# Settlor's Retention of Powers in Civil Law Trusts

In the English trust, the centrality of the trustee-beneficiary relationship in defining the trust means that it is easy to see how the settlor, in spite of his role in providing the trust property and the goals of the trust, drops out of the picture after the formation of the trust, unless he expressly reserves power to himself within the trust structure.[1] The creation of a trust is often explained as the expression of the paramount autonomy of a property owner to use and dispose of property.[2] In such a configuration, it is easy to explain why the settlor has no continuing rights, as he is not an object of the trustee's duties.[3] Although the settlor's intention governs the architecture of the trust, and along with beneficiaries' consent, delineates permissible actions on the part of the trustee,[4] the settlor's intention can be overridden by the beneficiaries' property rights in some circumstances.[5] Thus, in English law one can explain the absence of a role for the settlor even without resorting to the practical difficulties, for example in taxation and insolvency protection, that are caused by failure to alienate property from the settlor.

This paper examines the role of the settlor in civil law trusts with reference to the Japanese and Chinese trusts as well as the French *fiducie*. Unlike the common law trust, which Donovan Waters describes as the "property model" in the sense that "it is the proprietary element that particularly catches attention";[6] the "obligational model" which characterises civilian trusts is based on an agreement between the settlor and the trustee.[7] What the basic distinction does not capture is the diversity of doctrinal structures within the obligation model: the Japanese trust, for example, provides a powerful proprietary remedy resembling rescission in the English sense,[8] whereas the French *fiducie* is strongly contractual, and trustee duties are owed to the settlor rather than the

[1] For recent judicial views on the settlor's retention of powers in common law trusts, see *Webb v Webb* [2020] UKPC 22, and a commentary by Sinéad Agnew, "The Reservation of Powers by Settlors: Intention and Illusion" (2021) 80 CLJ 18.

[2] Agnew and Simon Douglas, "Self-Declarations of Trust" (2019) 135 LQR 67, 87.

[3] Paul Matthews, "From Obligation to Property, and Back Again? The Future of the Non-Charitable Purpose Trust" in David Hayton (ed), *Extending the Boundaries of Trusts and Similar Ring-Fenced Funds* (Kluwer 2002) 225.

[4] Ying Khai Liew and Charles Mitchell, "Beneficiaries' Consent to Trustees' Unauthorised Acts" in Paul Davies, Simon Douglas and James Goudkamp (eds), *Defences in Equity* (Hart 2018).

[5] *Saunders v Vautier* (1841) 49 ER 282.

[6] Donovan Waters, "The Distinctive Characteristics of the Anglo-Saxon Trust" in STEP France (ed), *Trusts & fiducie: concurrent sou compléments? Actes du colloque tenu à Paris les 13 et 14 juin 2007* (Academy & Finance 2008) 33. This is notwithstanding a longstanding and prominent debate in English trusts law on whether the beneficiary's interest is proprietary or obligational in nature. See for example Ben McFarlane and Robert Stevens, "The Nature of Equitable Property" (2010) 4 J Eq 1, and Elena Christine Zaccaria, "The Nature of the Beneficiary's Right Under a Trust: Proprietary Right, Purely Personal Right or Right Against a Right?" (2019) 135 LQR 460.

[7] Waters (n 6) 33.

[8] Trust Act, Act No 62 of Taishō 11 (1922), art 31. For English-language overviews of the Japanese trust, see Ying-chieh Wu, "Trusts Reimagined: The Transplantation and Evolution of Trust Law in Northeast Asia" (2020) 20 Am J Comp L 1, and Masayuki Tamaruya, "Japanese Law and the Global Diffusion of Trust and Fiduciary Law" (2020) 34 Tru LI 35. To Wu, the functioning of trusteeship as an "office", the independence of the trust fund, and the existence of a purpose are common features to Northeast Asian trusts, and by extension to all trusts.

beneficiary.[9] In all obligational models, the settlor is usually the person charged with policing the performance of the trust.[10] While the precise designation of powers and duties to each part of the trust structure is a matter of institutional design,[11] it is submitted that unless the settlor is subjected to some form of fiduciary control, it would be meaningless to describe the institution as a trust comparable to the common law trust, because property would not have meaningfully departed the settlor's hands. The historical neglect of this question stems in part from the lack of taxation considerations in civilian trusts. Unlike the English trust, where the designation of property as remaining within the settlor's control may render the settlor liable for income tax on trust property, in civilian jurisdictions trust taxation lacks the sophistication of common law systems. Consequently, the pressures for a clarification of the roles of trusts parties, especially that of the settlor, have to come from the practical purposes which the trust is designed to achieve, including the goal of preventing the settlor's contract creditors from enforcing their claims against the trust.

At the risk of complicating matters at the outset, it is worth noting that the American trust, which many civilian trusts are based upon,[12] also emphasises the role of the settlor in its rejection of *Saunders v Vautier*.[13] Although in his comparison of English and US law on this question, Paul Matthews rejects the significance of this distinction for the nature of property rights in a trust,[14] the greater power of the settlor in civilian trusts requires further explanation. Given the doctrinal similarities between the civil law trust and the US trust and the predominance of commercial trusts in both locations,[15] the commonalities with the US trust cannot be ignored. From a European perspective, French jurist Claude Witz has pointed to a desire to emulate the English trust or to remain committed to the civilian basis of a *fiducia* contract as the primary internal difference between civilian trusts.[16] Witz's taxonomy is echoed in Quebec jurist Madeleine Cantin Cumyn's tripartite classification, in which the Japanese trust as well as the Scots trust belongs to the former, whereas the *fiducie* belongs to the latter, with the Quebec trust creating a watertight and "ownerless" patrimony constituting a distinct third group.[17] The Chinese trust arguably belongs to the first group, although its position is awkward not only in the sense that the settlor is subjected to

[9] C civ, art 2022. The weakness of the French *fiducie* is also discernible from the perspective of the beneficiary's rights. As jurist Camille de Lajarte explains, while the French beneficiary may have a personal right against the trustee under article 2026 where there is a breach of trustee duties, he has no claim whatsoever against third parties, even if the trustee has acted in bad faith. Lajarte, "La nature juridique des droits du bénéficiaire d'un contrat de fiducie" (2009) 60 RLDC 71, para 43.

[10] Waters (n 6) 33.

[11] Jessica Hudson and Mitchell, "Justificanda" (Property Law Connections, Oxford, June 2021) suggests that as the trust is above all a legal construct used by parties to achieve particular effects, jurisdictions can differ in their conceptualisation of trust rules, which in turn can be used to justify individual rules.

[12] As Masayuki Tamaruya explains, the wartime destruction of trust companies' client bases explains the profound influence of the American use of the trust as a form of banking after the Second World War. In France, the fear of the offshoring of French enterprises also motivated the introduction of the *fiducie*. Tamaruya (n 8) 44; François Barrière, "La reception du trust au travers de la fiducie" (PhD thesis, Université Panthéon-Assas Paris II 2001) 179.

[13] (n 5); *Claflin v Claflin*, 149 Mass 19, 20 NE 5454 (1889) prevents beneficiaries from collapsing a trust contrary to the settlor's intent.

[14] Matthews, "The Comparative Importance of the Rule in *Saunders v Vautier*" (2006) 122 LQR 266, 292.

[15] John Langbein, "The Secret Life of the Trust: The Trust as an Instrument of Commerce" (1997) 107 Yale LJ 165.

[16] Claude Witz, "Les caractères distinctifs de la fiducie" in STEP France (n 6) 65.

[17] Madeleine Cantin Cumyn, "La fiducie face au trust dans les rapports d'affaires" in Cumyn (ed), *La fiducie face au trust dans les rapports d'affaires* (Bruylat 1999) 16.

fewer controls, but also owing to the unusual problem of the lack of a clear requirement to transfer property from the settlor to the trustee.[18]

For illustrative purposes a "typical"[19] Japanese commercial trust is one where the settlor's primary goal is to benefit himself ("self-settled" trust, or *jieki shintaku*) through utilising the trustee's investment skills, and by drawing in investors through selling parts or all of the fund in smaller slices. He achieves this by entering into a trust contract (the trust instrument) with the trustee, and transfers property to the trustee in exchange for a beneficial interest. Usually he would assign the bulk of the interest to other parties, namely investors, as "senior" beneficial interests. Even if the settlor sells all of his beneficial interests, however, he remains a "residual" beneficiary given his entitlement to property at the end of the trust, should no senior beneficiary be identified.[20] Like in the US commercial trust, residual rights which are differentiated from primary beneficial interests per Article 182(2) are often retained by the settlor, in part because of the practical difficulties in assigning the residual interests for value,[21] which means that the settlor usually retains a residual entitlement to property even after he has assigned the entirety of the "senior" classes of beneficial interests.[22] Although such an arrangement is effectively an act of collateralised lending, it nonetheless directly utilises the trust structure in the sense that the beneficiary has a strong legal right over the property, including rights against third parties and insolvency protection against the settlor's creditors, even if he is not able to unilaterally terminate the trust to secure the underlying property. The Chinese trust shares with Japan an emphasis on the use of the trust as a security in loans, although the practice of "*gangxing duifu*" (rigid conversion) suggests that there are sharp departures from the fundamentals of trust relationships, which are well covered in the existing literature.[23] In France, the lead drafter of the *fiducie* Senator Philippe Marini has envisioned that the *fiducie* would serve a variety of commercial purposes with the goal of improving French law's competitiveness in a globalising world,[24] although doctrinal limitations such as trust creditors' access

[18] For a discussion of the serious doctrinal difficulties which the Chinese law poses, see Kenneth Reid, "Conceptualizing the Chinese Trust: Some Thoughts from Europe" in Lei Chen and CH van Rhee (eds), *Towards a Chinese Civil Code: Comparative and Historical Perspectives* (Martinus Nijhoff 2012).

[19] As Steven Schwarcz explains in relation to the US, the use of commercial trusts differs greatly according to its "type" and the commercial use to which the trust form is applied, which means the labels are often imprecise. Schwarcz identifies the primary uses of commercial trusts as special purpose vehicles, trusts for diversifying lending risk, and business trusts which are *de jure* legal entities. The last type of trusts does not exist in Japan. Steven Schwarcz, "Commercial Trusts as Business Organizations" (2003) 58 Bus. Law. 559, 564-569.

[20] Trust Act, Act No 108 of Heisei 18 (2006), art 182(2). As explained in Schwarcz (n 19) 565-566, the tiering of beneficial interests is also common in US commercial trusts used to diversify lending risks, where the bank as lender transfers loans and credit card balances it holds to a trust, and assigns beneficial interests in multiple classes to investors. In such an arrangement the bank retains a residual, or an inferior class of beneficial interest, which enables it to recoup remaining assets once the investors are repaid based on designated contractual terms.

[21] Takahashi Masahiko, *Shōkenka no hō to keizaigaku* ("The law of securitisation and economics") (NTT 2009) 237.

[22] The tiering of interests, which is common in the securitisation context, allows beneficial interests to be marketed to a wider range of investors, at the same time it enables the lender-settlor to manage the asset's exposure to risk. Because the transfer of the underlying asset to beneficiaries is incomplete, the lender-settlor is able to reclaim part or all of the underlying asset if he is able to meet the terms under which the senior beneficiaries acquired their beneficial interests. Kawakita Hidetaka and others, *Shōkenka: arata na shimei to risuku no kenshō* ("Securitisation: new mission and the validation of risk") (Kin'yū jijō zaisei jijō kenkyūkai 2012) 14-15.

[23] Lusina Ho, "Business Trusts in China: A Reality Check" (2020) 88 U Cin L Rev 767; Ruiqiao Zhang, "A Guide to the Chinese Legal Regime of Commercial Trusts" (2017) 23 Trusts Trustees 866.

[24] Philippe Marini, "Enfin la fiducie à la française" (2007) D 1347.

to the settlor's own funds suggest that the *fiducie*'s ability to perform these tasks may in fact be limited.

The continuing role of the civilian settlor can be analogised with the role played by a protector or enforcer in a typical offshore trust structure, which is an important discussion owing to the potentially destabilising role which the protector has in discussions on the "beneficiary principle".[25] As David Hayton notes, the most important features that distinguish trusts from an outright gift are the voluntary assumption of duties by trustees and the granting of enforcement rights to a party who can hold the trustee accountable, and it is not necessary for the protector to have a beneficial interest in the property.[26] In selecting a protector for such a purpose, there is no reason why the settlor himself should not serve in the role.[27] Thus, a settlor's retention of powers is logically permissible if he is able to enforce the trustee's duties without reducing the beneficiary's rights; for example one can consider whether the power should be conceptualised as a fiduciary power, or at least a power subjected to some form of control.[28] There is also the additional question of the relative importance of the settlor's intention vis-à-vis the beneficiary's property rights, where Japanese law adopts a similar position to many US states, which privileges the former over the beneficiary's *Saunders v Vautier* rights,[29] although American doctrine does not go as far as giving settlors a right to litigate against trustees to enforce his instructions. In French law, this question is largely moot, in the sense that the beneficiary only enjoys rights where these are specifically stated in the trust instrument, and cannot be said to enjoy real rights over the trust property until the *fiducie* is terminated.[30]

This paper is divided into four sections: the powers and duties of the settlor, the settlor's role in the constitution of the trust, the rationale for the settlor's role, and the consequences of a large and uncontrolled role of the settlor.

## Part I: Powers and Duties of the Settlor

In both common law and civilian trusts, the settlor is the party who initiates the trust, provides the trust property, and specifies trust objectives. However, whereas in English law the settlor drops out of the picture the moment a trust is created, this is not the case in civilian trusts. The question of whether the role of settlors should be rolled back, or whether they should be subjected to some sort of fiduciary duty is an important one, for it raises the question of whether a trust fund is genuinely independent from the settlor. Unlike in England, the absence of taxation incentives in the civilian context further highlights the importance of identifying reasons from within the trust structure to require a clear relinquishment or delineation of the settlor's powers and duties.[31]

[25] See Matthews (n 3); Lionel Smith, "Massively Discretionary Trusts" (2017) 70 CLP 17.
[26] Hayton, "Developing the Obligation Characteristic of the Trust" (2001) 117 LQR 96. See also more recent commentaries by Kelvin Low, "Non-Charitable Purpose Trusts: The Missing Right to Forego Enforcement" in Richard Nolan, Low and Tang Hang Wu (eds), *Trusts and Modern Wealth Management* (CUP 2018) and Smith, "Give the People What They Want? The Onshoring of the Offshore" (2018) 103 Low L Rev 2155.
[27] Hayton (n 26) 103.
[28] Ryan James Turner, "Is the Power to Appoint a Trustee a Fiduciary Power in the Hands of a Non-Fiduciary?" (2018) 32 Tru LI 163.
[29] In *Claflin* (n 13) 24, 456, the Massachusetts Supreme Judicial Court justified its decision on the basis that "the strict execution of the trust has not become impossible; the restriction upon the plaintiff's possession and control is…one that the testator had a right to make; … and we see no good reason why the intention of the testator should not be carried out."
[30] Lajarte (n 9) para 43.
[31] See n 119 below.

**Powers**

*Japan*

Unlike the English trust, the settlor has certain powers to preserve the purpose of the trust, and this makes it impossible for beneficiaries to take full ownership of the underlying trust property without the settlor's consent by terminating the trust. Per articles 149, 151, 155 and 159, the agreement of all trust parties is required for changes to trust terms. However, the settlor's consent is not required for the merging or division of trust property where the changes are in accordance with the trust's overall purpose, although this is a non-core rule. Per articles 150 and 165, all trust parties have the right to apply to the court to amend or to terminate the trust. Where there is agreement between the settlor and the beneficiary, they can act together to terminate the trust under article 164. As the settlor tends (although he is not required) to be a residual beneficiary of the trust (*zanyo zaisan juekisha*), when the trust terminates, per article 182(2), he is entitled to the fund if no senior beneficiary is identified.

It is important to note that the powers conferred on settlors by the 1922 Act have been reduced by the 2006 Act. Under the old Japanese Trust Act, which is similar to the present Chinese statute, the settlor was a full "enforcer" of the trust, with the right to object to mandatory execution or the sale of trust property in breach of trust,[32] the right to request a change in the methods of management,[33] a right to request compensation or the restoration of trust property upon the breach of trust,[34] the right to inspect documents or to receive explanations with respect to trust affairs,[35] and also to dismiss the trustee.[36] However, it was not possible for the settlor to give instructions to trustees unless he had reserved such powers in the trust instrument, as trustee duties were owed to the beneficiary, rather than the settlor.[37] In effect, the settlor's powers with respect to monitoring the trustee were almost the same as those of the beneficiary, although unlike the later Chinese statute, he only had the right to object to the mandatory execution or the sale of trust property in breach of trust, but not the right to set aside the trustee's actions. Further, he did not have the power of beneficial enjoyment over the property, unless he was also separately a beneficiary. However, as the Japanese scholar of the common law Kishita Toyoshi commented, in the triangular relations between settlor, trustee, and beneficiary, the settlor was the weakest of the three parties as his primary interest was restricted to ensuring the performance of his intent, rather than a direct economic ownership of the property. He was placed third after the trustee and the beneficiary in the listing of the three parties who had standing to oppose a claim on the trust fund in draft reform proposals in the 1980s.[38]

After the reduction of settlor powers under the new act, based on Dōgauchi Hiroto's characterisation, the residual powers of the settlor fall into the categories of a monitoring role over trustees, a power of veto over fundamental changes to the trust, and his residual interest.[39] Significantly, the rules conferring these powers are now designated as non-core rules, meaning that

[32] Trust Act (n 8), art 16(2).
[33] Ibid., art 23.
[34] Ibid., arts 27, 29.
[35] Ibid., art 40.
[36] Ibid., arts 47, 72.
[37] Supreme Court of Judicature, Shōwa 9-5-29, Hyōron 23-400 (1934).
[38] Kishita Toyoshi, "Shintaku zaisan / juekisha / itakusha no chi'i" ("The place of the trust fund, beneficiary, and settlor") (1985) 47 Shihō 36, 40-41.
[39] Nōmi Yoshihisa and Dōgauchi Hiroto (eds), *Shintakuhō zeminā (3): juekishatō itakusa* ("Trust law seminar [3]: beneficiaries and others, and settlors") (Yūhikaku 2015) 259-260.

it is possible to further reduce the powers retained by the settlor through the trust instrument.[40] These changes are a step forward in the sense that settlors now enjoy a much more limited right to complain, and cannot directly demand compensation from the trustee; although these changes also limit the settlor's ability to function as a protector. In line with the settlor's role to monitor the trustee, the act also introduced changes which strengthen the position of the settlor, by imposing upon the trustee the duty to report to the settlor as well as the beneficiary.[41]

*China*

In principle the role of the Chinese settlor is not meant to be different from that in England or Japan. As Chinese trusts scholar Zhao Lianhui puts it, the role of the settlor is meant to be "passive, defensive and supervisory".[42] However, owing in part to cultural and psychological considerations in jurisdictions without a tradition of trusts,[43] the Chinese legislator appears to have considered the problem of the trust primarily from the perspective of the settlor and his concerns for the security of the fund and the purpose of the trust, in an environment where beneficiaries may not be able to provide adequate supervision.[44] In this respect, the role of the settlor—which is considerably stronger in China than in Japan[45]—appears to be more deliberate than was the case under Japan's 1922 Act. As jurist Zhang Junjian points out, articles 2 and 22 defining the trust without requiring a transfer of property and granting the settlor the power to set aside the trustee's acts appear to have gone against the basic nature of trusts, and the wavering positions throughout the drafting process highlight the deliberate even if inconclusive nature of the legislator's will.[46] In particular, the settlor's aforementioned ability to set aside the trustee's acts is problematic. Per article 51(1), (2), the settlor can either change the beneficiaries or dispose of the beneficial interest where the beneficiary commits a "major tort" against the settlor or against other beneficiaries, or through other means designated in the trust instrument. Otherwise the agreement of all parties is required to terminate the trust,[47] which suggests a significantly greater power retained by the settlor compared to that of the beneficiary.

In contrast to Japan, the powers of the settlor under the Chinese Trust Law are extensive. Per article 20, the settlor enjoys right to information; per article 21, the right to change the method of management of the trust; per article 22, to invalidate acts in breach of trust; per article 23, to dismiss the trustee; per article 51, to change the beneficiary, or to make dispositions to that effect; per article 38, to approve the trustee's resignation; per article 40, to appoint new trustees; per article 17(2), to oppose unlawful mandatory execution against trust property ; and in conjunction with the beneficiary, per article 35, the right to determine the level of remuneration of the trustee,

[40] Trust Act (n 20), art 145(1).
[41] Ibid., art 36.
[42] Zhao Lianhui, *Xintuofa jieshi lun* ("An explanatory thesis on trust law") (Zhongguo fazhi chubanshe 2017) 257.
[43] Adam Hofri, "Shapeless Trusts and Settlor Title Retention: An Asian Morality Play" (2013) 136 Loy L Rev 135.
[44] Zhang Junjian and Wang Wei, "Xintuo zai Zhongguo de tuibian yu xinsheng: Zhongguo (Changsha) xintuo guoji luntan jianping" ("The radical change and new life of the trust in China: a brief summary of the international trusts symposium in Changsha, China") <http://www.law-lib.com/lw/lw_view.asp?no=5263> accessed 4 Oct 2019.
[45] Dōgauchi has also taken note of this point, which he notes is often explained to him on the basis that as the settlor is the party setting up the trust, he holds the most power in the trust structure, in contrast with the current Japanese view that the powers of the settlor should be restricted. Nōmi (n 39) 259.
[46] Zhang Junjian, "Lun Zhongguo xintuofa zhong de weituoren de chexiaoquan" ("Discussing the settlor's power to set aside [a trustee's acts] in the Chinese Trust Law") (2007) 3 Faxuejia 90.
[47] Trust Law of the People's Republic of China, Order No 50 of 2001, art 53(4).

and per article 41, to approve reports from the trustee on trust affairs. Per article 54(2), the settlor is a residual beneficiary of the trust, and per article 73, in the case of a charitable trust, the settlor, trustee and beneficiary each has the right to initiate action at a court upon breaches of the Trust Law on the part of the trust's management.

*France*

In France, the settlor is the most important party in the trust structure, as trustee duties are owed to the settlor rather than the beneficiary.[48] The beneficiary is only entitled to assets where this is specifically designated in the trust instrument,[49] whereas the settlor serves as the default owner of the fund at the end of the *fiducie*.[50] Like in the other trusts, the settlor defines the objectives of the trust in the trust contract.[51] Alongside the beneficiary or the protector, the settlor can apply to court to replace the trustee.[52] Similarly, from the perspective of access to trust information, it is the settlor, not the beneficiary, who is entitled to the information;[53] unless specified in the trust instrument, the beneficiary has no automatic right to trust information. Given the centrality of information as held in *Schmidt v Rosewood* by the Privy Council,[54] this suggests strongly that the settlor, not the beneficiary, is the primary party in the French *fiducie*. Like in Japan, the settlor's powers may be delegated to a protector,[55] an office which is not yet available in China.

Although the legislator has attempted to distinguish the *fiducie* from the mandate by removing the right of revocation;[56] as Jean-Paul Béraudo points out, in reality the settlor can bring an end to the *fiducie* unilaterally by rendering it illegible for corporation tax.[57] In this respect, the French *fiducie*—like the Chinese trust—differs significantly from the common law and Japanese trusts in that the greatest risk to the stability of the trust structure comes from the settlor. It also differs from Quebec in that the French *patrimoine d'affectation* is far from watertight, even though it remains open to question whether the only way of ensuring that a trust fund is completely independent is by stripping it of all owners.[58]

**Duties**

What duties should a settlor-protector owe when exercising his powers? At one level it seems right that this should depend on a particular settlor's intention. As Hayton notes, the rights of objects of

[48] C Civ, art 2022.
[49] Blandine Mallet-Bricout, "The Trustee: Mainspring, or Only a Cog, in the French *fiducie*?" in Smith (ed), *The Worlds of the Trust* (CUP 2013) 148.
[50] Olivier Fille-Lambie, "La fiducie : nouvelle garantie des crédits syndiqués?" (2010) 192 Dr et patri 76.
[51] C civ, art 2018.
[52] Ibid., art 2027.
[53] Ibid., art 2022.
[54] [2003] 2 AC 709.
[55] C civ., art 2017.
[56] The right of revocation is central to the French law of mandate, per C civ, art 2004. The revocability of the mandate was also held not to be contrary to public order in Req 8 avril 1857, DP 1858. I 134. See also Anne Marie Toledo-Wolfsohn, "Le trust et la gestion des sûretés" (2006) RLDC 67.
[57] Jean-Paul Béraudo, "La loi du 19 février 2007 créant une fiducie française" in STEP France (n 6) 141.
[58] Witz notes the importance of being able to dissociate the ability to replace the trustee from the irrevocable nature of the patrimony, which the Quebec model of an autonomous patrimony achieves particularly effectively. Witz, "La fiducie en Europe: France, Suisse, Luxembourg, Allemagne, Leichtenstein. Analyse des lois existantes et des projets en cours " in J Herbots and D Philippe, *Le trust et la fiducie : implications pratiques* (Bruylant 1998) 67. For a critique of the Quebec trust's assault on the very notion of property, see Frédéric Zenati-Castaing, "L'affectation québécoise, un malentendu porteur d'avenir. Réflexions de synthèse" (2014) 48 RJTUM 623.

power depend upon the construction of the trust instrument.[59] In *Centre Trustees v Pabst*[60] the court suggested that the question of fairness is also important when assessing the extent to which a protector-beneficiary is entitled to exercise his powers in a self-serving way, to the detriment of other beneficiaries. Although it is unclear how far the court's finding actually deviated from the trustee's duties prescribed by the trust instrument, it nonetheless raises the question as to whether core trust rules should impose restrictions on a donee's exercise of powers.

*Japan*

In Japan, an analogy with the power to give binding instructions to trustees (*sashizuken*) is helpful. As a mandatary, the donee of such a power comes under the duties of loyalty and care which are owed to the settlor and—through the settlor's intent to create a trust—to the beneficiary.[61] As it is commonplace for settlors to sell their beneficial interest to investors (new beneficiaries) while retaining their own position as a residual beneficiary, latent conflict between the settlor and the beneficiary is not a moot issue. On the contrary, it is fundamental even if it is true that the overlap between the settlor and residual beneficiary is one that technically stems from practice, namely the creation of tiered beneficial interests and the difficulty of assigning the residual interest, rather than one that is required by the legal rules governing the architecture of the trust.

Nonetheless, under the 2006 Act the Japanese legislator attempted to partially remedy the problem of latent settlor-beneficiary conflict by reducing the scope of the settlor's powers. This is a helpful change, although the settlor is still not subjected to any clear duties. It is submitted, however, that good faith is a useful concept for courts to introduce,[62] as placing a settlor under no enforceable duties in his exercise of powers hampers efforts to implement the settlor's original intention and may detract from the beneficiaries' interests. This is especially important as investors are likely to be passive actors who are not involved in the design of the trust. Hence it is desirable for the law to require settlors and trustees to design these mechanisms in a way which protects beneficiaries and prevents damage to the reputation of trusts as an institution, and to mandate that settlor-beneficiaries exercise their powers in accordance with the purposes for which the powers were given.

*China*

In China, while article 25 imposes the duties of good faith, care and effective management upon trustees and regulatory rules mandate similar duties for trust companies,[63] there is no evidence that these duties are applied to settlors even if they were to exercise powers. Clearly the Chinese settlor is viewed as a de facto beneficiary, with little consideration of taxation consequences, and more problematically, of asset partitioning. As in Japan, juristically the settlor's retention of a position is often justified on the grounds that the settlor is a contractual party, although as argued below, such an argument is unconvincing. Furthermore, as in Japan, cultural and psychological challenges in a

[59] Hayton (n 26) 105.
[60] [2009] JRC 109 [27]-[34]
[61] Such powers are often analogised with a relationship of mandate, and in the commercial context they also come under the ambit of regulatory law, specifically Trust Business Act, Act No 154 of Heisei 16 (2004), arts 65-66, which prescribe the duty of loyalty and standards of behaviour on such donees. Kimura Hitoshi, "Sashizukensha tō ga kanyo suru shintaku no hōteki shomondai" ("Various legal questions relating to trusts with powers to offer instructions to trustees") (2013) 64 Hō to seiji 1172, 1128.
[62] Mitchell, "Good Faith, Self-Denial and Mandatory Trustee Duties" (2018) 32 Tru LI 92; *Sheikh Tahnoon Bin Saeed Bin Shakhboot Al Nehayan v Kent* [2018] 1 CLC 216.
[63] Xintuo gongsi guanli banfa ("Measures for the administration of trusts companies"), China Banking Regulatory Commission Order 2 of 2007, art 24.

society without a trusts tradition are relevant, and the fact that the Chinese Trust Law does not currently provide for a trust protector is significant in view of the court's lack of experience and ability to engage with non-litigated issues.[64] There is also the unfortunate view on the part of Chinese courts that they should not meddle in areas of financial law which they see as part of the remit of the regulator, who is seen as the party with greater experience, notwithstanding the damaging effects this may have on the coherence of general law.[65]

With respect to settlor "duties", these are normally categorised under the requirements for the constitution of the trust in England. In order to form a trust, the settlor has to "entrust" property to the trustee,[66] and has the duty to remunerate the trustees out of the trust fund,[67] which may extend to personal liability where the trust fund is not able to meet these costs.[68] There is also an implicit duty to transfer control over the property discussed below. Like the Japanese trust, the Chinese trust contract takes the form of a "consensual" contract (*nuocheng*/*dakusei*) rather than a "real" contract (*shijian/yōbutsu*), on the basis of article 8 which states that a trust is constitued when a trust contract is concluded. This means that the trust comes into effect even without property being transferred, which is the requirement for the "real" contract. This is unlike England where, as observed above, a trust is only formed after a declaration of trust is accompanied by a transfer of property.[69] The interim period between the two places trustees in a position of significant vulnerability.

*France*

The main difference between French and Chinese settlor duties lies in the requirement to transfer property in order to constitute the trust "patrimony".[70] The settlor is normally excluded from the management of the property, unless otherwise specified, for example in the case of a security trust.[71] However, the formation of such a patrimony is incomplete, because where the trust fund is exhausted, creditors of the trust have access to the settlor's personal patrimony.[72] While such a rule is justified from the perspective of protecting the trustee, who must be a professional entity subject to corporate tax, it nonetheless means that the *fiducie* is not in fact a genuine patrimony that is separate from the trust's constituent parties,[73] which contrasts with the Quebec trust bearing the same name (*patrimoine d'affectation*). In this respect, the French *fiducie* resembles an unlimited company, in which the settlor is one of its partners.[74] This could create problems, for example in securitisation, where genuine asset partitioning is required,[75] and the same problem is not found in

[64] Kishita (n 38) 38-39.
[65] Wang Yi and Li An'an, "Fayuan ruhe fazhan jinrongfa: yi jinrong chuangxin de sifa shencha wei zhongxin zhankai" ("How do courts develop financial law? Centring on judicial review for the purpose of financial innovation") (2016) 18 Zhengquan fayuan 208, 215.
[66] Trust Law (n 47), art 2.
[67] Ibid., art 34.
[68] Zhao (n 42) 270.
[69] *Re Ralli's Will Trusts* [1964] Ch 288.
[70] C civ, art 2011.
[71] Michel Grimaldi, "La fiducie: réflexions sur l'institution et sur l'avant-projet de loi qui la consacre (a) (b)" (1991) 18 Defrénois 961, para 48.
[72] C civ, art 2025(2).
[73] Béraudo (n 57) 137.
[74] Bénédicte François, "Fiducie" in *Répertoire des sociétés* (Dalloz 2011) ch 2 para 161. See also Zenati-Castaing and Thierry Revet, *Les Biens* (PUF 3rd edn 2008) 441.
[75] In France, a *sui generis* equivalent to a special purpose company known as fonds commun de créances (FCC) is used. As Barrière notes, unlike common law special purpose vehicles (SPV), FCCs are designed only to hold

Quebec.[76] However, compared to the mandate, the settlor is more protected than a mandator in the sense that his own patrimony is resorted to only after the trust patrimony is exhausted.[77] Usually the settlor is expected to remunerate the trustee, although this needs to be specified through contract.[78]

As trustee duties are owed to the settlor rather than the beneficiary, it is extremely difficult to speak of the settlor as owing "fiduciary" duties to any party. In any event, French fiduciary duties in other areas of law are often disparate in nature, taking forms such as a commercial judge's discretion in relation to specific facts, approval requirements in the corporate context, or criminal sanctions for the misuse of corporate assets.[79] However, with respect to third parties, settlor fraud would invalidate the trust, and additional safeguards are in place concerning the time period immediately after a transfer.[80] Thus, while the settlor is not subjected to specific duties, "control" over the settlor in French law comes in the form of the curtailed remit of the *fiducie*, which severely limits the institution's potential and its core virtue of flexibility.

## Part II: The Settlor's Role in the Constitution of the Trust

### Role of the Settlor as a Contractual Party

Because civilian trusts are usually created by contract between the settlor and the trustee, the settlor's continuing role is often rationalised by the fact that the settlor is a contractual party. Unlike the English trust where a trust can also be created by a declaration of trust accompanied by the transfer of property,[81] or by the settlor declaring himself as a trustee,[82] in Japan a trust is usually created by a contract between the settlor and the trustee,[83] and like in China, the trust takes effect prior to the transfer of property.[84] For the French *fiducie*, there is a requirement for the beneficiary to accept the *fiducie* before the contract can be perfected, which suggests that the timing of the creation of the *fiducie* is independent of the actions of the contract parties.[85] Under the 2006 Act self-declared trusts are now possible in Japan under certain conditions,[86] although many

credit from a sole issuer, whereas there is demand from practitioners for a more flexible vehicle such as the SPV. Barrière (n 12) 186.

[76] Michele Patricia Akiobe Songolo, "La crise des subprimes: vers un meilleur encadrement des risques financiers et juridiques liés à la titrisation des créances" (LLD thesis, Université Laval 2019) 246.

[77] Béraudo (n 57) 138.

[78] François (n 74) ch2 para 157.

[79] Martin Gelter and Geneviève Helleringer, "Fiduciary Principles in European Civil Law Systems" in Evan Criddle, Paul Miller and Robert Sitkoff, *The Oxford Handbook of Fiduciary Law* (OUP 2019) 597-598.

[80] C civ, art 1167 allows creditors of the settlor to attack a contract of *fiducie* designed to defraud creditors, whereas article 2025 gives creditors of the settlor priority over the *fiducie*'s creditors. Per C com, art 632(1), a *fiducie* is void if concluded during a suspicious period.

[81] *Re Ralli's Will Trusts* (n 69) requires legal title to be vested in the trustee. However, *Re Rose* [1952] Ch 499 and subsequent cases have modified the rule with respect to settlors who have not completed all formalities.

[82] *Milroy v Lord* [1862] 4 De G.F. & J. 264; 45 E.R. 1185.

[83] Trust Act (n 20), art 3(1).

[84] Ibid. art 4. Arai Makoto, "Kaisei shintakuhō no seiritsu to shintakuhōgaku no yakuwari" ("The enactment of the reformed Trust Act and the role of trusts legal scholarship") (2007) 79 Hōritsu jihō 1, 2. Arai also commented that the non-requirement of the transfer of property for a trust to take effect is unique globally, other than article 2 of the Chinese Trust Law as observed in Ho, *Trust Law in China* (Sweet & Maxwell Asia 2003) 67.

[85] C civ, art 2028; Béraudo (n 57) 131.

[86] Trust Act (n 20), art 3(3).

practitioners believe this development to be premature.[87] Nonetheless, the introduction of the self-declared trust also affirms earlier arguments that the use of the contractual form in the creation of trusts in Japan is primarily a matter of convenience. This is different from continental European trusts such as the French *fiducie* which centres on the fiduciary contract inspired by the Roman *fiducia*.[88]

Thus, in the case of the Japanese trust, it is doubtful that the contractual explanation is persuasive in explaining the role of the settlor.[89] As jurists Nōmi Yoshihisa and Dōgauchi explain, the Japanese trust is plainly different from contracts for the benefit of third parties or other legal forms such as the mandate,[90] and the Japanese beneficiary has never had to depend on the settlor to enforce his rights against the trustee.[91] Early cases suggest that the Japanese court is sensitive to the distinctiveness of the trust relationship. In a 1933 case the Tokyo District Court held that article 653 of the civil code, which terminates a mandate upon the death or insolvency of either party, cannot apply in a settlor's trustee in bankruptcy's claim on trust assets. The court justified the decision on the basic juristic differences between a trust and a mandate, which mean that a trust is not affected by the death or insolvency of the contracting parties.[92]

Although the English trust is not typically thought of as an "agreement" between the settlor and trustee, Ying Khai Liew and Charles Mitchell have observed that the trustee's consent is far from unimportant, especially with respect to personal rights a beneficiary can exercise against the trustee, as opposed to the underlying proprietary rights that the beneficiary enjoys irrespective of the trustee's consent.[93] Although contract does not redefine the trustee's authority in the same way as a trust,[94] the compatibility between trusts and contract nonetheless means that the use of contract can serve a useful communicative function in making trusts more understandable to non-common law jurists. In other words, as a means of incentivising settlors to select the trust structure, the use contract can be viewed as a matter of juristic convenience rather than a reflection of the Japanese or Chinese trust's juristic nature.

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[87] Kimura Kōichi, "Shin shintakuhō no kadai" ("The subject of the new Trust Act") in Arai (ed), *Shin shintakuhō no kiso to un'yō* ("The foundations and use of the new Trust Act") (Nihon hyōronsha 2007) (n 66) 359-361.

[88] As Witz puts it, the French *fiducie*, like its Luxembourgish counterpart, remans faithful to the Romano-Germanic tradition of the trust, notwithstanding the similarities between the secondary features of the *fiducie* and the English trust. Witz (n 16) 67, 71.

[89] Thus Japan falls into the group of civilian trusts which Witz classifies as being inspired by the English trust. In the US the contractual form is also not the explanation for the settlor's greater role. In some instances, the "special interest" of American settlors has been recognised in the charitable context, and in a much more restricted way for private trusts, for example the ability to remove trustees per article 706(a) of the Uniform Trust Code of 2006. Edward Halbach, "Standing to Enforce Trusts: Renewing and Expanding Professor Gaubatz's 1984 Discussion of Settlor Enforcement" (2008) 62 U Miami L Rev 713, 715, 731.

[90] For instance, in contracts for the benefit of third parties, a beneficiary is required to declare his intent (*Willenserklärung*) in order to become a beneficiary, and the beneficiary assumes liability, in contrast to the position under Japan's new Trust Act. Furthermore, contracts for the benefit of third parties are revocable until the declaration of intent by the beneficiary (article 538 of the Civil Code), whereas a beneficiary holds a beneficial interest in the asset from the point a trust is created by contract. Nōmi (n 39) 2-4. Both of these "default" positions in Japanese contract law describe the French *fiducie* accurately.

[91] Trust Act (n 20), art 30 directs the trustee's duty of loyalty to the beneficiary and not the settlor, whereas art 92 sets out the core powers of the beneficiary which can be exercised against the trustees and which cannot be limited by the trust instrument.

[92] Tokyo District Court, Shōwa 8-12-9, Hyōron 23-511 (1933).

[93] Liew and Mitchell, "The Creation of Express Trusts" (2017) 11 J Eq 133.

[94] Hudson (n 11).

*France*

Unlike the Japanese trust, in France the trust is fundamentally conceived as a contract. Unlike the Japanese trust, the French *fiducie* only becomes irrevocable when the beneficiary accepts his interest,[95] which to Béraudo suggests that the key trust relationship is that between the settlor and the beneficiary.[96] The key innovation made in the French *fiducie* is the departure from the mandate, which was vulnerable to revocation by the settlor, and was thus unsuitable for commercial purposes.[97] However, as discussed earlier, it remains possible for the French settlor to terminate the *fiducie* by changing its fiscal status, which means that the process of rendering the *fiducie* a distinct legal institution is largely incomplete.

**Transfer of Property to the Trustee**

While the Japanese and French trusts unequivocally require the transfer of property as part of the constitution of the trust,[98] the most distinctive and significant limitation of the Chinese Trust Law lies in the ambiguity surrounding the transfer of property. Under the Chinese Trust Law: article 2 requires the settlor to "entrust" the property to the trustee, who must "obtain" the property;[99] whereas article 15 requires the settlor to segregate the property. The significant ambiguity with respect to the language of the act is well recognised in the scholarship.[100] To practitioner Zhang Tianmin , the term "entrust" lacks sufficient force.[101] Although the exact reason for the choice of the word is unclear, Wang Lianzhou—one of the chief draftsmen of the Trust Law—remarked that the choice was partly to weaken the cultural resistance of potential settlors.[102] Significantly, the word was not necessarily the chosen term used in previous drafts.[103] It is possible therefore that the continuing ambiguity may be intentional, with senior figures holding that the current ambiguity is acceptable.[104]

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[95] C civ, art 2028.
[96] Béraudo (n 57) 131.
[97] The French mandate can be made "irrevocable" in some cases, although in such cases the mandate is less irrevocable than that the mandator must compensate the mandatary for his losses. E Sallé de la Marnierre, "Le mandat irrévocable" (1937) RTD civ 241; R Perrot, "Le mandat irrévocable" in *Travaux de l'Assoc Henri Capitant* (Dalloz 1959).
[98] Trust Act (n 20), art 3(1)(2); C civ, art 2011.
[99] Trust Law (n 47), art 14.
[100] Reid (n 18). To London-based solicitors Toby Graham and Peter Steen, it is very difficult for the trustee to exercise his duty to administer the trust property per article 25 without some degree of possession. Graham and Steen, "The Chinese Trust" (2012) 18 Trusts Trustees 36, 40.
[101] Zhang Tianmin, *Shiqu hengbingfa de xintuo: xintuo guannian de kuozhang yu Zhongguo xintuofa de jiyu he tiaozhan* ("Trusts without equity: the expansion of the trust concept and the opportunity and challenge of Chinese trusts law") (Zhongxin chubanshe 2004) 340.
[102] Ibid. See also Bian Yaowu (ed), *Zhonghua renmin gongheguo xintuofa shiyi* ("An explanation of the Trust Law of the People's Republic of China) (Falü chubanshe 2002) 3-4. Jiang Ping, one of China's leading scholars in civil law, also remarked that "in spite of the vagueness of the Trust Law when it was passed, it may well be the case that history would show that it was the correct approach". Jiang, *Chenfu yu kurong: bashu zishu* ("My ups and downs through time: an autobiography at eighty") (Falü chubanshe 2010) 415.
[103] Zhang (n 101) 94.
[104] Jiang commented in March 2019 that the legislative appetite for tightening the Trust Law is low; rather, effort is likely to be invested in practical areas such as trust taxation, private trusts, charitable trusts, and the registration of trust property. "Xintuo fa dianjiren Jiang Ping: yingdang xiugai guoqu bijiao culueshi de guiding" ("The founder of the Trust Law Jiang Ping: there is a need to amend the coarse rules from the past") (Xinlang caijing zonghe, 30 March 2019) < http://finance.sina.com.cn/trust/xthydt/2019-04-01/doc-ihsxncvh6818930.shtml?cre=tianyi&mod=pcpager_fin&loc=31&r=9&rfunc=100&tj=none&tr=9> accessed 31 October 2019.

It is likely that the weakness of the rule requiring the transfer of property to trustee encourages settlor fraud. In their overview of trusts-related litigation at the financial tribunal of the Shanghai Second Intermediate People's Court, justices Fan Lihong and Zhou Quan note that trustees are often in a vulnerable position where settlors do not provide the level of capital as required under a trust contract, which leaves the trustee as the legal owner of the underlying asset or interest vulnerable to incurring liability, for example in maintaining the asset or fees and charges payable by the legal owner of the asset, without being able to reclaim these costs from the trust fund. Furthermore, in the cases of "trust loans", sometimes trustees and borrowers act fraudulently to put trustees in a vulnerable position where they are unable to fulfil their fiduciary duties but yet are vulnerable to claims for compensation by the same parties.[105] It is likely that these dangers were not envisioned by the legislator, who was probably more concerned with the appeal of the trust to potential settlors than with fraud against trustees, at least judging from the balance of power in favour of settlors in the Trust Law. Thus, from this perspective it is vital that the Chinese Trust Law is improved in order to protect trustees and to uphold the integrity of the trust as an institution.

**Limits of a "Contractarian" View**

It is important to consider whether the settlor's greater role can be related to the "contractarian" view of trusts, as proposed by the American legal scholar John Langbein.[106] While it is not disputed that the settlor's greater role means that civilian trusts conform to Langbein's description to a greater extent than English trusts, it is unclear whether the settlor's role in Japan and China can be justified on the basis that trusts are essentially "deals". As submitted earlier, the emphasis of *Claflin* was on the settlor's continuing intention in a donative context;[107] it is simply a different emphasis—albeit a basic one—from the English trust. It is worth noting in this regard that Langbein objects to the inability of a settlor to enforce a trust, and describes the explanation given in the Second Restatement that the parties' intention is not to have a trust that a settlor can enforce as a "false tautology".[108] This problem does not exist for the French *fiducie* which is clearly a particular species of contract, with stronger (albeit porous) safeguards against revocability.

With respect to the settlor's role, it is submitted that the usual criticisms against Langbein's views in the English context can also be made for Japan. Firstly, as Japanese courts and jurists readily acknowledge, a trust has important third-party effects which does not usually exist in contracts. Even if contracts for the benefit of third parties exist both in England and in Japan, these contracts do not usually impose the same range of duties on a contractual party towards a third party, but rather they primarily confer a particular benefit to designated parties.[109] Secondly, in terms of remedies, the trust offers far more significant protection against third parties. Although the ability of the Japanese beneficiary to recover property from third parties may be weaker than English law, the Japanese Trust Act nonetheless allows the beneficiary to exclude third parties from the property,

[105] Fan Lihong and Zhou Quan, "Woguo xintuo gongsi yunyingzhong cunzai de wenti ji duice: yi 2002-2011 nian Shanghai Shi Di'er Zhongji Renmin Fayuan she xintuo gongsi shangshi an'jian wei yangban" ("Existing problems and solutions in the operation of trust companies in China: based on cases pertaining to trusts at the Shanghai Second Intermediate People's Court between 2002 and 2011") (2013) 36 Liaoning shifan daxue xuebao (shehui kexue ban) 178, 180.
[106] Langbein, "The Contractarian Basis of the Law of Trusts" (1995) 105 Yale LJ 625.
[107] (n 13).
[108] Langbein (n 106) 664.
[109] Civil Code, Act No 89 of Meiji 29 (1896), art 537(1) describes the duty owed to a third party as a "certain performance", whereas Contracts (Rights of Third Parties) Act 1999, s 1(3), (4), confers expressly identified parties the right to enforce a specific term rather than a contract generally.

most notably through his ability to oppose mandatory execution against trust property.[110] This is not unlike English law where the beneficiary's right against third parties is sourced not only in the intention of the settlor and trustee but also in general law rules which prevent third-party interference.[111] In this respect the interests of the Japanese beneficiary are at least partly proprietary, which suggests that they cannot solely arise as a result of a contract between the settlor and the trustee. Rather, the source of the beneficiary's protection stems from the legal form of the trust provided for by the settlor and trustee's intent to invoke the Trust Act, which protects the interests of the beneficiary rather than those of the settlor.

Thirdly, in the English trust at least, the *Saunders v Vautier* principle means that adult beneficiaries acting together have the ability to terminate the trust.[112] Such a rule does not exist in many US states (or some Commonwealth jurisdictions such as Alberta), and in any case is not always easy to apply given that in most discretionary trusts there are a sizable number of beneficiaries and potential objects, and *Saunders* rights can be easily overridden by the trust instrument. Although in Japan this right cannot be exercised by beneficiaries alone, but rather requires the consent of the settlor,[113] the veto power of the beneficiary nonetheless marks a significant departure from ordinary contracts in Japanese law, as contractual parties do not require the consent of the third party to terminate a contract for his benefit. Thus, until the benefit is conferred upon the third party, the contractual parties have the power to revoke the benefit, unlike in the case of the trust, where the creation of the trust results in the transfer of the interest in the property to the beneficiary.[114]

## Part III: The Rationale for the Settlor's Role

### Advantages of a Residual Role for the Settlor

The retention of powers by settlors brings significant practical advantages in civilian jurisdictions, where trusts are usually formed to further the settlor's commercial interests. Here a comparison with the US commercial trust is again useful,[115] and there are three reasons why it may be desirable for Japanese settlors to maintain some control over the trusts. Firstly, as the residual interest in the trust property is valuable, settlors cannot be expected to relinquish this interest without consideration. Secondly, even after the sale of the primary beneficial interest, the originator as the party with the most knowledge about the trust structure is best placed to monitor the trustee,[116] and therefore there is a practical interest on the part of other beneficiaries for the settlor to exercise a monitoring function. Thirdly, it incentivises the settlor to design a more robust trust structure.[117] These features can partly be explained with reference to the practical operation of the Japanese trust, which, as explained in the introduction, is arranged in such a way as to maximise sale price

[110] Trust Act (n 20), art 23.
[111] Smith, "Transfers" in Peter Birks and Arianna Pretto-Sakmann (eds), *Breach of Trust* (Hart 2002).
[112] For recent discussions of *Saunders v Vautier* see Derwent Coshott, "Contextualising the Rule in *Saunders v Vautier*: A Modern Understanding" (2020) 136 LQR 658, and Aleksi Ollikainen-Read, "The Origin and Logic of *Saunders v Vautier*" [2020] Conv 296. To Coshott, *Saunders* is best understood as a doctrinal rule associated with the common law's commitment to a particular view of the trust, whereas *Claflin* represents a public policy choice.
[113] Trust Act (n 20), art 164(1).
[114] Nōmi (n 39) 4, 6-7, on the basis of Civil Code (n 109), art 538 which only disallows contract parties from modifying or terminating third-party rights after the declaration of intent by the third party.
[115] Schwarcz (n 19) 563; Kiuchi Seishō, Shōji shintaku no soshiki ("Organisation of commercial trusts" (Shinzansha 2014) 152. Trust Act (n 20), art 182(2).
[116] Shinomiya Kazuo, Shintakuhō ("Trust law") (Yūhikaku 1989) 341-344.
[117] Kiuchi (n 115) 196, 180.

which differs from the donative trust in the English context. In fact, the settlor's residual beneficial interest can signal to potential investors that the settlor has designed the trust well, to the extent that the settlor's own financial interests are also affected by the trust's performance.

There are other practical reasons at the cultural and psychological level and with respect to taxation which make the settlor's retention of a role a logical feature. As Adam Hofri points out, in a society without a tradition of trusts, the retention of power reduces potential settlors' resistance to the juristic form.[118] Furthermore, the absence of taxation advantages for settlors also means that the goal of separating the asset from the settlor's creditors becomes the primary *raison d'état* for the civilian trust. Civilian tax rules do not respond to trusts as sensitively as English tax rules: whereas in Japan, beneficiaries are taxed as the "de facto economic owner" in most cases without further calibration,[119] in France the settlor remains liable to tax until the property passes onto the beneficiary.[120] Despite the tiering of beneficial interests, Japanese tax rules are also insensitive to these distinctions and levy securities tax on both superior and residual beneficial interests.[121] The absence of adverse taxation consequences upon a settlor's failure to relinquish his rights in the property reduces the incentive to devise safeguards to ensure that the property is fully alienated from the settlor. In the absence of serious thought on the question of alienation, it leaves open the normative intuition that as the provider of the property, the settlor ought to have a say on how the property should be disposed.

**Absence of the Administrative Supervision of the Court**

There is another major structural difference between English and civilian trusts in the form of supervision from the court.[122] Although article 41 of Japan's 1922 Trust Act provided for the court's general supervision, this was rarely invoked. Another opportunity in which the court could become involved was under article 47, where the settlor, the settlor's heir, or the beneficiary could petition the court to appoint a new trustee, as a way of enforcing the trust. As Nakano Masatoshi puts it, the ability to petition the court in such circumstances was a power that emanated out of the special nature of the trust contract, which underlay the court's rejection of a settlor's trustee in bankruptcy's petition to the court.[123] Although it was not as wide ranging as common law's assertion

[118] Hofri (n 43).

[119] In Japan, tax tends to be levied on the beneficiary as the economic owner of the trust per Income Tax Act, Act No 33 of Shōwa 40 (1965), art 13, which shows a strong (incorrect) presumption that most trusts are fixed trusts. As the attorney Urabe Hironori points out, taxing the beneficiary is not appropriate if the trustee has any discretion over how much the beneficiary receives. Similarly, the rule that the settlor should be taxed where beneficiaries are yet to be ascertained can seem somewhat odd, especially when legal title to the property has already been transferred to the trustee. Urabe Hironori, "Kōreika shakai ni okeru shintaku zeisei / sōzoku zeisei no arikata" ("The manners of trust and succession taxation in an aging society") in Arai (ed), *Kōrei shakai ni okeru shintaku to isan keishō* ("Trust and succession of property in an aging society") (Nihon hyōronsha 2006) 109-111.

[120] Marini (n 24).

[121] Nishiura Shinpei, "Shintaku o riyō shita shōkenka to kazei: fukusōka sareta juekiken ni tsuki pass-through debt certificates o sankō ni" ("Securitisation based on trusts and tax: based on tiered beneficial interests attached to pass-through debt certificates") 9-12 (Tax resource centre [Sozei shiryokan] prize essay competition, Nov 2014) < https://www.sozeishiryokan.or.jp/award/023/z_pdf/ronbun_h26_16.pdf> Accessed 21 Nov 2019.

[122] Nolan, 'Invoking the Administrative Jurisdiction: The Enforcement of Modern Trust Structures' in Paul Davies and James Penner (eds), *Equity, Trusts and Commerce* (Hart 2017); Daniel Clarry, *The Supervisory Jurisdiction Over Trust Administration* (OUP 2018). For France see Witz (n 58) 67.

[123] Nakano Masatoshi, *Shintakuhō hanrei kenkyū* (Sakai shoten 2005) 278. Tokyo District Court, Shōwa 2-5-2, Shinbun 2691-6 (1927).

of a general supervisory role over trusts, it nonetheless showed the awareness on the part of the legislator of the 1922 act of the role that common law courts play in the administration of the private trust. In France, the contractual nature of the *fiducie* means that the court's direct involvement is not envisaged except where it concerns the appointment of replacement trustees, which in part explains the use of the patrimony model to give the *fiducie*'s creditors direct access to the trust fund, without recourse to subrogation which necessarily involves the court.[124] As discussed below, the role of the Chinese court is itself a source of uncertainty in potential conflicts between the settlor and the beneficiary.

Under the present Japanese act the ability by trust parties to petition the court is limited to a range of specified circumstances including: the appointment of trustees in testamentary trusts,[125] cases where settlor fraud is alleged,[126] the division of property consisting of both trust property and the trustee's other property,[127] the appointment of an inspector upon cases of breach,[128] the approval of the resignation of trustees,[129] the appointment of new trustees,[130] the appointment of a manager between the resignation of a trustee and the appointment of another,[131] the determination of price in the case of the buyout of minority beneficial interests,[132] the appointment of a protector where beneficiaries are not ascertained,[133] upon unforeseen circumstances requiring changes to the trust,[134] the termination of a trust upon request by public authorities on grounds of the public interest,[135] to compel the trustee to produce documents in relation to the keeping of accounts of limited liability trusts,[136] and certain powers with respect to the liquidation trustee for such trusts.[137]

Although these powers may appear extensive, as Arai Makoto observes, they are a retreat from the general jurisdiction exercisable under the old article 41.[138] As Kishita points out, in a civilian jurisdiction the court simply lacks the experience and ability to intervene on non-litigated matters,[139] which contrasts sharply from common law jurisdictions. However, it is also easy to overstate the significance of the court's general jurisdiction, as a court's ability to intervene ultimately depends upon the vigilance of trust parties, and their awareness of the basic rules of the trust. Thus the enumeration of the court's powers may in fact be a more effective way of allowing the court to supervise the trust compared to a general residual power. Yet, unlike a contractual situation the Japanese trust covers situations where beneficiaries may yet be unascertained, perhaps to fill a gap otherwise left by civil law where a contract for the benefit of such parties is difficult to create.[140]

As a settlor is a necessary party in any trust and he is interested in what happens to the property, it is possible to explain the settlor's role as the ideal person to step in to assist as a default protector,

[124] Witz (n 16) 73.
[125] Trust Act (n 20), art 6.
[126] Ibid, art 11, in which case the settlor's creditors have the right to petition the court.
[127] Ibid, art 19(2), (4).
[128] Ibid., arts 46-47.
[129] Ibid., arts 57-58.
[130] Ibid., art 62.
[131] Ibid., arts 63-64, 66, 71, 74.
[132] Ibid., art 104.
[133] Ibid., arts 123, 131, 258.
[134] Ibid., arts 150, 165.
[135] Ibid., art 166.
[136] Ibid. art 223.
[137] Ibid., art 230.
[138] Arai, *Shintakuhō* ("Trust Law") (Yūhikaku 4th edn 2014) 2.
[139] Kishita (n 38) 38-39.
[140] Nōmi (n 39) 7.

for example where beneficiaries are not yet ascertained or lack capacity.[141] In the US there is also no general prohibition against the settlor having standing to enforce a trust on behalf of beneficiaries who may be incapacitated, unascertained, or unborn, which can be achieved by his applying for appointment as a guardian or "next friend" of the beneficiaries to the court, whereas in England the different rules facilitating the representation of such beneficiaries do not involve the settlor.[142]

## Part IV: The Consequences of the Settlor's Role

**Key Consequence of the Lack of Alienation: Insolvency Protection**

Two significant problems exist where property is not fully alienated from the settlor, the most important being the issue of asset partitioning. Traditionally, Japanese jurists have assumed that because asset partitioning is a core feature of the trust, it should exist by default when the trust form is used.[143] In two 1930s cases involving claims by the settlor's trustee in bankruptcy on the trust property or attempt to remove the trustee, the Tokyo District Court dismissed the claims with reference to the distinctive nature of the trust contract based on the provisions of the Trust Act, which meant that the rights and duties of the trustee continue in spite of the settlor's bankruptcy,[144] and which did not grant the settlor's trustee in bankruptcy the power to invoke article 47 to remove the trustee.[145] While these decisions were probably correct on the facts, and there was no suggestion of the lack of alienation of property by the claimants, it should be noted that the court's understanding seemed to go as far as holding that asset partitioning is an inherent feature of the trust, rather than looking more closely into any claims that the settlor's creditors may have notwithstanding these trust features.[146] It was perhaps significant that the Japanese settlor's ability was limited to a claim against the trustee for compensation or restoration of the trust fund in cases of breach, rather than to void the trustee's action under the current Chinese law.

The Japanese tax specialist Satō Hideki identifies four situations in which the alienation of the property from the settlor is questionable: where the settlor is able to revoke the trust, where the settlor enjoys a beneficial interest at the end of the trust, where the settlor derives direct or indirect income from the trust, and where the settlor controls the beneficiary's ability to enjoy the benefits of the trust.[147] Given that in a commercial situation, an investor is unlikely to purchase a beneficial interest in a fund that is not alienated from the settlor, the safeguards against the overt retention of control by the settlor are partly contained in industry standards on accounting rules for financial instruments.[148] These rules require the protection of the buyer of a financial asset through contract, the conferral on the buyer of the ability to exercise his ordinary contractual rights with respect to

[141] Marini (n 24).
[142] Halbach (n 89) 732. In England, although the court is able to give consent on behalf of such beneficiaries, where there are no ascertained beneficiaries a trust risks failing to satisfy the rule on the certainty of objects. See *Re Gulbenkian's Settlement Trusts* [1970] AC 508, 524 (Lord Upjohn) on the importance for the court to know who the beneficiaries or objects of the trust.
[143] Arai (n 138) 129-131, 345.
[144] Tokyo District Court, Shōwa 2-5-2, Shinbun 2691-6 (1927).
[145] Tokyo District Court, Shōwa 8-12-9, Hyōron 23-511 (1933).
[146] This point is discussed in more detail below for China, where the jurist Zhang Junjian suggests that the settlor's retention of the power to set aside the trustee's actions, which is arguably a more extreme case of a power available to the settlor, may be used by the settlor's creditors in a way that would place the court in an awkward position with respect to the inherent logical inconsistency in the Chinese legislation.
[147] Satō Hideaki, "Isan shōkei ni kakawaru shintaku zeisei ni kansuru jakkan no kōsatsu" ("Certain observations on trusts tax rules in testamentary trusts") in Arai (n 119) 174-177.
[148] Accounting Standards for Financial Instruments, ASBJ (Accounting Standards Board of Japan) Statement No 10 (1999, most recent version 2008).

the asset, and that the seller should not have the option of repurchasing the asset until the termination of the trust.[149] To Arai, the centrality of the problem of settlor alienation means that more thought needs to go into the issue of asset partitioning even in a commercial context. As Briggs J (as he then was) observes in *Pearson*, there is an inverse correlation between parties' consensual disapplication of core features of the trust relationship, and the likelihood that they can be found to have intended a particular legal form.[150] While the default nature of Japanese statutory provisions makes the case of validity prima facie more compelling, the core difficulty involving asset partitioning remains. So long as the Japanese court is unaware of this difficulty, the trust form is vulnerable to potential abuse, especially against the settlor's creditors.

For the French *fiducie,* the aforementioned loophole where a settlor can revoke the *fiducie* by changing its fiscal status, or the lack of an express requirement for the Chinese settlor to transfer property entail similar deficiencies in alienation, which makes it difficult to see these trusts as adequate solutions in commercial situations such as securitisation, where strong asset partitioning is required.

**Dual Centres of Power**

Further, a significant residual role for the settlor can also lead to uncertainty, in the event of conflict between the settlor and other beneficiaries. However, in Japan this problem should not be overstated, as there is no question that the trustee's duties are owed to the beneficiary rather than the settlor.[151] The reverse is true in France, where the beneficiary enjoys no explicit rights other than to refuse the *fiducie*.[152] In the testamentary context, both Japanese[153] and French[154] laws provide that a will can be changed at any time up to the point of death, which may explain the juristic acceptance of the reservation of powers by the settlor.[155] However, there is also a recognition that such acts of settlor intervention may undermine the trust structure in the commercial context, for example in the use of the trust form in the succession of enterprises or in the M&A context.[156] Furthermore, Japanese jurists also concur that the exercise of such a power must stay within the bounds of the power: in cases where the power to add beneficiaries is used to appoint property to persons who are unrelated to the purpose of the trust, it would be an abuse of rights and thus invalid.[157]

Nonetheless, it remains a valid observation that if part of the goal of the trust is to implement the original intentions of the settlor in the long-term management of property, then it is unhelpful to have the living settlor redefine his intentions at some later point, unless his original plan is to have continuing control over the composition of beneficiaries and appointment of property.[158] Once again the French *fiducie* allows this explicitly: serving the settlor's interests directly is one of the main purposes envisioned for the *fiducie*, and in security trusts, the settlor can retain control over the

[149] Arai (n 138) 131.
[150] [2010] EWHC 2914 (Ch) 225 [260].
[151] Supreme Court of Judicature, Shōwa 9-5-29, Hyōron 23 shohō 400 (1934).
[152] Mallet-Bricout (n 49) 149-150.
[153] Civil Code (n 109), art 1022.
[154] Grimaldi (n 71) para 60.
[155] Nōmi (n 39) 22.
[156] Ibid.
[157] Ibid. 23. In English law, see *Re Wright* [1920] 1 Ch 108.
[158] Trust Act (n 20), art 89.

asset.[159] However, although the Japanese settlor can himself be the donee of such a power,[160] this can only be done by an express designation in the trust instrument. In other words, the Japanese settlor is no more entitled to resile from his promise to confer beneficial interests upon beneficiaries than an English settlor once the trust has been formally constituted.[161] Given the current state of Japanese law which assumes some degree of retention of settlor powers, arguably a simple good faith duty would be sufficient to allow the court to detect incidents when the right to petition the court is capriciously used to undermine the beneficiaries' interests, and it appears that a situation of this kind would be covered by the Japanese "abuse of rights" doctrine as identified in Nōmi and Dōgauchi above.[162]

In China, as Zhao points out, recent developments such as the revocable trust in the US and offshore jurisdictions have led Chinese jurists to perceive that settlors are increasingly interested in and able to retain a wide range of powers and benefits.[163] However, it remains odd that the powers of the Chinese beneficiary are parasitic upon those of the settlor: per article 49, the beneficiary is able to exercise the powers available to the settlor in enforcing the trustee's duties. In exercising these powers, if the settlor disagrees with the beneficiary's actions, the beneficiary can apply to the court for adjudication, which creates significant problems of uncertainty and costs.[164]

The most trouble aspect of the Chinese settlor's retention of powers lies in his ability to set aside the trustee's acts in breach of trust under article 22. In both the English and Japanese trusts, the ability to set aside the trustee's actions is not usually necessary, because in cases of breach the trustee can simply demand compensation from the trustee or for the trustee to restore the trust fund. By allowing the settlor the right to set aside the trustee's acts in breach of trust, the Chinese Trust Law is in effect creating a third set of exclusionary rights to legal and "beneficial" titles, which pose a challenge to the *numerus clausus* principle.[165] Further, it threatens the independence of the trust fund, as it is questionable that a settlor who is able to set aside the trustee's actions at will has relinquished control of the fund. In the view of jurist Zhang Junjian, such a weakness in the juristic architecture of the trust is fatal to the trust's integrity. In spite of articles 15 and 16 declaring the trust fund as independent from both the settlor and the trustee, it is plausible that the settlor's creditors can assert their rights over the trust property by using the settlor's right to set aside the trustee's actions to show that property has not in fact been alienated. This not only defeats the trust, but also places the Chinese court in the potentially awkward position of adjudicating between contrary legal provisions.[166]

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[159] Grimaldi (n 71) paras 34(2), 54; C civ, art 2018(1).
[160] Arai (n 138) 225.
[161] *Re Rose* (n 81); *Pennington v Waine* [2002] 1 WLR 2075.
[162] Nōmi (n 39) 23.
[163] Christopher McKenzie, "Having and Eating the Cake: A Global Survey of Settlor Reserved Power Trusts" (2007) 5 PCB 336; Jonathan Russen QC, "The Reserved Powers Trust: When Might Power be Property" (2013) 20 JITTCP 239; Victoria Pratt and Kim Paiva, "Reserved Powers Trusts—Halcyon Solution or Recipe for Conflict?" (AO Hall) < http://aohall.com/file/6/n9-280414-handout-final-kp-and-vp.pdf> accessed 4 December 2019.
[164] Yu Haiyong, "Zhongguo xintuoye xianru dimi de falü fenxi" ("A legal analysis of the downturn of the Chinese trusts sector") in Fan Jian (ed), *Zhongguo xintuofa luntan* 2014 ("Chinese trust law forum 2014") (Falü chubanshe 2015) 37.
[165] As Nolan argues, the potential damage of the English trust to *numerus clausus* is limited by the exceptions carved out, most notably the trust's ineffectiveness against bona fide third party purchasers for value without notice. Nolan, "Equitable Property" (2006) 122 LQR 232, 235.
[166] Zhang (n 46) 93.

**Duties of the Settlor and Analogy with Donees of Powers**

Currently the Japanese Trust Act does not impose any duties on the settlor after the formation of the trust, in spite of his continued role in the trust as a donee of non-fiduciary powers or a protector, and the fact that as a residual beneficiary, his interests may conflict with those of other beneficiaries. However, aside from the questions of asset partitioning and taxation, arguably there is no reason why a settlor should not be able to reserve non-fiduciary powers.

In this respect, a strong analogue to the settlor's retained powers would be donees of the power to give instructions to trustees. In Japan the donees of such powers usually hold them in a fiduciary capacity. In the view of Kimura Hitoshi the donee's duties include duties of loyalty and care akin to those which trustees owe to beneficiaries.[167] In the context of regulated trusts, article 65 of the Trust Business Act imposes a form of fiduciary duty on such donees, which is owed to the beneficiary. This is justified juristically on the basis that the duty flows from an agreement between the settlor and the donee, which creates a relationship analogous to mandate where the mandatary owes a duty of loyalty and care to the mandator. These duties in turn are subjected to the goals of the trust as expressed through the intent to create a trust in the contractual agreement between the settlor and trustee.[168] This is in spite of the fact that such the duties of loyalty and care, good faith and fairness prescribed by article 133 (1) and (2) for trust protectors in Japan are not imposed on the donees of such powers per se, which means that in an unregulated context the duty has to be imposed by analogy with mandate. Kimura goes as far as arguing that in cases of breach, the donee should in principle be liable for either compensating or restoring the trust, per article 40 (1) and (3) of the Trust Act applied to trustees.[169]

However, as Kimura points out, even the law with respect to donees of such powers faces a limitation in cases where the settlor is the donee, in which case the power is seen as a non-fiduciary one. This is because in cases where the settlor is viewed as a beneficiary in Japanese law, and is thus entitled to exercise the power to benefit himself, the power is understood to be a non-fiduciary one.[170] However, as discussed in the introduction, in the same way that a trustee or a trust protector can also be a beneficiary, it is vital that fairness between different classes of beneficiary is maintained.[171] In this respect, the notion that a donee who is also a beneficiary should not be subjected to any duties is unsound. In such situations the settlor, like the donee, should be subjected to the basic duties of loyalty and care not exceeding good faith, in other words the same level of core duties as trustees.[172] Juristically this can be done by applying the duties imposed on trustees by analogy to settlors who are functioning as de facto donees of a power, on the basis that the intent of the settlor and trustee to benefit the beneficiary necessarily requires the settlor to exercise any residual powers in good faith, and in ways that do not subvert the intent of the settlor and the trustee as expressed in the trust instrument.

The weak position of the French beneficiary vis-à-vis the settlor makes it difficult to foresee how, in a more purely contractual situation, the settlor can be subjected to fiduciary duties, other than the duty not to commit fraud against third parties. As the settlor remains ultimately liable for losses

[167] Kimura (n 61) 1129.
[168] Ibid. 1128. This is with the exception of cases where the donee is the sole beneficiary. Ibid. 1127.
[169] Ibid. 1128.
[170] Halbach (n 89) 729. Restatement (Third) Trusts § 48.
[171] See *Centre Trustees* (n 60).
[172] Joyman Lee, "The Irreducible Core of Trustee Duties in East Asian Trusts" (2021) 27(4) Trusts Trustees (forthcoming); ttab013, https://doi.org/10.1093/tandt/ttab013.

caused by non-negligent trustee actions,[173] it is difficult to assert that the French settlor has in fact relinquished his beneficial interest over the property (unless it is actually transferred to the beneficiary at the end of the *fiducie*). Thus, any imposition of fiducial duties on the settlor would be unconstructive. The more pertinent conversation is whether the *fiducie* is suitable for commercial purposes such as securitisation, where substantive asset partitioning is a core requirement.

## Conclusion

This paper has shown that the strong residual role of the settlor in the Japanese trust, which can be analogised with that of an enforcer or protector in the offshore context, is not the result of the use of contracts in creating trusts, but it is an expression of the greater emphasis on the settlor's intention which civilian trusts share with US trusts. The irrelevance of taxation considerations, and the lack of appreciation of the logical inconsistency between the lack of alienation of an asset from the settlor and insolvency protection, further permit the settlor to retain a larger role than in the common law trust. This issue has not arisen as a problem in part because of the lack of litigation that concerns trust relations, and in extreme cases at least one Chinese jurist has suggested that it may be open to settlors' creditors to allege that trust property has in fact not been alienated on the basis of the settlor's ability to set aside an act of the trustee in a self-interested manner. In France the trust goes as far as separating the assets from the trustee's patrimony, but talk of genuine separation from the settlor's assets is idle.

To this end, should civilian trusts aim to achieve the proprietary effects of the English trust, the Japanese reduction of settlor's duties and the imposition of a degree of fiducial control is a helpful one. It is submitted that imposing duties on settlors akin to good faith is helpful, especially in cases where the settlor's interests conflict with those of other beneficiaries. In China, however, the continued stalemate with respect to the transfer of property is unproductive, and the net effect of the ambiguity is to reduce judicial effectiveness by requiring first instance courts in metropolitan areas to deal with the problem on a case-by-case basis, or to abandon control over the development of trusts rules to the regulator. In the short term, reducing the inconsistencies between the Chinese and Japanese trust statutes, for example by expressly introducing the position of trust protector, may help to reduce the need to depend on the settlor as an enforcer, with its undesirable consequences such as the lack of certainty for beneficiaries in the event of conflict. With respect to the French *fiducie*, it is up to the legislator to decide whether the trust should assume a more meaningful role in commercial operations. If the answer is affirmative, either for France or for other continental European jurisdictions, then it is submitted that the Japanese trust offers a particularly successful mode for replicating the proprietary effects of the common law trust in a civilian environment.

[173] Per C civ, art 2026, the trustee is responsible for losses caused by his own fault, although the law does not specify the nature of the regime of contractual responsibility. François (n 74) ch2 para 165.