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

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

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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 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 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.

No CLF is identical to another and, when it comes to the question of recognition, there is no room for stereotypical solutions

Comparison one: The recognition of trusts

In the field of inheritance law, the Hague Trust Convention (HTC) 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. Even though you cannot establish a trust under Swiss law, Switzerland basically treats a trust established under, say, English law in the way English law itself would treat it.

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). This re-interpretation or ‘transposition’ can be seen critically as it risks to distort the will of the testator.

5. For an overview, see J Niegel and R Pease (eds), Private Foundations World Survey (OUP 2013).
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. This recognition-friendly approach is, however, restricted by some follow-on limitations, such as *ordre public* (public policy protection) or mandatory rules. 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. 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, Liechtenstein law knows no such prohibition. Recently, the Swiss Federal Supreme Court has—convincingly—we think—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.

*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 and the concept of abuse of rights regarding foundations belong to this latter group.

**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

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


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


whether the HTC applies to CLFs as well. In our view, an outright application is problematic 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’ 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—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). 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. 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.

Transposition and limitations to recognition

The fourth of the aforementioned questions deserves particular attention, i.e. 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 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. 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.

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

**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...
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.

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