (Greece, Luxembourg and Portugal) put the manager's clients on the same footing with the manager's general creditors in the situation of Case 4. Note, however, that in several countries insurance schemes cover the risks associated with the manager's insolvency if his or her activity is a regulated profession. This reduces the impact of the risks related to the manager's insolvency and shows how a contractual technique effectively surrogates (or strengthens) the risk allocation functions of trusts with respect to the manager's insolvency.

These remarks do not address directly the legal condition of assets held for investors by financial services firms. Generally speaking, national financial services law, which is mostly put under the umbrella of EC law, seeks to enhance investors' protection above the level of protection afforded to the investment firm's general creditors in cases like the ones covered by our questionnaire. Yet, financial services law operates against the background of the general law of each European country. The residual, but significant, discrepancies existing at the level of the national law on the tracing issue raise the question whether that target is actually always reached (cf. Case 5 and Case 6).

A further point concerns the stability over time of the relationship between manager and client. The first case study involves a number of legal forms: representation, fiducia, mandate, commission, trust. To be sure, they are mentioned in the study of the case because they all satisfy the need to obtain asset management services. The first four arrangements in the list realise the possibility of creating legal relationships in which the manager is, as a rule, obliged to comply with the client's instructions. The fifth institution mentioned in the list is the trust. The reason to put the trust on a different footing is that the relationship between trustee and beneficiary is not based on the same assumption, i.e. that the beneficiary has the right to instruct the trustee about the proper course of action in each case and that the trustee must obey the instructions. It is rather based on the reverse assumption, i.e. the trustee is not obliged to follow instructions from his client about how to perform the managerial task. Indeed, as a rule of thumb, trustees acting upon beneficiaries' instructions violate one of their basic duties, i.e. the duty not to surrender their discretions to others. The independence of trustees from beneficiaries shows that trusts are designed to last over time and to operate even in favour of beneficiaries who, being incapable, are unable to direct or to evaluate trustees' performance. If independence from the determinations of others is the hallmark of ownership of property rights, trustees are precisely in that position, while other managers, empowered through mandate, commission, fiducia and other arrangements of various kinds, powers of attorney, etc., are not.

The situation outlined in Case 1, however, is such that all these distinctions are cast into doubt, inasmuch as our characters – all competent adults – proceed to arrange their deals without paying much attention to the lines drawn by the law. The first element that is common to all the legal systems involved in the research is the refusal to keep the relationship between the parties going, if one of them intends to put an end to it. The decision to end the relationship, if made without cause, may carry a cost, because a fixed term was agreed. In several countries, however, that term will be struck down, being contrary to public policy. In those countries, the law protects the freedom to manage one's own affairs to the point that it does not allow competent persons to enter into binding arrangements that curtail that freedom. Quite unexpectedly, there is no way to predict which country belongs to one or the other group by simply consulting the map of Europe's common law and civil law jurisdictions.

The last point touched upon in the general part is the impact of the Hague Convention on trusts in those European countries where it is in force and, more generally, the role of party autonomy in the choice of the law applicable to trusts. A first effect of the Convention, as noted in the Introduction, is to require the recognition of trusts as distinct legal institutions. A court which previously might have 'translated' the trust into legal categories known to the *lex fori* is now generally required, instead, to recognise the trust as a trust. Moreover, a legal system which never previously had any choice of law rules for trusts, as such, now has such rules under the Convention. Before the Convention, this recognition was a matter of course only where trusts played a major role in the life of the law. The second clear effect of the Convention is to allow wider scope for the choice of law exercise (compare the report for Ireland with those for England and Scotland on Case 7). The text in force in England and in Scotland omits to reproduce art. 13 of the Convention. Accordingly, in both jurisdictions party autonomy in the choice of the applicable law and the recognition of trusts are restricted only by the forum laws of immediate application and by *ordre public* or other escape clauses, such as those enacted in art. 15 of the Convention. The approach based on full party autonomy prevails by and large in Italy as well, where the Convention was ratified in its original version. In the Netherlands, where the Convention is also in force, a different approach seems to prevail, at least where, as in our case, the foreign law chosen by the parties is the only element not pointing to the forum. Recalling the discretionary provision of art. 13 of the Convention, the Netherlands report argues that in Case 7 non-recognition of the trust would probably follow as a consequence of the lack of any objective connection between the law chosen by the parties (Jersey law) and the Netherlands. The consequences of non-recognition in our case remain unclear, however. The Luxembourg report is more open to the idea that, in principle, the foreign law should govern the validity, effects, construction and administration of the trusts as a consequence of the entry into force of the Convention in Luxembourg in 2003. Since Luxembourg law has put in place rules on *la fiducie*, which may well come under the notion of trust set forth in art. 2 of the Convention, arguments opposing the recognition of trusts on the basis of art. 13 of the Convention would have little weight in that country. Nonetheless, the choice of the foreign law is likely to have limited impact in practice due to the application of mandatory provisions of Luxembourg law, to which most connecting factors point in our case. In other European countries where the Convention is not in force we find a variety of approaches. Despite the tendency to consider inter vivos trusts as contracts, the Rome Convention of 1980 on the law applicable to contractual obligations rules out trusts from its sphere of application.[16] Hence, the role that the national rules on the conflict of laws leave to party autonomy will determine the validity of the choice of law clause. Even where that

[16] Convention on the Law Applicable to Contractual Obligations, art. 1(2)(g). The Giuliano – Largarde *Report on the Convention on the Law Applicable to Contractual Obligations*, [1980] OJC 282/1, at 15, notes: ‘The exception concerns “trusts” in the sense in which they are understood in the common law countries. The English word “trust” is properly used to define the scope of the exclusion. On the other hand similar institutions under continental laws fall within the provisions of the Convention because they are normally contractual in origin. Nevertheless it will be open to the judge to treat them in the same way as the institution of the common law countries where they exhibit the same characteristics.’

clause is valid, it will generally govern only the obligatory aspects of the relationship between trustee and beneficiary. All the other aspects will be governed by the *lex rei sitae*, in this case the forum law. Lacking specific regulation, the evolution of the national legal systems will therefore determine whether or not we will have a common core of operative rules on this issue. Note, however, that national legislation implementing Community directives on undertakings for collective investments in transferable securities and on investment services has greatly reduced the margin of uncertainty linked to the existing differences among the various national laws. These directives (and the corresponding national measures) enact the principle that an investment vehicle may not carry out any activity unless licensed by the competent authorities of the Member State where it is situated.[17] The authorisation requirements are harmonised under Community legislation. Once the required authorisation is granted, it is valid for all Member States. Under this regime, the law of the place where the investment vehicle is situated has a central role, which cannot be displaced by the choice of a different law. If the investment vehicle markets its products in another Member State as well, the host Member State is obliged not to apply any other provision to it, except those allocated to the host Member State under the harmonised regime.[18]

[17] Cf. Directive 85/611/EEC on undertakings for collective investments in transferable securities, art. 4(1) (on authorisation by home Member State). Art. 3 of this text provides that UCITS are deemed to be situated in the Member State in which the investment company or the management company has its registered office. To avoid the possibility of 'letter boxes' management and investment companies, the head office of the company must be situated in the same Member State as the registered office. Directive 93/22/EEC on investment services, arts. 3 and 14, adopted the same regime. For commentary, see Niamh Moloney, *EC Securities Regulation* (Oxford, 2002), 252 ff. (UCITS passport); 370 ff. (ISD passport); see also above, p. 25, note 67. Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments repeals Directive 93/22/EEC on investment services, but sets out greatly to enhance the 'single passport' approach for investment firms which was the basis of the previous regime as well. Implementing EC and national legislation is pending.

[18] This approach was first launched with Directive 85/611/EEC and expanded by Directive 93/22/EEC on investment services. It was first modified with the adoption of the principle of the Member State of origin (or Member State of establishment) control in the field of E-commerce (Directive 2000/31/EC). But Member States can, in exceptional cases, apply consumer protection rules to cross-border financial services provided over the Internet without infringing the 2000 E-Commerce Directive: *Application to financial*

3 Comparative remarks on the special part

The four cases in the special part show, first of all, the difference that Community law makes when the question is what degree of integration among European legal systems can be achieved with (or without) Community measures.

Of the four transactions mentioned in Cases 8 to 11, only the collective investment scheme of Case 9 is within the range of Community legislation. If we leave aside forms that are suitable for sophisticated investors, two main legal forms for collective investment schemes compete across Europe: the fund form and the corporate form. The fund form presents some further variations concerning the way the relationship between investors and the fund is organised and conceptualised. In the UK, the pool of assets included in the fund is held under a trust for the investors. The investors are trust beneficiaries and they are co-owners of the managed assets in accordance with trust law. In other countries, like France, investors are also considered to be co-owners of the fund, though their relationship to the fund is not characterised as a trust. Lastly, there are countries where the fund is considered to be a separate patrimony, which properly speaking is not co-owned by the investors, at least if the expression 'co-ownership' in this context has to carry the meaning usually assigned to it. Going over these differences, one is at pains to find any operative dimension to them. If there is a realm of pure concepts in the law, they probably belong to it. Even the distinction between the corporate form and the fund form is largely diluted when considered in functional terms. The company's variable capital coincides with a pool of assets into which investors' money is invested. The company is the fund, in other words. It is regularly managed as such, on the basis of a contract with an

services of article 3(4) to (6) of the electronic commerce directive, COM (2003) 259 final. The weakness of the compromise under art. 11 of Directive 93/22/EEC and the changing scenario of investment services regulation is discussed in Moloney, *EC Securities Regulation*, 399 ff. Directive 2004/39/EC on markets in financial instruments sets out to remedy that weakness by developing a single European 'securities rule book' framework. This probably further reduces the 'general good' residual jurisdiction of Member States to impose public-interest regulation in this field by adopting a comprehensive investor protection approach (see Moloney, *EC Securities Regulation*, 264, 311 ff., 321 ff., 572 ff., Niamh Moloney, 'Investor Protection and the Euro: An Uneasy Relationship', in Guido Ferrarini, Klaus J. Hopt, Eddy Wymeersch, eds., *Capital Markets in the Age of the Euro* (Oxford, 2003); Michel Tison, 'Unravelling the General Good Exception: The Case of Financial Services', in Mads Andenas and Wulf-Henning Roth, eds., *Free Movement of Services* (Oxford, 2002).

investment advisor. Community law did not invent these schemes. The diffusion of these forms in several European countries took place before the intervention of Community law. The usual process of imitation, adaptation and competition has been the first motor of change in this area, as in many other areas of the law in Europe. Community law, however, accelerated this process by setting a level playing field for the cross-border marketability of securities issued by these issuers and by imposing an overarching legal framework, which forced everybody to see what all these legal forms had in common.[19]

The legal framework and the social and economic realities of the pension fund sector present a more complex picture than the world of other collective investment schemes. While our study developed, more data on the pension regimes available under national laws in Europe were published.[20] These data too show the fragmentation of pension fund laws and realities across Europe, as well as some common trends, like the shift from defined benefits to defined contributions schemes. Community action on pension funds is now on the way to ensuring the fulfilment of several objectives, including the establishment of a market for occupational retirement provisions organised

[19] This step did not bring with it rapid integration of the UCITS market, which has maintained significant national features, also related to preferences of local investors for investments in certain types of securities: Moloney, *EC Securities Regulation*, 272.

[20] *Joint Report by the Commission and the Council on Adequate and Sustainable Pensions*, of 18 March 2003. The *Report* is based on the national strategy reports submitted by the Member States in September 2002 to the EC Commission. They were prepared to show how the Member States are planning to cope with the challenges of adequacy, financial sustainability and modernisation of their pension systems in a long-term perspective. They can be consulted with other documents at the site: http://www.europa.eu.int/comm/employment_social/soc-prot/pensions/index_en.htm. The Internal Market *Study on Pension Schemes of the Member States of the European Union* (May 2000) is also covering the field (available at: http://www.europa.eu.int/comm/internal_market/pensions/docs/studies/2000-schemes_en.pdf). The latest statistics for the pension fund sector in Europe, still raising issues of geographical and intertemporal comparability, show wide variations in the amounts of total assets held by private pension funds and a rapid growth of supplementary pension expenditure in the EU. See the bulletin *Statistics on Pension Funds*, by Petra Sneijers, published 4 February 2003 in English, French and German by Eurostat in the collection *Statistics in Focus* within the theme *Industry, trade and services* (Eurostat product code KS-NP-03-001), available only in electronic form on the Eurostat website, http://epp.eurostat.cec.eu.int (search by product code).

on a European scale[21] and the full recognition of pension rights across Europe.[22]

Our study shows that 'pension fund' is a rather generic label, denoting a rich variety of legal forms. Here we are concerned only with pensions payments provided by the private sector on a collective basis. Within this field, contract, trust, or entities like associations, foundations and companies, are the legal techniques in place to provide pensions. 'Contract' takes two forms. Either the employer directly promises pension payments by securing them through funded reserves, or an insurance company is responsible for pension payments. The question of who owns capitalised money in the case of a surplus is easily answered in both cases, as we have seen, but it is interesting to note, once more, how the contractual technique replicates trust-based approaches. As could be expected, 'trust' is the legal

[21] See Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORPs). This instrument is an essential step in the creation of an internal market for occupational pensions, under a prudential framework which should be strong enough to protect the rights of future pensioners. The Directive is designed to allow pension funds to manage occupational pensions schemes for companies established in another Member State and to allow pan-European companies to have only one pension fund for all their subsidiaries in Europe, within a legal framework that should ensure a high level of security and efficiency in occupational pensions transactions. The institutions involved (such as pension funds and superannuation schemes) cover about 25 per cent of the Union's labour force and manage assets worth €2,500 billion (29 per cent of EU GDP).

[22] The portability of occupational pensions rights of mobile workers at the European level is safeguarded by the Council Regulation (EEC) No. 1408/71 on the application of social security schemes to employed persons, self-employed persons and to members of their families moving within the Community, as well as by Council Directive 98/49/EC of 29 June 1998 on safeguarding the supplementary pension rights of employed and self-employed persons moving within the Community. Full recognition for all of pensions rights at the European level has been limited so far by the refusal of the Member States to allow tax deductibility for pension contributions paid to pension funds in other Member States for fear of losing tax revenues. This argument is addressed in the Commission Communication on the elimination of tax obstacles to the cross-border provision of occupational pensions, COM (2001) 214 final, with suggestions and proposals. The ECJ has consistently dismissed the Member States' argument based on loss of tax revenue by deciding that refusal of tax deductibility of pensions contributions paid abroad is contrary to art. 49 of the EC Treaty: *Skandia and Ramstedt* v. *Riksskatteverket Försäkringsaktiebolaget* (Case C-422/01) [2003] I-06817; *Danner* (Case C-136/00) [2002] ECR I-8147. An update to June 2004 on the steps taken by the Commission in this matter is provided by Schonewille, 'The Elimination of Tax Obstacles to Pan-European Pension Funds: An Overview', available at: http://europa.eu.int/comm/taxation_customs/taxation/information_notes/occ_pen_article3.pdf.

form of most pension funds in England, Scotland and Ireland. Historically, among the various reasons for the widespread recourse to that form there was its inherent flexibility that was largely exploited by skilful lawyers to tailor trust deeds to employers' demands as to legal prerogatives, or de facto control, over the trust fund.[23] Once more, in continental Europe the establishment of a separate fund can be achieved with, or without, the help of legal personality. This is therefore yet another example of the many ways that are available to obtain a certain outcome, which a robust law of foundations, unincorporated associations and legal persons achieves as well. Whatever legal form for the pension fund is chosen in this list, the country reports show also that several factors influence the solution of the case concerning the pension fund surplus. First, it makes a difference whether the scheme is ongoing, or is in liquidation. In the ongoing scheme, the distribution of surplus assets may ultimately endanger the viability of the scheme; this danger does not exist when the scheme must be wound up. Hence, a more lenient approach to the employer's claim to the surplus may prevail when the scheme is wound up. Second, the tax regime of contributions to the scheme and the rigidity of the fiscal policy that prevents employers from getting back tax advantages designed to promote supplementary pension schemes may influence the outcome of the case. Third, what counts as workers' remuneration is relevant in determining the issue of the case. Party autonomy plays a role in this respect because the pension fund rules may address the issue. If those rules are silent on the issue of surplus ownership, as sometimes happens, conflicting considerations come in. On one view, once the employer has fulfilled its obligations under the fund rules, he can act in his own interest and thus decide to take a contribution holiday. From a different perspective, it is still possible to argue that pension fund assets are employees' assets in any case. Even in England, where the legal form of pension funds smacked originally of nineteenth-century philanthropy, courts in due time advanced the distinction between private trusts that were gifts, for which the beneficiary must only be grateful, and pension funds trusts, where former employees may feel they have earned the pension. Judges have thus remarked that pensioners' rights under a pension trust 'derive from contractual and commercial origin. They [i.e. the employees] have purchased their rights as part of their terms of

[23] See in detail Richard Nobles, *Pensions, Employment and the Law* (Oxford, 1993), 12 ff, 39 ff.

employment.'[24] This more realistic approach still leaves open the possibility that pensions payments beyond defined benefits are not deferred remuneration, but rather in the nature of gifts.[25] Some other European countries support the same approach as well, whatever legal form is there available to establish the separate fund. The consideration that under a defined benefits plan the employer runs the risk of having to make higher contributions to fulfil the pension promise reinforces the idea that in principle it is reasonable to let him benefit from the surplus. Other national reports, however, reflect the opposite view that favours employees, paying due consideration also to the strength of the workers' representation or trade union presence on pension fund boards and supervisory bodies. Though in the UK the Pensions Act 1995 provides that one-third of each trustee board should be nominated by members of the pension fund, member-nominated trustees in the UK are not employee advocates. Rather, they are bound by the same duties of loyalty and care as any other trustee, and these duties are owed to all beneficiaries of the pension trust. The UK experience is therefore different from those just mentioned, because member-nominated trustees do not actually reflect union involvement in the administration of the pension fund, nor stand for equality of representation of the workforce among the trustees, nor act as recognition of increased employee stakes in their jobs.[26]

[24] *Kerr* v. *British Leyland (Staff) Trustees Ltd* [2001] WTLR 1071 (26 March 1986, CA), per Fox LJ. There are other cases that develop the same point: *Mettoy Pension Trustees Ltd* v. *Evans* [1991] 2 All ER 513, 537 per Warner J; *Imperial Group Pension Trust Ltd* v. *Imperial Tobacco Ltd* [1991] 2 All ER 597; *Malik* v. *BCCI* [1997] 3 All ER 1. In *Barber* v. *Guardian Royal Exchange Assurance Group* [1990] ECR I-1889 (applied in subsequent cases), the ECJ adopted the same approach with regard to the equal pay principle of art. 119 of the EC Treaty. The Court applied that principle to pension schemes that are established either by an agreement between workers and employers or by a unilateral decision taken by an employer – whether financed by the employer alone or by both the employer and workers – which may by law, with the employee's agreement, operate in part as a substitute for the statutory scheme. According to the ECJ, the retirement pensions paid under such schemes constitute consideration paid by the employer to the worker in respect of his employment. Art. 119 of the Treaty therefore applies to consideration received indirectly from the employer, such as contributions to a private occupational scheme that was set up in the form of a trust that is administered by trustees who are technically independent of the employer.

[25] But under the above-mentioned principle of equal pay, the gift may not be discriminatory.

[26] Graham Moffat, *Trust Law. Text and Materials*, 3rd edn (London, 1999), 510, notes that the Goode Committee report on pension law (paving the way to the Pensions Act 1995, ss. 16–21) recommended that some trustees should be nominated to the trust board by

While the law of pension funds in several European countries is undergoing a process of rapid change, the question raised by Case 10, i.e. how to issue secured debt instruments for multiple investors, is instead a classic one on company law and trusts. Even today, however, a tiny minority of European jurisdictions do not provide effective mechanisms to grant debenture holders a real security which can be conveniently enforced. Denmark seems to be in this situation. In Finland, there is no substantial use of devices that are common in other jurisdictions, but in that country insurance coverage provides debenture holders a viable functional alternative to more common approaches. In several other countries, the protection of debenture holders' rights is the task of a specially appointed subject, who has the power to enforce their rights vis-à-vis the issuer. The relationship between that subject and the debenture holders is a trust (England, Ireland, Scotland, Germany, but the debenture holders have no security rights in the company assets in Germany), a mandate or a representation relationship for the collective group, which may or may not have legal personality (France, Italy, Belgium, Luxembourg, Spain, Greece, the Netherlands, where the relationship in question could also be a *bewind*, or a trust; in Italy, trusts governed by foreign laws have been employed to this purpose as well).

The last case of the questionnaire ('securitisation') poses several legal problems. The aspects of the operation more closely related to our general topic concern the possibility to swap future income for present capital value while shifting the risk of default on the loans generating the income to the market. The market placement is carried out by issuing financial instruments representing the outstanding debt (asset-backed securities). An accurate assessment of the risk of default on the debt is essential for the success of the operation. Hence the portfolio of loans must be isolated from the claims of the lender's creditors that could unravel the transaction. In anglophone jurisdictions, the trust has a key role to play here: it is used by the lender to segregate money collected and held for the entity that acquired the loans against a capital payment. The trust is also deployed to hold pools of loans for multiple lenders, who contributed to the acquisition of the loans, proportionally to their respective contribution. In several

members only, to ensure that employee interests were kept clearly in mind in any trustee decision-making process. Again, this goal is somewhat different from the ideas of employee representation or trade union involvement in pension fund administration.

continental countries, a wave of recent legislation provides a viable legal framework for asset securitisation. In many cases, that legislation replicates the previous experience with collective undertakings in transferable securities. This means that the assets in question are either held as a separate fund of the special purpose vehicle, or are co-owned by the owners of the asset-backed instruments, or constitute a separate pool of assets that are incorporated as a company. In other European countries, the legal framework for this operation is not well developed, or faces restrictions or difficulties of some kind. In those countries, the legal regime applicable to the transfer of the income-producing assets, the tax treatment of the operation, or the licence and the capital requirements of the special purpose vehicle, pose obstacles that hinder the development of the market.[27]

4 What's next?

As mentioned in the beginning, this volume has no pretence whatsoever of being a complete discussion of comparative trust law, nor even of the whole field of comparative commercial trust law. The topics selected for comparative treatment were chosen because of their promising theoretical and practical nature, not because they necessarily represent the most glaring examples of the use of trusts in the commercial context. Nonetheless, this volume is at least a first step in the direction of enquiring into the existence of a common core of trust law based on a patient collection of data relating to the commercial context.

To summarise the results of our enquiry, we at least claim that there is a larger area of agreement than one would expect between jurisdictions that have been traditionally set apart. Moreover, the variety of approaches to the cases uncovered in the laws of continental Europe poses a serious challenge to the idea that the crucial distinction in our field is the opposition between civil law and common law.

Summing up our results, we can say that in the field covered by this volume there is a significant common core of operative rules across Europe, which is documented despite the wide variety of legal forms

[27] The Securities Expert Group appointed to assess the impact and the prospects of securities regulation in Europe points to assets securitisation as one of the areas of the internal market in which more harmonisation is needed. Securities Expert Group, *Financial Action Plan: Progress and Prospects*, 2004, available at: http://europa.eu.int/comm/internal_market/en/finances/actionplan/docs/stocktaking/fasap-stocktaking-report-securities_en.pdf.

admitted by national laws. Even more important, however, is the observation that all these legal systems struggle to solve a very significant *common core of institutional problems* linked to the development of an efficient legal framework for the marketplace of investment services.

The existence of such a common core of problems stimulates some thoughts located in the domain of the 'ought to be' (or *de lege ferenda*, in the language of the civil law tradition), which are connected to the present phase of development of the European legal landscape.

Some years ago, the European Commission asked the European scholarly community to venture into this domain to obtain an informed guess as to the desirability of a general instrument (be it a Restatement or a Code) of European private law.[28] The very important question posed was whether, in the process of harmonisation of contract law, other neighbouring areas of the law, namely torts and property, had to be tackled as well. The sense was that the background structure of patrimonial private law could be adversely affected if further legal harmonisation initiatives were to include contract law only. Despite this initial move, the Commission's *Action Plan on Contract Law* issued in 2003 covers contract law only, but the general issue remains on the table and the results of our study offer some food for thought in this respect.[29]

Trusts absorb a variety of issues that would otherwise find their *locus solutionis* in the area of contract law. As noted above, jurisdictions where trusts flourish define the borders of contract law in a narrow way in comparison to jurisdictions where the compass of contract is broad, covering problems related to the fiduciary relationship between the investor and the manager. The question thus arising is whether issues that in economic parlance come under the label 'agency' are better solved

[28] Cf. Communication on *European Contract Law* COM (2001) 398 final, § 6.

[29] Communication on *A More Coherent European Contract Law – An Action Plan*, COM (2003) 68 final. In September 2003 the European Parliament and the Council passed resolutions supporting the Action Plan. This was followed in 2004 by the publication of the *Study on Property Law and Non-contractual Liability Law as they relate to Contract Law submitted to the European Commission* (Health and Consumer Protection Directorate-General) by Prof. von Bar and Prof. Drobnig, available at: http://europa.eu.int/comm/consumers/cons_int/safe_shop/fair_bus_pract/cont_law/study.pdf. The study covers the relationship between trust and contract law, noting their overlapping and their co-existence in several contexts (see pp. 45–46, 349–367). The report claims that the alleged historical flexibility of continental contract law explains why on the continent the law of contracts could work as a substitute for trust law. But the claim is not substantiated by legal history. Continental contract law before the nineteenth century did not go as far as to provide for the general enforceability of contracts for the benefits of third parties.

by means of contract law, or of trust law.[30] In other words, can managers who enter into a relationship of economic agency be monitored at lower costs within the framework of an institutional background in which contracts have the lion's share, or is a specialised legal field, that of trust, required (or at least advisable) for the same purpose?[31]

Contracts, in the version elaborated by American law and economics, now attracting attention in Europe, is a wide-ranging field of the law. It even extends to the field of business corporations,[32] a direct alternative to trusts as a form of business organisation. Despite this remarkably flexible attitude, it is however a fact that, in a world characterised by significant transaction costs, entities exist that go beyond the typical *one shot–no loyalty* structure of exchange contracts. The need for such entities is evidenced by their emergence throughout the jurisdictions that we have surveyed.

While the aggregation of many contracts in a relatively low transaction costs setting generates efficient outcomes, a degree of institutional specialisation seems advisable to meet the needs of governance of highly complex fields, such as those explored in our study. There are needs of accountability and of general reliance to balance against needs of speedy and unburdened decision making, which contract law is poorly equipped to tackle. In the ideal continuum from contracts, to trust, to business corporations, from the simplest to the most complex and sophisticated tools of governance of economic activity, trust law seems to occupy a much needed middle ground between the risky choice of stretching contracts to the limits of their structural reach, and the outright recourse to the law of legal entities such as the business corporation.[33]

[30] On the economic theory of agency, see the overview by Robert Clark, 'Principal and Agent', in *The New Palgrave. A Dictionary of Economics*, 3 (1987), 967 ff.; the intersection between that theory and fiduciary relationships law is examined by some classic essays: Tamar Frankel, 'Fiduciary Law', 71 Cal. L. Rev. 795 (1983); Robert D. Cooter and Bradley J. Freedman, 'The Fiduciary Relationship. Its Economic Character and Legal Consequences', 66 NYUL. Rev. 1048 (1991); with special regard to trusts, see now: Robert H. Sitkoff, 'An Agency Costs Theory of Trust Law', 89 Cornell L. Rev. 621 (2004).

[31] The discussion is open, particularly in the American academic debate. See Henry Hansmann and Ugo Mattei, 'The Functions of Trust Law: A Comparative Legal and Economic Analysis', 73 NYU L. Rev. 434 (1998). See also Steven L. Schwarcz, 'Commercial Trusts as Business Organizations: Unraveling the Mystery', 58 Bus. Law. 559 (2003).

[32] The theme is inextricably linked to the contribution of Frank H. Easterbrook and Daniel R. Fishel, *The Economic Structure of Corporate Law* (Cambridge, Mass., 1991).

[33] Schwarcz, 'Commercial Trusts as Business Organizations', above, note 31; D. W. M. Waters, 'The Future of the Trust from a Worldwide Perspective', in John Glasson, ed., *The International Trust* (Bristol, 2002), 597.

This is why, thinking to the 'ought to be', trusts represent an advisable alternative road to an efficient marketplace.[34] The data collected in this study show that trust law successfully competes with contract law to tackle problems of economic agency. There is little doubt, therefore, that issues of unification of contract law in Europe are affected by the availability or not of the trust structure and of a well-developed law of trusts. The point is not to be overlooked, especially when the very initial question of the content of the category of 'contracts' is posed at the European level.[35]

Offering this insight for the purpose of the European debate, we now turn to the issue of the legal sources regulating our transactions. In a common law jurisdiction, the label 'trust' signals the availability of an extensive body of law that the parties introduce by default in their arrangement whenever they choose that legal form. The choice by the parties of the mandatory part of trust law implies the introduction of this body of law to govern the shadow of the transaction.[36] No such option is available thus far in most European jurisdictions, at least not on the scale that common lawyers are familiar with. This means that, in those continental jurisdictions, if the contract is silent or incomplete, the question of what law is applicable has no obvious answer, even though their arrangement may be aimed at producing exactly the same effects that any common lawyer would bring under the heading of 'trust'.

Once more, the issue of the 'sources of law' raises analytical and normative questions. On the analytical ground, the reports show an extensive reliance on mandatory rules established to protect the weaker party, who is assumed to be the non-professional investor. True, in most systems contractual freedom, or 'freedom of trust', allows the parties to tailor the contents of the relationship. Nevertheless, the sense that our enquiry is located in the domain of mandatory law is quite strong because of the impact of the trust relationship on third parties and of the role of the legal system in protecting entitlements. When examined in a comparative setting, the domain surveyed shows at work the

[34] Ugo Mattei, *Comparative Law and Economics* (Ann Arbor, Mich., 1997), 147 ff.; Ugo Mattei, 'Should Europe Codify Trust?', in Peter Birks and Arianna Pretto, eds., *Themes in Comparative Law in Honour of Bernard Rudden* (Oxford, 2002), 235 ff.

[35] See above, note 3.

[36] John H. Langbein, 'Mandatory Rules in the Law of Trusts', 98 Nw. U. L. Rev. 1105 (2004); David J. Hayton, 'The Irreducible Core Content of Trusteeship', in A. J. Oakley, ed., *Trends in Contemporary Trust Law* (Oxford: Clarendon Press, 1996), 47; Hansmann and Mattei, 'The Functions of Trust Law', above, note 31.

evolution of efficient principles, generated by the appropriate ratio of mandatory and default law. Formalism and paternalism are sometimes used to prevent investors with unstable or unsettled preferences from entering into transactions that are strongly suspect. Community law, which sometimes merely reinforces local law, and at other times introduces wholly new rules, relies on these techniques. Freedom of contract is nevertheless safeguarded as a fundamental default principle, first of all because the parties have the choice whether to enter into a trust relationship, or into a debtor–creditor relationship. Different sources of law limit or exclude the freedom to shape the parties' relationship in the presence of recognisable opposing requirements of protection (particularly of third parties without notice).

Facing this scenario, the fundamental question whether yet more uniformity is needed in this domain looms large. Again, our collection of data can help to address the issue. To begin with, a significant variety of patterns emerges, particularly in the special part, when it comes to the diffusion and development of devices such as pension funds, or of operations like asset securitisation. This means that not all the European contexts are the same from the perspective of the development of some of the fundamental institutions of market capitalism. True, over time legal change takes place. Even during the development of our study we have witnessed significant changes in the law of several European jurisdictions and at Community level. This means that, in any case, the picture we are considering is not drawn once and for all; it is evolving, and quite rapidly indeed. The desirability of further uniformity nonetheless still confronts us, and raises the question of the impact of uniform rules in different economic contexts. Over-regulation or under-regulation inevitably bring significant costs, which might discourage a project aimed at top-down uniformity. The most radical alternative to cross-border uniformity imposed from above is regulatory competition. Extensively advertised in the domain of corporate law and of securities regulation,[37] regulatory competition should deliver flexibility

[37] Roberta Romano, *The Genius of American Corporate Law* (Cambridge, Mass., 1993); Romano, 'Empowering Investors: A Market Approach to Securities Regulation', in Klaus J. Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch, Stefan Prigge, eds., *Comparative Corporate Governance* (Oxford, 2002), 141 ff. To be sure, the extension of the 'internal affairs' doctrine (i.e. the choice of the incorporation state law as a connecting factor) to cross-border securities transactions, as advocated by Romano, would reduce the possibility of disparity of treatment of securities holders due to the fact that they bought the securities at various places. Note, however, that Romano does *not* suggest

and a high degree of adaptability to local circumstances, which in turn are supposed to stimulate innovation. The European Court of Justice, in the *Centros*, *Uberseering* and *Inspire Art* cases,[38] looked favourably on this approach, inspired by the US experience, thus bolstering the possibility of applying it even in areas where the hope that competition would generate a rush to the top, rather than to the bottom, is, perhaps, optimistic. The domain that we have explored has been free thus far from efforts at systematic regulation for the mere sake of uniformity, however.[39] Despite the remarkable variety of legal forms, the evolutionary trend of the systems that we have investigated goes in the direction of enhancing protection of the interests of investors and third parties, while at the same time struggling to maintain a competitive market for managers. The data collected above show that a variety of legal forms are used to resolve a common core of fundamental problems that can be summarised as system risk, and the need to avoid opportunistic behaviour of market actors entrusted with other people's money.[40]

Competition produces knowledge and avoids the stiffening of innovation caused by outright uniform regulation. In an area of rapid change like that of financial markets law, the knowledge of alternatives, flexibility and innovation are very important assets. To safeguard them, it is tempting to suggest the acceptance of a higher degree of risk and to abandon general efforts at regulation. This recipe is, however, illusory,

that broker–dealer regulation should be based on the market approach that she advocates.

[38] *Centros Ltd* v. *Erhvervs-og Selskabsstyrelsen* (C-212/97), [1999] ECR I-1459; *Uberseering BV* v. *Nordic Construction Company Baumanagement GmbH* (NCC) (C-208/00), [2002] ECR I-9919; *Kamer van Koophandel en Fabrieken voor Amsterdam* v. *Inspire Art Ltd* (Case C-167/01). On these developments, see Eva-Maria Kieninger, 'Internationales Gesellschaftsrecht nach "Centros", "Überseering" und "Inspire Art": Antworten, Zweifel und offene Fragen', Zeup, 2004, 685; Christian Kirchner, Richard W. Painter, Wulf A. Kaal, 'Regulatory Competition in EU Corporate Law after *Inspire Art*: Unbundling Delaware's Product for Europe' (2004) (paper available on the www.ssrn.com website).

[39] Gérard Hertig, 'Regulatory Competition for EU Financial Services', in Daniel C. Easty and Damien Geradin, eds., *Regulatory Competition and Economic Integration: Comparative Perspectives* (Oxford, 2001), 218 ff., argues that the mutual recognition approach based on minimum harmonisation has been of sufficient magnitude to allow for positive externalities. Since the enactment of the first instruments, there has been no sign that the European passport permits large-scale fraud or permits Member States to impose higher system risks on other Member States. But going beyond minimum harmonisation has become a necessity with the growth of cross-border securities trading. Cf. Dale D. Murphy, *The Structure of Regulatory Competition* (Oxford, 2004), 72 ff.

[40] These are definitely the features of the most recent wave of EC legislation in the financial services field. See Niamh Moloney, 'New Frontiers in EC Capital Markets Law: From Market Construction to Market Regulation', [2003] CML Rev. 809.

for reasons that are not too difficult to grasp. Economists teach lawyers that regulation is at high risk of being captured by special interest groups seeking rents. Certainly in the area of business trust, such groups would be very alert at the national level and possibly even more so in Brussels, where special interests are particularly active and professionally organised.[41] On the other hand, lawyers are trying to teach economists and policy makers that 'regulation' is not a word with a uniform meaning. In the life of the law, a variety of sources perform regulatory tasks, and different forms of regulation can prove to be resistant in different degrees to the risks of capture. Civil codes in the civilian sense, for instance, being mostly scholarly products of broad reach, are no easy prey for capture, while so-called special statutes usually reflect special interests at a much more worrying intensity. Indeed, it is fair to predict that the more a law is of general scope, being based on principles rather than on specific rules, the more special interests will have to compete to influence its application, and the higher is the probability of a carefully balanced final outcome of the regulatory process.[42]

[41] By now, at last, the Commission is strongly aware of the problem of political legitimacy raised by special interests representation. See: Commission Communication, *European Lawmaking: Better Governance*, COM 2002 (275) final; Commission Communication, *General Principles and Minimum Standards for Consultation of Interested Parties by the Commission*, COM 2002 (407) final. With regard to the financial services sector, the Commission explicitly acknowledged the need to redress the imbalance of inputs between industry and the retail and consumer sectors (press release of 25 July 2003, IP703/1119). To remedy the disparity, the Commission set up a 'FIN-USE' Forum of financial services experts (chairman Prof. Udo Reifner) that will formulate policy recommendations on EU financial services initiatives. The focus is on problems encountered by retail consumers and small and medium-sized businesses. The Forum reflects the EC commitment to open up policy making and make it more inclusive and accountable, in accordance with the White Paper on European Governance (see www.europa.eu.int/comm/internal_market/finservices-retail/fin_en.htm).

[42] Securities regulations in Europe now involve several layers of regulatory competence in descending degrees of generality. Under this scheme (the 'Lamfalussy process') the Council and the Parliament have only the task of adopting directives and regulations of a general nature. Implementation measures are taken care of by other bodies, i.e. the European Securities Committee, with regulatory functions, and the Committee of European Securities Regulators, with advisory functions, upon delegation by European institutions. The architecture of the new system is presented in the final report of the Commission of wise men chaired by Alexander Lamfalussy, which launched the reform process (available at: http://www.europa.eu.int/comm/internal_market/en/finances/general/lamfalussy.htm). The Lamfalussy process involves extensive consultations of interested parties at the various levels and periodic reviews by the Inter Institutional Monitoring Group for Securities Markets which reports to the European Parliament, to the Council and to the Commission (reports available at: http://europa.eu.int/comm/internal_market/en/finances/mobil/lamfalussy-comments_en.htm).

In the landscape of business trust, what is lacking is a common phrasing of general principles that, with local variations, are already present in the different jurisdictions. Spelling out those principles and exploring their connection with the different remedial devices available to investors, managers and creditors all over Europe might end up in giving to the label 'trust' a lasting meaning and a value outside of the common law tradition as well.

Such general principles address a well-defined economic problem that we will summarise as follows: (a) to reduce transaction costs by providing unimpaired proprietary decision-making power to the manager; (b) to reduce agency costs by providing proprietary protection to the investor.

One of the main themes of this study is that these interests are in tension and the law has to produce a balance to take care of them. What tools should be employed to produce the balance? Should it be based on regulatory competition, on Restatements, on other 'soft' options, or should it be provided by the development of a common set of mandatory principles applicable throughout the European marketplace of investments?

Our research was not designed to advise on the feasibility or desirability of reform.[43] Nevertheless, if a level playing field for European market activity is desirable, as experience has shown, then the sector of trust law we have surveyed should probably reach a level of commonality that goes beyond what we have been able to unearth in our study. If the task is to make market actors and investors indifferent, wherever located, to the institutional background of their activity, then the solution of that tension must be largely the same across the single market. Default law can well be left to local variations. But a minimum hard set of principles will be necessary, if not sufficient, to make investors indifferent to the location of their manager and managers indifferent to where to conduct their activity, especially if the consumer and retail sector is to benefit from market integration and increased competitiveness.[44] The recent developments of Community law in the field

[43] Those who are interested in the views expressed by one of the editors, based on the materials of this volume, can see Mattei, 'Should Europe Codify Trust?', above, note 34.

[44] Empirical research shows that many wholesale financial services are provided on a pan-European basis now. On the other hand, financial services for the retail sector are still segmented on a national basis, for a number of reasons, including existing de jure or de facto regulatory barriers, which the legislation enacted under the Financial Services Action Plan aims to remove. See the Report for the European Financial Services

of securities and pension funds regulation seems to confirm this analysis.[45]

More empirical work is needed than we have done in order to understand to what extent differences in the legal processes of Member States, as affected by the local context, are so significant as to frustrate efforts to reach a level playing field by means of substantive law reform.[46] One master of comparative law, the late Honorary Editor of the Common Core Project, Professor Schlesinger, suggested that much procedural reform may be required to pursue the end of approximation of laws in the field of trust law.[47] We leave the reader with this question open, in the hope that some empirical enquiry will soon cover that field too.

Roundtable (chaired by Peer Gyllenhammar) on *The Benefits of a Working European Retail Market for Financial Services* (2002), prepared by the Zentrum für Europäische Wirtschaftsforschung and the Institut für Europäische Politik, available at: http://www.iep-berlin.de/publik/sonstige/eu-market/zew_iep_report_whole.pdf.

[45] Cf. the *Progress Report on the Financial Services Action Plan*, published by the Commission, available at: http://europa.eu.int/comm/internal_market/en/finances/actionplan/index.htm, and the documents related to the ongoing stock-taking on the Financial Services Action Plan which became available in May 2004.

[46] The European Commission has set to work to identify ongoing structural changes in the financial market landscape, to ensure common implementation and enforcement of Community law, as well as to understand shortcomings in the financial integration process. To this end, it is developing policy guidance indicators and tools for remedial action together with Member States, meeting in the Financial Services Committee.

[47] Rudolf B. Schlesinger et al., *Comparative Law: Cases, Notes and Materials*, 6th edn (New York, 1998), 869, n.42. Schlesinger drew attention to the fact that in the common law tradition, trustees can easily seek the advice and direction of the court on questions of law, without launching a full lawsuit, and even in the absence of a genuine dispute between parties. Note similarly the observation of Pierre Lepaulle: ‘Le trust vit à l’ombre du Palais de Justice qui lui apporte à la fois le conseil et le contrôle’ (‘The trust lives in the shadow of the court house, which both advises and supervises it’): *Traité théorique et pratique des trusts en droit interne, en droit fiscale et en droit internationale* (Paris, 1932), 207.

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The reader is referred to ‘United Kingdom’ entries in the case of statutory law which applies UK-wide (for example, pension funds). For areas not governed by UK-wide statutes see ‘England’ and ‘Scotland’ entries.

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