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Swiss Recognition of Foreign Trusts

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Introduction

The Swiss Private International Law Act of December 18 1987, as amended, has changed the manner in which Swiss courts examine foreign trusts for recognition purposes, providing for choice of foreign law to test the validity of these trusts within the Swiss legal framework. A common law-style trust is not recognized per se under Swiss substantive law. However, through the application of Articles 150 and following of the act governing companies, as applied in the 1994 Zurich cantonal lower court case OD-Bank in Liquidation v the Bankrupt Estate of WKR (ZR-98-52, August 20 1999 appellate court ruling on other aspects; District Court of Zurich Case fb20075, judgment rendered February 1 1994), future recognition of foreign trusts under Swiss private international law rules has been immeasurably improved.

Previous Framework

Prior to enactment of the Private International Law Act, the leading trust decision in Switzerland was rendered by the Swiss federal Supreme Court in Harrison v Credit Suisse, ATF 96 II 79ff, JdT 1971 I 329ff.

In that case the settlor, Mr Harrison, a US citizen, had intended to establish a trust in the form of a contract for the benefit of his ex-wife and their three children, with Credit Suisse as trustee. The deed contained a Swiss law governing law clause. Subsequently, the settlor remarried and at his death his widow filed suit in Zurich to have the trust declared null and void under Swiss law, in order to bring the assets of the trust into the settlor's Swiss estate.

This presented a significant and unprecedented problem for the Swiss Supreme Court, as there was no basis in Swiss law upon which to recognize trusts per se. Therefore, the court

set out to find a workable legal structure within the Swiss legal system through which it could address the notion of a trust.

The Supreme Court reasoned that a trust was a legal structure that combined many different notions of Swiss law in reaching its objective. It further stated that the use of a combination of these legal concepts was not necessarily objectionable to Swiss legal theory, as long as it violated none of the mandatory rules of Swiss law.

The court found that the Harrison trust combined various elements of Swiss law under the Swiss federal Code of Obligations and the Swiss federal Civil Code. In particular, the trust combined principles of:

- mandate;
- fiduciary transfer of ownership;
- promise to gift and donatio mortis causa (ie, a gift in prospect of death);
- stipulation for third party;
- deposit agreement;
- foundations and family foundations;
- fideicommission substitution;
- usufruct; and
- mixed contract arising from diverse contractual obligations.

Based on its analysis under Swiss law, the Swiss federal Supreme Court determined that the combination of the above Swiss legal notions formed a mixed contract under the Code of Obligations which violated no mandatory rules of Swiss law as concerned the trust objectives, and further that the legal patchwork met the formal requirements of Swiss law. Therefore, the trust settlement was upheld as valid under Swiss law.

This was the first case of impression where a Swiss court considered and actually recognized a trust under Swiss law. However, the court did not truly recognize this structure as a trust per se, but rather went to great lengths in its analytical efforts to reclassify the trust differently under Swiss law.

The Private International Law Act

A major shift in Swiss law treatment of trusts following the 1970 Harrison Case occurred only when Switzerland enacted the Private International Law Act of December 18 1987, which took effect on January 1 1989. The first application of the relevant company provisions of the Private International Law Act in regards to trusts arose in 1994, in the groundbreaking case of OD-Bank in Liquidation v the Bankrupt Estate of WKR.

The Private International Law Act was intended to promote and to make more coherent the use of international forum selection and choice of law clauses in matters with international context coming within the jurisdiction of Swiss courts. It was also intended to provide for situations in which the Swiss courts were forced to deal with foreign matters that were not conceived of or addressed under substantive Swiss law. Under the Private International Law Act, where there is an express choice of law clause that choice will be honoured, save in the case of violations of public policy. Another triggering event under the act occurs where there is a foreign element or a foreign component of the case which calls for the application of foreign law under Swiss private international law rules. Article 1 of the act states:

"This statute regulates in international matters: (a) the jurisdiction of Swiss judicial or administrative authorities; (b) the applicable law; (c) the conditions for recognition and enforcement of foreign judgments; (d) bankruptcy and composition; (e) arbitration."

Act's Application to Trusts

The Private International Law Act was first applied to trusts in the WKR Case, which signalled a change in the Swiss approach to trusts and stands as a leading case in Switzerland. Henceforth, it is expected that foreign settled trusts coming for consideration before the Swiss courts under Swiss private international law rules will now be subjected to analysis under Articles 150 and following of the Private International Law Act.

In the WKR matter, a series of companies and a multi-layered structure of 100 or more holding and subsidiary companies were formed. At the head of this corporate conglomerate was the Omni group, and within the Omni group there was a banking entity, the OD-Bank. When the Omni group corporate pyramid collapsed as a result of one of Switzerland's largest credit scandals involving WKR, the financier and beneficial owner of the Omni group - resulting in his filing for personal bankruptcy, followed by forced bankruptcies filed on a massive scale engulfing practically the entire conglomerate - the OD-Bank was also put into liquidation under Swiss bankruptcy law. However, the OD-Bank in liquidation requested that it be duly registered as a priority creditor in the schedule of creditor claims of the bankrupt estate of WKR. The bankrupt estate of WKR challenged this creditor claim on the alleged ground that the OD-Bank in liquidation and WKR were in reality the same economic entity. As it turned out, the OD-Bank's shares were held by its sole parent company, the BB company, the shares of which in turn were held by another sole parent company, the AA company, itself an underlying company of and wholly owned by the WKR trust, a foreign trust settled by WKR under the laws of Guernsey.

At issue in the case was the relationship of the WKR trust to WKR and to the creditor claim raised by OD-Bank in liquidation with respect to the bankrupt estate of WKR. The Zurich District Court in Switzerland was thus faced with the task of determining the nature and legal status of a foreign settled, so-called 'express' trust - that is, a trust reduced to and settled in writing in the form of a formal trust instrument.

The court found that the WKR trust was formed under the laws of Guernsey. This gave the case an international nexus which caused the analysis using the Private International Law Act to apply under Swiss private international law rules.

In order to proceed under Swiss law and the Private International Law Act the court needed to determine the nature of a trust using the language contained in the Private International Law Act. As was noted above, the Swiss Supreme Court in Harrison had summarized its legal analysis by reference to a mixed contract theory. However, in the WKR Case the Zurich District Court found that the definition and function of the WKR trust as the head holding company over a corporate conglomerate would more appropriately fit under provisions of a 'company' as defined in the Private International Law Act.

Article 150(1) of the act takes a broad approach in defining what would constitute a 'corporate entity' by including therein the notions of any association of organized persons and/or organized property. This definition was intended to take account of the vast range of

companies and company-like structures existing in various jurisdictions around the world, which otherwise are foreign to substantive Swiss law notions of 'company'. As a result, Article 150(1) defines a 'company' as any "organized bodies of persons and organized units of assets". This definition thus applied to an association of organized property, the category under which the lower court placed the WKR trust.

However, the district court made clear in its opinion that not all types of foreign trust may be viewed as organized asset units and may therefore not qualify as companies under the Private International Law Act. In this respect, the explanatory comments made on November 10 1982 by the Swiss federal council concerning this definition of 'company', included in the Swiss federal statute on international law, are noteworthy: "On the one hand there are formal requirements in order to be able to consider that there is an organized asset unit." This can be read as requiring that foreign trusts, in order to be qualified and recognized as such by Swiss courts by recognition under the Private International Law Act as a company, must meet minimum formal company-like requirements conceived under Swiss private international law rules. These formal requirements would include (but are not limited by the manner in which such an 'association of property and/or persons' conducts itself) the existence of a formal writing that, in at least a minimal manner, creates and regulates the association of property and/or persons, as well as some form of organized structure. In other words, the WKR opinion is restricted in its application to so-called 'express' trusts. Other types of trust structures (eg, constructive trusts) will not necessarily be governed by the WKR Case.

The Zurich District Court also made reference to the fact that issues of estate and family law often present in cases dealing with trusts were absent in the case at hand.

Further, the court noted that the manner, use and purpose of the WKR trust as top holding company for the Omni group conglomerate rendered the instant finding as a 'company' particularly apparent under Article 150(1). The use of the WKR trust within the overall conglomerate structure of the Omni group companies made clear that the WKR trust was established merely as a de facto holding and management entity. Therefore, based on the court's corporate definition and function theory applied to Article 150(1), the court found that the foreign trust in question was expressly created based on formal and organized principles applicable to a 'company' structure, and that the trust purpose and design were corporate in nature. These findings led the Zurich District Court to hold accordingly that the WKR trust was defined as a 'company' under Article 150(1).

The next step in the lower court's analysis of the WKR trust was to apply the laws of the place of incorporation or, in the case of a trust, the place of settlement. The court found its authority under Article 154(1) of the act, which states:

> *"Companies are subject to the laws of the country according to which they are organized if they meet its provisions on publicity or registration or, if no such provisions exist, if they organize themselves according to the laws of that country."*

The Swiss court held that under the Private International Law Act the WKR trust would be governed and interpreted using the applicable laws of Guernsey, the governing law indicated in the trust document which established the WKR trust. The Swiss court then undertook an examination of Guernsey trust law using the Trusts (Guernsey) Law 1989 as its authority on the use and legal status of said trust in the Swiss bankruptcy proceedings.

With the above finding the Swiss courts recognized the validity and institution of a foreign trust in Switzerland, despite the fact that no such institution is known under Swiss substantive law. By using the Private International Law Act in this manner, qualifying 'express' foreign trusts may now be founded and recognized under Swiss private international law rules and brought within the Swiss judicial system in international contexts. As such, the act's company provisions will refer Swiss courts faced with international conflicts and choice of law rules concerning the validity and interpretation of such foreign trusts, their internal provisions and the relationship of persons to those provisions to the law of the jurisdiction where the trust was settled.

The Zurich court next embarked on the process of testing the validity of the WKR trust using Guernsey trust principles and general common law trust principles. This analysis is very instructive as regards probable future treatment of foreign trusts by Swiss courts.

The first point made by the Swiss court was to explain the nature of a trust whereby property ownership is transferred by the settlor to a trustee. The trustee not only obtained legal title to the property but held it as a fiduciary for the benefit of the beneficiaries. It is the trust deed and the law of the country of formation of the trust that controlled and sealed these relationships. The court noted that a trust may be structured in many ways to fit the individual needs of the settlor. However, the court also observed that this freedom of disposition would be limited by public policy. The court quoted an English secondary legal source in this respect, stating: "Where a trust which as such would be valid violates these principles [breach of public policy - the equivalent to some extent of the continental civil law notion of public order] it cannot be enforced." (Shell's Principles of Equity, 28th edition, London 1982, at page 91.) In this way, the Swiss court emphasized that not only would it apply the foreign law relating to the formation and validity of the trust, but also public policy principles - both foreign and domestic - should the case arise.

Then the Swiss court turned to an analysis of the trust instrument itself. The court found that:

- a trust must conform with the provisions set forth in the trust deed;
- it must be compatible with the applicable trust law; and
- the intent of the settlor must have been consistent with the principles governing a trust, not only at its formation, but also thereafter during its life.

The trustee has certain duties and roles that must be met in order for a trust to exist. After stating these conditions, the Zurich court applied them to the WKR trust. The court took what amounted to an 'all-circumstances test' approach in determining the validity of the WKR trust. The court stated:

> *"When a trust is formed in a non-objectionable way, formally speaking, there is a presumption that the settlor had the actual intent to create the trust and wants to follow up on the legal implications of the trust, the so-called 'idea of the trust'."*

The Swiss lower court held that the conduct of WKR as settlor of the WKR trust should be established by both intrinsic and extrinsic facts, and would be controlling in the examination of the WKR trust's validity. The Swiss court relied heavily in this respect on the Royal Court of Jersey case decision In re Clothhilde Rahman v Chase Bank (CI) Trust Co Ltd, June 6 1991, in which the Jersey court found that both the pre and post-trust settlement behaviour of the settlor was conclusive to the finding of a sham trust.

The Swiss court then used the above principles and applied them to the facts found in WKR. The court found that the WKR trust acted and functioned a manner that was inconsistent with the settlor WKR's intent to create a trust, the so-called 'idea of the trust'. In particular, on numerous occasions the settlor not only interfered with but explicitly intervened in the affairs of the WKR trust and the decisions of its trustee. WKR did so in such a way that the WKR trustee was considered negligent by the Zurich court in allowing this behaviour and was himself committing breaches of trust. This holding should put trustees on notice that in Switzerland 'rubber stamp' trustee practice will be closely scrutinized and may give cause for finding by the Swiss courts that a foreign trust is invalid and sham under its own governing laws.

Furthermore, the Swiss court made explicit reference to the trust deed in its review of the WKR trust, observing that nowhere in the deed was WKR as settlor given the power to act for the WKR trust, the trust being discretionary. The court did not address whether the existence of such powers would have affected the validity of the trust, but instead remarked that under this particular trust deed, and in accordance with governing trust law in Guernsey, the manner in which the WKR trust had been administered and operated was clearly in violation of Guernsey trust law and common law trust principles. In support of its finding of sham under Guernsey trust law, the Zurich court cited several specific factual circumstances whereby WKR himself acted and held himself out towards third parties as direct owner of the WKR trust assets, issued instructions to third parties regarding the disposition of the WKR trust assets, and issued orders in respect of administration of the WKR trust and disposition of its assets to the WKR trustee. The trustee acted more as the mere agent of WKR than as a trustee exercising independent trustee discretion on trust matters and in his trustee decisions.

Based on the above findings, the Zurich District Court therefore held that the WKR trust was nothing more than a sham trust. It held that the WKR trust was invalid based on the laws of Guernsey. Accordingly, the WKR trust assets legally belonged to WKR, the bankrupt debtor, who had never respected the idea of the trust, and therefore those assets belonged to the bankrupt estate of WKR. As such, the Swiss court used its holding invalidating the WKR trust as a sham trust under its governing laws to find that the alleged creditor, OD-Bank in liquidation, in fact part of the invalidated WKR trust assets, was in reality the same economic entity as WKR.

Comment

The WKR Case represents a major shift in Swiss judicial recognition and treatment of foreign settled trusts. Through the use of the Private International Law Act the Swiss courts have gone much further, to their credit, than would otherwise have been expected, even under the Private International Law Act, in addressing complex issues of validity by reference to foreign law when such a unique foreign institution as the trust is under enquiry before them. Previously, prior to the 1987 Private International Law Act, the Swiss courts had attempted to define a trust against a legal patchwork of then existing Swiss code-based civil law institutions. However, now the Swiss courts empowered by the Private International Law Act are able to reach beyond Switzerland's own legal institutions when addressing international issues related to recognition of foreign trusts. The WKR decision thus presents an excellent legal analysis by the Swiss judiciary of the concepts and requirements relating to recognition of foreign trusts and trust law under Swiss private international law conflicts and choice of law rules. Moreover, the Swiss court in question not only exposed its judicial analysis of the trust formalities, but also applied expert evidence under the foreign governing

trust law, in formulating a well-reasoned decision holding invalid the WKR trust. As a result, future legal analysis of foreign trusts for recognition purposes in Swiss litigation has become more clear. The Zurich District Court has not only provided insightful practical guidance on the future recognition of foreign trusts in Switzerland, but has also set a timely judicial standard for the legal analysis of their validity within the international context of the Swiss legal framework defined by Swiss private international choice of law rules incorporated into the company provisions of the Private International Law Act.

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