

# CONCEPTUALIZING THE CHINESE TRUST

## I. INTRODUCTION

With growing international recognition and utilization of the trust concept, China caught up the trend by enacting a Trust Law<sup>1</sup> of China in 2001. Its main purposes were to regulate trust-related economic activities that were already in place and respond to the increasing demand for applying the trust in asset management, financial planning and charitable activities. Drafting work began as early as 1993, but the process took longer than expected because of the lack of technical expertise and disagreements on whether trust and investment companies (TICs)<sup>2</sup> were to be regulated. Nevertheless, the collapse of one of the biggest TICs, the Guangdong International Trust and Investment Corporation (GITIC) in 1998, and China's accession to the World Trade Organisation in 2001, provided further impetus. Lawmakers hoped that the Trust Law would promote professional management of assets and, ultimately, modernize China's financial infrastructure and provide a platform for further development of the private sector in China.<sup>3</sup> Indeed, since its enactment, the Trust Law has been supplemented by laws and regulations pertaining to private investment, such as securities investment funds,<sup>4</sup> occupational pension funds,<sup>5</sup> collective investment trusts<sup>6</sup> etc.

The Trust Law sets out, in 74 articles, basic default rules governing a trust relationship and its administration. The mechanics of adapting a trust institution to a civilian jurisdiction like China, however, was not dealt with and remains a question that continues to vex many academic lawyers. English trusts are founded on the conceptual basis of equity and its consequent division between legal and equitable ownership.<sup>7</sup> The law–equity duality is able to explain the location of trust property; the trustee's powers and duties; as well as the beneficiaries' interests.<sup>8</sup> Accordingly, the

<sup>1</sup> Adopted at the 21st session of the Standing Committee of the Ninth National People's Congress on 28 April 2001 promulgated and came into force on 1 October 2001.

<sup>2</sup> These were non-bank financial institutions established to obtain overseas funding through carrying out so-called 'trust businesses' for Chinese provincial governments. Although earlier drafts of the Trust Law included provisions governing trust companies, they were excluded from its final form. Instead, Trust Law, art 4 provides that '[w]ith regard to trustees that engage in trust activities in the form of trust institutions, the State Council shall formulate specific measures for the organization and administration of such institutions'. Hence, various laws and regulations have been subsequently promulgated to address issues pertaining to trust companies.

<sup>3</sup> See L Ho, *Trust Law in China* (Sweet & Maxwell Asia, Hong Kong, 2003) para 1.01; W Hutchens, 'The PRC's First Trust Law: Trusts *Without* Chinese Characteristics' (2001) 15 *China Law & Practice*.

<sup>4</sup> Law of the PRC on Securities Investment Fund; came into effect on 1 June 2004.

<sup>5</sup> Trial Measures for Enterprise Annuities and Trial Measures for the Management of Enterprise Annuities Fund; came into effect on 1 May 2004.

<sup>6</sup> Measures for the Administration of Trust Companies and Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds; came into effect on 1 March 2007.

<sup>7</sup> DJ Hayton et al (eds), *Underhill and Hayton: Law Relating to Trusts and Trustees* (LexisNexis Butterworths, London, 2006) art 2.1 [hereinafter: Hayton, *Underhill & Hayton*]; GL Gretton, 'Trusts without Equity' (2000) 49 *ICLQ* 599.

<sup>8</sup> Under English law, the trustee has legal ownership of the trust property, whereas the beneficiary has beneficial ownership and hence enjoyment of the trust property. By virtue of the trustee's legal ownership, he is subject to various duties, including fiduciary duties and duties of

legal and equitable forms of ownership are indisputably essential features of the trust in any common law jurisdictions. Yet this conceptualization is evidently not suitable for the Chinese Trust. In civil law jurisdictions including China, one of the perceived difficulties in transplanting a trust institution is the need to have split ownership of the trust property in English law. There is no division of dominium into legal and equitable ownership in China. Ownership is an interest which cannot be fragmented. Further, the *numerus clausus* principle which delimits recognised categories of property rights (eg ownership) and restricts the creation of new property rights suggests that the Chinese Trust remains an anomaly.

Given these difficulties, the basis of the Chinese Trust is rarely conceptualized. Existing writings on the Chinese Trust tend to focus on two areas, though not without deficiencies. First, they distil the core elements of a civilian (Chinese) trust.<sup>9</sup> Important though they are, the core elements merely show that the civilian (Chinese) trust may be *functionally* equivalent to an English trust which is different from other legal institutions. They do not, however, tell us the conceptual basis of the civilian trust. Secondly, there are also commentaries on the merits and demerits of the Chinese Trust.<sup>10</sup> Again, they tend to do so without first exploring, let alone agreeing on, its conceptual basis.

However, a conceptual framework is indispensable to the resolution of many trust issues and explanation of the core features of a Chinese Trust, such as the location of trust property, the duties of trustees, the segregation of trust property, and the protection to beneficiaries etc. Given the lack of an equity heritage and the hurdles created by some indigenous civilian concepts, the present article seeks to consider the following conceptual issues: first, Part II of this article examines some civilian explanations that have already been propounded to explain a civilian trust to see whether they fit into the structure of a Chinese Trust. This involves an examination of whether the Chinese Trust is similar to existing legal institutions; in other words, whether it can be explained in terms of civil law, rather than common law, principles. While a Chinese Trust may be functionally equivalent to a common law trust, whether it is also conceptually a trust may depend on questions like how it is enforced (eg whether only by means of contractual remedies; who exercises control of the arrangement). But given that a comparative analysis of institutions in different jurisdictions is difficult, Part III of this article goes on to explore a possible conceptual basis of the Chinese Trust through examining some indigenous civilian (Chinese) legal concepts. It will be suggested that in order to discern the conceptual basis, if any, of the Chinese Trust, the possibility of conceptualizing the Chinese Trust as an obligation with limited proprietary effects may be explored. Whether this view places the Chinese Trust on a secure conceptual footing which is at the same time consistent with its core features will also be considered.

care and diligence. The beneficiaries' beneficial ownership also enables them to assert equitable proprietary claims against the trust property by way of a tracing process.

<sup>9</sup> See eg MJ de Waal, 'In Search of a Model for the Introduction of the Trust into a Civilian Context' (2001) 12 Stellenbosch Law Review 63; L Ho, 'The Reception of Trust in Asia: Emerging Asian Principles of Trust?' (2004) Singapore Journal of Legal Studies 287.

<sup>10</sup> See eg Z Tan, 'The Chinese Law of Trusts—A compromise Between Two Legal Systems' (2001) 13 Bond Law Review 224.

## II. A COMPARATIVE ANALYSIS OF SOME COMMON CIVILIAN EXPLANATIONS OF THE (CHINESE) TRUST

The lack of a law–equity divide proves no hindrance to the reception of trust in China. Rather, the perceived advantages of a trust device in regulating financial operations in China led to the enactment of a Trust Law in 2001. In attempting to obtain the practical benefits of the trust, the technical difficulties of building it on a sound theoretical foundation were often overlooked. What follows is an examination of two common civilian explanations to see whether a conceptual basis of the Chinese Trust can be identified.

*A. Trust as a Separate Patrimony*

One of the most prominent conceptual bases of a civil law trust is that propounded by the French jurist Pierre Lepaulle. Lepaulle's theory focuses on the location of the trust property, namely whether it is in the hands of the settlor, the trustee or the beneficiary, or whether the trust property should be treated as a separate juristic person or even owned by nobody. He invokes the concept of patrimony which is more familiar to civilians. Each person has only one patrimony, comprising the totality of his assets and liabilities. In a trust, however, he suggests that there are two patrimonies: (i) general/private patrimony containing the trustee's personal wealth and his personal liabilities; and (ii) special/trust patrimony containing assets of the trust and its liabilities. But the trustee holds his own patrimony only. This view explains satisfactorily the beneficial enjoyment of the trust property by the trust beneficiaries, as well as the protection afforded to them. The private patrimony of the trustee is distinct from the trust patrimony, so that in the event of the trustee's insolvency, the trust property is protected from being used to satisfy the claims of the trustee's private creditors. Conversely, trust creditors have access to the trust property but not the trustee's personal assets. Thus, rather than speaking in terms of duality of ownership which is unfamiliar to civilians, this view advocates a duality of patrimony. But the trustee holds his own patrimony only. Accordingly, Lepaulle further suggests that trust property can be understood in terms of an ownerless patrimony (*patrimoine d'affectation*).<sup>11</sup> This means that a trust is a patrimony whose rights and obligations can be affected or appropriated to a purpose. Therefore, in his view, it is possible to have a trust without any trustee.<sup>12</sup> Lepaulle's view has been adopted to explain the trust in a number of civilian jurisdictions, such as the trust in Scots law.<sup>13</sup>

<sup>11</sup> P Lepaulle, *Traite Theorique et Pratique des Trusts* (1932). Lepaulle defines the trust as a legal institution consisting of an estate independent of any legal person. For a discussion of his theory in English, see Gretton (n 7) 608–617. Lepaulle's theory has inspired Mexican trusts law: see RM Pasquel, 'The Mexican *Fideicomiso*: The Reception, Evolution and the Present Status of the Common Law Trust in a Civil Law Country' (1969) 8 *Columbia Journal of Transnational Law* 54.

<sup>12</sup> cf KW Ryan, 'The Reception of the Trust' (1961) 10 *ICLQ* 265, 271 who suggests that the trust patrimony is autonomous rather than ownerless. This means that the trust property is subject in the hands of trustee to a different regime from that applicable to the rest of his property, and thus constituted a segregated patrimony. But this does not mean that the trust property no longer forms part of the patrimony of any person.

<sup>13</sup> KGC Reid, 'Patrimony not Equity' the Trust in Scotland' (2000) 8 *European Review of Private Law* 427.

Does the ‘dual patrimony’ view provide a satisfactory conceptual explanation for the Chinese Trust? At first glance, it appears that the Chinese Trust does maintain a dual patrimony. By virtue of article 16 of the Trust Law, ‘[t]he trust property shall be segregated from the property owned by the trustee (hereinafter referred to as his “own property”, in short), and may not included in, or made part of his own property of the trustee.’ The existence of a dual patrimony is further reinforced by the requirement to manage the trust property and the trustee’s private property separately under article 29.<sup>14</sup>

However, a close reading of the provisions of the Trust Law reveals that they do not indicate clearly that the trust property constitutes a separate patrimony for the following reasons. First, article 16 does not assert that the trust property forms a patrimony. This stands in sharp contrast with jurisdictions that clearly adopt dual patrimony as the juridical basis. For example, the Quebec Civil Code provides that ‘[t]he trust patrimony, consisting of the property transferred in trust, constitutes a patrimony by appropriation, autonomous and distinct from that of the settlor, trustee or beneficiary and in which none of them has any real right’.<sup>15</sup> More importantly, the requirement of segregation of trust fund in article 16 does not seem to entail the existence of two separate patrimonies. Rather, it merely points to segregation *within* the trustee’s estate: segregation is required so that trust property, by virtue of article 16, ‘shall not be included in, or made part of *his own property of the trustee*’. Thus, the need for separation of management in article 29 is premised upon the fact that there is only one patrimony of trustee, and the function of segregation is simply to avoid confusion of ownership.<sup>16</sup> This differs from the Quebec Civil Code which necessarily implies a dual patrimony, or the Scots trust where the trustee owns his private patrimony as well as the trust patrimony,<sup>17</sup> or the South African Trust Property Control Act which approves the separation of private and trust estates.<sup>18</sup> Even the Principles of European Trust Law

<sup>14</sup> Trust Law, art 29: ‘The trustee shall administer the trust property separately from his own property and keep separate accounting books . . .’.

<sup>15</sup> Quebec Civil Code, art 1261. Cf Louisiana Trust Code, which does not appear to have adopted a patrimony view, §1731: ‘A trust . . . is a relationship resulting from the transfer of title to property to a person to be administered by him as a fiduciary for the benefit of another’.

<sup>16</sup> The same view may also be applied to the Hague Convention on the Law Applicable to Trusts and on their Recognition [hereinafter: Hague Trusts Convention] which suggests that ‘the trust assets constitute a separate fund and are not a part of the trustee’s *own* estate’ (emphasis added). It is less clear whether the trust property is included in the trustee’s private patrimony, with the consequence that there is only segregation within the trustee’s one single private patrimony. Professor Lupoi takes the view that this refers to segregation within the trustee’s estate only: M Lupoi, ‘Civil Law Trust’ (1999) 32 *Vanderbilt Journal of Transnational Law* 967, 980, even though the Hague Trusts Convention also says that they do not belong to the ‘trustee’s own estate’.

<sup>17</sup> KGC Reid ‘National Report for Scotland’ in D Hayton, *Principles of European Trust Law* (Kluwer Law International, The Hague, 1999) 68. See, further, MJ de Waal & RRM Paisley, ‘Trusts’ in Reinhard Zimmermann and Daniel Visser and Kenneth Reid (eds), *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Scotland and South Africa* (OUP, Oxford, 2004) Ch 27, 839–842.

<sup>18</sup> Trust Property Control Act 1988, s 1 defines a trust as ‘the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed (a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument . . .’. For a general discussion the South African trusts law, see MJ de Waal, ‘The Uniformity of Ownership,

defines a trust as an institution where the “trustee” *owns* assets segregated from his private patrimony’.<sup>19</sup> That the trustee *owns* trust property which is separate from his private patrimony suggests that there are two patrimonies. None of these implications, however, can be made to the Chinese Trust.

Furthermore, the patrimony theory has some doctrinal difficulties in itself. If the trust patrimony is owned by no one, it will, as a matter of law, fall to the State as *bona vacantia*, a consequence which does not seem to be contemplated by the Chinese Trust. Besides, Lepaulle’s theory has recently come under strong criticisms by Professor Lionel Smith. He argues that while it is true that trustees’ personal creditors have no access to the trust *assets*, the same cannot be said of trust *liabilities*. This is because at the level of liabilities, no distinction is drawn between personal liability and trust liability of the trustee: all of the trustee’s liabilities are liabilities of his own patrimony. It is therefore incorrect to speak of dual patrimonies.<sup>20</sup> Following Smith’s criticisms, it may be said that this theory is difficult to explain in situations where the trustee may incur personal liability for trust debts; where the beneficiary may hold trustee personally liable for breach of trust; or where there is mixing of trust assets and assets of the trustees. Consequently, Lepaulle’s exposition of the trust doctrine may not work very well, let alone explaining the Chinese Trust. Indeed, it would be necessary to look more closely at the Trust Law itself to identify possible conceptual basis of the Chinese Trust.

### B. Trust as an Agency or Contractual Arrangement

A Chinese Trust is defined in article 2 of the Trust Law as follows:

For purposes of this Law, trust refers to that the settlor, based on his faith in trustee, *entrusts* his property rights to the trustee and allows the trustee to, according to the will of the settlor and in the name of the trustee, administer or dispose of such property in the interest of a beneficiary or for any intended purposes (emphasis added).

It can be seen that this definition of the trust requires ‘entrustment’ (*weitu*, 委托) of trust property to the trustee, and differs from the general requirement of a *transfer* of trust assets to the trustee in common law jurisdictions. Irrespective of the location of the ownership of the trust assets, English law generally acknowledges that both declaration of trust and constitution of the trust by vesting of trust property in the trustee are essential,<sup>21</sup> unless the settlor declares himself to be the trustee. Accordingly, the use of the word ‘entrustment’ in defining a Chinese Trust raises the question of whether it suggests an absence of vesting of property in the trustee, such that the arrangement does not create a trust, but merely a contractual (agency) arrangement.

A number of arguments may be ventured to support a contractual (agency) view. First, it is submitted that there are certain provisions of the Trust Law which suggest that the ‘entrustment’ of trust property does not imply any vesting of property in the trustee. To start with, the notion of ‘entrustment’ does not only appear in the definition

*Numerus Clausus* and the Reception of the Trust into South African Law’ (2000) European Review of Private Law 439.

<sup>19</sup> Principles of European Trust Law, art 1 (emphasis added).

<sup>20</sup> L Smith, ‘Trust and Patrimony’ (2008) 38 *Revue générale de droit* 379. I am grateful to Professor Smith for granting me a preview of his forthcoming article.

<sup>21</sup> Hayton, *Underhill and Hayton* (n 7) Art 9.

of trust in the Trust Law; the same word ('entrust') is also used in article 30, where a trustee is permitted to 'entrust' others to handle the trust affairs on his behalf.<sup>22</sup> This, however, appears to be a simple authorization of delegation of trust administration to others, with no transfer of property contemplated. An analogy with article 30 thus suggests that a transfer of property to the trustee is also not contemplated under article 2. Besides, after the settlor's act of 'entrustment' in article 2, Article 15 still requires separation of trust property from private property of the *settlor*. The act of separation of trust property from the settlor's own property would have been superfluous if property had already been transferred to the trustee. Without any transfer of property, such entrustment may simply point to an agency arrangement. In fact, entrustment is an agency concept. Under the Contract Law<sup>23</sup> of China, an entrustment contract (*weituo hetong*, 委托合同) is 'a contract whereby the principal and the agent agree that the agent shall handle the affairs of the principal'.<sup>24</sup> Although the same concept of 'entrustment' is employed in such an arrangement, it is evident from the definition of an entrustment contract of commission agency that there is no transfer of property in an agency arrangement.

In this connection, one may counter-argue that, by virtue of article 14 of the Trust Law, which says that the trustee *obtains* (*qude*, 取得) trust property,<sup>25</sup> there is indeed vesting of property in the trustee, for no trust property can be acquired by him without the act of transfer in the first place.<sup>26</sup> It is submitted, however, that article 14 is of little avail, for the same Chinese word '取得' (*qude*, acquired) is also used in describing the contract an entrustment arrangement in the Contract Law, where the agent is required to hand over the acquired property to the principal.<sup>27</sup> Although article 14 does not go so far as requiring the trustee to hand over the acquired property to the settlor, it is equally silent on whether the trustee *owns* the trust property after it is being acquired.

Apart from being consistent with the definition of a Chinese Trust, an agency theory also sits comfortably with provisions of the Trust Law which allow the settlor to retain extensive powers after the arrangement, including power to manage the trust property, right to inspect trust documents, and even right to request the trustee to adjust the methods of management.<sup>28</sup> If property were vested in the trustee, the settlor should retain no (beneficial) interest that would allow him to interfere with the trustee's

<sup>22</sup> Trust Law, art 30: 'The trustee shall handle trust business himself, but may entrust another person to handle such affairs on his behalf where the trust documents provide otherwise or he has to do so for reasons beyond his control.'

<sup>23</sup> Adopted at the Second Session of the Ninth National People's Congress on 15 March 1999, and came into force as of 1 October 1999.

<sup>24</sup> Contract Law, art 396.

<sup>25</sup> Trust Law, art 14: 'The property obtained by the trustee due to a trust accepted is trust property.'

<sup>26</sup> See CZ Qu, 'The Doctrinal Basis of the Trust Principles in China's Trust Law' (2003) 38 *Real Property, Probate and Trust Journal* 345, 357. According to this view, despite the wording in article 2, reading it in context, the definition of trust still requires a transfer of property to the trustee.

<sup>27</sup> Contract Law, art 404: The agent shall hand over to the principal any property acquired (取得) in handling the entrusted affairs.

<sup>28</sup> Trust Law, arts 20–23. Nonetheless, it should be noted that by virtue of art 49, the beneficiary is also granted rights prescribed in arts 20–23. If there is a conflict between the views of the settlor and the beneficiary with regard to the exercise of these rights, the beneficiary may apply to the court for ruling.

management of the trust property,<sup>29</sup> for it is axiomatic that the settlor drops out of the picture after establishing the trust.<sup>30</sup> Thus, the provisions reserving extensive powers for the settlor make it evident that after the entrustment, the settlor (as principal) remains the owner of the property entrusted. Indeed, it is also provided that the trust property remains *his* property:

The settlor shall have the right to know the administration, use and disposition of, and the income and expenses relating to, *his* trust property . . . The settlor shall have the right to check, transcribe or duplicate the trust accounts related to *his* trust property and other documents drawn up in the course of dealing with trust business.<sup>31</sup>

Further, conceptualizing the Chinese Trust broadly as a contract is consistent with the French view of the trust. In France, the concept of *fiducie* was recently introduced in February 2007.<sup>32</sup> A *fiducie* is an agreement created by contract, with assets being used in accordance with the terms and conditions of the fiduciary contract.<sup>33</sup> It has been suggested that a *fiducie*, instead of being a property law mechanism, stems from a contractual arrangement.<sup>34</sup> In a similar vein, the Trust Law describes the trust as arising from a contract. Article 8 of the Trust Law requires written forms such as trust contracts to be adopted for the establishment of a trust, thus anticipating the trust to be created by virtue of a contract.<sup>35</sup> This view of the trust is also consistent with the extensive powers and rights reserved by the settlor as a party to the contract, who would not otherwise have any interest to be protected by the extensive powers reserved for himself. The corresponding reduction of the 'ownership position of the trustee' thus renders him 'a simple agent or fiduciary nominee'.<sup>36</sup> Besides, the mechanics of creating a Chinese Trust also seems to suggest that, unlike an English trust, unilateral declaration of trust is not possible.<sup>37</sup> Consequently, a Chinese Trust is comparable to a contract which requires at least two parties. Indeed, this impossibility follows the

<sup>29</sup> See eg *Re Astor's Settlement Trusts* [1952] Ch 534 (Ch D), 542.

<sup>30</sup> For example, it is not settlor, who may have access to the trust information in order to render trustee accountable. The debate in English law has always been on the basis on which beneficiaries, not the settlor, may seek disclosure of trust information: *Re Londonderry's Settlement* [1965] Ch 918; *Hartigan Nominees v Rydge* (1992) 29 NSWLR 405; *Schmidt v Rosewood* [2003] UKPC 26; [2003] 2 AC 709.

<sup>31</sup> Trust Law, art 20 (emphasis added).

<sup>32</sup> Law 2007–211 of 19 February 2007 on *Fiducie*.

<sup>33</sup> The statutory definition of a *fiducie* is as follows: 'an operation by which a constituent transfers all kinds of rights to a legal or natural person called fiduciary, the latter having the responsibility of administering these rights or disposing of them in the interest of one or more beneficiaries in accordance with the terms and conditions of the contract for the purposes of management, collateral or transfer for consideration, either exclusively or cumulatively': unofficial translation in JF Adelle, 'French Law adopts Fiduciary Arrangements' (2007) *Butterworths Journal of International Banking and Financial Law* 180.

<sup>34</sup> P Matthews, 'The French *Fiducie*: and Now for Something Completely Different (2007) 21 *Trust Law International* 17. cf JH Langbein, 'The Contractarian Basis of the Law of Trusts' (1995) 105 *Yale Law Journal* 625.

<sup>35</sup> 'Written form shall be adopted for the establishment of a trust. Written form includes trust contracts, wills or other written documents as provided by laws and regulations'. Admittedly, a trust contract is not the only means of creating a trust in China.

<sup>36</sup> M Lupoi, *Trusts: a Comparative Study* (CUP, UK, 2000) 310.

<sup>37</sup> The settlor cannot be the trustee at the same time: cf art 43 of the Trust Law: '. . . The settlor may be a beneficiary and may also be the only beneficiary under the same trust. The trustee may be a beneficiary but may not be the only beneficiary under the same trust.' By allowing the trustee to be the beneficiary, one may also argue that this is closer to a trust arrangement.

'agency' theory: the settlor entrusts property to the trustee, which renders constitution of the trust by declaration inherently inconsistent with the act of entrustment.

The Chinese Trust thus appears in substance to be a contractual (agency) arrangement: the settlor remains the principal and owner of the trust property. One may still label this arrangement as a trust by reference to the definition of trust adopted by the Hague Trusts Convention, which provides that '... the term "trust" refers to the legal relationships created ... by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose'.<sup>38</sup> The phrase 'placed under the control' does not necessarily imply a transfer of title. Given this definition, it may be said that the Hague Trusts Convention (and similarly the Trust Law of China) allows a trust to exist even if the settlor is still regarded as the owner of trust assets.<sup>39</sup>

Nevertheless, despite remarkable similarities with a contractual (agency) arrangement, the difficulties of such a conception of the Chinese Trust should not be underestimated. If the trust is merely seen as a contractual arrangement, then it appears that it would be akin to a contract for the benefit of third parties (beneficiaries). Yet there is no provision in the Contract Law of China relating to contracts for the benefit of third parties.<sup>40</sup> Indeed, the enactment of a separate Trust Law suggests that the Trust is a different species from contract, which simply cannot be explained satisfactorily under existing contractual principles. More significantly, there are provisions in the Trust Law which militate against an agency theory. For example, the Chinese Trust requires segregation of the trust fund, which has been accepted as a core feature of the trust that distinguishes a trust from a contractual agreement.<sup>41</sup> The Chinese Trust also differs from a contract in that the former gives beneficiaries evidently more extensive rights than personal rights under a contract. For example, where the trustee becomes insolvent, the trust assets are ring-fenced from his creditors so that they are immune from claims of the trustee's personal creditors.<sup>42</sup> Where trust assets are transferred to third parties in breach of trust they may also be recoverable.<sup>43</sup> In short, while there is much

<sup>38</sup> Hague Trusts Convention, art 2. But note that as the purpose of the Hague Trusts Convention is to promote recognition of common law trusts in non-trust jurisdictions, the definition of trust is crafted more broadly.

<sup>39</sup> Lupoi (n 16) 979.

<sup>40</sup> It may be argued that Contract Law, art 64 can be viewed as such a provision. Art 64 provides: 'Where the parties agree that the debtor shall discharge the debts to a third party and where the debtor fails to do so ... , the debtor shall bear the liability for breach of contract to the creditor.' However, art 64 only provides for the debtor's liability to the creditor if he fails to perform its obligations to a third party as agreed; it does not give the third party any independent right of action. Accordingly, it is submitted that the better view is that art 64 does not create a contract for the benefit of third parties, but only a contract whereby the debtor is required by the debtor to perform his obligations to a third party.

<sup>41</sup> See eg Ho (n 9).

<sup>42</sup> Trust Law, art 17: 'No compulsory measures may be taken against the trust property unless one the following circumstances arises: (1) where, before the creation of the trust, the creditors enjoyed the priority right to be paid with the trust property and may exercise this right according to law ...'; and art 18: 'The claims arising from the administration or disposition of trust assets by the trustee may not be used to offset the liabilities incurred by the trustee's own property.'

<sup>43</sup> Trust Law, art 22: 'Where the trustee disposes of the trust property in breach of the purposes of the trust, or causes losses to the trust property due to this departure from his administrative duties or improper handling of trust business, the settlor shall have the right to apply to the People's Court for annulling such disposition and the right to ask the trustee to restore the property to its former state or make compensation. Where a transferee of the said trust property accepts



to be said for the view that the arrangement under the Trust Law of China simply creates a contractual (agency) arrangement, the Chinese Trust does possess some core features of an English trust. This necessitates a conceptualization that suits the characteristics of the Chinese Trust on the one hand and the institutional background against which it is implemented on the other.

### III. CONCEPTUAL BASIS OF THE CHINESE TRUST?

The foregoing views focus on the location of the ownership of trust assets. Attempts have been made to suggest that the trustee is the owner (agency/contract), or that neither the trustee nor the trust beneficiary, but the trust itself, is the owner (patrimony theory). A possible interpretation of the Trust Law may suggest that the settlor, the trustee and the beneficiary are all owners to a certain extent. Yet it appears that the peculiar features of the Trust Law of China suggest that none of the views examined so far provides a satisfactorily conceptual basis of the Chinese Trust. But the difficulties in conceptualizing the Chinese Trust also stem from certain indigenous concepts such as the *numerus clausus* and indivisibility of ownership principles. Both relate to the fundamental question of the nature of the trust beneficiary's rights.<sup>44</sup> In China, the trust beneficiary has for the most part a personal right against the trustee. He is not the owner of the trust assets, and has only a limited property right in the trust assets. The nature of a beneficiary's right thus remains a matter of controversy. Any attempt to conceptualize the Chinese Trust must try to reconcile these principles. Hence, the following analysis attempts to address (a) the *numerus clausus* principle; and (b) the equitable ownership concept.

#### A. Principle of Numerus Clausus

Chinese law draws a distinction between property and obligation. The recently enacted Property Law<sup>45</sup> of China defines 'property rights' (物权, *wuquan*) to mean 'the exclusive right enjoyed by the obligee to directly dominate a given thing according to law, which consists of the right of ownership . . .'.<sup>46</sup> Property rights, including property ownership rights, are protected by law pursuant to article 4 of the Property Law. Property rights differ from creditors' rights (obligatory rights) (债权, *zhaiquan*) which is merely '[a] debt [that] represents a special relationship of rights and obligations established between the parties concerned, either according to the agreed terms of a

the property while knowing the violation of the purposes of the trust, he shall return the property or make compensation.'

<sup>44</sup> See, generally AW Scott, 'The Nature of the Rights of the *Cestui Que* Trust' (1917) 17 Columbia Law Review 269; DWM Waters, 'The Nature of the Trust Beneficiary's Interest' (1967) 45 Canadian Bar Review 219.

<sup>45</sup> Adopted at the fifth session of the Tenth National People's Congress on 16 March 2007 and came into effect on 1 October 2007.

<sup>46</sup> Property Law, art 2. 'Property ownership' (财产所有权, *caican suoyouquan*) is defined under article 71 of the General Principles of the Civil Law of China (adopted at the Fourth Session of the Sixth National People's Congress, promulgated on 12 April 1986, and came into effect on 1 January 1987 [hereinafter: GPCL] as 'the owner's rights to lawfully possess, utilize profit from and dispose of his property'. For a general discussion of the Chinese system of property rights, see J Chen 'Conceptions of Property Rights in the PRC in Historical and Comparative Perspectives' (1992) 17 Bulletin of the Australian Society of Legal Philosophy 199.

contract or legal provisions . . .'.<sup>47</sup> Property rights are absolute rights in the sense that they are enforceable against third parties (except bona fide third parties), whereas obligatory rights may be regarded as relative rights, with effect on the counterparty only.

While articles 43 and 44 of the Trust Law<sup>48</sup> of China stipulate that beneficiaries have the 'right to benefit' ('beneficial right') of the trust, the nature of this right is unclear. Unlike an English trust, which is generally regarded as a hybrid of obligation and property concepts, the Property Law does not contain any concept of trust or beneficial right; although article 39 provides that '[o]wners of immovables or movables shall be entitled to possess, use, benefit from and dispose of the immovables or movables according to law', it does not recognize a property right known as the beneficial right of enjoyment. Further, the Chapter on 'Ownership' makes no reference to the Trust Law, or to beneficial enjoyment or ownership rights of beneficiaries. More importantly, the *numerus clausus* principle is enshrined in the Property Law by virtue of article 5 which requires '[t]he categories and contents of the property right shall be stipulated by law'.<sup>49</sup> This means that new property rights can only be created by law. Thus, in the absence of express recognition of the 'beneficial right' as a form of property right, the Chinese Trust has not recognized a new ownership right that confers beneficial enjoyment on the owner.<sup>50</sup> That being so, can the Chinese Trust be conceptualized as a mere obligation so as to overcome this legal hurdle?

It has been suggested recently by Professor Lionel Smith that a common law trust is founded on obligations owed by the trustee in relation to the trust property. The essence of the common law trust is that trust beneficiaries hold rights in the rights that the trustee holds as trust property.<sup>51</sup> Since a trust cannot exist without a trustee, a beneficiary has no rights in relation to the trust property except derivatively and through the trustee's rights to that property. In other words, the beneficiary's 'ownership' only manifests in his rights in the rights of the trustee. Such rights are not property rights, but are founded on obligations. So understood, it is not necessary to treat the beneficiary's right as a property right as such, and accordingly, it is not subject to the civilian principle of *numerus clausus*.

It is submitted that there is much to commend this novel view of the common law trust. While acknowledging that trust is a combination of property and obligation, it clarifies that the trust is merely an equitable *obligation* relating to property. However, this view is based on an essential feature of the common law trust, that a trust cannot exist without a trustee, so that trust property is held by the trustee. To the extent that the

<sup>47</sup> GPCL, art 84.

<sup>48</sup> Trust Law, art 43: 'The beneficiary is the person that enjoys the right to benefit from a trust . . .'; art 44: 'The beneficiary shall enjoy the right to benefit from a trust beginning from the date the trust becomes effective . . .'.

<sup>49</sup> This principle can be justified on the basis of the *in rem* nature of property rights, whose hidden creation may prejudice third parties, and so should be prohibited to ensure security of transactions and reduce information costs: H Hansmann and R Kraakman, 'Property, Contract, and Verification: The *Numerus Clausus* Problem and the Divisibility of Rights' (2002) 31 *Journal of Legal Studies* 373. See, further, TW Merrill and HE Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, (2000) 110 *Yale Law Journal* 1; B Rudden, 'Economic Theory v Property Law: The *Numerus Clausus* Problem' in J Eekelaar and J Bell (eds), *Oxford Essays in Jurisprudence: 3rd series* (Clarendon Press, Oxford, 1987) 237, 249–63.

<sup>50</sup> Thus, it may be argued that the Property Law also echoes the 'entrustment' view of property holding in the Trust Law. <sup>51</sup> Smith (n 20).

Trust Law of China does not stipulate clearly that the trustee holds the trust property as examined above, this view may not be sufficient. It would therefore still be necessary to consider the property aspect of a trust.

### B. Principle of Indivisibility of Ownership

In the Chinese context, as mentioned above, although the beneficiary is defined as having the 'beneficial right' of the trust, the nature of a beneficiary's right is unclear. A proper understanding of this right is made further complicated by the conventional (English) label of 'equitable ownership' of beneficiaries, a notion which has no place in the Chinese legal system. It is submitted that a better understanding of the beneficiary's 'beneficial right', and hence proper conceptualization of the Chinese Trust, requires demystifying the notion of 'equitable ownership'.

English law draws a distinction between legal and equitable ownership to enable beneficiaries to have equitable proprietary interests in the trust assets. Yet historically, equity's jurisdiction was personal. A claimant invoking the equitable jurisdiction had only personal rights against the defendant, rather than proprietary rights against specific property for the benefit of the claimant. It was subsequently when the Chancellor enforced equitable rights to property against strangers that created the concept of equitable proprietary rights. Thus, there is nothing inherently proprietary with equity. The notion of 'equitable ownership' accordingly did not originally entail that the claimant had a proprietary interest in the subject matter of the claim. So understood, a beneficiary's *equitable* ownership of the trust property does not necessarily have to entail *in rem*, proprietary rights over the trust property.<sup>52</sup> In light of this, can we still understand the beneficiary's 'beneficial right' in a Chinese Trust as a form of (property) ownership?

'Ownership', according to Professor Honoré, is 'the greatest possible interest in a thing which a mature legal system recognises', consisting of a bundle of rights and incidents in respect of the thing.<sup>53</sup> The significance of Honoré's contribution is that he shows ownership does not refer to a single right to exclusive use and control of a thing, but a bundle of rights which may vary from case to case.<sup>54</sup> While permitting certain amount of variation in content, a list of standard incidents of ownership can still be compiled. These standard incidents<sup>55</sup> comprise the right to possess, the right to use, the

<sup>52</sup> T Honoré, 'Trusts: the Inessentials' in J Getzler (ed) *Rationalizing Property, Equity and Trusts: Essays in Honour of Edward Burn* (OUP, Oxford, 2003) 17–19 [hereinafter: Honoré, 'Trusts: the Inessentials']; Gretton (n 7) 603–608. In a similar vein, Smith points out that 'equitable ownership' is merely a metaphor, and insofar as it suggests that there is a direct relationship between the beneficiary and the trust property, it is inaccurate: Smith (n 20).

<sup>53</sup> T Honoré, 'Ownership' in T Honoré in *Making Law Bind: Essays Legal and Philosophical* (Clarendon Press, Oxford, 1987) Ch 8 at 162 [hereinafter: Honoré, 'Ownership'].

<sup>54</sup> Criticized by Professor Penner who defended the view that ownership relates to exclusive use and possession of a particular thing: JE Penner, *The Idea of Property in Law* (Clarendon Press, Oxford, 1997) 152.

<sup>55</sup> Honoré 'Ownership' (n 53) 162–179. This is, according to Honoré, an account of the 'liberal concept of full individual ownership'. Note that the Property Law seems to have adopted this conception of ownership: see eg Property Law, art 39: 'Owners of immovables or movables shall be entitled to possess, use, benefit from and dispose of the immovables or movables according to law.'

right to manage, the right to the income, the right to the capital, the right to security, the incident of transmissibility, the incident of absence of term, the prohibition of harmful use, the liability to execution and the incident of residuary.<sup>56</sup>

Obviously, the beneficiary of a Chinese Trust cannot be said to possess ‘ownership’ of the trust assets according to the classical understanding of the concept of ownership. Does it mean that the beneficiary enjoys no ownership of the trust assets? It is submitted that the classical understanding of the concept of ownership, which entails a standard list of incidents of ownership, is not necessary for a trust in the civilian context, because (i) not even the standard list of incidents of ownership is necessary for a common law trust to operate; and (ii) so long as the trust institution comprises a right of beneficiaries against the trustee to regulate their relationship and to exclude third parties from the enjoyment of trust assets, which right carries with it at least some proprietary effects, this is sufficient to constitute ownership under a Chinese Trust.

(i) *The standard list of incidents of ownership is not necessary for a common law trust to operate*

Even Honoré’s list of standard incidents of ownership does not intend to elucidate the necessary and sufficient conditions of ownership in the standard, uncomplicated cases. The list of standard incidents represents the model case that the concept of ‘ownership’ fits. It is neither absolute nor unitary, but merely provides a model against the background of which lesser property interests can be assessed.<sup>57</sup> Further, neither is there a particular one incident which an owner has to have, nor are the incidents common to all types of property.<sup>58</sup>

*A fortiori*, it is not essential to define ownership in a trust according to this classical understanding, for ownership is, in substance, split through the structure of a trust, even though it can be said that the property held on trust is ‘owned’ simultaneously by the legal and equitable owner, or that both law and equity presupposes the same ownership privileges over one single piece of property. The leading incidents of ownership are split in a trust institution: the trustee has exclusive physical control and right of management of the trust assets, but the trust assets are not available to satisfy his debts on his insolvency; whereas the beneficiary, though not having the right of management, possesses the right to enjoyment, including the right to fruits derived from the trust assets. What necessarily follows is that neither the trustee nor the beneficiary can be regarded as the owner in the conventional sense, for neither possesses the standard incidents of ownership.<sup>59</sup> Although this does not invalidate Honoré’s model, it does

<sup>56</sup> Also known as the ‘ultimate residuary right’ in the thing owned. This incident is necessary so that, for example, where a person grants the bailee the right to possess, he remains the owner by virtue of retaining an ultimate residuary right in the thing owned that corresponds to the lesser interest that has been granted: see Honoré, ‘Ownership’ (n 53) 175–179. However, this necessary condition cannot be found in the context of split ownership. In such a situation, it is difficult to locate who the owner is, because ‘an ultimate residuary right is not coupled with present alienability or with the other standard incidents [of ownership]’.

<sup>57</sup> T Honoré, ‘Property and Ownership: Marginal Comments’ in T Endicott and others (eds) *Properties of Law: Essays in Honour of Jim Harris* (OUP, Oxford, 2006) Ch 7 134 [hereinafter: Honoré, ‘Property and Ownership’].

<sup>58</sup> K Campbell, ‘On the General Nature of Property Rights’ (1992) 3 *King’s College Law Journal* 79–90.

<sup>59</sup> Honoré does not deal with the situation of split ownership in detail, or the question whether the persons interested should still be called the owner: see Honoré ‘Ownership’ (n 53) 176.

mean that ownership is a flexible concept and ownership in the assets can be located in the trustees, the beneficiaries or nobody.<sup>60</sup> This also means that the concept of ownership may need to be fine-tuned. In a trust context, the essential incident of ownership in respect of the trustee is the right to manage while the rest are merely contingently involved. On the contrary, the essential incident of ownership in respect of the beneficiary is the right of enjoyment while the rest are contingently involved. This is also the view of the Trust Law of China, as stipulated in article 43: '[t]he beneficiary is the person that enjoys the right to benefit from a trust'. Despite the fact that the beneficiary holds only one incident of ownership, this does not prevent him being recognized as the owner where appropriate. The beneficiary's 'beneficial right' under a trust can still be regarded as an ownership interest.

(ii) *so long as the trust institution comprises a right of beneficiaries against the trustee to regulate their relationship and to exclude third parties from the enjoyment of trust assets, which right carries with it at least some proprietary effects, this is sufficient to constitute ownership*

Even though the beneficiary's 'beneficial right' is a form of (property) ownership right, it is still necessary to understand what the core feature of the beneficiary's ownership in a Chinese Trust is. It is submitted that the core proprietary feature of a Chinese Trust is that the beneficiary has a primary right to exclude third parties from the enjoyment of trust assets.<sup>61</sup> Article 16 of the Trust Law stipulates that 'The trust property shall be segregated from the property owned by the trustee . . . Where the trustee dies . . . or is declared bankrupt according to law, and the trusteeship is thus terminated, the trust property shall not be deemed his legacy or liquidation property'. Thus, the trust property is considered as a separate fund, and the beneficiary's interest survives the insolvency and death of the trustee, such that the trustee's creditors or successors cannot claim against the trust assets under that provision.<sup>62</sup> Thus, it is not the patrimony theory, but this right of exclusion which explains the doctrinal requirement of keeping trust assets separate from the inherent property of the trustee so that they are immune from the claims of third parties, and which constitutes the beneficiary's core proprietary right under the trust.

This view is also more compatible with the view that a beneficiary has no right over the property in a trust;<sup>63</sup> his positive right is only a right in the right of trustees in relation to the trust property.<sup>64</sup> But this 'beneficial right' has only limited proprietary effects. This is because, in the first place, it is proprietary only in the exclusionary, negative sense, as evident from article 16. Secondly, this primary right only has limited

Rather, he proffers a more pragmatic solution that in any case, even if ownership of the assets is vested in the trustee, the trust assets must still be separated from the trustee's private assets in order that the beneficiaries can be protected. His ownership, consequently, is different from the standard incidents of ownership. It is the function of split ownership (separation of management and enjoyment), not terminology or origin, that is crucial. It is only for convenience purpose that title/ownership vests in the trustee: Honoré 'Trusts: the Inessentials' (n 52) 9–11.

<sup>60</sup> Honoré 'Property and Ownership' (n 57) 137; 'Trusts: The Inessentials' (n 52) 9.

<sup>61</sup> This is similar to R Nolan, 'Equitable Property' (2006) 122 LQR 232.

<sup>62</sup> Although it seems that the trustee's spouse is not so bound and the beneficiary's interest does not survive the divorce of the trustee.

<sup>63</sup> See also Lupoi (n 36) 183–193; 224.

<sup>64</sup> Smith (n 20).

effects on third parties. If the trustee misapplies the trust assets and transfers them to third parties, the beneficiary's primary right to exclude third parties from the enjoyment of the trust assets is infringed. The beneficiary will then be able to claim the misapplied trust assets (and potentially their fruits). But this secondary right is only limited, as article 22 of the Trust Law provides that '... [w]here a transferee of the said trust property accepts the property while knowing the violation of the purposes of the trust, he shall return the property or make compensation'.

Thus, the secondary right to demand trust property to be returned or compensation from third parties is premised upon the primary right being infringed, and also aims at excluding the third parties to have access to the trust assets. More significantly, third parties will only be affected if they have knowledge, as article 22 requires the transferee to be accept the trust property 'knowing' that the disposition violates the purpose of the trust.<sup>65</sup>

Hence, the Chinese Trust allows only limited proprietary claims arising from the beneficiary's 'beneficial right'. This stems from the peculiar feature of the Chinese Trust that the beneficiary's 'beneficial right' is not a well-recognised, full-fledged property right. A proprietary right of the beneficiary in the exclusionary, negative sense ensures that while the Chinese Trust is not merely an obligation, any inconsistency with the principles of *numerus clausus* and indivisibility of ownership is also kept to a minimum. Such primary right of exclusion is protected by a secondary right to vindicate if it is being infringed. Consequently, it is submitted that China only needs to recognise that beneficiaries have exclusionary, negative, rights *in rem*. This is sufficient to constitute ownership.

#### IV. CONCLUSION

English law, where there is no principle against divisibility of ownership, may not see the need to clarify the concept of ownership. Besides, English law, by virtue of its equitable roots, permits both the trustee and beneficiary to own the property in different ways. It is thus not necessary to ask who owns the physical trust property, or what precise ownership rights each has, for each owns a different estate: legal estate and equitable interest. In transplanting an English trust institution to a civilian jurisdiction by the stroke of a legislative pen, China seems to have overlooked the technical difficulties of explaining the location of the trust property and the nature of the beneficiary's rights.

This article attempts to place the Chinese Trust on a more secure conceptual footing. It argues that the common civilian explanations do not fit the peculiar features of the Chinese Trust. Any conceptualization of the Chinese Trust must attempt to reconcile it with the indigenous civilian concepts. In this regard, it is suggested that the concept of ownership can still be retained for the trust, although it must first be recognized that it is a fluid concept, with the precise content being comparatively irrelevant. The Chinese Trust is best understood as an obligation with limited property rights in a negative

<sup>65</sup> While the requirement of knowledge is the subject of debate in English law, this provision does not explain in detail the meaning of knowledge or notice. Further, note that while English law allows tracing (the process of identifying the asset into which a previous asset has been transformed) to support far-reaching proprietary claims against the traceable proceeds, there is no such concept in the Chinese Trust Law.

sense. In so doing, it is hoped that a Chinese Trust can be saved from being designated as a contract or an agency arrangement, simply to avoid the apparent inconsistencies with inherent civilian concepts. Having clarified the concept of ownership, it can be better understood why China, a civil law jurisdiction, can have a trust institution with special features of its own, but yet still reflects the legal structure of an English trust. The beneficiary's 'beneficial right' only needs to be recognized as a form of limited property ownership. But as it is a limited ownership interest in the negative sense, any incompatibility with indigenous civilian principles will be kept to a minimum. This analysis acknowledges that the nature of the Chinese Trust is that whatever ideas it has borrowed, it has to be viewed in the distinctive context in which it has been transplanted—one where the transplantation arose out of practical commercial needs and took place within an evolving legal infrastructure that only allows conceptual issues to be worked out over time.

REBECCA LEE\*

\* Faculty of Law, The University of Hong Kong. Email: [rebecca.lee@hku.hk](mailto:rebecca.lee@hku.hk). The author acknowledges the research funding provided by the Research Grants Council of Hong Kong (RGC Ref No. 744107).