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Transnational Legal Ordering of Modern Trust Law

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7.1 INTRODUCTION

Law is conventionally associated with the law of the nation-state. Halliday and Shaffer's seminal work on transnational legal ordering shows, however, that legal ordering occurs transnationally along multiple dimensions. The legal norms that order the understanding and practice of law transcend and permeate the boundaries of nation-states, which can give rise to transnational legal orders (TLOs) that reflect, penetrate, and harness national law and legal institutions.[1]

This chapter demonstrates that transnational legal ordering is particularly evident in the law of trusts. The concept of local or national trust law does not adequately capture the global and transnational flow of ideas and institutions that shape the making of modern trust law, as it exhibits variations in legal ordering beyond nation-states. Instead, modern trust law exemplifies the dynamics of TLOs, because modern trust norms are themselves transnational: They often vary in their geographic and substantive legal scope, producing multiplicities of legal orders that invariably transcend, span, and permeate nation-states, including both offshore and onshore jurisdictions, as well as both common law and civil law jurisdictions.

This chapter focuses on the processes through which modern trust norms develop and flow across borders to become a substantive body of transnational and comparative trust law. It discusses how the making of modern trust law at the transnational, national, and local levels develops dynamically over time, by reference to two recent

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[1] Halliday and Shaffer define a "transnational legal order" as "a collection of formalized legal norms and associated organizations and actors that authoritatively order the understanding and practice of law across national jurisdictions." Terence C. Halliday & Gregory Shaffer, *Transnational Legal Orders*, *in* TRANSNATIONAL LEGAL ORDERS 3, 4 (Terence C. Halliday & Gregory Shaffer eds., 2015); *see also* Chapter 1 of this volume.

phenomena that illustrate the interplay of trust norms across national boundaries. The first phenomenon pertains to the rise of global wealth, which is driving offshore trust jurisdictions to adapt and embrace innovations and transformations in trust law in order to remain competitive in the holding and management of that wealth. This has prompted some onshore jurisdictions to adopt certain offshore modifications, a practice Lionel Smith calls the "onshoring of the offshore."[2] Second, the interplay of trust norms across national boundaries is evident in the rise of the civil law trust in East Asia, which has led both civil and common law jurisdictions to rethink the core elements of the trust. These phenomena have prompted scholars to explore how transnational trust law has developed through horizontal interactions among onshore and offshore jurisdictions and civil law and common law jurisdictions. This chapter concludes that examining the trust law terrain would make a significant contribution to TLO theory, because such an examination would go far beyond the traditional categorization of laws as civil versus common, or Asian versus Anglo-American, and demonstrate that transnational legal ordering processes apply in the making of modern trust law.

Although this chapter focuses on the horizontal dimensions of transnational legal ordering, it is worth noting that, in addition to horizontal dimensions, there are also vertical dimensions of transnational legal ordering in the context of modern trust law. Vertical ordering of trust law occurs whenever non-state actors purport to provide benchmarks for the creation of trust norms on the national level within multiple national states. A notable example is the Hague Convention on the Law Applicable to Trusts and on their Recognition ("Hague Trusts Convention").[3] The Hague Trusts Convention was developed by the Hague Conference on Private International Law, an international organization with ninety-one members, with another sixty-five nonmember states being parties to conventions that it has developed. As the trust institution was developed by courts of equity in common law jurisdictions, civil law jurisdictions – which do not have the concept of a trust (or equitable proprietary interest) as part of their domestic law – could not give effect to a trust by simple analogy to existing civil law institutions. Aiming to address this problem and providing guidance on choice of law rules in cross-border trusts disputes, the Hague Trusts Convention purports to "establish common provisions on the law applicable to trusts and to deal with the most important issues concerning the recognition of trusts."[4] Notably, it proposed a harmonized definition of the trust:

[2] Lionel Smith, *Give the People What They Want? The Onshoring of the Offshore*, 103 Iowa L. Rev. 2155, 2174 (2018).

[3] The Convention was opened for signature on July 1, 1985 and entered into force on January 1, 1992. So far, fourteen states have ratified the Convention. For a discussion of the civilian experience of ratification of the Convention, *see* Michele Graziadei, *Recognition of Common Law Trusts in Civil Law Jurisdictions under the Hague Trusts Convention with Particular Regard to the Italian Experience*, *in* Re-Imagining the Trust: Trusts in Civil Law (Lionel Smith ed., 2012).

[4] Hague Trusts Convention, Preamble.

> The term "trust" refers to the legal relationships created – inter vivos or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.[5]

Insofar as the Hague Trusts Convention provides benchmarks for the creation of trust norms on the national level in multiple states, it is a basis for transnational legal ordering of the modern trust law. Vertical ordering takes place to the extent that trust norms created by the Hague Trusts Convention trickle down into national legal systems and gain normative force comparable to national law. Because, however, this sort of vertical ordering has played a comparatively minor role,[6] this chapter focuses upon horizontal interactions that have shaped trust law as a transnational body of law.

7.2 TRUST LAW AS A TRANSNATIONAL BODY OF LAW: OFFSHORE INNOVATIONS AND ONSHORE MODIFICATIONS

7.2.1 *The Rise of Transnational Trusts*

The interplay of trust norms at the transnational, national, and local levels to become a substantive body of transnational trust law is evident in the rise of transnational trusts.[7] Who are the key actors driving the processes of transnational legal ordering in this context? And what innovations and modifications of the trust have been brought about as a result?

In the 1960s and 1970s, offshore financial centers began to emerge. Financial institutions in offshore financial centers engaged primarily in business with non-residents, and their services typically featured low taxation, light financial regulation, and banking secrecy. Over time, offshore financial centers were also used to provide asset management and protection services through offshore trusts to enable clients to minimize their tax liability, ring-fence their assets from onshore lawsuits, and avoid forced inheritance provisions in their home jurisdictions.[8]

Countries with small domestic financial sectors soon found the development of offshore financial and trusts businesses attractive, as they generated employment for the host economy and revenue for the government. Indeed, offshore trust

[5] Hague Trusts Convention, art. 2.

[6] The Hague Trusts Convention is in force in the following common law jurisdictions: Australia, Canada, Hong Kong, Malta, Cyprus, and the United Kingdom; as well as the following civil law jurisdictions: Italy, Liechtenstein, Luxembourg, Monaco, Netherlands, Panama, San Marino, and Switzerland. France and the United States have signed, but not ratified, the Convention.

[7] For a recent empirical study on the worldwide growth and transformation of trust practice, *see* Adam S. Hofri-Winogradow, *Trust Proliferation: A View from the Field*, 31 TRUST L. INT'L 152–82 (2017).

[8] International Monetary Fund, *Offshore Financial Centers: IMF Background Paper* (June 2020).

jurisdictions such as the Cayman Islands and the Channel Islands became heavily reliant on offshore trust business as a major source of both government revenues and economic activity. As more capital aiming to shield or hide assets by way of the offshore trust rushed in, jurisdictional competition for trust business intensified. A process of transnational legal ordering was underway, and this brought about further innovations of the trust. Examples include trust protectors, legislative enshrinement of settlor reserved powers, abolition of the rule against perpetuities, and legalization of noncharitable purpose trusts. The lucrative business opportunities drove other offshore jurisdictions, followed by onshore jurisdictions, to emulate these initiatives. In addition to the demand for innovation from clients and the supply of trust services by governments, trust law professionals (including lawyers and asset managers) were key actors in the horizontal competition between onshore and offshore jurisdictions. They often drove innovation through lobbying or otherwise advocating for legal changes in their jurisdictions. They would ascertain the needs of the potential clients, which might range from protecting assets from creditors, disgruntled beneficiaries or divorcing spouses, to maximizing control and management of the trust assets. They then worked with their local legislatures to introduce client-friendly trust or trust-like structures.[9]

In recent decades, the explosion of global tech entrepreneurship has increased demand for trust and wealth management services from a modern, younger clientele, who are more reluctant than previous generations to relinquish control over trust assets, which often comprise business empires that they are still actively managing or using as an investment vehicle. In order to compete for trust business, many offshore jurisdictions, alongside onshore wealth management centers such as Singapore and Hong Kong that provide sophisticated offshore trust services, have been eager to pioneer innovative developments to accommodate the desires of this new clientele. Among them are the pervasive use of objects and duty modification clauses in modern trusts.[10] These two emerging features not only challenge our traditional understanding of the trust, but also capture the recursive nature of the TLO process. Both defy our traditional understanding of the scope of the trustee's powers, discretion, and duties and, in turn, the dynamics of the tripartite relationship within a trust.

7.2.2 *Objects of Discretionary Trusts*

Trusts in offshore jurisdictions and wealth management centers operate very differently from those in onshore jurisdictions. Traditionally, the beneficiary principle lies at the core of the trust, and its primary rationale is to hold trustees to account. Thus,

[9] *Id.*

[10] *See* Rebecca Lee, *The Evolution of the Modern International Trust: Developments and Challenges*, 103 Iowa L. Rev. 2069, 2076–81 (2018).

traditionally at least, a trust is enforceable only by the beneficiaries, who enjoy an equitable proprietary interest in the trust property.[11] However, to enable a trustee to respond to unforeseen circumstances, modern trusts are invariably settled as discretionary trusts. Not only are trustees given discretion; they are also given, at least in theory,[12] wide dispositive discretion to distribute the trust assets (including, for example, the power to decide whom to pay, how much, and when). In addition to empowering trustees to add or remove beneficiaries, many discretionary trusts now have no beneficiary but merely objects to whom a trustee may appoint capital or income. Although objects of powers are not a new feature in traditional trusts, they have become a defining feature of modern discretionary trusts.[13] Objects of discretionary powers are not beneficiaries in the strict sense: Unless the trustee makes an appointment to them, objects have no right to the trust property, no standing to sue, no interest in the trust capital, no right to a definable part of the trust income, and no transmissible right. Instead, an object has only a limited right to be considered as a potential recipient of a benefit by the trustee and, as a corollary, through the trustee's proper exercise of his or her power. Given the limited rights of objects, as a conceptual matter, they cannot sensibly be treated as beneficiaries, and their presence does not satisfy the traditional beneficiary principle. As a result, trust professionals usually include a default beneficiary clause in a discretionary trust to satisfy the beneficiary principle, even though no one expects that the default beneficiary will receive any trust property. The trust property will almost invariably be distributed pursuant to the wide dispositive discretion of the trustee rather than via the default clause naming the residuary or default beneficiaries. As a result, the trustee's wide dispositive powers effectively displace the beneficial interests of the sole (default) beneficiaries, and they are thus an affront to the trust concept.

Professor Smith describes these highly discretionary trusts pejoratively as "massively discretionary trusts."[14] Because the primary rationale of the beneficiary principle is to hold trustees to account, massively discretionary trusts do not satisfy that principle and distort the trust concept. According to Professor Smith, these law reforms driven by clients and jurisdictional competition are necessarily shortsighted.[15] Why? As a doctrinal matter, not only may onshore courts hold that a

[11] Lynton Tucker et al., Lewin on Trusts ¶ 1-005 (20th ed 2020).

[12] In practice, settlors (the creators of trusts) express nonbinding requests through letters of wishes to trustees concerning how the latter's wide dispositive discretion is to be exercised: *See* Australia: Hartigan Nominees Pty Ltd v. Rydge (1992) 29 NSWLR 405, 408; England: Breakspear v. Ackland [2008] EWHC 220, [5]; Jersey: In re Rabaiotti 1989 Settlement [2000] JLR 173, 173–74.

[13] Peter Turner, *The Entitlements of Objects as Defining Features of Discretionary Trusts*, *in* Trusts and Modern Wealth Management 242–76 (Richard Nolan et al. eds., 2018).

[14] Lionel Smith, *Massively Discretionary Trusts*, 70 CLP 17 (2017).

[15] Smith, *supra* note 2, at 2174.

resulting trust can arise in favor of the settlor from the moment of the trust's inception, but beneficiaries may also collapse the trust.[16]

Nonetheless, even onshore jurisdictions have begun to grapple with the prevalence of objects in modern trusts alongside other offshore innovations. For example, in *Schmidt v. Rosewood*,[17] Lord Walker held in relation to two trusts set up in the Isle of Man with distributions to be made by the exercise of powers of appointment, rather than through interests in discretionary trusts, that no distinction exists between discretionary trusts and powers of appointment for the purpose of seeking the disclosure of information from the courts. Accordingly, a beneficiary under a discretionary trust and an object entitled to benefit under a power are equally able to seek protection in respect of the rights they have. The Privy Council affirmed that its right and duty to intervene in the administration of a trust are based on its inherent jurisdiction to do so. Professor Smith criticizes *Schmidt* for downgrading the rights of fixed beneficiaries by denying them an entitlement as of a right to see trust accounts, thereby eradicating the irreducible core of the trust. Not everyone agrees, however. Some scholars have defended such trusts on the ground that objects of discretionary powers should be treated as beneficiaries for the purposes of the beneficiary principle. Such objects have a proprietary right that applies against third parties; they also have standing to apply to the courts to protect their interests.[18]

The divergence of views highlights the difficulty of finding the conceptual limits of the trust. It is now well established in English law that there is an "irreducible core" of the obligations owed by the trustee, which include the duty to perform the trust honestly and in good faith for the benefit of beneficiaries, who have a correlative right to hold trustees to account for the performance of their duties.[19] That duty was considered by Millett LJ in *Armitage v. Nurse* as the "minimum necessary to give substance to . . . trusts," which is "fundamental to the concept of a trust."[20]

This principle creates tension between legal concepts and on-the-ground legal practice – and thus the possibility of recursive development of trust norms. Applying the principle of an irreducible core of trust duties to a "massively discretionary

[16] Smith, *supra* note 14, at 18.

[17] Schmidt v. Rosewood Trust Ltd (Isle of Man) [2003] UKPC 26; [2003] 2 AC 709.

[18] Charles Holbech, *Discretionary Objects and the Beneficiary Principle*, 27 T&T 321, 324 (2021); *see also* Turner, *supra* note 13, at 242–76.

[19] Armitage v. Nurse [1998] Ch 241 held that a trustee can validly exempt liability for a breach of trust unless it is a dishonest breach of trust. It thus follows that it is also permissible for an exemption clause to exempt a trustee, whether lay or professional, from liability for a loss arising from negligence: Armitage v. Nurse at 253H-254A; *see also* Lee v. Torrey [2015] NZHC 2135 at [127]. But even though such clauses are capable of excluding a trustee's liability for a breach of trust in a wide array of circumstances, they must not infringe the "irreducible core" of the obligations owed by the trustee.

[20] Armitage v. Nurse [1998] Ch 241 at 253. *See also* Adam Hofri-Winogradow, *The Irreducible Cores of Trustee Obligations*, 139 LQR 311 (2023); Alexander Trukhtanov, *The Irreducible Core of Trust Obligations*, 123 LQR 342, 344 (2007); David Hayton, *The Irreducible Core Content of Trusteeship*, *in* Trends in Contemporary Trust Law 47–55 (A. J. Oakley ed., 1996).

trust"[21] leads to the conclusion that a trustee's core duty to perform the trust honestly and in good faith for the benefit of the beneficiaries should not be curtailed. Yet, in trusts with objects and a default beneficiary, there is no beneficiary to enforce the trust. Thus, if mere objects exist (along with a default beneficiary who is unlikely to benefit in reality), it can hardly be said that the trustee still owes any meaningful irreducible core duty in order for the trust to exist. Although Professor Smith suggests that onshore courts will not accept such structures,[22] on-the-ground practice suggests otherwise. As Professor Tang has argued, because these global trusts are the norm rather than the exception in practice, it is likely that judges in jurisdictions hosting international wealth management centers will accommodate them via a liberal interpretation of trust jurisprudence rather than take a strict view of trust law that would undermine the trust industry in the jurisdiction concerned.[23] Indeed, such a pragmatic judicial attitude probably prevailed in Hong Kong in *Zhang v. DBS*, a case on duty modification clauses to which we now turn.

7.2.3 *Duty Modification Clauses*

First, some background is necessary. The trust assets of a modern trust often comprise companies owned by the settlor-entrepreneur. *Bartlett v. Barclays Bank*[24] held that where a trust whose sole asset is a controlling shareholding in a company, the trustee has a consequent duty to keep him or herself informed of the company's affairs, and to use his or her powers to obtain information and decide whether to intervene. As a result, the trustee-shareholder cannot sit passively and leave the running of the company wholly to the directors but instead is under a duty to supervise the management of the company.

The rule of *Bartlett* creates several problems for trust practice. First, contrary to traditional practice, modern settlors often wish to retain active control over the management and investment activities of their company even after they have transferred it to a trust administered by a third-party trustee. Second, the trustee may not have the expertise necessary successfully to manage the business of the underlying holding company. Besides, the trustee's duty under *Bartlett* may require him or her to supervise and intervene in the company's business, such as by preventing it from entering into an inappropriately risky venture.[25] Yet, the settlor may prefer the controlled underlying company to pursue an aggressive speculative

[21] Smith, *supra* note 14, at 17.
[22] *Id.* at 18.
[23] Hang Wu Tang, *From Waqf, Ancestor Worship to the Rise of the Global Trust: A History of the Use of the Trust as a Vehicle for Wealth Transfer in Singapore*, 103 Iowa L. Rev. 2263, 2289–90 (2018).
[24] Bartlett v. Barclays Bank [1980] 2 WLR 430.
[25] Zhang Hong Li v. DBS Bank (Hong Kong) Ltd [2019] HKCFA 45; (2019) 22 HKCFAR 392; Tucker et al., *supra* note 11, at 34-056–34-058.

investment policy, and the trustee may find him or herself in a vulnerable position if the *Bartlett* duty is not modified.

In modern trusts, therefore, anti-*Bartlett* clauses are frequently inserted to enable trustees to accept trusteeships while delimiting their duty to inquire into or interfere in the conduct of the company. Anti-*Bartlett* clauses stipulate that the trustee need not be actively engaged – or involved at all – in corporate management. Such provisions, in turn, separate the function of trust administration from the function of corporate management and, in turn, ensure that the settlor retains control over the company held in trust. They also negate a trustee's duty to supervise or intervene in investments by the trust in an underlying holding company unless he or she is guilty of dishonesty or of failing to intervene in circumstances where he or she had actual knowledge of dishonesty in the company's management.

A question remains as to whether the trustee is still subject to a "residual, high-level supervisory obligation"[26] to oversee the underlying company's operation despite the presence of a clause that comprehensively excludes his or her duty to supervise, interfere, or make inquiries. The Hong Kong Court of Final Appeal in *Zhang v. DBS*[27] rejected the suggestion of any such high-level supervisory obligation. It unanimously held that the anti-*Bartlett* clauses in the relevant trust deed were valid and that there was no residual obligation or high-level supervisory duty of the trustee that might otherwise contradict or override such express clauses.[28] The effect of the anti-*Bartlett* clauses in *Zhang v. DBS* was to "restrict the power of the trustees to interfere in the conduct or management of [the company's] investment business," with the court holding that the powers to intervene "were, on their true construction, unavailable to the trustees."[29] DBS Trustee's concomitant duty to ensure that the company was managed prudently was therefore also excluded. Thus, the only obligation that can be said to be "residual" is the obligation to act in cases involving actual knowledge of dishonesty not covered by anti-*Bartlett* clauses.[30] Thus, the decision in *Zhang v. DBS* suggests that there is no public policy that

[26] Zhang Hong Li v. DBS Bank (Hong Kong) Ltd [2019] HKCFA 45; (2019) 22 HKCFAR 392 at [39]. *See also* Appleby Corporate Services v. Citco Trustees 17 ITELR 413 for a discussion of the trustee's duty of supervision.

[27] Zhang Hong Li v. DBS Bank (Hong Kong) Ltd [2019] HKCFA 45; (2019) 22 HKCFAR 392. In that case, Zhang and his wife Ji had established a family trust governed by Jersey law with themselves and their minor children as beneficiaries. The only trust asset was the sole share of their private investment company that had been set up to make high-risk investments. The trust deed contained extensive anti-*Bartlett* clauses that restricted the trustee's duties. For example, the deed stipulated that the trustee was under no duty to interfere with the management or conduct of the business of the investment company, but was to leave it to the directors and Ji, and was under no duty to supervise them unless it had actual acknowledge of dishonesty.

[28] Zhang Hong Li v. DBS Bank (Hong Kong) Ltd [2019] HKCFA 45; (2019) 22 HKCFAR 392 at [45].

[29] *Id.* at [79].

[30] *Id.* at [61]–[63]. On the facts, there was no actual knowledge of dishonesty that required DBS Trustee to interfere.

requires the recognition of such a supervisory duty in the trust instrument and that its existence, if any, is a matter of the instrument's construction.[31]

Zhang v. DBS is likely to be highly persuasive in offshore and Anglo-common law jurisdictions. It is, after all, the first case examining the effectiveness of an anti-*Bartlett* clause at a final appellate level, and Lord Neuberger, former President of the Supreme Court of the United Kingdom, sat as a nonpermanent judge in the case. Moreover, trustees will likely welcome the decision, as it relieves them of a high-level supervisory duty to underlying company investments so long as the trust instrument expressly removes such duty. For their part, settlors rely on such clauses to restrain trustees from interfering in or obtaining information on the affairs of the underlying company. Thus, while scholars have questioned whether trustees can or should be completely exonerated from their duty/power to interfere in the management of a trust-owned company by anti-*Bartlett* clauses,[32] there are powerful market participants who will continue to press for precisely that norm.

Underneath the exclusion of duties of trustees is the persistent settlor control that is uninterrupted by the transfer of trust property to the trustee. Once the formal, conceptual layer of the trustee-beneficiary relationship in modern trusts is stripped away,[33] a substantive, commercial relationship between a client and a private banker/professional trustee is revealed. Given that relationship and the desire for persistent settlor control, it is pertinent to ask about the limits on [of] offshore discretionary trusts, the extent of influence that a settlor can retain consistent with prevailing conceptions of trust law, and, correspondingly, the extent of the duties otherwise owed by trustees that can be curtailed.[34] Professor Barnett, in examining offshore trusts in the South Pacific, even questions how far the concept of the trust can be stretched before it breaks.[35] Anti-*Bartlett* clauses, in effect, reserve to the settlor (or some third party) an ability to, inter alia, direct the trustee in the trust investments, alter the nature of the obligations that the trustee owes, and reduce the obligations otherwise imposed on him or her. Such relational dynamics in the modern trust may threaten the irreducible core aspect of the trust.[36] But because such clauses remove the trustee's duty of care, which is not part of the trustee's irreducible core duty, they may be reconcilable with the traditional conception of

[31] Tucker et al., *supra* note 11, at [34-059] subpara. 7.

[32] Underhill and Hayton Law of Trusts and Trustees [51.55] (Charles Mitchell et al. eds., LexisNexis Butterworths 2022).

[33] For additional discussion, *see* Adam Hofri-Winogradow, *The Stripping of the Trust: A Study in Legal Evolution*, 65 U. Toronto L.J. 1 (2015).

[34] *See, e.g.*, David Russell & Toby Graham, *The Limits of Discretionary Trusts: Have Powers of Addition and Removal Been Taken a Step Too Far?*, 27 T&T 280 (2021); Katy Barnett, *Offshore Trusts in the South Pacific: How Far Can the Concept of the Trust Be Stretched before It Breaks?*, *in* 1 Asia-Pacific Trusts Law: Theory and Practice in Context 373 (Ying Khai Liew & Matthew Harding eds., 2021).

[35] *Id.*

[36] *See* Rebecca Lee & Man Yip, *Exclusion of Duty and the Irreducible Core Content of Trusteeship*, 10 J. Equity 131, 141–49 (2020).

the trust. Nonetheless, by tailoring the trust deed at the outset in such a way that the trustees have to comply with investment-related directions given by the settlor, the trustees' investment powers are effectively removed. It is only in the absence of such prescribed directions that a trustee may act as he or she sees fit in accordance with the terms of the trust deed and his or her fiduciary obligations.

7.2.4 *Implications*

The proliferation of objects and duty modification clauses are but some examples of the significant changes trust law has undergone at a phenomenal speed in the past few decades. Not only have the traditional rules been liberalized, the making of trust law norms has also become transnational. Despite our conception of the trust as a quintessential English concept that emerged in medieval England, the modern trust is embedded in a transnational context. The trust has spread transnationally, and innovations and transformations have been introduced. The innovations and modifications demonstrate that transnational trusts are a new category of their own to be scrutinized from multi-jurisdictional angles. Modern trust research therefore has begun to shift from a predominantly national context to one that emphasizes the interaction between transnational, national, and local lawmaking. Professor Lupoi crafts a new label of "industrial trusts" for these trusts:

> Nowadays trustees in the offshore version of trusts (but not only) are companies the business of which is to serve as trustees; each company is the trustee of thousands of trusts (at times, I am told, of tens of thousands). I shall refer to those trusts as "industrial trusts." It is difficult to understand how the trustee of an industrial trust could fulfil his fiduciary obligations or make use of his fiduciary powers in accordance with the rules laid down with reference to the trustees d'antan. It is also difficult to understand how much it would cost to have such a trustee keep trace of the trust beneficiaries, of their needs and of their desires, so as to be in a position to act "in the interest of the beneficiaries" as the standard jargon would require him to do.[37]

Trust norms were created centuries ago. The modernization and transnationalization of trusts signify the eventual decline in the popularity of the traditional trust and corresponding rise of the transnational trust. Over the centuries, the reasons for setting up a trust have also evolved from property-holding to succession planning and asset protection from creditors and a potential divorce. There is no a priori reason to exclude these goals from the modern transnational trust and to treat such trusts as devices for tax evasion. Nonetheless, given the aforementioned developments, the transnational trust is transforming what it means to be a trustee. A trustee is a custodian, not an active manager with equitable obligations to beneficiaries.

[37] Maurizio Lupoi, *Trusts and Their Comparative Understanding*, 27 T&T 286, 293–94 (2021).

7.3 TRUST LAW AS A TRANSNATIONAL BODY OF LAW: CIVIL LAW TRUSTS IN EAST ASIA

The transplantation of the common law trust to civil law jurisdictions first took place in Europe and then in East Asia. Following national recognition of the Hague Trusts Convention by countries such as Italy and the Netherlands, the trust as a legal institution has gained ground in other civil law countries in Europe.[38] In East Asia, Japan historically led the way in introducing the Western legal system and ideas to the region.[39] Many civil law jurisdictions in East Asia have introduced the trust by legislation.[40] Starting in Japan, the trust as a legal institution spread via South Korea and Taiwan to China.[41] As the Japanese economy flourished after the Second World War, trust banks emerged to focus mainly on commercial trust activities, such as pension trusts or loan trusts to raise funds for infrastructure projects. The Japanese experience in the reception of the trust inspired South Korea, Taiwan, and China, and trust laws were enacted to regulate trust and investment companies. Most of the theoretical obstacles to the reception of the trust in these civil law jurisdictions stem from the perceived incompatibility of the trust with civil law property concepts. These include the absolute nature of ownership, the doctrine of *numerus clausus*, the absence of certain key trust components in indigenous law (such as the fiduciary duty of loyalty), and the existence of different remedial rules in civil law jurisdictions, to name but a few. While it is easy to lift specific rules pertaining to the trust concept and codify it in a trust statute, the presence of the aforementioned theoretical obstacles made the transplantation of the system of laws pertaining to the trust a mammoth task. A process of transnationalization has emerged regarding the conceptual foundation of the trust, the duties requiring a trustee's loyal behavior, and remedies for breaches of trust. What follows is an examination of how these trust norms have settled and become aligned at the transnational level in the East Asian jurisdictions of Japan, South Korea, Taiwan, and China.[42]

[38] *See, e.g.*, M. J. De Waal, *In Search of a Model for the Introduction of the Trust into a Civilian Context*, 12 STELLENBOSCH L. REV. 63 (2001); H. L. E. Verhagen, *Trusts in the Civil Law: Making Use of the Experience of "Mixed" Jurisdictions*, 3 EUROPEAN REV. PRIVATE L. 477, 488 (2000).

[39] Japan enacted the Trust Act in 1922 (Law No. 512 of 1922). *See also* Masayuki Tamaruya, Chapter 8 of this volume, suggesting that Japan has played a positive role in promoting transnational ordering, making informed suggestions for potential domestic reform.

[40] *See also* Chapter 2 of this volume.

[41] *See* Lusina Ho & Rebecca Lee, *Reception of the Trust in Asia: A Historical Perspective*, *in* TRUST LAW IN ASIAN CIVIL LAW JURISDICTIONS: A COMPARATIVE ANALYSIS ch. 2 (Lusina Ho & Rebecca Lee eds., 2013).

[42] *See* Lusina Ho & Rebecca Lee, *Emerging Principles in Asian Trust Law*, *in* Ho & Lee, *supra* note 41, ch. 13. The East Asian trust laws discussed in this chapter include: Shintaku-hō [Trust Act], Law No. 108 of 2006 (Japan); Sintagbeob [Trust Act], Act. No. 10924, Jul. 25, 2011 (South Korea); Xintuofa [Trust Law], Law of Jan. 26, 1996; amended Dec. 30, 2009 (Taiwan);

7.3.1 *Conceptual Foundation of the Trust*

The laws of the aforementioned East Asian countries all have strong historical roots in the German civil code (*Bürgerliches Gesetzbuch*). As a consequence, they not only lack equity courts, but also are historically situated within a legal framework built around the concept of single ownership.[43] The *numerus clausus* principle of property rights adopted in many civil law jurisdictions means that only absolute ownership can be vested in a civilian trustee, which runs counter to the core element of the trust architecture, namely the dual ownership of trust property.

The duality of ownership at common law explains the segregation of trust property: The trustee has legal ownership of the property, whereas the beneficiary has equitable ownership. Such equitable ownership means that the beneficiary has a right over the trust assets that is enforceable against the whole world except a bona fide purchaser of a legal estate for value without notice (known as "equity's darling"). The beneficiary's equitable ownership of the trust property also provides the traditional justification for the immunity of trust property. In an English trust, trust assets (and their traceable products) are segregated from the trustee's own assets, and hence are immune from any claims of the trustee's personal creditors, heirs, and spouse (unless that party is equity's darling). Such segregation is necessary for the operation of the trust and protection of the beneficiary's rights. Otherwise, the trust property could be affected by trustee liability incurred for matters unrelated to the trust.[44]

The reception of the trust in East Asia has prompted an inquiry into whether the absence of equitable jurisdiction will hinder the reception of the trust, and, in turn, a rethinking of the conceptual foundation of the trust in both civil and common law jurisdictions. The independence and segregation of trust assets in these East Asian jurisdictions are achieved by way of statutory provisions stipulating that trust assets do not form part of the trustee's bankruptcy estate[45] and are immune from the claims of the trustee's heirs, spouse, and personal creditors.[46] As a practical matter, these statutory solutions address the problem of lack of an equity jurisdiction and dual ownership. From a conceptual perspective, statutes conferring immunity to the trust assets can be justified through the notion of patrimony in civil law, which provides

Xintuofa [Trust Law], Order no. 50 of the President of PRC of 2001, Oct. 1, 2001 (China). For ease of reference, the Trust Act of Japan 2006, Trust Act of Korea 2011, Trust Law of Taiwan 2009, and Trust Law of China 2001 are referred to as the Japanese Trust Law, Korean Trust Act, Taiwanese Trust Law, and Chinese Trust Law, respectively, in this chapter.

[43] Chapter 2 of this volume.

[44] *See* Maurizio Lupoi, Trusts: A Comparative Study 199 (2000).

[45] *See* Japanese Trust Act, art. 25(1); Taiwanese Trust Law, art. 11; and Chinese Trust Law, art. 16.

[46] *See*, *e.g.*, Japanese Trust Act, art. 25(1); Korean Trust Act, arts. 24 and 25; Taiwanese Trust Law, arts. 10 and 11; and Chinese Trust Law, arts. 16 and 17.

the conceptual foundation of the civil law trust.[47] In a trust arrangement, the trustee has two distinct patrimonies: the trust patrimony (comprising the trust assets and liabilities) and his or her own private patrimony (comprising the trustee's own assets and liabilities). Each patrimony has its own creditors, and thus the trustee's personal creditors can claim only the trustee's private patrimony, while the trust creditors (beneficiaries) make claims upon the trustee's trust patrimony.[48] Beneficiaries have personal claims against the trust patrimony, which is immune from the trustee's personal creditors (the latter having access only to the trustee's private patrimony). Beneficiaries do not have "proprietary rights" over the trust patrimony.

This civil law conceptualization of the trust, prompted by the reception of common law ideas, has recursively prompted common law jurisdictions to rethink the nature of the beneficiary's right. Some scholars have suggested that even in the English trust, it is not necessary to give the beneficiary any in rem right in the trust property.[49] All that the beneficiary has is a claim against the segregated trust fund (or trust patrimony), which is not available to the spouse, heirs, or personal creditors of the trustee.[50] Consequently, the creation of a trust would not violate the *numerus clausus* principle of property rights adopted in many civil law jurisdictions.

7.3.2 *Fiduciary Duty of Loyalty of the Trustee*

Even though the trust is a creature born and bred in common law, the concept of the trustee's fiduciary duty of loyalty demonstrates that a transnational trust law framework can encompass both civil law and common law jurisdictions. In common law jurisdictions, the significance of the concept of fiduciary duty can be seen from the US Restatement Third of Trusts, which defines the trust as "a fiduciary relationship with respect to property [that] subject[s] the trustee to duties to deal with it for the benefit of charity or for one or more persons."[51] Thus, it has been

[47] Kenneth Reid, *Conceptualising the Chinese Trust: Some Thoughts from Europe*, *in* Towards a Chinese Civil Code: Comparative and Historical Perspectives 209 (Chen Lei & C.H. van Rhee eds., 2012); Kenneth Reid, *Patrimony Not Equity: The Trust in Scotland*, 8 European Rev. Private L. 427 (2000); Rebecca Lee, *Conceptualising the Chinese Trust*, 58 Int'l & Comp. L.Q. 655 (2009); Kai Lyu, *Re-Clarifying China's Trust Law: Characteristics and New Conceptual Basis*, 36 Loy. L.A. Int'l & Comp. L. Rev. 447 (2015).

[48] Thus, there is a duty to segregate and administer trust property from the trustee's own property: *see, e.g.*, Japanese Trust Act, art. 34(1); Korean Trust Act, art. 4(2); Taiwanese Trust Law, art. 24.

[49] *See* Ben McFarlane & Robert Stevens, *The Nature of Equitable Property*, 4 J. Equity 1 (2010) for the view that the beneficiary's right is a right against the specific right of the trustee over the property, but not a property right itself. *Cf.* the traditional view that beneficiaries have equitable title to the trust property: James Penner, *The (True) Nature of a Beneficiary's Equitable Proprietary Interest under a Trust*, 27 Canadian Journal of Law & Jurisprudence 473 (2014).

[50] Verhagen, *supra* note 38, at 488.

[51] US Restatement of the Law (3d) of Trusts, § 2 (Am. Law Inst. 2003).

said that "a trust is the quintessential fiduciary relationship."[52] A trust implements the settlor's freedom of disposition: By making a transfer in trust rather than outright, a settlor ensures that the property will be managed and distributed in accordance with his or her wishes as expressed in the terms of the trust.

Fiduciary duties are the primary safeguard for beneficiaries in modern trust practice. Nonetheless, it has been said that transnational fiduciary law recognizes different shades of loyalty, and it remains contested whether the duty of care should be seen as a fiduciary duty.[53] East Asian civil law jurisdictions have incorporated the full range of duties typically seen in English law into their trust statutes, such as the duties to comply with the terms of the trust, to take care,[54] to act honestly and in good faith, to provide information to beneficiaries or interested parties, and to segregate the trust fund from the trustees' own assets or other assets held by them,[55] although the scope of these individual duties is sometimes narrower than in English law. Until recently, China, Japan, Taiwan, and South Korea had no open-ended standard establishing a (fiduciary) duty of loyalty in trust law.

In recent decades, some East Asian countries have introduced the duty of honesty and good faith. Even so, its scope is much narrower than in common law jurisdictions. In English law, the fiduciary no-profit or no-conflict rules are sufficiently wide to cover both the misuse of trust assets and the misuse of the trustee's position for personal profit where there is a conflict of interest. In some East Asian countries, however, in order to violate the fiduciary duty of honesty and good faith, the misuse of trust assets – as opposed to trust information – is necessary. For example, although both the Japanese Trust Act and Chinese Trust Law contain express *general* stipulations on fiduciary duty,[56] the examples of prohibited conflicts of interest in both statutes revolve around the abuse of trust property and self-dealing transactions.[57] The Taiwanese Trust Law does not even contain express stipulations on fiduciary duty, but only prohibitions on a trustee's entitlement to trust benefits and on converting trust property for his or her own use.[58] Thus, the civil law trusts in Japan, Taiwan, and China expressly prohibit only the use of trust assets; neither the making of personal profits for the trustee nor the making of profits out of the trust position or information is covered.

[52] Robert H. Sitkoff, *Fiduciary Principles in Trust Law*, *in* The Oxford Handbook of Fiduciary Law (Evan J. Criddle et al. eds., 2019).

[53] Bristol and West Building Society v. Mothew [1998] Ch 1, 18; Permanent Building Society (in liq) v. Wheeler (1994) 11 WAR 187.

[54] Japanese Trust Act, art. 29(2); Korean Trust Act, art. 32; Taiwanese Trust Law, art. 22; and Chinese Trust Law, art. 25.

[55] Japanese Trust Act, arts. 34 and 36–39; Korean Trust Act, arts. 37 and 39; Taiwanese Trust Law, arts. 24 and 31; and Chinese Trust Law, arts. 20, 29, 33 and 49.

[56] *See* Japanese Trust Act, art. 30 and Chinese Trust Law, art. 25.

[57] *See* Japanese Trust Act, art. 31 and Chinese Trust Law, arts. 26–28.

[58] Taiwanese Trust Law, arts. 34 and art. 35.

A couple of observations may be made. First, even though there are functional equivalents of the duty of loyalty in the respective trust laws of East Asian countries, the content and extent of those equivalents await further clarification in comparison with their common law counterparts. In particular, Western conceptions of loyalty may be understood differently from the status-based conceptions of loyalty to family elders and authority in most East Asian civil law jurisdictions, which display unique Asian dynamics in the development of fiduciary norms.[59] This observation reflects transnational legal ordering as a recursive process and is consistent with Halliday and Shaffer's account that the development of TLOs is dynamic, involving interactions among international, transnational, national, and local actors. Second, the transnationalization of trusts has laid a foundation for transnational fiduciary law as a field existing at the intersection of transnational law and fiduciary law,[60] thereby expanding both transnational law and fiduciary law by establishing new perspectives on both. This new field shows how transnational law can evolve out of national norms that cross borders and are implemented within local fields that may – or may not – differ in their substantive understandings of loyalty and good faith or their institutional frameworks for remedying breaches of these norms.

7.3.3 *Remedies for Breach of Trust*

This section first highlights two major remedial differences between Anglo-common law approaches and approaches in East Asia. It then discusses how one may think about those differences from the perspective of TLO theory. Two notable differences from the Anglo-common law approach can be discerned, namely the scope of disgorgement remedy and the availability of the constructive trust. Where a trustee breaches his or her duties, English trusts generally provide for the disgorgement of profits made from the breach,[61] in addition to compensation for damages arising from the breach. To invoke this remedy, it is irrelevant that the beneficiary has suffered no loss from the breach or may have even profited from it.[62] There is some Anglo-Australian authority suggesting that it is not necessary to prove that, but for the

[59] In the context of Japan, *see* Masayuki Tamaruya, *Japanese Law and the Global Diffusion of Trust and Fiduciary Law*, 103 Iowa L. Rev. 2229 (2018) and Chapter 8 of this volume.

[60] Tamar Frankel, *Transnational Fiduciary Law*, 5 UCI J. Int'l, Transnat'l, & Comp. L. 15 (2020).

[61] Regal (Hastings) Ltd v. Gulliver [1942] 1 All ER 378. In fact, traditional English principles go further to suggest that the trustee is liable to hold the profit and assets purchased with bribes and secret commissions on (constructive) trust for the beneficiaries: AG for Hong Kong v. Reid [1994] 1 AC 324; FHR European Ventures LLP v. Cedar Capital Partners LLC [2014] UKSC 45, overturning Lister & Co. v. Stubbs (1890) LR 45 Ch D 1.

[62] Regal (Hastings) Ltd v. Gulliver [1942] 1 All ER 378.

breach, the trustee would not have made the profit concerned, although the position remains unsettled.[63]

In civil law trusts in East Asia, trustees are liable primarily through a compensatory remedy. The Japanese Trust Act stipulates only the remedy of rescission in the event that a trustee has breached his or her duty of loyalty, with no mention made of the disgorgement remedy.[64] Even when the disgorgement remedy is available in other jurisdictions, it is fairly limited in scope. For example, the Taiwanese Trust Law provides for a duty to disgorge profits to the trust fund where a trustee has converted trust property for his or her own use, but only on the condition that the trust property has suffered a loss.[65] The Chinese Trust Law also contains a disgorgement remedy, but applies it only to profits obtained in breach of trust (by misuse of trust assets), not to other breaches (e.g., converting trust property into the trustee's property or self-dealing transactions). The most recently revised Korean Trust Act also added a disgorgement remedy, which, unlike the Taiwanese provision, allows for the disgorgement of profits obtained from a breach of the trustee's duty of loyalty even though the trust property suffers no loss.[66]

Another notable difference from English common law is the availability of constructive trusts and proprietary claims against trust assets and their substitutions. It is well established in English law that, first, the trust fund includes the original settled sum and all assets representing it from time to time, whether derived lawfully or unlawfully. Second, as long as the trust assets are traceable into exchange products (substitutions), beneficiaries can assert a proprietary claim in the form of a constructive trust against assets[67] held in the hands of any recipient except a bona fide purchaser without notice. Thus, if a trustee breaches a trust and transfers property to a third party, the beneficiary can invoke the equitable tracing process and plaintiff-friendly tracing rules to identify the value of an original asset in a new, substituted asset even though the property has passed through several hands. These tracing rules often include artificial presumptions in favor of the beneficiaries, such as presumptions against the wrongdoing trustee when trust property is mixed with

[63] England: Murad v. Al Saraj [2005] EWCA Civ 959; [2005] All ER (D) 503; Australia: Ancient Order of Foresters in Victoria Friendly Society Ltd v. Lifeplan Australia Friendly Society Ltd [2018] HCA 43; (2018) 265 CLR 1, 88. The Hong Kong Court of Appeal in Kao, Lee & Yip v. Koo [2003] 3 HKLRD 296 has expressed the principle in a more circumspect manner, suggesting the need for reasonable approximation between the breach and the gain made, whereas the Singapore Court of Appeal in UVJ v. UVH [2020] SGCA 49 recently affirmed the requirement of but-for causation. *See also* Matthew Conaglen, *Identifying the Profits for Which a Fiduciary Must Account*, 79(1) Cambridge L.J., 38 (2020).

[64] Japanese Trust Act, art. 31(6) and (7).

[65] Taiwanese Trust Law, art. 35(3).

[66] Korean Trust Act, art. 43(3).

[67] The beneficiary can assert his or her beneficial title over the substituted trust asset by way of a constructive trust: Foskett v. McKeown [2001] 1 AC 102 at 127. Needless to say, he or she may also bring a personal action to require the trustee to restore the trust fund.

the trustee's own property, in order to protect the beneficiaries.[68] Furthermore, the trust assets and their traceable products are also immune from the claims of the heirs, spouses, and creditors of the third-party transferees, who are also subject to duties to refrain from using those assets to meet their personal liabilities. Thus, the rights of beneficiaries under English trust law are enforceable against the whole world, with the exception of a bona fide purchaser for value without notice.

With respect to civil law trusts in East Asia, although the relevant statutory provisions stipulate that trust property includes substituted assets resulting from the trustee's lawful or unlawful conduct,[69] they do not contain the extensive tracing rules found in common law trusts. There are thus no rules of (equitable) tracing to resolve evidentiary ambiguities and allocate losses to defaulting trustees. Furthermore, there is no constructive trust on traceable assets, notwithstanding the presence of provisions on the liability of third parties. In other words, a constructive trust is not imposed on traceable assets currently in the hands of unauthorized third parties; there is only personal liability against knowing recipients of trust property (to compensate for a loss)[70] or a right to rescind the transaction.[71] Accordingly, if recipients become bankrupt, the trust property will be subject to the claims of their personal creditors.

What does the limited availability of disgorgement and constructive trust in East Asia tell us about the transnational legal ordering of trust law? First, one can see that the transnational processes of legal ordering of trust law are inflected by local and national understandings of remedial law. When the legal ordering of trust norms is viewed transnationally across both common law and civil law jurisdictions, the differences on the availability and scope of disgorgement from the Anglo-common law approach raise the question of whether the beneficiary's right to demand that the trustee disgorge profits obtained from a breach is a basic feature of the trust. It is probable that the disgorgement remedy serves only the purpose of providing an additional deterrence to breaches by removing trustees' temptation to engage in a breach. Without the disgorgement remedy, a beneficiary can still rely on the compensatory remedy, although it is less extensive. As to the more limited scope of rights against transferees in civil law jurisdictions in East Asia, this probably suggests that, unlike beneficiaries' personal rights against their transferees, the proprietary liability of transferees is not a necessary feature of the trust. It is probably

[68] For example, where a trustee mixes trust monies with his or her own, the rule in Re Hallett (1880) 13 Ch D 696 presumes that the trustee draws out his or her own monies first so that the beneficiary may claim the balance of the fund. However, if property is purchased from the mixed fund, and the remaining trust fund is then dissipated, the beneficiary can claim against the property: Re Oatway [1903] Ch 356. *See generally* LIONEL SMITH, THE LAW OF TRACING (1997).

[69] *See, e.g.*, Korean Trust Act, art. 27; Taiwanese Trust Law, art. 9(2); and Chinese Trust Law, arts. 14 and 26.

[70] Chinese Trust Law, art. 22.

[71] Korean Trust Act, art. 75(1); Japanese Trust Act, art. 27(1); Taiwanese Trust Law, art. 18(2).

a matter of policy whether to allocate the losses arising from a trustee's breach completely to heirs, spouses, and creditors of third-party transferees who are innocent of the breach. As a matter of policy, English law prefers the interests of beneficiaries over those of an innocent volunteer who receives the trust property, as well as those of innocent creditors, both of whom will be prejudiced by hidden proprietary rights raised against them, whereas East Asia civil law jurisdictions take the opposite view and prefer not to allocate the losses arising from the trustee's breach completely to this group of innocent third parties. Examining the trust law terrain across both common law and civil law jurisdictions thus illustrates the relevance of TLO theory because such an examination goes far beyond the traditional categorization of laws as civil versus common, or Asian versus Anglo-American, and shows how modern trust lawmaking is a transnational process.

Second, the remedial differences identified earlier also show that there are limits to the unification of trust law. The remedial approach in East Asia is to impose liability on defaulting trustees primarily through a compensatory remedy, whereas the disgorgement remedy and the availability of the proprietary constructive trust are the most important remedies in equity's armory in Anglo-common law. Whereas common law anchors its regulation of trusts in equity and property law, the basis of civil law's regulation of trusts is statutory. As trust law has spread in both common law and civil law jurisdictions, the story of East Asian civil law trusts reflects the idea of transnational legal ordering as a dynamic and interactive process. A common question that pertains to different features of the East Asian civil law trust is whether a single, unified theoretical approach to trusts would produce a better understanding of the institution. Significantly, transnationalization does not automatically lead to the uniformity or harmonization of trust law. The East Asian experience shows that it is difficult to unify trust law in light of the remedial differences between Anglo-common law approaches and approaches in East Asia, which reflect different local and national understandings of the basic features of the trust and how the trust should be regulated; rather, "transnational trust law" stands for an approach that seeks to reinterpret existing doctrines of trust law in light of the specific instances of trusts arising in transnational settings. The East Asian dynamic will continue to drive transformations in the future of transnational trust ordering.

7.4 CONCLUSION

This chapter uses TLO theory to explore the processes through which modern trust law has developed transnationally. It focuses on the horizontal interactions among onshore and offshore jurisdictions, and civil law and common law jurisdictions, as the driver of transnational legal ordering of trust law. Both offshore and onshore jurisdictions, as well as both common law and civil law jurisdictions, have developed rules to regulate the voluntary arrangement involving a settlor, trustee, and beneficiary that is known as the trust. The TLO concept as applied to trusts captures the

creation, diffusion, and modification of trust norms across national borders, and it fosters a deeper understanding of the nature of the trust and the process of law-making and application regarding trusts in a globalized world.

The modern transnational trust, whether offshore or onshore, is almost antithetical to our conventional understanding of the English trust wherein the settlor drops out of the picture and the trustee assumes equitable obligations to the beneficiaries, who have proprietary rights attached to the trust fund. The transnational dimension of the trust shows that the English trust is but one type of trust; it is definitely not the only acceptable rendition of the trust concept. Only some features of the trust constitute features that are minimally necessary for a civil law trust to exist and function. These observations suggest that regardless of their differences in traditions and technical approaches, from a functional and pragmatic perspective, the divide between onshore and offshore, and between common law and civil law, may be crossed. Nonetheless, given the varieties of the modern transnational trust, a single, unified theoretical approach to trusts is unlikely to produce a better understanding of the institution.