THE PUBLICITY OF TRUSTS IN COMMON LAW AND CIVIL LAW SYSTEMS

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ABSTRACT

This article compares the formalities for the creation of trusts in common law jurisdictions with the registration requirement in civil law jurisdictions, with special reference to Chinese law. It argues that writing requirements, derived from land law and applied to certain trusts in land, should not be confused with the compulsory requirement of registration of title to land, and that compliance with registration formalities should not be a precondition to the validity of a trust. This is because land title registration gives immediate indefeasibility to the registered proprietor while the validity of a trust is derived from a properly executed trust, and not from registration.

I INTRODUCTION

All legal jurisdictions recognising trusts impose formal requirements for the validity of at least some trusts. This article compares the formalities for the creation of trusts in common law jurisdictions with the registration requirement in civil law jurisdictions, with special reference to Chinese law, assuming China to be a civil law jurisdiction for this purpose.

The basic arguments of the article are that writing requirements, derived from land law and applied to certain trusts in land, should not be confused with the compulsory requirement of registration of title to land, and that compliance with registration formalities should not be a precondition to the validity of a trust because land title registration gives immediate indefeasibility to the registered proprietor while the

validity of a trust is derived from a properly executed trust, and not from registration. The civil law policy that dealings in land should be made public and satisfy formal requirements is regarded, at least by common lawyers, as inapplicable to trusts, since the policy reasons requiring trusts to satisfy writing and registration requirements are different from the policy reasons for publicity or registration of land title. Moreover, to require, as Chinese law does, trusts to be in writing and registered as a precondition to validity and enforceability is inconsistent with the private nature of some trusts and may undermine or frustrate a settlor's intention to keep the trust private. Proposed justifications for imposing compulsory writing and registration requirements such as the protection of third parties who deal with the underlying trust property and other worries about unregistered trusts are, in this context, unconvincing, misleading and impractical.

II PUBLICITY AND PRIVACY OF TRUSTS

Formalities serve a variety of purposes in trusts law.[1] They can provide evidence of the existence of a trust; they may facilitate the transfer of interests under a trust; and they may alert a party acquiring property that is impressed with trust obligations. Formalities may help to prevent fraud and facilitate the enforcement of tax laws

[1] Patricia Critchley, 'Taking Formalities Seriously' in: Susan Bright & John Dewar (eds), *Land Law Themes and Perspectives*, (Oxford University Press, 1998) 506. See also: Jill E. Martin, *Modern Equity* (Sweet &Maxwell, 16th ed, 2001) 80; Philip H Pettit, *Equity and the Law of Trusts* (Butterworth, 9th ed, 2001) 82-94; J D Heydon and P L Loughlan, *Equity and Trusts Cases and Materials* (LexisNexis Butterworths, 7th ed, 2007) 622-3

against property owners who deal with trust property.[2] In common law jurisdictions the *Statute of Frauds 1677* (UK) primarily justified writing requirements in terms of preventing fraud rather than of publishing transactions, although other rationales have developed over time.

In contrast, the settlor's objective of keeping property transactions private has long been a motivation for creating valid but informal trusts. Indeed, the rationale of the secret trust was to create enforceable post mortem obligations on recipients of property under wills and on intestacy, in cases where no will has been executed. The existence and terms of a fully secret trust will not be revealed by the will or any other document.[3] Oral *inter vivos* trusts are also enforceable unless the trust is caught by the modern successors to the *Statute of Frauds 1677* (UK).[4] Moreover, the principle that equity will not permit a statute to be used as an instrument of fraud has long been a source of informal trust obligations.[5] In most cases an informal trust carries the risk not of invalidity but of the inability of a beneficiary to establish that the trustee was not intended to take the property absolutely. This is a risk that many settlors, if not as many beneficiaries, are prepared to take. For settlors, the trust's lack of publicity is a positive advantage. For these settlers, trusts are private arrangements which should not be exposed to the glare of publicity. As Professor Hayton observes:

> The trust instrument revealing the names of beneficiaries does not have to be filed in any public register and is a private document which normally remains confidential between the

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[2] *Grey v Inland Revenue Commissioners* [1960] AC 1.
[3] *McCormick v Grogan* (1869) LR 4 HL 82; *Blackwell v Blackwell* [1929] AC 318.
[4] For example: *Conveyancing Act* 1919 (NSW), ss 23C and 54A; *Property Law Act 1969* (WA), s34. Also see *Adamson v Hayes* (1973) CLR 276. On the interrelationship between writing provisions see *Khoury v Khouri* [2006] NSWCA 184.
[5] *Rochefoucauld v Boustead* [1897] 1 Ch 196*; Bannister v Bannister* [1948] 2 All ER 133.

> trustee and the beneficiaries. Indeed, the names of beneficiaries do not always appear on the face of the trust instrument …[6]

Trusts cut across legal boundaries. Their proprietary nature has persuaded civilian jurists that publicity rules applicable to property transactions should also determine the validity of the trust. But this approach is too simple: a trust does not fit into a system which classifies rights as being either *in rem* or *in personam*. A trust contains both types of rights. The right *in rem* represents the public side of the trust, in the sense that the exercise of trust rights can have an impact on third parties to the trust, while the right *in personam* represents the private side of the trust and is primarily concerned with the internal relationship between the trustee and the beneficiary. Nevertheless, the essence of a trust is a private arrangement to manage property which concerns the internal relationship between the trustee and the beneficiary rather than an external relationship affecting a third party. In other words, it is more private than public although the trust will inevitably affect third parties when the trust property is dealt with in the course of business transactions. Dialectically speaking, a trust is subject to rules governing two types of validity – an internal validity and an external validity. The former is governed by trusts law and the latter by property law.

Formalities are prescribed for the transfer of interests in real property such as land,[7] but such formal requirements do not conflict with the principle that most informally created trusts will be enforced in equity since these formalities apply to all dispositive

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[6] D J Hayton, *Hayton & Marshall Commentary and Cases on the Law of Trusts and Equitable Remedies* (Sweet & Maxwell, 11th ed, 2001) 2.
[7] See *Conveyancing Act 1919* (NSW), s 23C; *Property Law Act 1969* (WA), s 34; *Property Law Act 1958* (Vic), s 53; *Property Law Act 1974* (Qld) s 11.

transfers of property, not just to property vested in trustees. Moreover, even these formalities will not be insisted upon in cases where the recipient of property can rely on the application of the principle that a transfer will be valid in equity where the transferor has taken all the steps necessary for her to complete the transfer. This has the practical effect of permitting formalities with which third parties must comply, such as registries of transactions, to be dispensed with for the purposes of obtaining equitable relief.[8] The relaxed formality requirements for resulting trusts and constructive trusts indirectly reflex the equitable maxim that equity will not allow a statute to be used as a cloak for fraud.[9]

Non-registration of trusts does not mean that trusts are secret arrangements with the potential to disadvantage third parties who acquire the trust property. The trustee's duty to segregate trust property from the trustee's own personal patrimony by earmarking the trust property will often provide sufficient evidence of the existence of the trust.

The role of informality in the law of trusts must of course not be overstated. Trusts which have no written record of their existence carry several risks. One is that the trust property can easily fall into the hands of a good faith purchaser for value of the legal interest in the property without notice of the existence of the trust. Although not conclusive, the absence of writing may readily support a claim to an absence of notice. Another is that the intended trustee may claim to be absolute owner of the trust

[8] *Re Rose* [1952] Ch 499*; Corin v Patton* (1990) 169 CLR 540.
[9] See Property Acts in: NSW, s 23C(2); Qld, s 11(2); SA, s 29(2); Vic, s 53(2); Tas, s 60(2); WA, s 34(2); NT, s 10; ACT, s 201.

property and therefore not subject to trust obligations. Writing may also help to resolve problems of the essential validity of the trust, such as whether the requirements of certainty of subject-matter and certainty of objects are satisfied. Trusts are evidenced in writing as much for reasons of prudence as for reasons of legal prescription.

Nevertheless, the versatility of the trust can be attributed in part to its relative freedom from formal requirements. The lack of publicity enjoyed by trusts, compared with, say, wills which after a testator's death become public documents is one of the reasons why the trust had become, by the eighteenth century, the preferred legal structure for effecting inter-generational transfers of wealth.[10] Some Australian jurisdictions have retained settled land legislation whereby land is settled on successive owners of the land, for example where the land is left in a will to A for life, with remainder to B. The land will be held on trust. If the land is sold the purchaser is not entitled to be informed of the details of the trust provided that he or she pays the purchase price to the trustees.[11]

Although this paper argues that the popularity of the trust is attributable in part for the absence of formality with which most trusts are created, it would be going too far to assert that informality in trusts creation is always desirable. In particular, where trusts are employed as security devices, informality can create problems for prospective lenders or creditors to the trustee who may be unaware that property to which the

[10] *Lawrence M. Friedman,* 'The Dynastic Trust' (1964) 73 *Yale Law Journal* 547; Henry Maine, *Ancient Law* (1927) 131; Maitland, *Equity* (1936) 26-7.

borrower holds title is held on trust terms. It is for this reason that countries which have enacted *Personal Property Security* legislation have required trusts created as part of security arrangements, including trusts created by reservation of title clauses, to be registered.[12] Whether *Quistclose*[13] trusts are in substance security devices is a vigorously contested question,[14] but if it can be shown that failure to disclose the existence of such trusts conveys an illusion of solvency to potential lenders to a borrower who is borrowing money on *Quistclose* terms, there would be a convincing policy reason for requiring registration of such trusts even if they do not meet the statutory definition of a security interest.

As we will see in the next section, a reason given by law reformers in civil law jurisdictions for subjecting trusts to registration requirements is that publicity will help to prevent trusts from being used as a device for avoiding payment of debts, or for preferring the claims of one creditor over another.[15] These are not reasons for insisting on formalities in common law jurisdictions. Trusts prejudicial to creditors can be avoided by several enactments.[16] Legislation based on the *Fraudulent Conveyances Act 1571* (UK) renders voluntary alienations of property intended to defraud creditors voidable. In addition, the "clawback" provisions of bankruptcy and

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[11] Most legislation derives from the model of *Settled Land Act 1882* (Eng). See, for example: *Settled Land Act 1958* (Vic).

[12] *Personal Property Securities Act 1999* (NZ); *Personal Property Securities Act 2009* (Cth). Both are based on Canadian and US antecedents. See also: *Associated Alloys v ACN 001 452 106 Pty Ltd* (2000) 202 CLR 588.

[13] *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567.

[14] See: William Swadling (ed), *The Quistclose Trust: Critical Essays* (2004); Michael G Bridge, Roderick A Mac Donald, Ralph A Simmonds and Catherine Walsh, 'Formalism, Functionalism, and Understanding the Law of Secured Transactions' (1999) 44 *McGill Law Journal* 567.

[15] *Xiaobin Yi and Linfeng Yang,*《试论中国信托财产登记制度的要点与配套制度》'On the Key Points of Registration System of Trust Property in China and the Facilitating Systems'(2004) 4 *Trends of Trust & Fund* 15-19.

insolvency legislation can result in the setting aside of a trust by the operation of the doctrine of relation back.[17] Formality requirements by themselves are ineffective to prevent trusts being employed as a technique of creditor avoidance.

Modern land title legislation, such as the Torrens legislation, does not conflict with the principle of informality in trusts law. Trusts law is primarily concerned with the internal relationship between the trustee and the beneficiary, leaving the external consequences of the relationship to be governed by property law. In cases of conflict between the interest of a purchaser and that of the beneficiary of a trust over the trust property, the latter must yield to the indefeasible title of the former and instead seek compensation in equity from the trustee if the disposition of the trust property was unauthorised.[18] If the third party is the trustee's creditor, no conflict exists because the trust property cannot be claimed by the trustee' personal creditors. If the third party is the settlor's creditor and the trust was created in order to avoid repayment obligations, bankruptcy legislation or the modern successors to the *Statute of Elizabeth* (UK) will apply.[19] If the third party is the beneficiary's creditor, there is also no conflict in substance since the interest of the beneficiary will only become available to the beneficiary after the trust creditor's claim has been satisfied.

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[16] See generally: Chapter 7 of HAJ Ford & WA Lee, *Principles of the Law of Trusts.*
[17] B Edgeworth, CJ Rossiter, MA Stone and P A O'Connor, *Sackville & Neave Australian Property Law* (LexisNexis Butterworths, 7th ed, 2008) 546- 555.
[18] David Hayton, 'Anglo-Trusts, Euro-Trusts and Caribbo -Trusts: Whither Trusts?' in David Hayton (ed) *Modern International Developments in Trusts Law* (Kluwer Law International, 1st ed, 1999) 1-2.
[19] For example, ss 423-425 of the *Insolvency Act 1986* (UK) enables the prejudiced creditors to set aside a trust which is purposely set up to avoid the obligation owed to them by the settlor.

We will also see in the next section that whereas common law systems require few trusts to be registered; the opposite is true of civil law systems. Most impose strict registration or publicity requirements on trusts. Moreover, Chinese law imposes even more rigid registration requirements on trusts than other civil law systems.

Formalities are only relevant to two types of trust. One is a trust of land.[20] The other is a trust of a subsisting equitable interest in land. The two provisions differ in the stringency of writing requirements applied to dealings in property. In *Pascoe v Boensch*,[21] the Full Federal Court held that the provision dealing with a declaration of trust respecting any interest in land only required the declaration to be manifested and proved, and therefore not created, by some writing signed by the declarant. In terms of type of writing, Lee J said in *Department of Social Security v James*:[22]

> The requirements of s 34(1)(b) [of the *Property Law Act 1969* (WA)] may be satisfied by a combination of documents capable of being read together. Any informal writing may stand as evidence of the existence of a trust including correspondence from third parties, a telegram, an affidavit or an answer to interrogatories … The date of creation of the writing is not material. It may come into existence at any time after the declaration of the trust.

Since 1990 Lee J's decision has been followed in later cases in all Australian jurisdictions.[23] The formality for creation of trusts of land is much less strict than that for land transfer. The former is only required to be manifested and proved in informal

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[20] *Conveyancing Act 1919* (NSW), s 23C(1)(b).
[21] *Pascoe v Boensch* (2008) 250 ALR 24.
[22] *Department of Social Security v James* (1990) 95 ALR 615.
[23] *Hagan v Waterhouse* (1991) 34 NSWLR 308; *Low v Dykgraaf* [2001] WASC 332; *Equuscorp Pty Ltd v Jimenez* [2002] SASC 225; *Gentsis v Forty-first Advocate Management Pty Ltd* [2004] VSC 398; *Yard v Yardoo Pty Ltd* [2006] VSC 109; *ThompsonvWhite* [2006] NSWCA 350.

writing. However, a disposition of an equitable interest must actually be in writing because it is in substance an assignment of that interest.[24]

Formality is required for the transfer of interests in different kinds of property but, as we have seen, these formalities are independent of, and differ in detail from, the formalities for the creation of a trust. The formalities for the transfer of registered land are a case in point. Trusts of land are exclusively governed by trusts law and were expressly excluded from the operation of the Torrens registration system when it was introduced into South Australia by German immigrants in the 1850s.[25] The immediate indefeasibility of the Torrens title is not undermined or threatened by the creation or enforcement of trusts of land. As we will see, the position is different in Asian trust jurisdictions where confusion exists between the publicity requirements for transferring interests in property, particularly land, and the requirements for creating a valid trust. In particular, policy objectives, such as the prevention of creditor avoidance, have been pursued by imposing formality requirements on all trusts made of registrable properties (land, chattel and shares) rather than by developing focused legislative provisions dealing with creditor avoidance or unauthorised dispositions by the trustee.

A comparative analysis of formalities imposed on trusts in both common law and civilian jurisdictions demonstrates that formality should not, for most purposes, be an issue when considering the validity of a trust. China is the jurisdiction that is out-of-

[24] *Conveyancing Act 1919* (NSW), s 23(1)(c); *The Comptroller of Stamps (Vic) v Howard –Smith* (1936) 54 CLR 614.

line in this respect. Although other Asian civil law jurisdictions impose more onerous writing requirements than common law jurisdictions tend to do, only Chinese law makes writing a precondition to the validity of a trust, and imposes the draconian sanction of invalidity if the trust does not meet the prescribed writing requirements. It will be argued that the Chinese approach fails to distinguish between the external validity of a trust, as against a third party, from its internal validity as between the parties to a trust.

III A COMPARATIVE ANALYSIS OF STATUTORY FORMALITIES

In jurisdictions which recognise trusts different approaches are taken to the question of publicity, in the sense of the imposition of formal requirements. The most lenient approach is taken by English trust law which requires no registration, except in the case of trusts of land. The most stringent approach is taken by the Chinese Trust Code (CTC) which requires compulsory registration of trusts of certain types of property.[26] It is no exaggeration to say that the more developed a trust law is, the more lenient the approach that is taken to formalities. The converse is also true; the newer a member of trust family is, the stricter approach is taken. In new trusts jurisdictions there is an apprehension that trusts can be created for the purposes of illegitimate creditor

[25] Murray Raff, *Private Property and Environmental Responsibility: A Comparative Study of German Real Property Law* (Kluwer Law International, 2003) 25-60.

[26] An important recent qualification is that French trust law which came into force in 2007 is the same as the Chinese Trust Code in imposing formal requirements. Like Chinese law it requires trusts to be in writing. See: the *French Civil Code*, Article 2019.

avoidance whereas in old jurisdictions bankruptcy and insolvency legislation has largely removed that fear.[27]

This paper will briefly discuss the formalities required to constitute trusts in five jurisdictions: England; the USA; the international trusts law as exemplified by the *Hague Convention on Recognition of Trusts*; the East Asian family of trusts (Japan, Korea and Taiwan); and China. We will find a spectrum ranging from the minimal requirements of English law at one end to the compulsory strict registration requirement in China, on the other. In between, we will find the 'international permissive approach' incorporated into the Hague Trusts Convention,[28] the American 'earmarking approach',[29] and the Asian civil law 'registration against third party' approach.[30] Each approach above reflects a different jurisprudential understanding of the trust and different priority criteria when claims are made to trust property.

IV THE ENGLISH APPROACH

The English approach, which is also the approach taken by Australian and New Zealand law, conceptualises the trust as a private disposition of property. Registration or other formality is unnecessary unless the trust is of land or of a subsisting equitable interest. The good faith third party and trust beneficiaries are sufficiently protected by

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[27] An example of this phenomenon is the newly revised *Japanese Trust Act 2006* and its *Bankruptcy Act 2004*. The new *Japanese Trust Act* removed the registration requirement and bankruptcy creditors are protected by *the Bankruptcy Act*, Article 160 and the new *Trust Act*, Article 11.
[28] *Hague Convention on the Law Applicable to Trusts and on their Recognition* (1985), Article 12.
[29] *Uniform Trust Code 2005* (US), s 810(c).
[30] Referred to the trust laws in Japan, Korea and Taiwan,

the general principles of property law and trusts law. Publicity is not desirable for the protection of a third party because the trustee is treated as the legal owner of the trust property and the third party is protected when dealing with the trustee as long as he is a purchaser who has no notice of the trust. The beneficiaries' interests in the trust property prevail over the interests of the personal creditors of the trustee in the event of the insolvency of the trustee. The justification for this priority derives from the identification of the beneficiaries as having a proprietary interest in the trust property whereas the trustee's personal creditors have only a personal claim against the trustee.[31]

It is therefore not surprising that the members of the Law Society of England and Wales felt puzzled on Article 12 of the Hague Trusts Convention, which permits registration requirements in jurisdictions recognising the Convention. The Law Society thought that registration of trusts was a strange and burdensome requirement, and that to impose registration on trusts would reduce the marketability of trust property.[32] Moreover, registration of trusts serves little purpose since they have little adverse impact on the interests of third parties.[33] For instance, in *Barclays Bank Ltd v Quistclose Investments Ltd*[34] the loan from Quistclose Investments was not registrable but was nonetheless held to be a trust. It is true that the finding of a trust

[31] This may be the differentiating point between the common law trusts and the civil law trusts. Civilian trusts commentators may argue where there is no way of telling which property is trust property and which is the trustee's own property if no registration is imposed. In business all properties should be treated alike without distinguishing trust property from other types of property. This concerns with the doctrine of notice in equity which govern the trust law in common law jurisdictions, and in the absence of equity law in civilian jurisdictions registration is required to serve the purpose of publicity.
[32] Maurizio Lupoi, *Trusts: A Comparative Study* (Cambridge University Press, 2000) 173, cited in: Wang Yong 'The Relationship between the Trust Law and the Property Law' (2008) 45 *Journal of Peking University (Philosophy and Social Sciences)* 93, 100.
[33] Ibid.

disadvantaged Barclays Bank, as an external creditor of the trust, but only because it was held to have notice of the trust. The key issues under English law is not whether a trust has been registered, or even (in most cases) whether it is in writing, but whether the requirements for a valid trust have been met and, where third party proprietary interests are concerned, whether the third party has notice of the trust. The fact that property is held on trust has little impact on bankruptcy. As Stevens remarks, 'The recognition of a beneficial interest under a trust does not, in itself, offend the *pari passu* rule.'[35]

V THE AMERICAN APPROACH

The American earmarking approach is prescribed in Section 810(c) of the *Uniform Trust Code* which has now been adopted by twenty-two states in the United States of America.

The provision and the commentary are as follow:

> Section 810
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> c) Except as otherwise provided in subsection (d), a trustee shall cause the trust property to be designated so that the interest of the trust, to the extent feasible, appears in records maintained by a party other than a trustee or beneficiary.

The commentary says:

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[34] *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567.
[35] Robert Stevens, 'Insolvency', in William Swadling (ed), *The Quistclose Trust: Critical Essays*, (Hart Publishing, 2004) 154.

> … Subsection (c) makes the requirement that assets be earmarked more precise than that articulated in Restatement (Second) § 179 by requiring that the interest of the trust must appear in the records of a third party, such as a bank, brokerage firm, or transfer agent. Because of the serious risk of mistake or misappropriation even if disclosure is made to the beneficiaries, showing the interest of the trust solely in the trustee's own internal records is insufficient …

The requirement of earmarking by the trustee having the trust identified in third party record is intended to prevent misappropriation of the trust property.[36] It differs from the requirement of registration in civil law trust codes which is designed to protect third parties who deal with or obtain ownership of the trust property. It is not therefore a publicity requirement, as some civil law scholars have argued.[37] It is only applicable to the circumstances under which the party other than the trustee such as a bank holds a paper or computer record of trust property, or where the trustee holds property under more than one trust. By earmarking the trustee is allowed to invest money from more than one trust jointly in a single investment.[38]

A legal system which does not have a 'bona fide purchaser' rule must institute a registration process for trust property in order to confer protection on third party recipients of the trust property. Conversely, if the 'bona fide purchaser rule' is available, registration of trusts is superfluous, although, as the *Uniform Trusts Code 2005* (US) provision shows, a third party recording requirement may be justifiable to prevent fraud. Modern civil law systems have adopted the 'bona fide purchaser'

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[36] George T. Bogert, *Trusts* (West Group, 6th ed, 1987) 359-62.
[37] Yong Wang, 'The Relationship between the Trust Law and the Property Law' (2008) 45 *Journal of Peking University (Philosophy and Social Sciences)* 93, 100.

rule,[39] and, although the code gloss may be desirable, there is no justification in these systems for superimposing registration on that rule.

VI THE INTERNATIONAL APPROACH

A more permissive approach has been adopted by Article 12 of the *Hague Convention on Recognition of Trusts*. It provides:

> Where the trustee desires to register assets, movable or immovable, or documents of title to them, he shall be entitled, in so far as this is not prohibited by or inconsistent with the law of the State where registration is sought, to do so in his capacity as trustee or in such other way that the existence of the trust is disclosed.

The Convention also provides in Article 14 that:

> The Convention shall not prevent the application of rules of law more favourable to the recognition of trusts.

Because the purpose of the Convention is to promote the recognition of trusts in the international community, including civil law countries,[40] Article 12 of the Convention has made it permissible for States ratifying the Convention to impose registration requirements on trusts. Article 14 of the Convention, however, does not exclude informal recognition of trusts, where this is preferred by the State. In other words the Convention adopts a very flexible approach towards the issue of registration; it

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[38] *Uniform Trust Code 2005* (US), s 810(d); See above n 36.
[39] *Property Rights Law 2007* (PRC), Article 106; *German Civil Code* (BGB), Articles 816 and 892.
[40] Maurizio Lupoi, *Trusts: A Comparative Study*, (Cambridge University Press, 2000) 329-30.

tolerates the stringent registration requirements imposed by civil law systems but also accepts the more relaxed common law standards.

Civil lawyers, who, unlike the English delegates to the Convention, favoured the adoption of Article 12, argued that since the enforcement of a trust affects the interests of a third party recipient of the trust property on the insolvency of a trustee, registration of trusts was desirable since it prevented detriment to third parties.[41] The answer to the argument can be found in the discussion earlier in this article of how third parties such as purchasers and creditors are protected. It raises three issues. They relate to the internal and external aspects of the trust, as well as to the nature of rights enforced under the trust.

The principal internal feature of the trust is the fiduciary relationship recognised in every trust relationship. The relationship is essential to ensuring the trustee's loyalty to the beneficiary, but it does not affect third parties to the trust, and it is not something of which third parties need to have notice. It is relevant in this context to note that Chinese trusts law, like other Asian codes, does not expressly recognise the trust relationship as being fiduciary, and there is less concern under these codes for the internal fiduciary character of the relationship, as opposed to its contractual and external aspects.

The external aspect of the trust relates to the impact of the trust on third parties, particularly on bankruptcy, and has already been discussed. In common law systems

bankruptcy is regulated by bankruptcy legislation, separated from trusts law. Moreover, third party claims to trust property are determined by the law of priorities, particularly the doctrine of notice. Since the priority rules have generally proved to be effective, except where specific legislation has been enacted in order to overcome problems of marketing property such as land and commercial personal property, there is no place for specific provisions requiring registration of trusts. In contrast, the Chinese civil law does not have priority rules based on the doctrine of notice or the distinction between legal and equitable interests. Thus registration acts as a substitute for such rules.

The final reason why civil law jurisdictions insist on registration of trusts relates to the interest enforced under the trust. The civilian trust may or may not be a trust without equity,[42] but it is certainly a trust without equitable interests, as these interests are understood by the common lawyer. The trust created by the Chinese Trust Code is in substance an agency relationship, the trustee receiving property as the agent of the settlor/beneficiary.[43] Being a recognised property interest, disputes with other interest holders, such as equitable mortgagees, can be resolved by the application of property law's priority rules, insofar as they are not covered by legislation. But the beneficiary's interest under a civilian trust is personal, and at most contractual. Priority of interest rules simply do not apply to such interests, and so registration of the trust is intended to act as a substitute for the general priority rules of property law.

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[41] Yong Wang, above n 37.
[42] Honore, 'Trusts: The Inessentials' in: Joshua Getzler (ed), *Rationalizing Property, Equity and Trust Essays in Honour of Edward Burn* (2003) 8, 16.
[43] Guoqing Liu, *The Role of Equity in Trusts Law: the Law and Practice of the Chinese Trust Code* (PhD thesis, The University of Melbourne, 2008).

This explains why delegates from civilian jurisdictions insisted that Article 12 of the *Hague Convention on the Recognition of Trusts* recognise registration of trusts. This explanation does not, however, justify the rigid registration provisions of the Chinese Trusts Code.

These three reasons explain why civil law jurisdictions place emphasis on the registration of trusts. It can nonetheless be argued that civilians ignore the drawbacks to registration. Registration, particularly as applied to personal property, impedes commercial activity, and is apt to become entangled in the bureaucratic requirements of registration. Civilians can learn a lesson, in this respect, from the Torrens system of title registration. The early drafters of the Torrens legislation excluded trusts of land from the registration requirements because to register them would be to make land less readily transmissible.[44] The drafters opposed trust registration for two main reasons. First, land title would become too 'clogged' with unregistered interests so that it would be harder, and certainly slower, to transfer the property. Secondly, the trust beneficiary is already sufficiently protected by equitable remedies made available by trusts law and does not need extra statutory protection.[45] The 'curtain principle' which applies both to Torrens land and to land registered under the English Land Registration Act, has worked effectively to keep trusts off the registered title without prejudicing the rights of the beneficiary. It is therefore wrong to suppose, as many civilian lawyers do, that the only way to balance the claims of trust beneficiaries and third party creditors is to make registration of trusts compulsory.

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[44] See: *Land Title Act 1925* (ACT), s 124; *Real Property Act 1900* (NSW), s 82; *Real Property Act 1886* (SA), s 162.
[45] Samantha Hepburn, *Principles of Property Law* (Cavendish Publishing, 1998) 211.

Indeed, many Torrens cases establish that third parties are protected – and perhaps even excessively protected – even without registration. In the controversial New South Wales decision of *Koteff v Bogdanovic*,[46] for example, Mrs Bogdanovic was promised by Mr Koteff that she could, after his death, live in his house for the rest of her life in return for living and taking care of him. Mr Koteff broke his promise and left the property to his son in his will and upon his death his son was registered as proprietor. Mrs Bogdanovic, who claimed that her caring of Mr Koteff entitled her to an interest under the doctrine of proprietary estoppel, lost her suit against the son for not caveating her interest prior to the registration of the son's title to property, on the ground that even a volunteer who was registered as proprietor could defeat an unregistered equitable interest. The case demonstrates that, in a priorities dispute the equitable interest holder may need as much protection as third parties.

Under the Torrens system a beneficiary can lodge a caveat to notify a prospective purchaser of the existence of a trust or other unregistered interest in the property.[47] Lodging a caveat is different from registering a title or other property rights. A caveat does not create any rights but warns the subsequent purchaser of the encumbrances claimed against the property. Caveating is a voluntary process and is not registration in the sense understood by a civil lawyer. Later in the paper the Chinese system of lodging a 'caveat' will be discussed.

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[46] *Koteff v Bogdanovic* (1988) 12 NSWLR 472.
[47] Chambers, *An Introduction to Property Law in Australia* (Lawbook Co. 2nd ed, 2008) 471.

VII THE ASIAN CIVIL LAW APPROACH

The Asian civil law concept of publicity of trusts, based on registration, was introduced by the trust codes of the respective jurisdictions. The Japanese, the Korean and the Taiwan trust codes almost identically provide that:

> If a trust of compulsory registrable property is set up, it must be registered before it becomes effective against third parties.
>
> If a trust is set up of stock securities, the documentation must be marked as 'trust property'. Company shares or company debentures, if they are held on trust, must be labelled 'trust property' and kept in the book of shareholders or the records of debentures of the original issuing company. Otherwise, they are invalid against a third party.[48]

'Third party' in the provision is not defined but is taken to mean a bona fide third party for value without notice of the trust interest. A possible source for the Japanese earmarking of documentary assets is the American earmarking requirement, discussed earlier, because the Japanese Trust Code was a modification and copy of the American model.[49] It may also be derived from European civilian notions of publicity. As Professor Arai notes, 'in drafting the Japanese Trust Code 'considerable efforts appear to have been made to avoid outright adoption of the English system and, instead, to harmonize it with the provisions of the Civil Code based on the principles of German law'.[50]

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[48] See *Japanese Trust Code* (1922), Article 3; *Taiwan Trust Code* (1996), Article 4; *Korea Trust Code* (1961), Article 3. The translation is based on the Chinese translation of the Japanese provision.
[49] Makoto Arai, 'The Law of Trusts and the Development of Trust Business in Japan' in: David Hayton (ed), *Modern International Developments in Trusts Law* (Kluwer Law International, 1999) 63, 66.
[50] Ibid.

The Korean and Taiwan trust codes followed the Japanese model and also provide for optional registration and earmarking for the purpose of safeguarding the rights of a third party. This harmonization is sensible. Although it may seem a bit clumsy to a common law trust lawyer, it does not deny the basic validity of a trust as between the trustee and the beneficiary. In contrast, The Chinese compulsory registration requirement is neither reasonable nor workable since it not only invalidates an unregistered trust against a third party but it also prevents such a trust from being enforceable by a beneficiary against a trustee. This denial of internal validity for reasons of protecting third party interests is a feature not only of its trust law but also its contract and property law. The feature is a controversial topic giving rise to much academic debate in China.

A Enforceability of Article 3 of the *Japanese Trust Code* (1922)

The following case, decided under Japanese law, illustrates the application of registration of trusts requirements under Asian trust systems.[51]

In 1922 X, the plaintiff, was adopted by A, the husband, and B, the wife, who was the defendant in the case. They lived together until 1933 when the relationship between the adopted son and the adoptive parents broke down. A and B called relatives in for a meeting to discuss the termination of the adoption relationship. There was no agreement as to the future of X, who then left home.

A and B instituted unsuccessful proceedings to terminate their adoption relationship with X. A, aged 63, realising that X would be the legal successor to his property after his death, wanted to find another adoptive son to succeed to his property. He divided his real property into five portions. He devised the first portion to B as a gift and the fourth portion to C, an outsider, as trust property. The transfers were registered on 7 September 1933. The next day, A and B divorced by agreement. B took back her family name and adopted D as her de facto adopted son. D lived with A and B, was registered in residence records, and took B's family name. A then promised to make gifts of his second and third portions of real property to B. On 20 December 1934 and 1 November 1935, the two portions of property were transferred to B in the form of sales of land and registered. Moreover A decided to donate to D the fourth portion held by C on trust and the fifth portion he purchased from an outsider Y. Both C and Y directly delivered the property to D who was registered as the purchaser of the land under a sale.[52]

A died in 1939. Believing that he would soon be conscribed into the army and that B would not be taken care of, D transferred the fourth and fifth portions of property to Z (B's brother's adopted son) on trust for B. Again the transfer was in the form of a sale of land which was registered.

None of the contracts were genuine. The true ownership of the properties was still vested in A. After A's death, X instituted proceedings against B and Z, claiming his

[51] The case is quoted from Nakano Masatoshi and Zhang Junjian, *A Study of Trust Cases* (China Fangzheng Press, 2006) 68.

inheritance rights to the estate of A. X lost at the first and second judicial levels and appealed to the Supreme Court of Japan. The argument presented in the appeal concerned the registration of the attempted trusts. X argued that the transfer from D to Z was not a real sale. If it was a trust, it had to be registered as such. Without registration it was not valid against X who was a third party. The decision made at the second judicial level was that the registration of the sale of the land served as registration, whether or not it was intended to be the registration of the trust for B, and was sufficient to defeat X's claim.

The Supreme Court dismissed X's appeal, holding that while Article 3 of the Trust Code requires the registration of a transfer of registrable property, this requirement cannot invalidate a transfer of property and the registered transfer of property in this case was strong enough to defeat X's claim. The requirement of trust registration does not determine the validity of a property transfer. Its purpose is to protect third parties, not to impair the validity of the transfer of the trust property. Failure to register a transfer as a trust should not result in the trust being void against a third party if the underlying transfer transaction, in this case a sale, had been registered.

The following conclusions can be drawn from this case:

1. Registration of trusts is intended only to protect third parties. Without publicity the trust is unenforceable against third parties but remains enforceable between the trustee and the beneficiary;

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[52] It is commonplace that gifts can be made in the form of sales in Asian countries, including China and Japan, without being regarded as fraudulent, often for tax reasons.

2. A transfer of property on trust, where the trust is not registered, may nonetheless defeat the claim of a third party where the transfer itself is valid and has complied with all relevant formalities. [53]

In this case the third party, X, was not a bona fide purchaser but a volunteer who was not a beneficiary of the trust. Indeed, the whole point of A's dispositions was to prevent X's inheritance. Moreover, it was legitimate for A to dispose of his personal property in his chosen manner. The transfer of property from D to Z was for a trust purpose, and the intention to create a trust was a matter between D and Z and was irrelevant to X's claim. The claim based on registration was irrelevant to the nature and validity of the transaction. As far as this author is aware, no reported case in Japan has decided that lack of registration of a trust has jeopardised a third party. Quite simply, there is no conflict between the interests of beneficiaries and the interests of third parties. Instead, the doctrine of knowledge or notice on the part of a third party determines the validity of a transaction as between the trustee and a third party.

VIII THE CHINESE APPROACH

The Chinese Trust Code (CTC) has adopted a stringent approach to trust registration. As discussed earlier, China relies heavily on registration in resolving disputes arising from trusts, contracts and property transactions as a substitute for protections

[53] Nakano Masatoshi and Zhang Junjian, above n 51, 71-2.

conferred by other concepts in common law systems. These include the absence of recognition of any equitable interest vested in the beneficiary, the failure to develop a concept of fiduciary obligation, and the lack of priority rules to determine competing claims to property. Registration also reinforces a public perception, derived from property law, that only registration can create valid rights in property.[54] Article 10 of the CTC provides that

> In establishing a trust, trust property shall be registered in accordance with laws and administrative regulations. If the trust is not registered at the time of creation late registration is permitted. In the event of failure to register the trust shall be void.[55]

This provision should not be read in isolation. Later legislation, the *Property Rights Law 2007* (PRC), makes provisions for the registration of immovable property and movable property.[56] Immovable property registration, like the Torrens system, confers a presumed indefeasible title on the registered proprietor while the registration of movable property gives the holder of registered chattels a priority over claims brought by third parties.[57] The different levels of protection conferred by real property registration and chattel registration is distinguishable in that property rights in real property are conferred or created by registration while property rights in chattels are recognised or protected by registration but not created by it.

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[54] This civilian theory of publicity is widely accepted in China that only registration can invest property right in the registered proprietor. 'No registration, no property right' is taken as a preferred approach to real property law.

[55] *Trust Law of the People's Republic of China* (2009) <http://www.civillaw.com.cn/english/article.asp?id=357> at 4 November 2009. The original translation was modified by this author from the original Chinese version.

[56] Article 9 and Article 24 regulate respectively the requirements for acquisition or transfer of real property and chattels.

However, Article 10 of the CTC draws no distinction between real property and registrable chattels but delegates the power to other 'laws and administrative regulations' to regulate the process of registration the CTC.[58] In addition to the irresponsible delegation, the Code fails explain why the compulsory registration is required. Some academic writings addressed the issue from the civilian perspectives which I will discuss below.

A The Arguments for Compulsory Registration

The following arguments for a compulsory registration reflect the viewpoints of Chinese trust scholars who think that registration of trusts is desirable.[59]

1 Externality of legal ownership of trust property

The first reason is that trust property must be registered so that the trustee can be recognised as officially having power to administer trust property. This reason is unsound because a completed transfer of property to the trustee or a segregation of trust property from settlor's non-trust property has already made the trustee legal owner of the property, thereby satisfying all legal requirements. There is no need to publish the establishment of a trust to the world at large, especially when the settlor's

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[57] See: *Property Rights Law of 2007* (PRC), Articles 9 and 24.
[58] It is a common phenomenon in China that a principal law does not lay down clear regulations but confers on other undefined laws the power to make rules. The undefined laws are unknown to the lawmakers themselves, and so labelled with vague expressions like 'other relevant laws and administrative regulations'.
[59] The arguments cited here are taken from: Xiaobin Yi and Linfeng Yang,《试论中国信托财产登记制度的要点与配套制度》'On the Key Points of Registration System of Trust Property in China and the Facilitating Systems' (2004) 4 *Trends of Trust & Fund* 15-19.

purpose is to create a private arrangement affecting his property. The CTC does not make it compulsory for the settlor to transfer the trust property to the intended trustee. Moreover, it defines a trust in a strange way.[60] It treats the settlor as retaining title to the trust property and defines the transfer of property as 'entrust to' the trustee, which has given rise to much confusion among Chinese and foreign experts.[61] The meaning of 'entrust to' has invited a great deal of criticism and was, like this compulsory registration requirement, a 'at the last minute' change to the original discussed draft.[62] The purpose of replacing the word of 'transfer' with 'entrust to' is to reserve the power of disposition to the settlor. A dispute in Shanghai between the settlor and the trustee about who is entitled to dispose of shares under a trust exhibits such an issue, typical of the Chinese trusts.[63]

2 Legality of purpose and impact on a third party

The second reason is that once a trust is established the trust property could not be claimed by creditors. In the absence of registration it would be hard, if not impossible, to determine whether property was available for distribution to creditors. The argument confuses writing and registration requirements. Registration is unnecessary because the trust instrument will be available to the court in the event of a dispute.

Proponents of registration argue that registration of a trust is necessary as evidence or a legal ground in court or arbitration tribunal. But any dispute will ultimately have to

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[60] See Liu, above n 43.
[61] Ibid.
[62] Ibid.
[63] Ibid, 150.

be resolved by the court. Although the CTC treats trusts as agency contracts, the contracts must in the final analysis be construed by a court. Registration can never be a substitute for judicial decision. Further, treating the trust as contracts, in a sense of autonomy of parties with the last resort to the court or arbitration, reflects the civil law misapprehension of the nature of trusts. A purely contractarian approach does not work satisfactorily with the trust because the trust is a court supervised institution.

Insisting on registration for validity of a trust means that a registered trust will receive protection and an unregistered will not, which is exactly what the registration requirement for real property transactions implies. This purely property law approach does not work satisfactorily with the trust either.

3 Certainty of obligations and rights

The third reason is that s if there is no registration system to define the rights of the parties under a trust, there are likely to be disputes among the parties. Legal certainty can only be guaranteed under a registration system.

Here also the argument confuses writing requirements with registration and assumes that clarity of definition is an overriding objective, and is particularly important to third parties dealing with the trust property. This reasoning ignores the fact that many family trusts and testamentary trusts are created in order to ensure that the distribution and management of private wealth is private. For these trusts, a written trust instrument is sufficient to ensure certainty. A writing requirement maybe considered desirable by the settlor and welcomed by beneficiaries to ensure that the trustee

complies with the terms of the trust deed but there is no reason to go further and insist on registration.

4 Security of transaction

The fourth reason is more technical. It is that the transfer of ownership of the trust property from the settlor to the trustee may not be complete when the settlor creates a trust. Two scenarios have the potential to give rise to disputes. First, the property held on trust may have been mortgaged by the settlor before the trust was created. Secondly, the settlor may mortgage the property which is already subject to a trust. Both scenarios can give rise to priority disputes. Supporters of registration argue that the disputes will be avoided if the trust is registered.

In the first scenario the priority rule is very clear: the security right will in most cases constitute a legal right and a legal or an equitable mortgage created prior to the trust will prevail. The second scenario is possible under the CTC because the Code reserves many powers to the settlor even after a trust has been set up.[64] This has created uncertainty as to the powers exercisable by settlors, trustees and beneficiaries under the trust. It is also due to the failure of the CTC to recognise the existence of equitable proprietary interests, which would have allowed priority rules applicable to both legal and equitable interests to be developed. Under the CTC registration is a substitute for priority rules. If a trust is registered, the beneficiary's rights to the trust property would be classified as legal rights and enjoy priority in the event of

[64] One of the defects of the CTC is that it reserves too much power to the settlor, disturbing the balance of legal power between the parties. See: Ibid.

conflict.[65] But registration can never be a substitute for proper priority rules, even though, as under the Torrens system, registration can be accommodated within those rules.

5 Administrative supervision

The fifth reason, by advocating that registration can help administrative supervision, emphasises the importance of the supervision exercised by the financial authority over the trust activities of trustee companies. This is the underlying purpose for enacting the Code. The supervision of trustee companies in China is conducted not by the court but by the governmental agency – China Banking Supervisory Committee.

The concerns highlight the differences between Chinese trusts law and trusts law elsewhere in the world. In my view, however, registration can solve none of these problems. They would exist even if registration is carried out. It is unrealistic to expect the procedural requirement of registration to solve substantive problems caused by the enactment of an excessively conservative version of the civil law trust.

B Bona fide purchaser rule and registration

The compulsory registration of trusts is undesirable for three reasons. First, it is neither reasonable nor sensible to apply to the validity of trusts of either registrable properties or unregistrable properties because it is not title registration which 'creates'

[65] Xiaobin Yi and Linfeng Yan, above n 59, 16.

and confers the property rights to the registered proprietor. Secondly, China has so far not established a practical and workable registration system, thereby rendering the registration system (let alone a compulsory registration system) otiose.[66] Thirdly, the sanction for failure to register is the invalidity of the trust, even between the trustee and the beneficiary. This sanction, which does not apply to unregistered trusts under other Asian codes, is excessive. It destroys both the external relationship between the trustee and the third party as do the other Asian trust laws, but also the internal relationship between the trustee and the beneficiary. In the latter respect, it is destructive of the trust itself.

Consideration, however, should be given to confining registration to some trusts, for example trusts in relation to land or the *Quistclose* trust. Settled Asian practice could also be followed by providing that unregistered trusts will not bind third parties who acquire the trust property in good faith, although the trust otherwise remains valid and enforceable as between the trustee and the beneficiary. Nevertheless, even if the registration requirement were to be applied more selectively and unregistered trusts were permitted a limited measure of enforceability, a fundamental question must be answered: why does the civil law impose publicity requirements on trusts? The rationale for the publicity requirement lies, as many civil law commentators assert,[67] in the belief that right *in rem* comes from registration required by law and no property right can be freely created by individuals.

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[66] For example, land and buildings are separately registrable by land authority and housing administration authority. See: Hongliang Wang, 'The Relativity of Publicity of Registration' (2009) 5 *Journal of Comparative Law* 31-5.

[67] Penggao Chang, 'The Proposed Structure of Immoveable Property Registration' (2009) 5 *Legal Science (Journal of Northwest University of Political Science and Law)* 128.

Since the CTC does not require a complete transfer of trust property to a trustee in order to create a trust, it uses registration as public evidence of the source of power in trust property management. At the same time registration functions as a guarantee of the external validity of transactions involving the underlying trust property. Registration ought to be irrelevant to the internal relationships between the trust parties. Registration should at most be required for two supplementary purposes: registering the proprietors of real property and ensuring that third parties who deal with trust property are properly protected.

As previously noted, the Chinese approach to ensuring publicity for trusts is the most stringent of all trusts jurisdictions. It is not explicable in terms of the absence of a bona fide purchaser rule. The notion of the bona fide third party was recently defined in the *PRC Property Rights Law (2007).*

Article 106 of the *PRC Property Rights Law (2007)* provides:[68]

> Where a person unauthorized to dispose of realty or chattel alienates the realty or chattel to an assignee, the owner is entitled to recover the realty or chattel. Unless it is otherwise prescribed by law, the assignee shall obtain the ownership of the realty or chattel if all of the following conditions are met:
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> 1. Acceptance of the realty or chattel in good faith;
> 2. Purchase of the realty or chattel at a reasonable price; and

[68] Minor linguistic improvements have been made to make the translation more grammatically correct.

> 3. Where registration is required by law, the alienated realty or chattel has been registered, while in cases where registration is not required, the delivery of property alienated shall have been effected.
>
> Having met the abovementioned conditions, an assignee obtains the ownership of the realty or chattel; the original owner may claim damages from the unauthorized person for the losses sustained.
>
> Where a *bona fide* purchaser obtains any other form of property right in good faith, the preceding two paragraphs shall also apply.

No statutory definition of 'in good faith' has been provided, and both the subjective requirement (the state of mind of being in good faith) and the objective requirements (paying a reasonable price and satisfying the registration formality) must be complied with. The question of whether the doctrine of bona fide, or good faith in civil law system, should include only actual knowledge or as well as constructive knowledge, has been debated by Chinese scholars. But the debate is not relevant to our discussion since our focus is on the necessity for registration of trusts. The Chinese bona fide purchaser rule is applied mainly to unauthorised alienations of property, whereas the compulsory requirement of registration of trusts under the CTC applies both to insolvency and misapplication of trust property. Both situations are concerned with priority of interests in property law. Registration of property will give the registered proprietor priority over an unregistered claimant but her property right is still subject to the claim of the bona fide purchaser who has both paid the purchase price and registered. Thus it is not registration that protects the third party or the beneficiary of a trust; it is the bona fide purchaser rule that gives the necessary protection. Registration serves only to warn the third party of the equitable interest in the

property. In summary, registration *per se* only makes the trust property earmarked or published to third parties. It does not determine the validity of a trust.

The unreasonableness and impracticality of Article 10 of the CTC has attracted criticism by many Chinese scholars.[69] On the other hand, the doctrine of publicity of property rights, including a beneficiary's rights to trust property, is so deeply rooted in Chinese traditional legal thinking that it has been extended into trusts law. China has an unnecessary fear of trusts because in the eyes of some Chinese legal professionals the trust creates confusion about the ownership of property and because of a belief that, unless restrained by registration, it will be abused for illegal or immoral purposes.

An interesting footnote to the discussion is that in the course of the drafting process China consulted German and Japanese scholars and followed the Japanese model, including the provisions concerning the definition of the trust and registration requirements.[70] To everyone's surprise, however, the enacted official version of the Code was substantially changed to the current model without any consultation.[71] The history of the enactment of the registration provisions shows that the current approach

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[69] Zhong Rui-dong and Hou Huai-xia, 'On the Principle of Publication of Trust Property' (2006) 39 *Journal of Zhengzhou University* 23; Hongliang Wang, 'The Relativity of Publicity of Registration' (2009) 5 *Journal of Comparative Law* 31; Liu Pingping, 'The View of Trust Publication' (2005) 21 *Journal of Hunan College of Finance and Economics* 78; Xu Lai, 'Publicity of Trusts and Protection of Transaction Safety' (2008) 1 *Finance and Economy* 46; Wang Heng, 'The Independence of Trust Assets and the Trust Demonstration & Registration System' (2004) 2 *Economic Survey* 146; Wang Yong, 'The Relationship between the Trust Law and the Property Law' (2008) 45 *Journal of Peking University (Philosophy and Social Sciences)* 93.

[70] Shaoping Zhu and Yi Ge, *The Compilation of Drafting Material for PRC Trust Code* (Jiancha Press, 2002) 187, 206.

[71] This type of 'change' has happened to other legislation as well. For example, Article 106 of the PRC *Property Rights Law 2007* was changed from requiring a valid contract to constitute the 'bona fide

is not well-thought or fully-discussed but a consequence of administrative bureaucracy.

C The Chinese caveat system

For the sake of completeness, something must be said of the Chinese caveat system. As mentioned previously, China's property law includes a caveat system, or rather, a disagreement lodgement procedure. It provides that if the registered proprietor and an unregistered person with interest in the property jointly agree that a mistake has occurred in the registration process, they can ask the registrar to correct the mistake. If the parties disagree, the interested person can lodge a caveat. Unless the caveator starts legal proceedings within 15 days of lodgement, the caveat will lapse automatically.[72] In practice almost all property disputes are brought to the court without lodging a caveat. Lodging a caveat simply serves the purpose of preventing a sale of the property, or to be more precise, preventing a change of ownership being registered. The fifteen day limitation period on the operation of the caveat system makes little sense in this context.

In the common law system trusts are not registrable but caveatable. But in a civil law system trusts, including trusts of land and other registrable properties, are to be registered. Moreover, neither registration nor caveating protects a beneficiary who is

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purchaser rule' to not requiring a valid contract. See: Wang, Li-ming, 'A Study of Components of Bona Fide Purchaser Rule in Real Property Law' (2008) 10 *Politics and Law* 2.

[72] *Property Rights Law 2007* (PRC), Article 19.

complaining of a breach of trust. As we have already noticed, the ‘internal’ aspects of the trust relationship are unaffected by registration requirements.

The internal relationship between the trustee and the beneficiary is a feature of trusts which does not apply to sales of land. The relationship does not hinder the execution of ordinary transactions. Trust property enjoys no special status in business transactions. The right of purchaser is protected by commercial law and the interest of the beneficiary is protected by equity and trust law. The only possible conflict of interest affecting the trust property occurs when a bankrupt trustee manages trust property. The trust property is protected by trust law which denies the claims of the personal creditors to the trust property unless there are statutory grounds for setting aside the trust. The rationale for this principle is not to jeopardise the personal creditors of the trustee but to punish the defaulting trustee and to protect the proprietary interest of trust beneficiaries. The substantial issue here is not whether the property is publically known as trust property but what consequences should follow from the improper disposition of the property by the trustee. The outcome of such a case does not depend on registration of the trust. Publicity of trusts property only serves as a warning to a stranger; it cannot be used as a legal ground against the interest of trust beneficiary or impair the validity of a trust.

D The implications of compulsory registration

A system of compulsory registration implies that there are two types of property known to a third party; trust property and non-trust property. The third party needs to

be careful in dealing with the trust property because there are encumbrances or hidden interests affecting it. The value and transmissibility of trust property would be greatly reduced if the hidden interests could not be identified. The cost of registration or the cost of investigation for each transaction affecting registered property would be high, not to mention the costs of de-registering when the property becomes non-trust property. A regime of compulsory registration of trusts undermines one of the objectives of trusts law, which is to provide a flexible, reliable and efficient means of property management and transmission.

From an economic point of view a scheme of compulsory registration of trusts is not advisable because its cost-benefit ratio is far too inefficient. A good trust law should harmonise trust law with other laws, and the emphasis should be on providing the appropriate balance of rights, powers and duties between the parties to the trust. From both an economic and a social perspective the compulsory registration requirement in trusts law is irrational.

Article 10 of the CTC should be repealed and the requirement of publicity of trust property should be re-examined. It may be justifiable to impose a registration requirement on commercial trusts because the 'caveat venditor' doctrine is entrenched in civilian commercial laws and there is no duty on the part of the buyer to investigate the title to property or the qualification of the seller. The buyer should have all information available to him before dealing with a commercial trust. Disclosure of information is necessary in business. Many trusts are, however, more like private arrangements between the settlor and the trustee (in commercial trusts) or between the

trustee and the beneficiaries (in private trusts). The private character of these trusts cannot and should not be compulsorily changed into a public character. Any requirement of publicity for trusts should be confined within a reasonable scope and should not distract from the primary aim of a trust law, which is to establish a rigorous regime of fiduciary accountability.

IX CONCLUSION

Reviewing the different approaches to the issue of publicity of trusts, we have seen how legal systems are based on different philosophies. A private institution can be compulsorily required to be publicised, not only so that it can be enforced against a third party but also to establish the internal validity of the relationship. The rationales underlying registration of trusts are defective. In the context of the convergence of common law and civil law systems it could be dangerous, and certainly inappropriate, for a non-common law jurisdiction to adopt the form of the trust without also taking the substance. The compulsory requirement of registration of trusts is unrealistic and unreasonable, and the belief that unregistered trusts can harm third parties is groundless. Publicity cannot be a substitute for imposing a strong regime of fiduciary duties on trustees; indeed, it may subvert the institution of the trust by depreciating the value of trust property to the beneficiary.

Recommending law reform for other jurisdictions is often arrogant and dangerous, even if it is not ignorant. But of the Chinese system of compulsory registration of trusts a clear recommendation can be made to all legal jurisdictions – do not adopt it.