Common Law Foundations and their recognition—a 'new kid on the block' in Private International Law

Peter Picht* and Caroline Kopp†

Abstract

With the creation of the 'Common Law Foundation (CLF)', a new actor has entered the stage of Private International Law and international wealth planning. The recognition of the CLF by other jurisdictions is not self-evident given its mixed legal nature. Although an independent jurisdiction is free to create new institutes of law, there is no guarantee that other jurisdictions will accept the new type of entity and grant it the desired legal effects. So far, there is no case law concerning the CLF. Consequently, guidance must be sought by looking at comparable legal institutes and the way they were treated by other jurisdictions, like, for example, Switzerland and Germany. When it comes to the question of recognition, there is no room for stereotypical solutions.

Introduction

With the creation of the 'Common Law Foundation' (CLF) through codifications in a multitude of jurisdictions, especially the so-called 'offshore jurisdictions',[1] a new actor has entered the stage of Private International Law and international wealth planning. From the point of view of other jurisdictions, eg from the perspective of Swiss law, this raises the question whether and how a CLF can be 'recognised'.[2] Although an independent jurisdiction is free to create new institutes of law, there is no guarantee that other jurisdictions will accept the new type of entity and grant it the desired legal effects, as for instance the capacity to sue and be sued in court or the legal independence from its founder that protects the entity's assets against the creditors of that founder. The recognition of the CLF, in particular, is not self-evident given its mixed legal nature. On the one hand, a CLF incorporates elements of the Anglo-American trust, on the other hand it shows traits of a 'traditional' Civil Law foundation.[3] For Common Law and Civil Law jurisdictions alike the CLF is, therefore, to some extent a 'strange animal'. Some critics even denounce CLFs as camouflaged trusts that have thrown over the coat of a foundation to mislead Civil Law courts.

A new actor has entered the stage of Private International Law and international wealth planning

So far, there is no case law concerning the CLF. Consequently, guidance must be sought by looking

* Prof. Dr. Peter Picht, LL.M (Yale), Chair for Commercial Law, University of Zurich, Freiestrasse 15, 8032 Zurich, Switzerland.
† Caroline Kopp, Academic Assistant at the Chair for Commercial Law (Prof. Picht), University of Zurich, Switzerland.

1. cf St Kitts Foundations Act 2003; Bahamas Foundations Act 2004; Antigua and Barbuda International Foundations Act 2007; Anguilla Foundation Act 2008; Jersey Foundations Jersey Law 2009; Seychelles Foundations Act 2009; Vanuatu Foundation Act 2009; Belize International Foundations Act 2010; Labuan Foundations Act 2010; Isle of Man Foundations Act 2011; Mauritius Foundations Act 2012; Cook Islands Foundations Act 2012; Guernsey Foundations Guernsey Law 2012; Barbados Foundations Act 2012.

2. cf P G Picht, 'Die Anerkennung von Common Law Stiftungen – neue Fragen im internationalen Privatrecht?' in L Brugger and C v Götz (eds), *Universum Stiftung*, Bericht zum 4. Zürcher Stiftungsrechtstag in: Npor, ZStV, PSR (Österreich) 2016 (forthcoming); PG Picht, 'Analoge Anwendung des HTÜ auf Common Law Foundations?' (2017) SJZ<.

3. P Panico, Private Foundations and Trusts: Just the Same but Different?' (2016) 22 Trust & Trustees 132, 137.

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at *comparable* legal institutes and the way they were treated by other jurisdictions. From the perspective of the Anglo-American jurisdictions, this raises the question to what extent the Common Law case law concerning trusts can be transferred, in the sense of being applied, to the field of CLFs. From a Civil Law point of view, it seems worthwhile to discuss civil law institutes that are comparable to the CLF and their treatment in the Civil Law jurisdictions. Thus, this contribution starts off with looking at the recognition of trusts and Liechtenstein (civil law) foundations[4] by Switzerland and Germany. The outcome of this analysis is an indicator of how these two jurisdictions, and possible others as well, would treat CLFs when a case arises.

This raises the question whether and how a CLF can be 'recognised'

The first step of this analysis must be a *caveat*: the CLF is not a homogeneous phenomenon and it should not be treated as such. Since CLFs in different jurisdictions vary[5] and since some types of CLF are particularly close to the trust model whereas others are closer to the traditional Civil Law foundation, it would be wrong to automatically treat all types of CLF the same way. Furthermore, the CLF concept is quite malleable and how the foundation will look like in the end thus largely depends on the CLF founder. In consequence, no CLF is identical to another and, when it comes to the question of recognition, there is no room for stereotypical solutions. This short contribution cannot cover all possible types and variations of CLF. It only intends to make some guiding remarks for courts and practitioners who will face the recognition issue rather sooner than later.

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Comparison one: The recognition of trusts

In the field of inheritance law, the Hague Trust Convention (HTC)[6] makes the main difference in the way Switzerland and Germany deal with the Anglo-American trust. By adopting the HTC, Switzerland pledged to recognize foreign-law trusts as an institute *sui generis*.[7] Even though you cannot establish a trust under Swiss law, Switzerland basically treats a trust established under, say, English law the way English law itself would treat it.[8]

Under German inheritance law, things look quite different. At least in cases in which the law applicable to an estate is German law and the decedent used the trust as an instrument to administrate and distribute his assets, the German courts do not recognize the trust as such. Instead, they re-interpret it as a comparable German legal institute, eg tail and expectancy (*Vor- und Nacherbschaft*) or execution (*Testamentsvollstreckung*).[9] This re-interpretation or 'transposition' can be seen critically as it risks to distort the will of the testator

4. Foundations based on the law of Liechtenstein.

5. For an overview, see J Niegel and R Pease (eds), *Private Foundations World Survey* (OUP 2013).

6. Convention on the Law Applicable to Trusts and on their Recognition ('the Hague Trust Convention'), concluded 1 July 1985, ratification in Switzerland on 1 July 2007.

7. cf P G Picht, 'Der Erb-trust und die neue EU-Erbverordnung' in *Festschrift für Makoto Arai* (2015), D Coester-Waltjen/V Lipp/D Waters (ed), 531–53, 536; NP Vogt, 'Trusts und schweizerisches Recht (das Haager Trust Übereinkommen und die neuen Art 149a–e IPRG)' (2007) Anwaltsrevue 199ff; D Jakob and PG Picht, 'Der Trust in der Schweizer Nachlassplanung und Vermögensgestaltung – Materiellrechtliche und internationalprivatrechtliche Aspekte nach der Ratifikation des HTÜ' AJP/PJA 7/2010, 856–86; D Jakob and PG Picht, 'Das Haager Trust-Übereinkommen und seine Geltungseinschränkung – ein Fass der Danaiden?' in *Innovatives Recht, Festschrift für Ivo Schwander* (2011), F Lorandi/D Staehelin (ed), 543–62; P Gutzwiller, *Trusts für die Schweiz* (2007) Anwaltsrevue 156ff; S Wolf (ed), *Der Trust – Einführung und Rechtslage in der Schweiz nach dem Inkrafttreten des Haager Trust-Übereinkommens* (2008); D Jakob and PG Picht, 'Der Einsatz von Trusts in Vor- und Nacherbschaftskonstellationen – Gedanken zum Zusammenspiel von Haager Trust Übereinkommen und Art 488 Abs. 2 ZGB' in *Privatrecht als kulturelles Erbe* (2012) 175–98; L Thévenoz, 'Les trusts sont-ils effectivement reconnus en Suisse? Un bilan sept ans après la ratification de la Convention de La Haye sur les trusts' (2014) 86 SZW 161.

8. Jakob and Picht (n 7) 856; L Thévenoz, 'Créer et gérer des trusts en Suisse après l'adoption de la convention de La Haye, in: Journée 2006 de droit bancaire et financier' (2007) 51–105; S Wolf and N Jordi, 'Trust und schweizerisches Zivilrecht – insbesondere Ehegüter-, Erb- und Immobiliarsachenrecht' in S Wolf (ed) (n 7) 29–77, 37f; Gutzwiller (n 7) 156.

9. BayObLG 1 February 1980—1 Z 72/79, IPrax 1982, 111; BayObLG 18 March 2003—1 Z BR 71/02, ZEV 2003, 503ff; OLG Frankfurt, Deutsche Notar-Zeitschrift (DNotZ) (1972) 543; AG Freiburg 3 April 2013—3 NG 246/2010; OLG München ZEV 2006, 456; see also: Picht, *Festschrift Arai* (n 7) 535ff, 546ff.

since the legal effects of the intended trust will never be exactly the same as those of the German institutions being applied after the transposition.

Comparison two: Liechtenstein foundations

Switzerland and Germany have more in common in their way of handling Liechtenstein foundations. Both recognize the Liechtenstein foundation without any transposition and apply to it Liechtenstein law as the law under which the foundation was incorporated.[10] This recognition-friendly approach is, however, restricted by some follow-on limitations, such as *ordre public* (public policy protection)[11] or mandatory national rules.[12] To put it briefly, these follow-on limitations can lead to non-recognition or a merely partial recognition of the Liechtenstein foundation if the latter violates mandatory rules or the fundamental notions of justice of the recognizing state.

In spite of the structural similarities between the Swiss and the German approaches, however, the two countries' focus in recognition *practice* differs. German courts, for instance, tend to be quite harsh on foundations containing 'black money' or reserving for the founder a very strong legal status and influence.[13] From the Swiss perspective, the Liechtenstein foundation may pose problems if it makes maintenance payments to its beneficiaries. While Article 335 of the Swiss Civil Code (SCC) prohibits maintenance payments to beneficiaries of a family foundation,[14] Liechtenstein law knows no such prohibition.[15] Recently, the Swiss Federal Supreme Court has—convincingly, we think[16]— held that Article 335 SCC does not qualify as a 'mandatory rule' in the sense of Swiss Conflicts Law and, hence cannot prevent the recognition of Liechtenstein foundations in Switzerland.[17]

Ordre public and mandatory national rules establish recognition obstacles stemming from the law of the recognizing state. These limitations must be distinguished from limitations that have their origin in the law of the state of incorporation of the legal institute. The 'Sham Doctrine' regarding trusts[18] and the concept of abuse of rights regarding foundations belong to this latter group.[19]

Core questions concerning the recognition of CLF

What lessons can we draw from this analysis for the recognition of CLF? We propose five core questions which may help to organize the numerous and diverse issues involved and which may form, at the same time, a kind of roster for assessing the recognisability of a CLF.

First of all, it has to be analysed whether there exists transnational law addressing the question of recognition. Swiss courts, in particular, will have to decide

10. BSK-ZGB I- Grüninger (5th edn, 2014) Art 335 N 16; BGer 3 A_339/2009 v 17 November 2009; OLG Stuttgart (5 U 40/09); OLG Düsseldorf 2010 (22 I 126/06); J Hoffmann, s 10 Stiftungen im Internationalen Privatrecht, in A Richter and T Wachter (eds), *Handbuch des internationalen Stiftungsrechts* (2007) 183ff, 195 mn 28; MünchKomm-BGB-Weitemeyer (7th edn, 2015) s 80, mn 246ff; MünchKomm-BGB-Kindler, IntGesR (6th edn, 2015) mn 315, 676; P Prast, 'Anerkennung liechtensteinischer juristischer Personen im Ausland' in H Heiss (ed), *Asset Protection: Möglichkeiten und Grenzen am Finanzplatz Liechtenstein – 2. Tagung des Zentrums für liechtensteinisches Recht an der Universität Zürich* (2014) 13–58.

11. For a brief explanation, cf: MünchKomm-BGB-v Hein, Einleitung IPR (6th edn, 2015) mn 281; BSK-IPRG-Mächler-Erne and Wolf-Mettier (3rd edn, 2013) Art 17 N 1ff; vgl BGE 84 I 121ff; BGE 64 II 98; BGE 76 I 129; BGE 78 II 251.

12. For a brief explanation, cf: MünchKomm-BGB-v Hein, ibid, mn 286ff; BSK-IPRG-Mächler-Erne and Wolf-Mettier, ibid, Art 18, 19.

13. BGE 135 III 614 (E 4); D Jakob, 'Ein Stiftungsbegriff für die Schweiz' (2013) 132 ZSR II, 185–340, 234ff; Jakob and Picht (n 7) 863ff.

14. KUKO ZGB-Jakob (1st edn, 2011) art 335 N 4ff.

15. D Jakob, *Schutz der Stiftung: Die Stiftung und ihre Rechtsverhältnisse im Widerstreit der Interessen* (2006), Mohr Siebeck, 55.

16. Some literature to the same effect: Jakob and Picht (n 7) 855, 863ff; S Herzog, *Trusts und schweizerisches Erbrecht, Einschränkungen bei der Anerkennung von Trusts aus der Perspektive des schweizerischen Erbrechts – unter besonderer Berücksichtigung von Pflichtteilen und deren prozessualer Durchsetzung* (2016), Schulthess Verlag, 150.

17. BGE 135 III 614 E.4.3. '. . . *le combat contre l'oisiveté n'a plus rien à voir avec la sauvegarde d'intérêts supérieurs.* . . .'; affirmative annotation to this judgment: Jakob and Picht (n 7) 855, 863ff.

18. T Haeusler, 'Einführung in den angelsächsischen Trust' in Richter and Wachter (n 10) 229, 242ff, mn 66ff, s 12.

19. cf FL-OGH, 3 C 388/96-25, s 916 mn 5; FL-OGH, 01 CG. 2008. 156, 7.2.2.; FL-OGH, 9 C 130/99-47, 6.4.4; FL-OGH on 3 November 2005, LES 2006, 373ff; M Büch, *Durchgriff und Stiftung: Eine Untersuchung der Rechtsfigur des Haftungsdurchgriffs im liechtensteinischen Recht im Kontext der Rechtsform Stiftung* (2015) 38ff; H Bösch, *Die liechtensteinische Treuhänderschaft zwischen Trust und Treuhand* (1995) 471ff.

whether the HTC applies to CLFs as well. In our view, an outright application is problematic[20] given the substantial differences between CLFs and trusts. Legal capacity, in particular, is a typical feature of the CLF while typical trusts do not possess it. Nonetheless, some underlying principles of the HTC may have an impact on the recognition of CLFs.

Secondly, if the HTC cannot be applied directly, the national provisions on Conflicts of Laws must be consulted to determine the applicable law. This depends on how the court of recognition 'qualifies'[21] the CLF and which Conflicts rule it consequently uses for identifying the substantive law that is to govern the CLF at issue. Whether the CLF can be qualified—as it is the case for traditional foundations[22]—as a particular form of 'corporation' depends in part on the concrete organization of the respective CLF. Given that CLFs are usually equipped with substantial legal independence vis-à-vis their founders and organs, however, a qualification as 'corporation' within the meaning of the term applied by the Conflicts rules ought to be the usual outcome. The factor determining the law applicable to 'corporations' can vary depending on the recognizing jurisdiction: in Swiss law, the law of incorporation would have priority pursuant to Article 154 Swiss Federal Code on Private International Law (CPIL).[23] The German Conflicts of Laws provision regarding 'corporations' would instead focus on the *legal seat* where the jurisdiction of origin of the CLF is not part of the European Union or the European Economic Area.[24] This can hold surprises for the persons involved. If, for instance, a foundation was established in Jersey but maintains its legal seat in Frankfurt on the Main, German law would be applicable—probably not the outcome intended by the founder. Fourthly, the court must consider whether the CLF can be recognized as a legal institute *sui generis* or whether a transposition seems necessary, for instance into a fiduciary relationship lacking legal capacity. Finally, and particularly in case of a *sui generis* recognition, follow-on limitations such as *ordre public* or sham must be taken into consideration.

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Transposition and limitations to recognition

The fourth of the aforementioned questions deserves particular attention, ie the consideration whether the recognizing state is prepared for a *veritable* recognition of a foreign-law CLF or just for a transposition. In Swiss law, the HTC principles should have an impact on this decision. As Switzerland has pledged, through Article 11 HTC, to recognize even the trust[25] which is less close to Swiss law concepts than the CLF, it would be inconsequent if the CLF were not to encounter at least the same acceptance.[26] This argument does not apply to German law, though. On the contrary, the German practice of transposition regarding the inheritance trust might suggest a transposition of CLFs that are particularly similar to trusts. Such a practice would, however, deserve sharp criticism

20. Against an analogous application: J Niegel, 'Editorial On Foundations and Chameleons' (2013) 19 Trusts & Trustees 497, 502; J Niegel, 'Editorial: Accompanying Private Foundations Over A Decade: Reception – Recognition – Harmonization Issues' (2014) 20 Trusts & Trustees 503, 507 (n 16).

21. General reference on the concept of 'qualification': *MünchKomm-BGB-v Hein* (n 11), mn 108ff.

22. cf German Federal Court BGH, 8 September 2016 – III ZR 7/15.

23. cf Swiss Federal Code on Private International Law (CPIL), SR 291 <http://www.umbricht.ch/en/cpil/> (accessed 13 December 2016); references to the Swiss incorporation theory: BSK-IPRG- Eberhard v Planta (3rd edn 2013) Art 154 N 9; IPRG-Kommentar-Vischer, Art 154 N 19; KUKO ZGB-Jakob (n 15), Art 335 N 18; BGE 117 II 494; A Heini, SZW 1993, 64.

24. MünchKomm-BGB-Kindler, Int GesR (6th edn 2015) mn 358, 142; German Federal Court BGH, 27 October 2008—II ZR 158/06 ('Trabrennbahn') = BGHZ 178, 192.

25. cf Annex.

26. In favour of recognition also Niegel (n 20); 503.

since it would neither reflect the founder's will, nor comply with the fundamental private international law doctrine of *comity*,[27] guaranteeing the respect and openness towards foreign jurisdictions.

Whether follow-on limitations interfere with the recognition of the CLF depends in part on decisions made by the founder. He should refrain from establishing excessive control rights for himself or from the inclusion of fiscally doubtful assets. In contrast, the maintenance character of a CLF should not be a hindrance to its recognition in Germany or Switzerland. Even if follow-on limitations are triggered, they do not necessarily result in a complete refusal of recognition. A kind of 'selective recognition' may deny legal validity to certain elements of the CLF only. The principles underlying Article 15 HTC, such as the protection of minors, of spouses, of persons entitled to statutory shares or of insolvency creditors, may indicate fields where a selective non-recognition could occur. This can be unfortunate for founders who intend, by using a CLF, to protect their assets from the groups of persons named in Article 15 HTC. Where follow-on limitations clash with the CLF's statutes or the provisions of the respective CLF jurisdiction, the (partial) non-recognition ordered by the 'recognising' jurisdiction is not unlikely to prevail in the end, at least where the foundation's assets are physically located not 'offshore' but in Zurich, Frankfurt, or London and thus form an easy target for enforcement measures.

Whether follow-on limitations interfere with the recognition of the CLF depends in part on decisions made by the founder

Summary

It seems likely that many types of CLFs will find at least limited recognition in Switzerland and Germany. It is much harder to predict details, for instance where courts may use follow-on limitations to deny recognition to certain (parts of) individual CLFs. Legislators of CLF jurisdictions and prospective CLF founders are—if they want to increase the chance of recognition—well advised to show moderation in the extent they deviate from classical foundation concepts. Recognition states are called upon to take into account their existing practice of recognition regarding legal entities similar to the CLF while, on the other hand, abstaining from a 'mechanical' transfer of existing schemes to the CLF. The CLF is an independent and a new legal institute that deserves an assessment in its own right. Recognition-friendliness should be a leading principle in this exercise. Doubts in individual cases may be eliminated by means of specific follow-on limitations. A 'Hague CLF Convention' will, if it ever sees the light of day, take a long time to come into force.

Until then, recognition states as well as CLF jurisdictions have to rely on an interaction which should be characterized by cooperation and mutual openness.

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Annex

Article 11 HTC:

A trust created in accordance with the law specified by the preceding Chapter shall be recognised as a trust.

Such recognition shall imply, as a minimum, that the trust property constitutes a separate fund, that the trustee may sue and be sued in his capacity as trustee, and

27. On comity in general: J K Bleimaier, 'The Doctrine of Comity in Private International Law' (2012) 24 Catholic Lawyer 327.

that he may appear or act in this capacity before a notary or any person acting in an official capacity.

In so far as the law applicable to the trust requires or provides, such recognition shall imply, in particular -

a. *that personal creditors of the trustee shall have no recourse against the trust assets;*
b. *that the trust assets shall not form part of the trustee's estate upon his insolvency or bankruptcy;*
c. *that the trust assets shall not form part of the matrimonial property of the trustee or his spouse nor part of the trustee's estate upon his death;*
d. *that the trust assets may be recovered when the trustee, in breach of trust, has mingled trust assets with his own property or has alienated trust assets. However, the rights and obligations of any third party holder of the assets shall remain subject to the law determined by the choice of law rules of the forum.*

Professor Dr Peter Picht *studied law in Munich, did his PhD at Munich University/the Max Planck Institute, and holds a master's degree from Yale Law School. He has been working, i.a., in the EU Commission's Directorate General for Competition, as a Senior Research Fellow with the Max Planck Institute for Innovation and Competition, and with the law firm Allen & Overy. Picht now holds a chair for Commercial Law at the University of Zurich and is head of the University's Centre for Intellectual Property and Competition Law (CIPCO). He remains, however, affiliated to the Max Planck Institute as a Research Fellow. Picht's academic teaching and writing, as well as his counselling activity focus on intellectual property law, competition law, international private, and procedural law. E-Mail: peter.picht@rwi.uzh.ch; www.rwi.uzh.ch/de/lehreforschung/alphabetisch/picht/person.html*

Caroline Kopp *now works as an Academic Assistant at the Chair for Commercial Law of Professor Peter Picht (LL.M. Yale) at the University of Zurich. She had worked for three years with the Max Planck Institute for Innovation and Competition, Munich. She focuses on Private International and Procedural Law. E-mail: caroline.kopp@rwi.uzh.ch*