2001

Basic Issues of Private Law Codification in Europe: Trust

Ugo Mattei

UC Hastings College of the Law, matteiu@uchastings.edu

Follow this and additional works at: http://repository.uchastings.edu/faculty_scholarship

Recommended Citation

Ugo Mattei, *Basic Issues of Private Law Codification in Europe: Trust*, 1 *Global Jurist Frontiers* Art. 5 (2001).
Available at: http://repository.uchastings.edu/faculty_scholarship/1289

This Article is brought to you for free and open access by UC Hastings Scholarship Repository. It has been accepted for inclusion in Faculty Scholarship by an authorized administrator of UC Hastings Scholarship Repository. For more information, please contact marcusc@uchastings.edu.

Global Jurist Frontiers

Vol. 1, Issue 1	2001	Article 5
-----------------	------	-----------

Basic Issues of Private Law Codification
in Europe: Trust

Ugo Mattei
Hastings College of the Law; Univ. of Turin, Italy

Abstract

In this paper I approach trust law from the perspective of the European legal system considering whether or not to codify this area of the law. My hope is that this practical focus can bring some better understanding of the nature of trust law. I try moreover to move a step forward in tackling some of the basic questions that should be on the agenda of European private law today.

Global Jurist Frontiers is in the Global Jurist family of journals.

Copyright ©2001 by the authors.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the publisher, bepress.

BASIC ISSUES OF PRIVATE LAW CODIFICATION IN EUROPE: TRUST.

Ugo Mattei¹

1. Introduction.

In this paper I approach trust law from the perspective of the European legal system considering whether or not to codify this area of the law. My hope is that this practical focus can bring some better understanding of the nature of trust law. I try moreover to move a step forward in tackling some of the basic questions that should be on the agenda of European private law today.

There is no need of much introduction on the question of Codification of the private law in Europe. The issue has been now on the table for a while. Although there still is much disagreement among scholars on whether or not it is worth doing it as well as on how it should be done, the fact is that a number of projects are going ahead so that the whole discussion on the whether, the if, and the how might become obsolete and boring pretty soon².

A better way to use scholarly energy seems to me that of learning by doing, being aware that the ultimate decision will be political and that as scholars the only responsibility we carry is that of producing technically decent building blocks for this enterprise.

In a previous paper I have argued that in the domain of contract law the European Civil Code should be limited to a number of mandatory provisions, common for consumers and merchants and

¹ Alfred and Hanna Fromm Professor of International and Comparative Law, Hastings College of the Law, University of California. Professore Ordinario di Diritto Civile, Università di Torino. This paper has been prepared for inclusion in the proceedings of the Comparative Law Conference held at the University of Hong Kong, June 4,5 1999. The author wishes to thank Michele Graziadei, Lionel Smith, Antonio Gambaro, John Langbein, Hein Kotz, Kenneth Reid, George Gretton, Mauro Bussani and all the participants to the meetings on Trust of the Common Core of European Private Law Project held in July 1998 and July 1999.

² See R. Sacco, *Non, Oui, Peut-Etre*, in *Melanges Christian Mouly* 163 (1998); A. Hartkamp, *The European Civil Code Project*, paper delivered at the July 1999 Meeting of The Common Core of European Private Law Project; A.S. Hartkamp et. al. Eds. *Towards a European Civil Code*, (2d. Ed. 1998)

enforced by an effective system of European Courts³. In this paper I approach trust, another area of private law that could be a good candidate for codification. Compared to the issue of codification of contract law, the law of trust immediately creates special problems. To begin with, none of the traditional paradigmatic civil law codes (Germany, France, Italy and Switzerland) includes a chapter on trust while all of them include contracts. Second, because the dispute on the nature of trust law itself is far from settled among scholars and the issue on whether trust is to be considered a matter of property or a matter of obligation is still loading the table of the scholarly discussion with useless conceptualism⁴. Third, because trust is itself a legal category lacking unitary meaning so that today its boundaries are certainly in need of more definition than those of contracts⁵.

Despite these difficulties, there are a few reasons that make trust law in a front running position to be considered for any project of European Codification. First, on the political ground, because trust is probably the most important contribution that common law countries are likely to offer to the whole codification enterprise. If the European Civil Code has to compromise between the different legal traditions of Europe, the inclusion of trust is likely to happen as a consideration paid to common lawyers for being involved in an enterprise that might have the stigma of being a biased civilian idea⁶. This political reason is by no means the only justification for giving thorough attention to trust in a codification project. Indeed, trust law has proved to be a very successful legal device. From its original crib in the English Chancery jurisdiction it has found its way in a very high number of other legal systems. Many jurisdictions in which today trust can be found are ignorant of the common law-equity division. Consequently, such legal systems have received trust at very different levels of their sources of law, sometimes placing it in the code, sometimes introducing special statutes, sometimes working out case law developments⁷. This variety shows

³ U. Mattei, Efficiency and Equal Protection in the New European Contract Law. Mandatory, Default and Enforcement Rules, in 39 Va. J. Int. Law 537 (1999).

⁴ The issue has been framed exactly in these terms at the Bristol Conference of the International Academy of Comparative Law. See the some of the reports in M. Canton-Cumin, Trust. A Matter of Property or of Obligation (Forthcoming 1999)

⁵ See generally, A.J. Oakley (Ed.), Trends in Contemporary Trust Law (1996)

⁶ See P. Le Grand, Against a European Civil Code 60 Mod. Law Rev. 44 (1997)

⁷ An updated panorama of statutory sources of trust law can be found in M. Luopoi, Trust. Legislative Sources (1998)

that trust has proved to be a desirable legal arrangement. Some scholarship has tried to show that this prestige stems from a higher degree of institutional efficiency lacking in the so called “trust like devices” or “trust alternatives” that some civil law systems have worked out in order to resist importing a legal device felt as incompatible with the traditional civil law notion of property rights⁸. Finally, trust law has strongly emerged from the ghetto of black letter comparative law and it has gained a central position in the high table of scholarly discussion by a number of theoretical articles devoted to it in the United States⁹, by the ambitious publication of a draft of principles of European Trust law¹⁰, and if I may, by the launching of a project on trust within the Common Core of European Private Law Project¹¹.

From the perspective of my involvement as a co-editor in this last project I delimit the scope of this paper’s inquiry. As it is very well known, the development of trust in the common law tradition has affected a large variety of areas of the law so that there is virtually no topic of Anglo-American private law in which the law of trust does not or could not play some role. In the following pages I do not approach two broad areas of private law in which Anglo-American trust plays a fundamental role: family law and successions¹². These two fields, connected as they are with each-other, are deeply imbedded in local cultural characteristics and indeed many scholars think that, because of this, there is no need to achieve any degree of uniformity in this domain. Trust moreover has been widely used for charitable purposes. Despite the effective competition that charitable form might introduce to business form as an institutional setting for transactions¹³ (such competitive effectiveness in the United States is certainly subsidized by tax law) it might be argued that trust like devices such as civilian “foundations” operate in a very similar way to charitable trust so that

⁸ See U. Mattei, Efficiency in Legat Transplants: An Essay in Comparative Law and Economics 14 Int Rev. Law and Economics 3 (1994) 10; A. Gambaro, Il Trust in Italia e in Francia. Studi in Onore di Rodolfo Sacco (1994). H. Hansmann-U. Mattei, The Functions of Trust Law, 73 N.Y.U. Law Rev. 434 (1998)

⁹ See the seminal piece by J. Langbein, The Contractarian basis of the Law of Trusts, 105 Yale L. J. 165 (1995)

¹⁰ See D.J. Hayton et al. (Eds.) Principles of European Trust Law (1999).

¹¹ See M. Bussani-U. Mattei, The Common Core Approach To European Private Law, 3 Colum. J. Eur. Law 339, (1997). For details on the trust project see *infra*.

¹² See Fratcher, Structural Variations in Property Law. Trust : 6 International Encyclopedia of Comparative Law (F. Lawson Ed. 1972).

¹³ See H. Hansmann, The Role of Non Profit Enterprise 89 Yale L. J. 835 (1980)

this is not the area of highest interest for my purposes¹⁴. The domain of my discussion (as that of the common core project on trust) is therefore commercial or business trust, in the broad sense of trust as an institutional arrangement aimed to reduction of transaction costs (including agency and monitoring costs) in order to achieve efficiency in the development of a European common market. The transactions that I am focusing on are those among capable adults interested in money investment or in other managerial services. I do not focus, therefore, on spendthrift trusts, trusts for the protection of the minors, incapable or unborn. Seen from this perspective --- that of individual capable of striking Coasian bargains in their self interest, one can focalize on the aspects that make trust a desirable market institution. It should then be possible to focus on the issue of how to reach desirable goals which are fully within the scope of the European treatises even before Maastricht. The question is whether an how a European Civil Code can help in this attempt.

Section 2 sketches the fundamental aspect of institutional desirability of the trust as it has been developed in the common law world. Section 3 clarifies the fundamental questions that one should ask in this domain. Section 4 approaches some preliminary problems that might frustrate the codification enterprise. Section 5 briefly explains the Common Core Questionnaire on Trust seen as a preliminary inquiry on the state of trust law in Europe today. Section 6 concludes approaching the limits of substantive law codification.

2. The basic economic structure.

Seen as a fundamental market institution, trust shares some characters with contracts and some with property. From the first perspective, a recent seminal paper by Professor Langbein has pointed out that the nature of trust law, like that of contract, is mostly that of an aggregate of default rules aimed at gap filling in certain recurrent transactions, so that the parties, by using the label trust, can incorporate in their contracts a highly developed body of law mostly aimed at the specification of

¹⁴ See W.A. Wilson (Ed.) Trust and Trust-Like Devices (1981)

the fiduciary duties of the trustee ¹⁵. As to the relationship of trust with property, two fundamental aspects can be pointed out. First, the trustee, as the owner of property, has full decision making power over the trust property and he can exclude from it anybody in the world including the beneficiary. This is particularly important in the business world where quick, reliable, unimpaired decision making is per se an important asset that an agent, in principle, does not enjoy but that the trustee does. This decision making power is one of the essential features of ownership, and in the case of full ownership is extended all the way to irrational behaviors that the legal system simply has no power to preclude. For example, one owner can keep a rare book for the only purpose of painting its pages. Such behavior can be precluded if it affects a borrowed book from the library, not if it is carried on by the owner. The trustee decision making can only be limited ex ante by the trust instrument and can not be affected by the beneficiary during the trust relationship. Consequently, the beneficiary might only recover damages ex post should the trustee irrational behavior ends affecting the value of the fund. Nevertheless he can not interfere, for example, with the risk taking attitude of the trustee should the instrument be phrased in a way to allow to the trustee full managerial powers. From the decision making perspective, the entitlement of the beneficiary is protected only by a *liability rule* and that the property right is vested in the trustee.¹⁶

The large transfer of decision making authority that the creation of a trust determines over the trust property can only be afforded by a legal system that grants significant and effective powers to the beneficiary. And indeed such a protection is another fundamental analogy between the structure of trust and that of property rights. This fundamental proprietary protection of the trust fund in favor of the beneficiary becomes apparent in case of bankruptcy¹⁷. In this case the creditors of the bankrupt trustee can not satisfy themselves on the trust property that remains bankruptcy remote at the disposal of the beneficiary. A number of remedial devices of which “tracing” is only the most

¹⁵ See Langbein, cit. supra note 9.

¹⁶ See G. Calabresi-D. Melamed, Property Rules, Liability Rules, Inalienability. One View of The Cathedral, 72 Harv.L. Rev (1980). Strong cases in favor of the general desirability of property rules in a variety of contexts have been recently made by R.A. Epstein, A Clear View of the Cathedral: The Dominance of Property Rules 106 Yale L.J. 2091 (1997)

interesting for a civil law observer¹⁸ complete the analogy between the remedial devices of the owner (that can chase his property wherever he finds it) and the beneficiary. One could say that in front of the third parties the entitlement of the beneficiary is protected by a *property rule*.¹⁹

If one observes this picture from the perspective of a civil law system his imagination is much more impressed by the proprietary aspects rather than by the contractarian aspects of trust law. Indeed trust as a body of default gap filling rules can be almost perfectly substituted by the provisions on the contract of mandate which are well developed in all the civilian countries. The proprietary aspects of it are, on the other hand, a traditional puzzle for the civilian lawyer who finds it difficult to conceive a property rights vested simultaneously on the trustee (managing powers) and on the beneficiary (protection in front of the third parties). According to traditional civil law thinking, when the trust relationship is established by means of contract without a formal transfer of ownership the trustee finds himself most of the time and by means of various devices in a subordinate position in front of the beneficiary who, being “the owner”, maintains a significant amount of decision making power. To be sure, the beneficiary can be stripped from decision making power (and in fact he is) by a variety of strategies to hide information or simply by the de facto informational asymmetry. Nevertheless the tension between the needs of effective decision making power for efficient management and the power-sharing outcome of the contractual arrangement creates a distorted incentive scheme. When the trust relationship is created by what the civilians call a fiduciary transfer of ownership, on the other hand, the beneficiary enjoys a very limited protection and the remedial devices he can use are extremely poor and ineffective. At most he is protected by a *liability rule* in front of the unfaithful trustee who is “the owner” in front of the whole world. Having parted from the ownership positions, the beneficiary will have to suffer the effective competition of the creditors of the trustee which in bankruptcy cases ends up being the

and J.E.Krier-S.J.Schwab, Property Rules and Liability Rules: The Cathedral in Another Light 70 N.Y.U.L.Rev. 440 (1995).

¹⁷ See Hansmann-Mattei, cit. supra note 8

¹⁸ See L. Smith, Tracing, (1998)

¹⁹ See U. Mattei, Comparative Law and Economics --- (1997)

most significant difference between the common law trust and the civilian alternatives. Moreover the beneficiary has tremendous difficulties in tracing property that he does not own.

As we will see, this *prima facie* impression that can be grasped by reasoning with the categories of ownership and obligation might not be entirely accurate and it is certainly in need of being verified. Nevertheless the institutional structure created by the “dual ownership” of the Anglo-American trust allows a plain division of labor between the trustee and the beneficiary that civilians find it different to reproduce.

Seen from the economic perspective, such division of labor is efficient. By granting proprietary protection to the beneficiary the law reduces agency costs. By granting proprietary powers to the trustee the law facilitates transfers to more efficient uses. In general, transaction costs are significantly reduced because the trustee can devote his resources on grasping business opportunities rather than on obtaining the consent of the beneficiary. The beneficiary will be able to devote his resources in his principal activity (e.g. teaching law or farming) rather than in trying to grasp himself business opportunities, an activity in which he is not specialized and where he would be better off by hiring a professional. Division of labor that follows from this efficient institutional arrangement is a crucial aspect of economic development²⁰. We might conclude that the structure of Anglo-American trust law constitutes an advanced institutional arrangements that more developed societies should recognize.

3. The relevant questions

Given the fact that advanced economic development is shared by a number of civil law countries, one could wonder how such countries tackle these basic problems of labor division. As often happens it is easier to see what would not work as an institutional solution rather than what would

²⁰ See D. North, *Institutions, Institutional Change and Economic Performance* (1991).

work so that one should get rid at least of the most useless questions that are usually asked in the comparative law literature on trust.

As the work of Professor Langbein has taught, the contract aspects of trust law should be interpreted in the very same way of any other contractual arrangement²¹. From the contractarian perspective the main aspect is gap filling and incorporation of a body of law as a system of default rules. The basic problem is then whether and if some rules should be considered mandatory (either because of paternalism or because of externalities problems)²². Hence, also in the prospective of Codification, the mandatory vs. default character remains crucial. Elsewhere I have argued that in the domain of contract the Code should be limited to mandatory rules²³. If the focus is on contract aspects (or if trust is to be approached as “a matter of obligation”) as in the traditional comparative law jargon one would say, the relationship between the parties involved in the trust deal occupies the center of the stage. Such a relationship, of course, is not developed in a vacuum but it might affect third parties as it invariably happens when the parties contract among themselves for managerial services that, in business transactions, involve transfers of property rights. The question then becomes how the body of law that the parties incorporate in their deals takes care of third parties, how in other words it is possible to avoid externalities and instead to signal to third parties incentives to actively transact rather than to be unwillingly affected by externalities. This is the traditional function of property law, or at least, to use Professor Carole Rose’s convincing reconstruction, of the “crystal” characteristic of property law²⁴. Contract law needs to be supplemented by property law when it comes to deals affecting third parties, because the parties involved in the contract might opportunistically shift some of their costs to third parties²⁵. Property law, because of the need to be interpreted in a relative uniform way by a high variety of individuals that do not share the particular knowledge that the parties of the contract generate by transacting

²¹ See J. Langbein cit. supra note 9

²² See I. Ayres-R.Gertner, Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules, 99 Yale L.J. 87 (1989).

²³ Mattei, cit. supra note 3.

²⁴ See C. Rose, Christsals and Mud in Property Law 40 Stan. L.Rev. 577 (1988)

amongst themselves, strives to remain simple in order to offer relatively uniform signals. Whether or not simplicity in property necessarily carries “mud” (in the sense that simple rules show potentially tragic commons problems and courts consequently mess them up ex post in a clumsy attempt to take care of them)²⁶ it remains true that property law is ill equipped to take care of the flexibility needs of complex transacting. There is a clear tension between the need of simplicity in signaling to a collectivity of non informed third parties and the need of flexible instruments to give legal form to the nuances of the meeting point between supply and demand. While, for example, it is technically possible to register and signal to third parties certain limitations of property rights but not the whole variety of contingencies that might affect them, one needs instruments capable of reflecting in detail the obligations that parties carry towards each other. As a consequence, some aspects of a deal live their whole life in the domain of contract law and can not be opposed to ignorant third parties while other aspects enter in the dimension of property and can be opposed to third parties that should have known them. It is simply too costly in the real world to make every possible detail of a deal among parties known to everybody. And of course it might not even be desirable. Legal systems have to strike a line somewhere. As a consequence, the relevant question is not whether trust is a matter of property or a matter of obligation but what aspects of the complex economic relationship that is called trust in the Anglo-American world should become known (at least in theory) to everybody and which should be kept among the parties to the deal. While the property structure is well equipped to take care of the former need and poorly for the latter the contract structure works the other way around. The complex institution called trusts needs both. The matter is to decide the correct ratio between them. Such decision should be taken rationally and not as a matter of path dependency from a far past. Because of different historical developments, common law systems might have overused property and civil law systems contracts. A European Civil Code might be a good occasion to seek the proper ratio.

²⁵ See M. Trebilcock, *The Limits of Freedom of Contract* (199)

²⁶ This theory is advanced in Rose, *cit. supra* note--

The obligation vs. property issue is not only a misleading dichotomy. It might also preclude the correct appreciation of other possible institutional alternatives to trust. It is interesting to observe that while a lawyer from the civil law if asked to inform a colleague from a common law jurisdiction on “alternatives” to trust law available in his country would invariably spend a long time to explain the obsolete and largely useless notion of the “*fiducia cum amico*” he would invariably omit any discussion of corporations. This phenomenon, made clear by the *prima facie* replies to the trust questionnaire offered by leading experts in civil law jurisdictions in the Common Core Project, almost exactly parallels the one pointed out by Professor Langbein in another recent article, that on the “Secret life of Trust”²⁷. Common lawyers nurture a vision of the importance of trust in a domain that is relatively trivial as compared to that in which this institution offers a really vital contribution. In the domain of business law, the area in which most of the stakes of European legal integration are at play, the relationship between trust and corporation as competitive alternatives needs to be tackled. This is an area in which possibly very substantial transaction costs might be saved by offering a simple legal form able to take care of both the needs of flexibility and those of notice that would be accomplished by the proper mix of contractual and property structure. In conclusion, three seems to be the relevant questions to be asked: 1. Which of the rules that govern a trust transaction should be mandatory and which ones should be default. 2. Which parts of the trust deal can remain internal and which part should be known (at least in theory) to third parties. 3. Which legal structure is best to take care of the basic needs of a trust transaction, i.e. managerial discretion and beneficiary protection.

4. Preliminary issues of trust law codification: legal pluralism, legal formants and jurisdiction.

No attempt to codify the law can be carried on without full consciousness of the nature and the limits of such enterprise. Nobody believes any more in nineteenth century civilian codes ideology,

²⁷ See J. Langbein, *The Secret Life of Trust*, 107 Yale L. J. 165 (1997).

i.e. the break with the past and the imposition of a single legal order. A code for the new millennium has to consider the importance of legal pluralism²⁸ and the nature of the law as a competitive mix of legal formants²⁹. Two aspects of these modern theoretical foundations become relevant in the domain of a proposed chapter on trust law of a European Civil Code. To begin with, the civil code will have to compete with other sources both of local national production and of private nature³⁰. The code has no authority to displace any one of these alternative sources in the domain of default rules. Parties to any private law transaction can pick up the law governing their relationship from where they like most. The process of making a European Civil law Code will most probably be highly loaded by political problems. Its technical nature is likely to reflect such problems and political compromises are not germane to technical clarity and accurateness. Consequently, the European Civil Code should be strictly limited to mandatory provisions, that minimum amount of rules (or perhaps standards) that neither the parties nor the member states would be free to change. This is of course where the issue of legitimacy might arise so that the case for mandatory European rules should be found in the needs behind the making a common market. Consequently such rules (or standards) should be justified by economic principles. Mandatory rules therefore must be codified for two possible reasons: a) to take care of the protection of the weaker party i.e. because of a paternalistic rationale or b) to take care of externalities i.e. to avoid that certain costs of the transacting amongst parties be transferred to innocent third parties³¹. Both these aspects deserve some discussion. As to the paternalistic rationale, nothing particular can be said in the domain of trust that one would not already say in that of contract. The only thing that one might stress here is that weakness in the domain of business trust usually does not stem from the personal status of either of the parties but rather from informational asymmetry between the investor (beneficiary) and the trustee (manager). Such asymmetry can simply be explained as a phenomenon

²⁸ See M. Guadagni, Legal Pluralism, in P. Newman (Ed.) *The New Palgrave. A Dictionary of Economics and the Law* (1998)

²⁹ See P.G. Monateri-R. Sacco, Legal Formants, in P. Newman (Ed.) *The New Palgrave. A Dictionary of Economics and the Law* (1998)

of bounded rationality on the side of the investor and it might actually convey appropriate incentives for healthy division of labor³². The investor is simply too busy in his personal activity to bother getting all necessary information so that it might be rational for him to trust the trustee and the law as his agency of protection towards the professional trustee. His reliance is of course justified only if the legal system does not allow the professional trustee to add to that bunch of paper that the investor is signing without reading another little form that lowers all the standards of professional liability.

The second rationale for mandatory rules, that of avoiding externalities, is typical of trust as a property instrument on which third parties would rely. In this context there is a balance to strike between the interests of the investor beneficiary and that of the general creditors of the trustee that, if the trust nature of the fund is not properly signaled, might rely on the trust property as belonging to the trustee. Here again there is a case for precluding the trustee and the beneficiary to make their secret deals prevail on the interest of third parties (and perhaps even of the tax authority). Striking the proper balance between mandatory and default rules is once more crucial. While the Code might be the only source enjoying the legitimacy that is necessary for drafting mandatory provisions it might be much better off to leave default rules to other agencies. This at least as far as what is known in Anglo-American legal circles as “majoritarian defaults”. To the contrary one could make the case that what are known as “penalty defaults” aimed at create incentives to disclose information from the trustee³³, might nevertheless be better contained in the Code since they can be considered an exercise in de facto coercive power itself in need of some legitimacy. It would go beyond the scope of my paper to further develop this argument. I suggest therefore that only

³⁰ See A.Ogus, *Competition Between National Legal Systems: A Contribution of Economic Analysis to Comparative Law* 48 Int. And Comp. Law Q. 405 (1999).

³¹ See Ayres&Gerner, cit. supra note 22

³² See H. Simon, *Administrative Behavior* (1947); H.Simon, *Rationality in Psychology and Economics*, 59 J. of Business 209 (1986); A.Tversky&D.Kahneman, *The Framing of Decisions and the Psychology of Choices*, 211 Science 453 (1981). The last two are partially reprinted in A.W.Katz (Ed.) *Foundations of The Economic Approach to Law* 267 (1998).

³³ The distinction is advanced in Ayres&Gerner, cit. supra 22

mandatory rules should be codified at first and that the possibility to codify penalty defaults (assuming that they can be identified with some clarity) be better explored.

The European Code not only has to select the proper ground of competition with private agencies and local national legislatures. It has to grapple with another crucial question: that of competition stemming from other legal formants. The question is here very tricky because it touches on the ground of local interpretation of Uniform rules, a ground that might create more diversity in action than one wishes to acknowledge³⁴. Interpretation is loaded with local culture so that it is not unlikely that the same text changes its meaning not only in the process of translation into the different local legal languages but also when the time arrives of applying it to particular factual circumstances³⁵. This question, like that of selecting the minimal amount of mandatory rules to be included in the Code can not be solved in abstract ex ante but it must be immersed in the peculiarities of each legal system that is involved. A modern European Civil Code most likely will have to be a code of minimum standards rather than a code of rules. This assertion might look contradictory. Standards, being by their nature more “mud” than “crystal”, are even more open to interpretive differences³⁶. Nevertheless, if the institutional aims of the Code are clear, there is nothing wrong in allowing each legal system to pursue them in the way that is more coherent with the internal fabric of its private law. In other words, discretion in front of standards means assumption of responsibility of the institutional actors that are involved in the decision making, while different reading of the same rule outside real appreciation of its economic and institutional meaning only means confusion. It seems sound policy to avoid attempts to impose crystal rules from the top down already knowing that they will be muddled in very different local ways. It is better to hope that a bottom up process of adaptation to local circumstances ends up clarifying as much as possible relatively muddy standards that a European legal culture might strive to properly

³⁴ See G. Teubner, *Legal Irritants: Good Faith in British Law or How Unifying Law ends Up in Divergencies* 61 *Mod. Law Rev.* 11 (1998).

³⁵ See R. Sacco, *Legal Formants. A Dynamic Approach to Comparative Law*, 39 *Am. J. Comp. Law* 1 (1991).

³⁶ See D. Kennedy, *Form and Substance in Private Law Adjudication* 89 *Harv. Law Rev.* 1685 (1976).

understand ³⁷. European legal culture is already used to such process. Standards contained in European directives are routinely translated into local applied law in different local ways reaching relatively compatible results.

Codification of property like aspects of trust law might create a problem of jurisdiction³⁸. Article 222 of the Treatise leaves property law in the jurisdiction of member States. Such an objection should not be exaggerated. To begin with, as we have seen, property is only one aspect of the trust structure. Considering trust as “property” is already a matter of interpretation: it means focusing on certain aspects and forgetting others. Second, and perhaps more important, the principle of “subsidiarity” allows a transaction cost reducing codification. If one can better obtain by mean of European instruments rather than of local law, the reduction of transaction costs that the structure of trust law allows, the aforementioned principle grants jurisdiction to the Union.³⁹

Transaction costs reduction by codification is a function of the content of the Code. The Code should in other words preserve as much as possible of what is already common among legal systems, perhaps hidden behind different legal form, and reduce changes to the minimum that is needed to reach its stated economic results⁴⁰. Private law systems develop complex, different and relatively stable professional routines in which their actors (judges, legislators, professors, agencies etc.) settle. Such routines, that someone likes to call legal culture, are tremendously resistant to any attempt to change them with the strike of a pen. They might change but almost invariably as incrementally as they have developed. Such routines develop rules, standards and very often professional ideology. Any attempt to successfully codify in the world of legal pluralism and of competitive legal formants needs some knowledge of what is hidden behind such professional ideology. In the field of trust, for example there is a need to know what is the reality behind the much emphasized ideological assertion that the structure of civilian property rights is incompatible

³⁷ Emphasis on the role of legal culture in creating legal uniformity is emphasized by many scholars. See, for example, R. Zimmermann, *Roman Law and European Legal Unity*, in *Towards a European Civil Code* cit. supra note 2 at 21

³⁸ See A. Gambaro, *Perspectives on the Codification of The Law of Property* 5 *Eur. Rev. Priv. Law* 497 (1997).

³⁹ See R. Van Den Bergh, *Subsidiarity as an Economic Demarcation Principle and the Emergence of European Private Law*, 5 *Maastricht J. Eur and Comp. Law*, 337 (1998);

with trust⁴¹. We need to know how and if the alternatives that are already out there work in pursuing the transaction costs reducing scheme of the Anglo-American trust. This includes of course the role of any European legal source that is already in place (such as regulation of collective investment schemes). In other words, before deciding whether and how to codify there is a need to have available a reliable map describing the attitude of European legal systems in front of all the relevant legal issues that I have pointed out in the first part of this paper. Once this map is available, we might find ourselves in a better position to making informed guesses on how the different legal formants involved in the complex world of European Private law might behave in front of the code. We might, in other words, take sound options in front of issues such as the appropriate semantic level of the Code in order to create the proper incentive scheme to reach a cost effective code of trust law.

5. Drafting the map: the Common Core Questionnaire.

It is now five year that a large group of scholars convey in Trento every july with the aim of drafting a general reliable map of what, if anything, is already common in European Private Law. Such effort can be regarded as an attempt of data gathering which is an aim in itself. It is not aimed at fostering uniformity nor at doing ground-work for codification. Its aim is knowledge⁴². We dig for data that the legal community will then be free to use or disregard as much as it likes. Two years ago a project on Trust was launched. Michele Graziadei from the University of Como, Italy, Lionel Smith from Oxford University and myself being the Editors. As the whole Common Core Project, also the trust one is based on the factual approach developed by the late Professor and Honorary

⁴⁰ See U. Mattei, The Issue of European Private Law Codification and Legal Culture. Biases, Strategies and Developments, 21 Hastings Int. And Comp. Law Rev 883, (1998).

⁴¹ See P.G. Monateri, Everybody's Talking: The Future of Comparative Law, 21 Hast Int. And Comp. Law Rev 825 (1998).

⁴² See M. Bussani, Current Trends in European Comparative Law: The Common Core Approach, 21 Hastings Int. And Comp. Law Rev 785 (1998).

Editor Rudolf B. Schlesinger at Cornell in the sixties⁴³, and upgraded by using the “legal formants” approach generated by Emeritus Professor and Present Honorary Editor Rodolfo Sacco in his groundbreaking work in comparative law⁴⁴. The trust project, whose finalized questionnaire can be seen in appendix to this article, is precisely focused on what we have regarded as the fundamental questions discussed above. The questionnaire is organized on 11 questions divided up in a number of different factual situations involving as *dramatis personae* one professional manager and one investor. The general part of the questionnaire approaches the basic property rights structure, developing factual situations whose actual solution by the legal systems can work as a proxy to the property rights asset. The special part of the questionnaire is mostly devoted to economic institutions like pension funds, collective investment schemes, trusts for debenture holders, and securitization, all areas of the law where in common law countries trust lives much of its secret life. The first part of the questionnaire is aimed at discovering the structure of the bundle of rights that make the property right of the trustee. To what extent is he “an owner”? The issue of the protection of the trustee in front of attempts by the beneficiary to intervene into the managerial decision making is hence covered. The amount of the discretionary power of the trustee both in acting and in omitting to act is discussed in question two. One major limit to the discretionary power of the trustee even outside of what is specified in the trust instrument stems from the need to avoid conflict of interest. The issue is approached in question three. The first three questions hence cover the extent to which legal system are able to give to the trustee a legal position similar to ownership in the fundamental character of making him the sole and unimpaired decision maker over the trust property⁴⁵.

Question four turns to the position of the beneficiary-investor and tackles the extent to which his position can be considered *protected as ownership*. No other area of the law could offer a better laboratory than the law of bankruptcy where some of the really relevant distinctions between trust

⁴³ See R.Schlesinger (Gen Ed.) *Formation of Contracts: A Study of the Common Core of Legal Systems* 2 Vols (1968)

⁴⁴ For an English language synthesis of a monumental bulk of work see R. Sacco, *cit. supra* note

⁴⁵ See A. Honoré, *Ownership*, in (De Guest Ed.) *Oxford Essays in Jurisprudence* (1961).

and no-trust countries seem to dwell.⁴⁶ If the trust property is remote from the bankruptcy of the trustee and the beneficiary can prevail over his general creditors, then there is ground to believe that the beneficiary has maintained an quasi-ownership position at least to this extent. The inquiry on the nature of the beneficiary's entitlement must be completed by a discussion of the remedies he enjoys over the property in the pathology of the fiduciary relationship. Hence, question six tackles a fact situations in which the remedy of tracing would be available to the beneficiary in a common law jurisdiction. The issue of mandatory vs. default aspects of trust law, which emerges indirectly in all the questions exploring the duties of the manager, is tackled directly from the point of view of the choice of law. Some of the European civil law systems, namely Italy and Holland have ratified the Hague Convention on recognition of the effects of a common law trust in civil law⁴⁷. Most other countries have not. To what extent, in both categories of countries, the trust law of a common law jurisdiction (or an invented body of trust law) can be used as a body of default rules just by choosing it as the law governing a contractual fiduciary transaction? This possibility is open in contract law with the only limit of local mandatory rules. Does trust share the regime of contracts or is it treated in a discriminatory way in the private international law systems of European member states?

National reporters picked among recognized experts in the field in their own legal systems⁴⁸ are encouraged not only to offer the prima facie answer that the average local lawyer would give to his client but also to focus on alternative business structures (such as corporations) that might be available to effectively solve these problems. It is of course important to know both the shared wisdom, the automatic, routine reply that a local lawyer would give to his client, and the amount of flexibility that each legal system allows for alternative solutions. Emphasis has been placed on taking into consideration all relevant sources of local law (statutory provisions and different

⁴⁶ See H.Hansmann-U. Mattei cit supra note--

⁴⁷ The text of the convention can be conveniently read and compared with a variety of statutes devoted to trust in M. Lupoi, cit. supra

interpretations) as well as European sources already in place. It is crucial that, the degree of effectiveness of any given source be briefly addressed too.

A very important part of the project, perhaps the most difficult, has been the drafting of fact situations reasonably unambiguous and interpreted in a similar way by lawyers belonging to different legal cultures (i.e. used to different professional routines). In this process the editors have relied on tentative answers produced by national reporters for a relatively large sample of member countries: Great Britain, Italy, Germany, Spain, France, Holland, Sweden and Portugal. Finalized versions of such national reports and reports for the other countries belonging to the E.U. are in preparation. In due course we should be able to know how European legal systems handle the fundamental problems that were introduced in the first part of this paper. At that point we might know what needs to be simply restated and what needs to be changed in order to create a transaction cost reducing chapter on trust for the European Civil Code.

6. A perfect European Code of Trust. Would it be enough?

Assume the unlikely possibility that from the results of the Common Core project would emerge a sufficiently common body of principles that could be put in the form of a statutory text. Something like the “Principles of European Trust Law” recently published in Holland,⁴⁹ with the difference that they originate from the bottom up rather than from the imagination of some legal scholars. According to my previous reconstruction, the bottom-up origin should minimize the possibilities of divergence in interpretation. Suppose moreover that, in order to follow the suggestions of this article, only mandatory provisions (perhaps more standards than rules) would be contained in such Trust Code. In full respect of healthy competition stemming from legal pluralism, the Trust Code

⁴⁸ Germany: H.Kotz; France: Francois Barriere; England: Lionel Smith; Italy: A.Gambaro & E.Andreoli, Holland: M. Koppenol La Force; Scotland: George Gretton; Spain: C. Gonzales Beilfuss & S.Camara Lapuente; Portugal: Pedro Pais De Vasconcelos; Austria: Gregor Schett; Ireland: P. Coughlan; Sweden: Torgny Hastad; Finland: Jarmo Tuomitso.

would consequently have the limited function of monitoring the compatibility of legal creativity with the need to avoid externalities and protect the ill-informed beneficiary. Private legislatures and national legal systems would remain in charge of producing the default rules that the parties would be free to pick up in a choice of law clause of their management contract. Would such a Code -- a perfect Code according to my taste -- work?

The question is very important despite its speculative outfit. Indeed it brings at the center of the stage one issue that has been recently pointed out in a brilliant paper by Professor Daniela Caruso: "The Missing view of the Cathedral".⁵⁰ According to this account, today the lively process of European private law building is too much concerned with substantive "core" private law issues. Insufficient attention is paid to deep divergence in the institutional structure, interpreted in the broadest possible meaning of "legal process". In other words, it might not be so much in the substantive rules of private law that the peculiarities of national legal systems resist to uniformity as much as in the legal process, including aspects such as access to justice, organization or disorganization of courts, structure of the legal profession and so on.

In the domain of trust law, the need to consider and adequately appreciate the impact of procedure over substance, is even more clear than elsewhere in the law. Not only the historical origin of trust is to be found in the dual set of courts, an accident of Anglo-American jurisprudence⁵¹. Many of the devices that characterize trust law --- tracing being the most important example --- can be seen as mere techniques of evidence law⁵², a branch itself lacking from the civil law. It is worth here to quote from a classic in the field of comparative law, the casebook of Professor R.B.Schlesinger: "Our law provides for a comprehensive and exceedingly effective scheme of judicial supervision of every phase of trust administration. The Court has power to construe the trust instrument, to determine its validity, to give directions to the trustee, to make the trustee account, to approve

⁴⁹ See Hayton and others cit. supra note

⁵⁰ See D. Caruso, The Missing view of the Cathedral: The Private Law Paradigm of European Legal Integration 3 Eur. Law J. 3 (1997)

⁵¹ An accessible account of this story can be read in J. Baker, An Introduction to English Legal History --- (1979)

⁵² See for such an idea M. Lupoi, Trusts, 74, (1997)

accounts voluntarily rendered, to remove the trustee for neglect of duty, and to follow the trust res into the hands of transferee. All this can be done by way of special proceedings admirably adapted to their purpose. In the civil law, equivalent remedies are either non-existent, or they have to be pursued (at least in the case of inter vivos trusts) by way of ordinary plenary actions....This *procedural* difference is often overlooked by comparatists who seek to explain the Anglo-American trust, and its absence from the civil law scene, exclusively in terms of contrasting concepts of substantive property rights. It is the combination of the two factors --- the procedural and the substantive --- which makes the Anglo-American trust truly different from its civil law substitutes and counterparts, and which renders it difficult to introduce the trust in a civil law country by a stroke of the legislative pen.”⁵³ This quote seems the best response to those that in the last few years have attacked Professor Schlesinger’s work and the common core methodology as black letter and formalistic! ⁵⁴

Professor Caruso’s point, however is very well taken and it is possibly a sound ground of critique to “integrative” exercises such as most of present day European private law building might be considered. To be sure, a limited attempt to take care of it is reflected in the Common Core Project methodology. Indeed questionnaire respondents are asked to assess the degree of effectiveness of a given solution, including what were called “metalegal formants” i.e. external factors that might actually affect the solution of the problem at hand⁵⁵.

Certainly however, while European substantive private law can live and even become relatively uniform only by means of interpretation, the same can not happen with the judicial process which needs an ad hoc political decision to be revamped. Perhaps the interest of trust as a contribution of common law countries to European private law codification must be appreciated as a pragmatic way to point out priorities. In the nineteenth century, the age of substantive law codification in the

⁵³ See R.B. Schlesinger-H.W.Baade-M.R.Damaska-P.E.Herzog, *Comparative Law*, (5 ed. 1988) 783 note 3

⁵⁴ See, for example, W. Ewald, *Comparative Jurisprudence*, I What Was it Like to Try a Rat? 143 U. of Pa. L. Rev. 1889 (1995).

Continent, England short from touching substantive rules has rationalized its judicial institutions (Judicature Acts 1873). Perhaps trust, the most significant and coveted British contribution to the building of European private law, can not be exploited outside of extensive previous reform of the European judicial process. The complexity of the transactions that are performed by trust law require highly skillful and competent judges able to supervise them. This kind of judiciary is simply absent from most European countries belonging to the civil law. A case might be made for discussing, together with the whether and how of a European Codification for the new millennium, the whether and how of a set of European Judicature Acts in order to obtain much needed upgrading of the European judicial process.

7. Conclusions.

The results of this preliminary study on a chapter on Trust for a European Codification can be summarized as follows:

1. Codification might be a necessary but not sufficient tool to make available to all European countries the advantages of the common law institution of trust. A thorough rethinking on the role of the judiciary in making European private law might is highly advisable.
2. The essential aim of the trust chapter is: a) to reduce transaction costs by providing unimpaired proprietary decision making power to the trustee. b) to reduce agency costs by providing property rule protection for the beneficiary.
3. The chapter on trust of the European Code should be limited to mandatory rules. Default rules are better provided by private enterprises.
4. The chapter on trust should avoid changes into national legal systems that are not necessary to reach its essential aims. In particular, it should be carried on with full knowledge of institutional

⁵⁵ General instructions on how to answer the Common Core Questionnaires can be read in appendix to Bussani-Mattei, cit. supra note--- for a penetrating discussion, see O. Lando, *The Common Core of European Private Law and the Principles of European Contract Law* 21 *Hast Int. and Comp. Law Rev* 809 (1998) 820

alternatives (e.g. corporations) that might allow the same fundamental results without disrupting local routines.

5. The chapter on trust might be better based on standards rather than on rules.

APPENDIX:

Commercial Trusts Questionnaire

Prepared By:

Michele Graziadei-Ugo Mattei-Lionel Smith

Version Date: 6 August 1999

I. General Part

Question 1. Creation and Revocation; Powers of the Manager.

John carries on the activity of a professional investment manager in his small office. Sam has been told that John is a skilful manager and he decides to take advantage of his services. In John's office, Sam signs a document granting John full investment powers over a capital value of Euro 2.000.000. By the terms of the document, John's powers are expressed to be irrevocable for the term of five years. These powers enable John, *inter alia*, to buy and sell any kind of asset, including immovables. The document also provides that John will credit all the income produced by the managed capital to Sam's bank account. It stipulates that John will be entitled to deduct an annual fee, calculated as a percentage of the capital value of the managed assets. Sam then writes a cheque payable to John for Euro2.000.000.

Alternative 1): In the second year of their relationship, Sam reads in a newspaper that John is implicated in the international trafficking of stolen art works. He does not know whether the allegations are true but he decides to terminate the relationship. He communicates this to John. He demands restitution of the managed assets, as well as a full account of the investments which have been made. Upon John's refusal, Sam sues asking for: a) a judicial declaration that the relationship is terminated; b) a remedy enjoining John from entering into any further transaction related to the assets; c) a full audit of the previous period; d) restitution of the managed assets; and e) damages. John counterclaims seeking a) a declaration that he still enjoys full managing powers until the end of the five year term b) damages.

Alternative 2): One of the investments which John buys for Sam is an immovable called Blackacre. In the second year of their relationship, Sam learns by chance that Elinor is purchasing Blackacre from John, at a price that Sam considers is too low. He writes to both of them to indicate that he does not want the sale to go ahead; his letters are received before any contract is concluded. Nonetheless, John and Elinor make the contract, the immovable is conveyed to Elinor and the price is paid to John. Can Sam recover Blackacre from Elinor?

Alternative 3): In the second year of the relationship Sam sends a note to John requiring him to purchase Blackacre as an investment. John refuses on the ground that in his view, Blackacre is not a good investment. Does Sam have any legal recourse?

Question 2. Investment Duties

The facts are as in the first paragraph of Question 1.

Alternative 1): In the second year of their relationship, Sam learns that John has made very risky investments which have done poorly; he has lost 50% of the value of the capital. Does Sam have any legal recourse?

Alternative 2): In the second year of their relationship, Sam learns that John does not use his own judgment to make any of the investment decisions. Instead John relies exclusively on the recommendations in a well-known monthly financial newsletter. Does Sam have any legal recourse?

Question 3. Conflict of Interest

Jacob is managing Esther,s assets with full power to sell them. One of the assets he holds on her behalf is an undeveloped piece of land called Blackacre.

Alternative 1): While exploring other investment possibilities for Esther, he learns that the zoning rules for the area which includes Blackacre are likely to change, in a way which will make land in that area more valuable. A month before the change is announced, Jacob uses his own money to buy Greenacre, another undeveloped piece of land in the same area. When the zoning change is announced, the value of Blackacre and Greenacre both increase by 100%. When Esther becomes aware of what has happened, she claims claims from Jacob an amount corresponding to the increased value of Greenacre. She claims that this increase is a wrongful gain from a transaction which created a conflict of interest and duty, since JacobÆs duty was to use the information he acquired in managing EstherÆs assets for her benefit and not for his own gain. Will Esther’s claim succeed?

Alternative 2): Jacob owns Greenacre, another undeveloped piece of land in the same area, in his personal capacity. Jacob sells Blackacre to Bill, a member of the zoning board responsible for the planning of the district which includes both Blackacre and Greenacre. The transaction is at market value. Six months after the sale, a change in the zoning ordinances (produced by the Board of which Bill is a member) increases the value of Greenacre and Blackacre by 100%. It is possible that the zoning change was brought about by the political influence of Bill, but the matter is not clear. When Esther becomes aware of

this fact she claims Blackacre back from Bill. She also claims from Jacob an amount corresponding to the increased value of Greenacre. She claims that this increase is a wrongful gain from a transaction which created a conflict of interest and duty, since Jacob's sale of Blackacre was arguably motivated by a desire to see the zoning ordinances changed so as to make his own land more valuable. Will either or both of Esther's claims succeed?

Question 4. Basic Bankruptcy Situation

Alternative 1): Tom is a real estate agent. One of the immovables he is trying to sell is an apartment belonging to Samantha. Bill is interested in buying this apartment. To show his seriousness in entering into negotiations, Bill writes a cheque for €10.000 as a deposit which is to be refundable if the sale does not go ahead. On Tom's instructions, Bill makes the cheque payable to Tom, and Tom pays this cheque into his own bank account. The negotiations between Samantha and Bill break off with no contract, and Bill tells Tom to refund the money. Tom, who has made no withdrawal from the bank account in the intervening time, has by this time become insolvent. Does Bill's claim to his deposit have priority over competing claims, or is he treated as a general creditor?

Would it make a difference if Tom were a practising lawyer?

Alternative 2): Tom is a travel agent. He sells to his customers tickets from various airlines. The money paid by his customers for the tickets is deposited in a bank account in Tom's name. When Tom becomes insolvent, some customers already have tickets and some have not (and those who have no tickets have no contractual claims against the airlines). The customers who have not been issued tickets claim back their money. The airlines claim payment from the bank account for tickets that have been issued. Tom's general creditors also claim the money in the bank account. Do the customers claiming refunds have any priority over competing claims, or are they treated as general creditors of Tom? Do the

airlines claiming the money paid for tickets have any priority over competing claims, or are they treated as general creditors of Tom?

Question 5. Insolvency of Investment Management

Roberto is a professional investment manager. He manages assets in the interest of different clients, namely Simon, Rebecca and Ruth. The managed assets are bought with money transferred to him by his clients. Roberto offers different forms for his services: a) individual management services, under which he is to keep separate the position of each client; b) participation in a collective investment scheme, whereby the assets managed for his clients are pooled and each participant in the scheme will share pro rata the returns on the collective investments; c) shares of an investment company (DEF Ltd.) which holds investments chosen by Roberto.

One year after receiving the money from his clients, Roberto becomes personally insolvent. Who is better off among his clients: Simon, who chose option a); Rebecca, who chose option b); or Ruth, who chose option c)?

Question 6. Tracing

The facts are as in Q5, except as detailed below. The following alternatives occur:

Alternative 1): Without authority, Roberto uses all of the money in Simon's account (Euro1.000) to buy a painting. When Simon learns of this, the market value of the painting has risen to Euro2.000. Roberto is still solvent. Simon wants to terminate the relationship and take the painting. Can he?

Alternative 2): As in Alternative 1., but before Simon learns of the transaction, the painting is destroyed. It is insured for its market value. By the time Simon learns of this, Roberto

has become personally insolvent. Simon wants to terminate the relationship and take the insurance claim. Can he?

Alternative 3): Without authority, Roberto uses all of the money in Simon's account (Euro 1.000), along with Euro1.000 of Roberto's own money, to buy a painting. By the time Simon learns of this, the market value of the painting has fallen to Euro1.000 and Roberto has become personally insolvent. Simon wants to terminate the relationship and take the painting. Can he?

Alternative 4): Roberto has an unsecured overdraft facility (revolving loan facility/line of credit) with his bank, in his personal capacity. He borrows Euro100.000 from this facility and uses it to buy a piece of land in his personal capacity. Later, without authority, he uses all of the money in Simon's account (Euro100.000) to pay the debt he owes to the bank. By the time Simon learns of this, Roberto has become personally insolvent. Simon wants to terminate the relationship and take the land. Can he?

Question 7. Choice of Law.

Jane manages property in the interest of her client Monica. The property is located in your country, where both Monica and Jane live and are domiciled. In their agreement they introduce a clause stating that their relationship is a trust governed by Jersey law. Litigation arises between them. Jane claims the invalidity of the trust provision of the arrangement, and claims that the relationship should be governed by local law. What is the result?