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Re-Clarifying China's Trust Law: Characteristics and New Conceptual Basis

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Re-Clarifying China's Trust Law: Characteristics and New Conceptual Basis

LYU, KAI*

Abstract: The common law trust institution always encounters modifications when it is transplanted to civil law jurisdictions. China designs its Trust Law with three characteristics in the process of localization: indeterminate title of trust assets, settlor's intrusive rights, and beneficiary's right *in personam* with two peculiarities. By virtue of these characteristics, Chinese lawmakers and politicians expect to make the trust institution more acceptable for the general public and orchestrated with the civil law tradition. However, these characteristics give rise to theoretical confusions and practical obstacles. This unintended result is not caused by insufficient rules in the Trust Law but by a deficient conceptual basis within the Chinese jurisprudence that is needed to underpin the trust institution. This paper addresses this problem by testing the prevailing contract theory and the novel special patrimony theory and, after systematic analyses, finds that the special patrimony theory works better to conceptualize China's Trust Law. This finding may provide some reflections to other trust-reception civilian jurisdictions to understand the trust institution.

Keywords: Trust, China, Characteristics, Conceptual Basis, Special Patrimony

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I. INTRODUCTION

Generally, a common law trust arises when a person, the settlor¹ or trustor, transfers its title to trust assets to another person, the trustee, who is obliged to deal with the trust assets as a separate fund for the benefit of a third party, the beneficiaries, or for a specific purpose.² As a unique institution originating in England,³ Maitland highly appraised it as “the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence.”⁴ Many civil law jurisdictions have incorporated this particular institution into their legal systems. By the early twentieth century, it was brought into China by its foreign conquerors.⁵ When the Chinese Communist Party took over Mainland China in 1949 and promoted socialism thereafter, the trust institution was viewed as a manifestation of capitalist ideology and thereby blocked by the Party.⁶ The trust institution reemerged again in the early 1980s after Chinese reformists implemented the “Reform and Opening-

1. The word “settlor” is also spelled as “settle” in some sources referred to in the paper.

2. See DAVID HAYTON ET AL., *LAWS RELATING TO TRUSTS AND TRUSTEES* 2 (18th ed. 2010); GARY WATT, *TRUSTS AND EQUITY* 18 (3d ed. 2008).

3. PHILIP H. PETTIT, *EQUITY AND THE LAW OF TRUSTS* 12 (11th ed. 2006); FREDERICK WILLIAM MAITLAND ET AL., *EQUITY: A COURSE OF LECTURES* 23-42 (2nd ed. 1949). Trust developed from the ancient “use” in England and then was widely used in the family successions and charitable donations. For an elaboration of the gradual development of “use”, see generally N.G. Jones, *Uses, Trusts, and a Path to Privy*, 56(1) *CAMBRIDGE L.J.* 175 (1997).

4. FREDERIC MAITLAND, *SELECTED HISTORICAL ESSAYS* 129 (1957).

5. Mujie Sheng, *Jiuzhongguo Jinrongye de Xintuo Yewu* [*The Trust Business of Financial Industry in China before 1949*], 2 *J. OF SHANGHAI FIN.* 20, 20 (1980) (China).

6. The Chinese Communist Party carried out a society-reconstruction project called “socialist transformation” in the 1950s and then launched a one-decade “culture revolution” spanning from the mid-1960s to the mid-1970s. Both the socialist transformation and culture revolution were designed to advance socialism in China by removing capitalist elements from the Chinese society.

up Policy.”⁷ Since then, three demands had fueled the rapid growth of trust: (1) banks setting up trust subsidiaries to provide financial services that banks were not allowed to do; (2) local governments establishing trust investment companies to channel extra-budgetary funds to local infrastructure projects for higher returns; and (3) the central government creating trust companies to bridge overseas capital with cash-starved domestic enterprises.⁸

It is worth noting that the name “trust company” is misleading because most services those trust companies offered at that moment, such as taking household deposits and providing loans, underwriting securities, and engaging in real property development, were not genuine *trusts*.⁹ Trust companies were superficially labeled as “trust” providers when they in truth merely provided agent or banking services.¹⁰ These companies brought about oversupply of capital and excessive liquidity, which gave rise to unscrupulous competition and economic bubbles.¹¹ In response, authorities tried several methods to rectify the situation, including shutting down highly-indebted trust companies, consolidating small-scale trust companies, and restricting trust companies from providing non-trust businesses and services.¹²

Unfortunately, most of these administrative rectifications ended up in failure. The most important reason for this failure is probably due to the absence of a formal trust code in China. The sole rule regulating trust companies at that time contained only thirty-three simple, dry articles.¹³ These articles not only failed in helping to clarify the concept

7. Immanuel Gebhardt & Holger Hanisch, *Development of the Chinese Trust Law – an Overview*, in DRAFTING MATERIALS COLLECTION OF CHINA'S TRUST 262 (Shaoping Zhu & Yi Ge eds., 2002). The reform and opening-up policy shifted the national focus from enforcing socialism to developing economy by introducing capitalist market principles.

8. Anjali Kumar et al., *China's Non-Bank Financial Institutions: Trust and Investment Companies* (1997) World Bank Discussion Paper, 1-2, available at <http://elibrary.worldbank.org/doi/pdf/10.1596/0-8213-3888-9>.

9. XIAOMING ZHOU, XINTUO ZHIDU BIIIAOFA YANJIU [A COMPARATIVE STUDY OF TRUST INSTITUTION] 181 (1996) (stating that trust companies issued bonds in off-shore markets and took domestic deposits as banks in the form of “trust deposits”, and then extended collected credit to business ventures through “trust investments” and “trust loans”).

10. Lusina Ho, *Xintou Lifa Buyi Caozhiguoji [A Law of Trust for the PRC: A Note of Caution]*, 1 PEKING U. L. REV. 618, 618 (1998) (China) [hereinafter Ho, *A Law of Trust for the PRC*].

11. See generally Zhicheng He and Ping Wang, *Woguo Jinrongye de Xinqi he Ta de Lishi Juxianxing [The Emergence and Historical Limitation of China's Financial Trust Industry]*, 6 J FIN. STUD. 25 (1990) (China).

12. Shuli Zhou, *Dui Woguo Jinrong Xintuoye de Huigu yu Zhanwang [The Retrospect and Prospect of China's Financial Trust Industry]*, 12 J. FIN. STUD. 25, 25-27 (1990) (China).

13. The rule was called “Provisional Regulations for Financial Trust and Investment

and governance of trust, but they were also unsuccessful in helping to build a comprehensive regulatory structure for trust companies to follow. Due to this deficient legal framework, academic scholars, industry experts, and even the regulators themselves appealed to legislators for “the making of a [Chinese] Trust Law” for a long time.¹⁴ Lianzhou Wang, chair of the Drafting Committee of the Trust Law, noted himself that there is not only an urgent need to elaborate the legal foundation of the trust institution, but to also regulate trust activities and align the legal system with China’s market economy reform.¹⁵

The legislation of the Trust Law, however, experienced a number of twists and turns.

The First Trust Bill, completed in 1996, was rejected by the National People’s Congress (NPC) on the grounds of there being too many controversial propositions.¹⁶ The Second Trust Bill, completed in 2000, failed to make it through the NPC due to the rotation of new standing members of the NPC.¹⁷ After two attempts, the NPC finally passed the Third Trust Bill, which came into force on October 1, 2001.¹⁸

In contrast to other jurisdictions more receptive to the concept of Trust, China’s Trust Law was designed with several distinguishing characteristics. The first is the indeterminate ownership of trust assets, which means that the title to trust assets could be vested in either the

Companies,” promulgated by the People’s Bank of China and effective from April 26, 1986 to January 12, 2001.

14. Xiao Zhang, *Background Information on the Drafting Process*, in DRAFTING MATERIALS COLLECTION OF CHINA’S TRUST LAW 278 (Shaoping Zhu & Yi Ge eds., 2002).

15. Lianzhou Wang, *Urgent Need for Chinese Trust Law*, in DRAFTING MATERIALS COLLECTION OF CHINA’S TRUST LAW 284-88 (Shaoping Zhu & Yi Ge eds., 2002).

16. For example, there were considerable disputes on whether regulations on trust companies shall be integrated into the Trust Law; what the business scope and functions of trust companies shall be specified; what kind of legal principles shall be adopted to guide the rectification of trust companies; and how to handle their rights and obligations. *See id.*, at 289.

17. Wang said the failure of the ‘Second Trust Bill’ was an “unexpected interlude” in the legislation of the Trust Law. Because the Drafting Committee had already elaborated the background and reasons to lay down the Trust Law in front of the NPC when the ‘First Trust Bill’ was submitted for approval in 1997, the Drafting Committee thought that it was duplicative to explain the background and reasons of legislation to the NPC when the ‘Second Trust Bill’ was submitted for authorization in 2000. However, most standing members of the NPC had been replaced, and new members did not understand the importance of the Trust Law. As a result, the ‘Second Trust Bill’ was denied. *See* Lianzhou Wang, *Zhonghua Renmin Gonghegou Xintuofa de Qianshi Jinsheng (Xilie Yi)* [*The History and Development of PRC’s Trust Law (Part I)*], 62 TRUST WEEKLY 3, 24 (2011) (China) [hereinafter Wang, *The History and Development of PRC’s Trust Law (Part I)*].

18. Trust Law of the People’s Republic of China (promulgated by the Standing Comm. Nat’l People’s Cong., Apr. 28, 2001, effective Oct. 1, 2001) (China), Preamble [hereinafter Trust Law 2001 (China)].

settlor or the trustee. This characteristic is significant because only very few jurisdictions have the indeterminate ownership locus.¹⁹ The second characteristic is the extensive rights afforded to the settlor by the Trust Law. This feature is less special since many offshore jurisdictions have also done so even though the title to trust assets is typically vested in the trustee in these jurisdictions.²⁰ The third characteristic is the nature of the beneficiary's right, which is a right *in personam* in China. This is different from the orthodox Anglo-American trust model that traditionally vests an equitable title in the beneficiary, but it is widely shared by civilian jurisdictions recognizing the trust.²¹ The two peculiarities of the beneficiary's right—relative nature and bankruptcy remoteness—however, make the beneficiary's right different from a usual right *in personam* when viewed under the Chinese civilian system.

Why does China's Trust Law have these characteristics? How should they be understood in the Chinese context? What is the conceptual basis of a trust in China? Following the introduction, Part II will delve into the topic of the indeterminate ownership of trust assets by presenting scholarly debates and political concerns. Part III will analyze the settlor's extensive rights from both a legal and political perspective. Part IV will first explore the nature of the beneficiary's right by examining scholars' arguments and by reviewing the historical evolution of the trust in common law. After that, Part IV will spell out the beneficiary's right as a right *in personam* with two peculiarities: relative nature and bankruptcy remoteness. Based on these characteristics, Part V will try to conceptualize the Trust Law by testing

19. It is said that the Israeli trust regime under the Trust Act of 1979 is the world's first shapeless trust regime. Shapeless trust means there is no determinate ownership locus of trust assets. However, this character in Israel may be about to be swept away in the new Civil Law Bill, which "moves Israeli trust law much closer to Anglo-American orthodoxy" and "redefines a trustee as the owner of property." Adam Hofri, *Shapeless Trusts and Settlor Title Retention: As Asian Morality Play*, 58 LOY. L. REV. 135, 169 (2012).

20. See, e.g., TRUSTS (JERSEY) LAW 1984, Article 9A, inserted by the L.21/2006 Amendment, which stipulates that powers reserved by a settlor "shall not affect the validity of the trust nor delay the trust taking effect." These powers may include power "to revoke, vary or amend the terms of a trust," power to manage the payment of trust benefits, power "to appoint or remove any trustee, protector or beneficiary," power to direct the administration of the trustee, and power to restrict any powers of the trustee. A new s.15, expressly authorizing the reservation or grant of certain powers by or to a settlor, was introduced into the Trusts (Guernsey) Law in the 2007 Amendment. Similar legislations could also be seen in Bahamian Trustee Act 1998 and San Marino Trust Law 2010.

21. In many civilian jurisdictions, such as Russia, Luxembourg, France, Liechtenstein, Japan, Taiwan, and South Korea, the beneficiary has a right *in personam* against the trustee. Lusina Ho, TRUST LAW IN CHINA 37-38 (2003).

the stereotypical contract theory and the compelling special patrimony theory. After elaborating on these theories and carefully comparing them with the Trust Law, Part V will argue that the special patrimony theory provides a reasonable conceptual foundation to China's Trust Law. This paper will end with a short concluding Part VI.

II. THE INDETERMINATE OWNERSHIP OF TRUST ASSETS

In common law, it has been well established that the settlor should do everything necessary in his or her power to transfer trust assets to the trustee unless the settlor declares himself or herself as the trustee.²² The trustee owns the legal title of trust assets while the beneficiary owns the equitable title. In civil law where there is only one title to each property,²³ there are four usual scenarios to vest the title to trust assets. The first scenario is that the settlor transfers the ownership of the trust assets to the trustee, who holds them in the interest of the beneficiary;²⁴ this is the most common approach.²⁵ The second scenario is that the settlor retains ownership of the trust assets but delegates the management power over these assets to the trustee.²⁶ In the third scenario, the beneficiary is the legal owner of trust assets while the trustee merely has exclusive powers to manage and dispose of them.²⁷ This is called “*bewind-trust*” in the Netherlands and South Africa, which possibly are the only two examples in civilian jurisdictions.²⁸ The

22. *Milroy v. Lord*, 4 De GF & J 264 (1862), *per* Turner LJ (“[I]n order to render a voluntary settlement valid and effectual, the settler must have done everything which, according to the nature of the property compromised in the settlement, was necessary to be done in order to transfer the property and render the settlement binding upon him.”). *See also Re Rose* [1952] Ch. 499, [1951] 1 All ER 1217.

23. Donovan WM Waters, *The Future of the Trust Part I*, 13 J. INT’L TR. & CORP. PLAN. 179, 182 (2006) (stating that “The civil law whose Roman roots are long pre-feudal has no doctrine of an estate or interest interposed between the person and the thing owned by the person; and therefore, there can be no division of the rights of ownership between two or more persons.”).

24. LUSINA HO, TRUST LAW IN CHINA 37-38 (2003) (hereinafter HO, TRUST LAW IN CHINA). Self-declaration trust also belongs to this scenario. Although the settlor declares herself as the trustee and trust assets are not transferred, they are held by the settlor in the status as trustee.

25. *Id.* (listing civil law jurisdictions and mixed jurisdictions that vest the title of trust assets in the trustee, including Japan, Taiwan, South Korea, Russia, Luxembourg, Cayman Island, Jersey, Guernsey, Scotland, South Africa, and Sri Lanka).

26. *Id.* at 41.

27. H.L.E. Verhagen, *Trusts in the Civil Law: Making Use of the Experience of ‘Mixed’ Jurisdictions*, 3 EUR. REV. PRIVATE L. 477, 496 (2000).

28. Tony Honoré, *Obstacles to the Reception of Trust Law? The Examples of South Africa and Scotland*, in *AQUITAS AND EQUITY: EQUITY IN CIVIL LAW AND MIXED JURISDICTIONS* 803 (A.M. Rabello ed. 1997); Verhagen, *supra* note 27, at 477.

last scenario is that neither the settlor, trustee, or beneficiary really owns trust assets, but the trustee has to manage the assets in the interest of the beneficiary. The Civil Code of Québec is a typical example of this approach,²⁹ as are the trust laws in Uruguay and the Czech Republic.³⁰

China seems to present a fifth scenario because the title locus of trust assets is quite ambiguous upon reading Article 2 of the Trust Law, which states that:

[B]ased on his faith in trustee, *entrusts* his property rights to the trustee and allows the trustee to, according to the will of the settlor and in the name of the trustee, administer or dispose of such property *in* the interest of a beneficiary or for any intended purposes.³¹

According to this definition, although the trustee has the right to manage and dispose of trust assets, whether the trustee has the ownership completely depends on the legal meaning of the word “entrust (*weituo*, 委托),” which is unfortunately not further clarified in the Trust Law.³²

The ambiguity has led to lengthy debates. Scholars hold various views, among which the two dominant propositions are the settlor-owned model and the trustee-owned model.³³ Some scholars opine that

29. In Québec, a trust results from an act whereby “a person, the settlor, transfers property from his patrimony to another patrimony constituted by him which he appropriates to a particular purpose and which a trustee undertakes, by his acceptance, to hold and administer.” Meanwhile, the trust patrimony is “autonomous and distinct from that of the settlor, trustee or beneficiary and in which none of them has any real right.” See Civil Code of Québec, S.Q. 1991, c. 64, arts. 1260-61 (Can.).

30. Hofri, *supra* note 19, at 143.

31. Trust Law 2001 (China), *supra* note 18, art. 2 (emphasis added).

32. Charles Zhen Qu, *The Doctrinal Basis of the Trust Principles in China's Trust Law*, 38 REAL PROP. PROB. & TR. J. 345, 356-57 (2003).

33. Beside the two mainstream views, Chinese scholars also have other views regarding the title locus of trust assets. However, these views are problematic and lack persuasiveness. See Shiyang Wen and Xingjun Feng, *Lun Xintuo Caichan Suoyouquan, Qian Lun Woguo Lifa de Wanshan [The Ownership of Trust Assets and the Improvement of Relevant Legislations in China]*, 58(2) WUHAN U. J. 203 (Phil. & Soc. Sci. ed. 2005) (China) (arguing that the beneficiary has the ownership of trust assets in China); Guanzhi Hu and Qing Chen, *Quanneng Fenge: Lun Woguo 'Xintuofa' zhi Xintuo Caichan Suoyouquan [Divided Right: An Analysis of the Ownership of Trust Assets in China's Trust Law]*, 39(6) J. ZHENGZHOU U. 84 (2006) (China) (arguing the ownership can be divided into three parts and the settlor, beneficiary and trustee own a part respectively); Zhiyong Fan, *Lun Xintuo Caichanquan de Guishu: Xintuo Caichan Gongyouquan de Guojian [The Title Locus of Trust Assets: Constituting the Right of Common of Trust Assets]*, 12(1) J. SOUTHWEST JIAOTONG U. 107 (Soc. Sci. ed. 2011) (China) (arguing the trust assets are jointly owned by the settlor and the trustee); Pu Chen, *Zuowei Suoyouquan Yundong Xingshi de Xintuo [Trust as the Movement of Ownership]*, 28(12) HEBEI L. SCI. 86 (2010) (China) (arguing that the settlor shall transfer the ownership to the trustee in normal situations and the ownership

the settlor reserves the ownership of trust assets.³⁴ Although the definition of “entrust” is not directly defined in either the Trust Law or in any other Chinese legislations, there are some analogous institutions that may shed some light on the meaning of the word “entrust.” The General Principle of the Civil Law (hereinafter “GPCL”), which codifies general rules of civil law and serves as the foundation of specific civilian laws in China, prescribes “entrusted agency,” which means that an agent performs civil juristic acts in the principal’s name within the discretion entrusted by that principal.³⁵ The Contract Law also incorporates Articles on “entrustment contract,” which is “a contract whereby the principal and the agent agree that the agent shall handle the affairs of the principal.”³⁶ Neither the GPCL nor the Contract Law compulsorily requires the transfer of the property ownership from the principal to the agent.³⁷ It has been widely recognized that the ownership is nevertheless vested in the principal.³⁸ In analogy, Zhang affirms that the settlor still owns the trust assets.³⁹ In addition, the settlor’s position as the ultimate owner can also be inferred from Article 20 of the Trust Law, which states that the settlor has a right to not only know the administration of “her (*qi*, 其)” trust assets, but to also have access to her trust accounts and other relevant documents concerning “her (*qi*, 其)” trust assets.⁴⁰ Therefore, the settlor, as stated by Article 20, literally still owns the trust assets.

Despite that, more scholars apparently support the trustee-owned

turns back to the settlor if the trustee breaches the trust instrument).

34. HO, TRUST LAW IN CHINA, *supra* note 25, at 41; Chun Zhang, *Xintuo Caichan Dulixing de Fali [The Legal Philosophy of the Independence of Trust Assets]*, 3 J. SOC. SCI. 102, 109 (2011) (China).

35. Minfa Tongze (民法通则) [General Principles of the Civil Law], (promulgated by the President of the People’s Republic of China, Apr. 12, 1986, effective Jan. 1, 1987), art. 64 [hereinafter China GPCL].

36. Contract Law of the People’s Republic of China (promulgated by the People’s Republic of China, Mar. 15, 1999, effective Oct. 1, 1999), art. 396 [hereinafter Contract Law of China].

37. *See generally* the GPCL and Contract Law.

38. *See* F.M.B. REYNOLDS ET AL., BOWSTEAD AND REYNOLDS ON AGENCY 23 (18th ed. 2006); G.H.L. FRIDMAN, THE LAW OF AGENCY 24 (7th ed. 1996).

39. Chun Zhang, *Zhongguo Xintuofa de Chuangzaoxing Guiding jiqi Pingxi [The Innovative Legislations in China’s Trust Law and the Analyses]*, 2 LEGAL SCI. 110, 112 (2002) (China).

40. Article 20 of the Trust Law reads: “The settlor shall have the right to know the administration, use and disposition of, and the income and expenses relating to, *his trust property*, and the right to request the trustee to give explanations in this regard. The settlor shall have the right to check, transcribe or duplicate the trust accounts related to *his trust property* and other documents drawn up in the course of dealing with trust business.” Trust Law 2001 (China), *supra* note 18, at art. 20.

model interpretation.⁴¹ Several articles in the Trust Law suggest that trust assets are vested in the trustee. For instance, Qu argues that a reading of how the word “obtain (*qude*, 取得)” is used in Article 14 of the Trust Law supports the trustee as the owner.⁴² Reid supplements this argument with another piece of evidence.⁴³ His argument goes as follows: Article 52 provides that the trust shall not be terminated by the death, incapacity, or bankruptcy of the settlor or trustee and, according to Articles 15 and 16, the trust assets do not fall into their legacies or bankruptcy estates.⁴⁴ In that case, a new trustee will take the place of the original trustee.⁴⁵ It is unclear, however, who would replace the settlor in the same scenario. If the settlor were to be the owner of the trust assets, then those trust assets would be ownerless because no one would succeed the settlor. These Articles, when read together, imply no ownership title held by the settlor.

Aside from the reasoning on the basis of legal provisions, proponents further support the trustee's ownership theory by appealing to functional justifications. Like most civilian jurisdictions, China uses trust “not out of intellectual curiosity but . . . to cater to [the] investment and commercial utilization of assets.”⁴⁶ In commercial fields, investors give assets to fund managers on the belief that professional skills and the sophistication of fund managers can create higher investment returns. The fact that the trustee is not treated as the owner may lower efficiency and flexibility of the trust scheme, particularly when the trustee's status as owner may be conducive to exclude improper interventions from the settlor during its management.⁴⁷ Moreover, if the trustee has no *prima facie* ownership of trust assets vis-à-vis the outside world, there may be tiresome burdens on her to prove her authority to

41. See Charles Zhen Qu, *The Doctrinal Basis of the Trust Principles in China's Trust Law*, 38 REAL PROP. PROB. & TR. J. 345, 356-58 (2003); Yu Haiyong, *Lun Xintuo Caichan de Suoyouquan* [On the Ownership of Trust Property], 50 J. SUN YAT-SEN U. 189, 200 (Soc. Sci. ed. 2010) (China); Linqing Jia, *Xintuo Caichanquan de Falu Xingzhi He Jiegou Zhi Wojian* [The Legal Nature and Structure of the Right of Trust Assets], 5 JURIST 81, 90 (2005) (China).

42. *Id.* at 357. Article 14 of the Trust Law says “the property **obtained** by the trustee due to a trust accepted is trust property.” Trust Law 2001 (China), *supra* note 18, at 14 (emphasis added).

43. See generally Kenneth G.C. Reid, *Conceptualizing the Chinese Trust: Some Thoughts from Europe*, in TOWARDS A CHINESE CIVIL CODE: COMPARATIVE AND HISTORICAL PERSPECTIVES 219 (Lei Chen & C.H. van Rhee eds., 2012) [hereinafter Reid, *Conceptualizing*].

44. Trust Law 2001 (China), *supra* note 18, at arts. 15, 16, 52.

45. Article 40 of the Trust Law says “Where the trustee's appointment is terminated, a new trustee shall be appointed . . . The new trustee shall take up the rights and obligations of the former trustee in the handling of trust business.” *Id.* art. 40.

46. Qu, *supra* note 32, at 348.

47. HO, TRUST LAW IN CHINA, *supra* note 24, at 38.

manage the trust assets to the satisfaction of third parties.⁴⁸

China is one of very few jurisdictions with an unclear locus of, or a “shapeless,” title to trust assets.⁴⁹ This, however, was not the case in the First and Second Trust Bill, which were both drafted by a committee of mostly law professors. This committee followed the hegemonic trustee-ownership model by imposing a duty on the settlor to transfer the ownership of trust assets to the trustee.⁵⁰ The indeterminate ownership model in the Trust Law in force was a final amendment made by politicians who were the ultimate decision makers.⁵¹

There are several considerations behind the amendment. First, the politicians conjectured that it was very hard for Chinese people to understand or accept the trust institution if the settlor lost the ownership of trust assets completely.⁵² The indeterminate ownership model, by which the settlor may reserve the ownership, was supposed to be more acceptable to potential settlors unaccustomed to it.⁵³ Second, Chinese people lacked faith in granting the full ownership to trust companies because they had the weakest status and experience amongst other financial institutions.⁵⁴ The settlor as owner of trust assets can, to some

48. Lusina Ho, *The Reception of Trust in Asia: Emerging Asian Principles of Trust?*, 2004 SING. J. LEGAL STUD. 287, 295-96 (2004) [hereinafter Ho, *The Reception of Trust in Asia*].

49. Lupoi argues that the Hague Convention on the Recognition of Trusts is also shapeless because it allows a trust to exist even if the settlor is still regarded as the owner of trust assets. See MAURIZIO LUPOI, TRUSTS: A COMPARATIVE STUDY 327-41 (Simon Dix trans.) (2000) [hereinafter LUPOI, TRUSTS: A COMPARATIVE STUDY]. Article 2 of the Convention defines a trust as “relationships created . . . by . . . the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.” Nonetheless, the Convention intentionally drafts the definition of trust in a broad way in order to promote the recognition of trust in civil law jurisdictions and attract more signed members. The jurisdiction-neutral Convention merely provides a minimal requirement, but for jurisdictions which have signed or borrowed the Convention, the ownership of trust property has to be clearly indicated. See Trust Law 2001 (China), *supra* note 18, at art. 2.

50. See Article 3 of the ‘First Trust Bill’ and Article 3 of the ‘Second Trust Bill’, which have the same words: “For the purpose of this law, a trust is an action by which the settlor, based on his confidence on the trustee, *transfers the ownership of his property to the trustee . . .*” DRAFTING MATERIALS COLLECTION OF CHINA’S TRUST LAW 529 and 557 (Shaoping Zhu & Yi Ge, eds., 2002) (emphasis added) [hereinafter “The First & Second Trust Bill”].

51. See Rongtao Yan, *Zhongguo Xintuo Caichan Suoyouquan Guishu Fenxi yu Goujian* [Analysis and Reconstruction on the Internal Structure of Trust Ownership in China], 9(9) J. KUNMING U. 60, 62 (Sci & Tech ed. 2009) (China).

52. *Id.*

53. This is a common consideration for jurisdictions with the shapeless feature. See Hofri, *supra* note 19, at 175-76.

54. See Lusina Ho, *Trust Laws in China: History, Ambiguity and Beneficiary’s Rights*, in RE-IMAGING THE TRUST: TRUSTS IN CIVIL LAW 201-02 (Lionel Smith ed. 2012) [hereinafter Ho, *Trust Laws in China: History*].

extent, act as a check and balance of the trustee's management.⁵⁵ Third, the amendment was said to be beneficial in protecting state assets that were invested overseas in the name of private companies and managed by private companies.⁵⁶ This way, even if these companies had misappropriated state assets or had become insolvent, the original grantors can attach the state assets to the name of the settlors who, according to China's Trust Law, would be the owners.⁵⁷

These conjectures proved to be wrong in later practice. On the one hand, the indeterminate ownership approach is unable to effectively protect overseas state assets. Even if a Chinese court decides that the state assets located in foreign countries are still owned by the settlor, it is difficult to get such a decision recognized and enforced by foreign courts.⁵⁸ On the other hand, the indeterminate ownership aggravates uncertainty and makes trusts harder to understand, even specialists like judges have opposite verdicts regarding similar fact. For example, one court held that the trustee was the owner of trust assets in *Shandong Food v Jinan Yingda Trust* while another held that the settlor owned the trust assets in *Beijing Haidian v Shenzhen Xinhua*.⁵⁹ The design of

55. *Id.*

56. According to Chinese socialism ideology, state assets owned by state-owned enterprises (SOEs) in appearance are owned by all Chinese people in theory. When these SOEs make overseas investments, the status as SOE may raise concerns such as sovereign immunity and underlying state guarantee, which to some extent not only cause adverse impacts on SOEs but also disrupt the level playing field of overseas jurisdictions. Therefore, the status as SOE is not very welcome by laissez-faire markets. In response, Chinese SOEs usually transfer state assets to private companies they incorporate in host markets or to individuals they designate for investments.

57. Wei Qin, *Xintuofa: Qinian Fengyujiancheng, Weilai Renzhongdaoyuan* [Trust Law: the Impediments over Last Seven Years and the Rocky Path to the Future], JRJ, <http://trust.jrj.com.cn/2008/10/000004040213.shtml> (last updated Oct. 22, 2008) [hereinafter Qin, *Trust Law: the Impediments*]; Wang, *The History and Development of PRC's Trust Law (Part I)*, *supra* note 17, at 6.

58. Qin, *Trust Law: the Impediments*, *supra* note 57 ("At that time, people attach great importance for the phenomenon of loss of state assets abroad . . . we often cannot successfully recover the loss of state assets . . . introducing trust system can better protect the safety of state assets.").

59. Shandong Province Food Co. v. Jinan Yingda Guoji Trust Investment Co., (Second Instance, Jinan Intern. People's Ct., Apr. 14 2002) (China) (finding that a contract, by which the appellee (food company) deposited monies in an account of the appellant (trust company) and entrusted the appellant to make loans in the interest of the appellee, was a trust contract rather than an entrusted contract, and holding that the trustee owns the ownership of trust assets). Beijing Haidian Technology Development Co. v. Shenzhen Xinhua Jinyuan Investment Co. et al. (First Instance, Chongqing Higher People's Court, Mar. 19 2007) (China) (finding that a contract, by which the Haidian Technology entrusted monies to the Xinhua Trust and the Xinhua Trust bought shares and managed shares for the benefit of the Haidian Technology, was a trust contract,

indeterminate ownership was expected to be more acceptable for the public, but ironically the result is the opposite. As Gao asserts, no private trusts, such as private living or testamentary trusts, have been set up by Chinese people.⁶⁰

Moreover, the ambiguity of ownership creates an unintended loophole in the Trust Law. Pursuant to Article 8, a trust is established when contractual parties sign the contract in express writing, and the transfer of the ownership of trust assets is not a co-condition.⁶¹ This Article works well when the settlor continues to be the owner of trust assets, but it may be troublesome when the trustee is the owner according to the contract. In the latter case, the transfer of ownership is merely a contractual obligation borne by the settlor after the establishment of contract rather than a precondition to bring the contract into effect.⁶² Therefore, it is possible that the settlor breaches her duty and transfers the ownership of trust assets to a third party.⁶³

III. THE SETTLOR'S EXTENSIVE RIGHTS

In common law, once the settlor has unilaterally transferred trust assets to the trustee, she completely drops out of the picture and the trustee only owes duties to the beneficiary unless the settlor is a beneficiary concurrently or reserves some rights against the trustee in the trust instrument.⁶⁴ The rationale is that, because legal title to trust assets has been vested in the trustee and the beneficiary enjoys the trust benefit, the settlor has no more interests in the trust assets.⁶⁵ Generally,

and holding the settlor owns the title of trust assets).

60. LINGYUN GAO, BEI WU DU DE XIN TUO [THE MISUNDERSTANDING OF THE TRUST] 241 (2010) [hereinafter GAO, BEI WU DU DE XIN TUO].

61. Article 8 of the Trust Law reads: "The trust shall take the form of writing . . . Where a trust is created in the form of trust contract, the trust shall be deemed created when the said contract is signed." See Trust Law 2001 (China), *supra* note 40, at art. 8. This Article provides that a trust could also be established by other written documents stipulated by laws and administrative regulations, but no laws or administrative regulations have prescribed other written documents to date. Therefore, the contract in writing continues to be the sole way to constitute a non-testamentary trust in China. See *id.*

62. Reid, *Conceptualizing*, *supra* note 43, at 218-19 (explaining that "whether a transfer takes place, therefore, would seem to depend on the terms of the trust contract, or . . . on the decision of the settlor.").

63. *Id.* at 219.

64. *Re Astor's Settlement Trusts* [1952] Ch. 534, 542; *Bradshaw v University College of Wales* [1987] 3 All E.R. 200 at 203; HAYTON ET AL., *supra* note 2, at 2, 4 (stating the settlor in exceptional cases may act "as the donee of a power of appointment over capital" or "as a protector . . . of beneficiaries that are as yet unborn or unascertained").

65. Qu, *supra* note 32, at 366.

if the settlor reserves too many rights to monitor or even intervene in the management of trust assets, she “risks being considered by the court as not having fully relinquished ownership” over her assets, which frustrates the trust objective.⁶⁶ In striking contrast, the settlor in China is overwhelmingly empowered with five categories of rights by China's Trust Law:

- right of information;⁶⁷
- right of intervention and revocation;⁶⁸
- right of appointment and dismissal;⁶⁹
- right of consent;⁷⁰ and
- right to obtain residual value of trust assets.⁷¹

In common law, the settlor may reserve these powers in the trust instrument by specific clauses,⁷² but these rights become default for the settlor in China.⁷³ Compared with other trust-reception civilian

66. HO, TRUST LAW IN CHINA, *supra* note 24, at 112.

67. The settlor has the right to know administrative affairs and to check the trust account and other correlative documents. *See* Article 20 of Trust Law 2001 (China), *supra* note 18. The trustee should report management progress and present documents to the settlor. *See id.* art. 33.

68. If the settlor believes the trustee's administration method is not favorable to the trust objective or to the beneficiary's interest, she has the right to unilaterally adjust that method. *See id.* art. 21. If the trustee breaches duties of administration or causes losses to trust assets, the settlor can set aside the trustee's activity and ask for restitution and compensation with the aid of a court. *See id.* art. 22. If the beneficiary commits a serious tort against the settlor or other co-beneficiaries, the settlor can deprive the beneficiary's right or even revoke the trust. *See id.* art. 51.

69. If the trustee has gross negligence in the course of administration, the settlor has the right to dismiss, or apply to the court to dismiss, the trustee. *See id.* art. 23. In the absence of otherwise provisions in the trust instrument, the settlor may appoint a new trustee when the term of the previous trustee expires. *See id.* art. 40.

70. The settlor may give consent to a self-dealing transaction conducted by the trustee at fair and open market price, the trustee's remuneration, the trustee's resignation, the termination of trust, and the settlement of dissident trustees who handle the trust affairs jointly. *See id.* arts. 28, 35, 38, 41, and 53(4).

71. The settlor has right to obtain residual value of trust assets after the beneficiary and her successors when the trust is terminated. *See id.* art. 54.

72. E.g., pursuant to Trustee Act, 2000, c. 29, § 6(1)(b) (Eng.), the settlor may reserve a power in the trust instrument to give instructions to the trustee regarding the investment of the trust funds; Trustee Act, 1925, 15 & 16 Geo. 5, c. 19, §36(1)(a) (Eng.) also provides that the power to appoint new trustees can be retained by the settlor in the trust instrument.

73. The Trust Law allows the trust instrument to alter some of settlor's defaulting rights, such as the settlor's right of consent with regard to the trustee's remuneration and the settlement of dissident trustees who handle the trust affairs jointly, the settlor's right to appoint a new trustee when the appointment of the previous trustee is terminated, and the settlor's right in the residual interest of trust assets. *See* Trust Law 2001 (China), *supra* note 18, arts. 31, 35, 40, 54. However, it is unclear whether the trust instrument can exclude the other powers.

jurisdictions, the settlor in China is far more powerful in some aspects. For example, as to the second category—right of intervention and revocation, the settlor may intervene into the trust management by unilaterally adjusting the method of administration.⁷⁴ This right puts the settlor in a very powerful position. When the trust is created by a contract, contract clauses can only be amended with the consent of both contractual parties, it cannot be amended by one party alone.⁷⁵ In civilian jurisdictions like Taiwan, South Korea, and Japan, whose trust laws are heavily drawn upon by Chinese legislatures, settlors can only change the method of trust administration by applying to the courts.⁷⁶ Some offshore jurisdictions have delegated extensive powers to the settlor like in China,⁷⁷ but these jurisdictions use that to compete for trust business.⁷⁸ It is said that powers delegated to the settlor in offshore jurisdictions are generally fiduciary in nature, and the settlor is prohibited from derogating from her benefaction.⁷⁹ However, no obligations, such as fiduciary duty and duty of care, are imposed on the settlor in China.⁸⁰ As some scholars confirm, China's Trust Law is very special to confer such extensive rights to the settlor.⁸¹

Unlike the indeterminate ownership of trust assets, which was a last-minute amendment by politicians, the settlor's status with extensive rights is an endogenous design by legislatures. Most of the settlor's rights mentioned above have already existed in the First Trust Bill and

74. *Id.*, art. 21.

75. Contract Law of China, *supra* note 36, at art. 77.

76. See Trust Law promulgated on Jan. 26, 1996; amended Dec. 30, 2009, art. 16 (Taiwan) (which states “[i]f the method of administration of a trust property is not in the beneficiary's interest because of change in circumstances, the settlor, beneficiary or trustee may apply to the court for the change in the method.”). The similar stipulation can be found in Trust Act, Act No. 900, Dec. 30, 1996; amended Mar. 31, 2005, art. 36. (S. Kor.) and Trust Act, Act No. 108 of 2006, art. 150 (Japan).

77. See, e.g., TRUSTS (JERSEY) LAW 1984, art. 9A, at 12, Trusts (Guernsey) Law, Cayman Island Trust Law, Bahamian Trustee Act, and San Marino Trust Law in *infra* note 18.

78. M.W. LAU, THE ECONOMIC STRUCTURE OF TRUSTS 32 (2011).

79. HO, TRUST LAW IN CHINA, *supra* note 24, at 113-14.

80. The Trust Law imposes the duty of care and fiduciary duty on the trustee only. “The trustee shall abide by the provisions in the trust document, and administer the trust affairs for the best interests of the beneficiary. The trustee shall perform his duties zealously as well as the obligations with honesty, good faith, care and efficiency.” See Trust Law 2001 (China), *supra* note 18, at 25. However, none of articles of the Trust Law imposes equivalent duties on the settlor.

81. QING WANG & CE GUO, ZHONGGUO XINTUOFA TIAOWEN QUANSHI [THE ANNOTATION TO ARTICLES OF CHINA'S TRUST LAW] 56, 64 (2001) [hereinafter WANG & GUO]; RUIDONG ZHONG & XIANGCONG CHEN, XIN TUO FA [TRUST LAW] 91 (2004) [hereinafter ZHONG & CHEN].

the Second Trust Bill, though the ultimate Trust Law confers some additional rights.⁸² There are two reasons for this characteristic, one of which legal, and the other political. In the common law trust, the settlor creates a trust by either declaring herself as the trustee or declaring someone else as the trustee and effectively transferring trust assets to others.⁸³ The settlor and the trustee have no rights against each other. On the contrary, Chinese trust other than the testamentary trust is set up by contract,⁸⁴ so the privity of contract is in place. In a contract, one party owns rights and at the same time owes obligations to the counterparty and vice versa. As Lupoi asserts, it is “difficult to deprive one contracting party of the right to take action against the other,” so the settlor, being a party to the contract, certainly has the right to monitor and demand the proper performance of the contract by the counterparty—the trustee.⁸⁵

The political reason goes further than the legal reason. For Chinese legislatures, the very notion of cutting off the settlor from her trust is perverse. As Zhong and Chen contend, “the trust relationship, after all, is established by the settlor.”⁸⁶ It is reasonable to consistently enhance the settlor’s status in order to ensure the accomplishment of trust purpose and to safeguard the balance of rights between the settlor and the trustee.⁸⁷ The legislatures believe no one is in a better position than the settlor to know whether the beneficiary’s rights, trust obligations, as well as the trust’s purpose have been conscientiously satisfied.⁸⁸ This notion gives the trust creator the justification to monitor the trustee’s management activities and even power of enforcement in some circumstances.⁸⁹ Moreover, like the political account in creating the indeterminate ownership model, the settlor’s superior position is intended to make the novel trust institution more acceptable to Chinese people.

However, by enacting such an amendment, the legislatures overlook the basic function of trust, which is designed to *benefit the beneficiary*. First, the settlor herself has no evident interests in trust

82. See generally, The First & Second Trust Bill, *supra* note 50, at 185-212.

83. HAYTON ET.AL., *supra* note 2, at 206.

84. Trust Law 2001 (China), *supra* note 18, at art. 8.

85. LUPOI, TRUSTS: A COMPARATIVE STUDY, *supra* note 49, at 310-11.

86. ZHONG & CHEN, *supra* note 81, at 91.

87. WANG & GUO, *supra* note 81, at 54, 126.

88. Frances H. Foster, *American Trust Law in a Chinese Mirror*, 94 MINN. L. REV. 602, 640-641 (2010).

89. *Id.*

assets. The settlor's "interests" are in the interest of the beneficiary's interests. Once the beneficiary's interests are protected, the settlor's "interests" are well served. Second, the beneficiary's interests can be more efficiently protected by the beneficiary herself with the assistance of the court. The beneficiary knows better whether the interests due to her are properly distributed, and she has a stronger incentive to ensure the proper administration of trust assets.⁹⁰ Third, the trustee is better placed than the settlor to judge how to administrate the trust. Nearly all Chinese trusts are currently commercial, so they require professional skills and sophistication on the trustee's part. The settlor, usually a layman in investment, may have no more knowledge than the trustee. Arbitrary intervention by the settlor will likely undermine the trust's purpose. Fourth, the settlor's status with extensive rights generates an aberrant trust business in China—trust loans.⁹¹ Under this structure, a bank (acting as the settlor), in order to circumvent capital regulations, would transfer monies to a trust company (acting as the trustee), and the trust company would "manage" the monies by way of providing loans to enterprises, the original borrowers of the bank.⁹² In practice, however, the trust company only acts as a passive conduit and does not manage the monies at all. The bank itself has to conduct due diligence on the borrowers' credit standing and monitor or even dominate the whole transaction. The settlor's extensive rights empowered by the Trust Law make that possible.⁹³ As Gao concerns, such practice, leaving the trustee in idle, obstructs the cultivation of a labor market of professional trustees in China.⁹⁴

IV. THE NATURE OF THE BENEFICIARY'S RIGHT

As a civil law jurisdiction, China has a distinction between property and obligation. A property right or a right *in rem* refers to the right to directly dominate a given thing according to law, which consists

90. Qu, *supra* note 32, at 367. In exceptional cases, such as when the beneficiary is a child or incapable for other reasons, the beneficiary may be unaware of her interests in the trust and the trustee's administration.

91. Because of the fiscal austerity policy since 2010, direct banking loans from banks to enterprises were controlled on a quota basis and so a lot of banking loans were disguised as uncontrolled trust loans.

92. JingJiang, *Shadow banking in China: Battling the darkness*, ECONOMIST, May 10, 2014, <http://www.economist.com/news/finance-and-economics/21601872-every-time-regulators-curb-one-form-non-bank-lending-another-begins>.

93. This point is attributable to Professor Charlie Weng, who commented on this paper in the Conference "The Rule of Law with Chinese Characteristics" on 6 June 2013.

94. GAO, BEI WU DU DE XIN TUO, *supra* note 60, at 100.

of the right of ownership, the usufruct, and the security interest on property.”⁹⁵ It is absolute against indeterminate persons in the world at large who have an implicit obligation not to infringe the right. An obligatory right or right *in personam* is based on the right of action, in which the counterparty can be demanded to fulfill her obligation as specified by the contract, other legal provisions (such as unjust enrichment),⁹⁶ *negotiorum gestio*, or tort.⁹⁷ Different from the right *in rem*, the right *in personam* merely imposes duties on determinate persons.⁹⁸ The Trust Law does not explicitly indicate the attribution of beneficiary's right, which causes debates in academia.

Basically, there are two dominant views among scholars.⁹⁹ The first view regards the beneficiary's right as a right *in rem*. Li et al. think the beneficiary's right has some proprietary attributes because it attaches not only to new assets the trustee gains in the course of management but also to unjust interests the trustee obtains for self-interest.¹⁰⁰ The argument of Li et al., based on the real subrogation nature of the beneficiary's right, is backed by Xu, who further strengthens the notion by arguing that the beneficiary's right to retrieve trust assets from a third party, empowered by Article 22 and Article 49

95. Property Law of the People's Republic of China (promulgated by the People's Republic of China, Mar. 16, 2007, effective Oct. 1, 2007), art. 2 [hereinafter Property Law of China], available at http://www.npc.gov.cn/englishnpc/Law/2009-02/20/content_1471118.htm (last visited Mar. 11, 2015).

96. China GPCL, *supra* note 35, arts. 84-85.

97. *Id.* arts. 92, 93, 117.

98. Austin Scott, *The Nature of the Rights of the Cestui Que Trust*, 17(4) COLUM. L. REV. 269, 273-74 (1917).

99. Besides the two dominant views, several scholars hold the third view: the beneficiary's right is an independent right, different from the right *in rem* and the right *in personam* but compounding some of their attributes together.). See TANG YIHU, XIN TUO CAI CHAN QUAN LI YAN JIU [RESEARCH ON THE RIGHT OF TRUST ASSETS] 45 (Beijing Shi: Zhongguo zheng fa da xue chu ban she, Di 1 ban 2005). Although this view has a kind of novelty, not only does it lack strong doctrinal support, but also it blurs the cut-off line between the property and the obligation, which is the foundation of the legal architecture of civil law jurisdictions. See CHEN HUABIN, WU QUAN FA [FOREIGN PROPERTY LAW] 27 (Beijing Shi: Fa lu chu ban she, Di 1 ban 2004); Xu Wei, *Xintuo Shouyiquan: Zhaiquan? Wuquan? Yihuo Xinquanli?* [*The Nature of the Beneficiary's Right: A Property Right? An Obligatory Right? Or A New Right?*], 30(5) J. ANHUI UNIV. (PHIL. & SOC. SCI. ED.) 64, 65 (2006).

100. Li Xiaotao, Nie Ying and Yuan Xiaodong, *Xintuo Shouyiquan de Falu Xingzhi Tantaoyan* [*Exploring the Legal Nature of the Beneficial Right*], 4 SEC. MARKET HERALD 30, 32 (2012) (China). Article 14 of the Trust Law says: "The property obtained by the trustee through administering, using or disposing of the trust property or by other means falls within trust assets." Article 26 of the Trust Law stipulates: "Where the trustee, in violation of the provisions of the preceding paragraph, seeks interests for himself by using the trust property, the interests gained therefrom shall be integrated into the trust property."

of the Trust Law, is a property right.¹⁰¹ Lee, from a doctrinal perspective, suggests the classical understanding of ownership, including a bundle of rights, to be too stringent.¹⁰² She contends that the beneficiary has the right to enjoy from the trust and at the same time to exclude third parties' intervention into her enjoyment, which are essentially proprietary elements and sufficient to constitute an ownership under the Chinese trust.¹⁰³

The second view is an opposite one. Li believes the beneficiary's right is obligatory in nature because her right cannot be realized against the trust assets directly but has to rely on the performance of the trustee's obligations.¹⁰⁴ As a proponent of Li, Yuhua Zhou, who distinguishes the beneficiary's right of retrieval in the Trust Law¹⁰⁵ from the tracing process in a common law trust,¹⁰⁶ opines that the former is an obligatory right against the trustee because it is designed by imitating the creditor's right to rescind the debtor's detrimental action in the Contract Law.¹⁰⁷ Lai and Wang refute Li's notion by stating that the

101. Xu Wei, *Xintuo Shouyiquan de Falu Xingzhi Xintan [A New Review of the Attribute of the Trust Beneficial Right]*, 8(4) J. SHANGHAI UNIV. FIN. & ECON. 47, 49-50 (2006) (China); Chen Xueping, *Xintuo Shouyiren Quanli de Xingzhi: Dui renquan yihuo Duiwuquan [The Nature of the Beneficiary's Right: A Right in Personam or A Right in Rem]*, 146 J. COM. L. STUD. 73, 76-77 (2011) (China) (supporting and complementing Xu's argument). Article 22 of the Trust Law reads "If the trustee violates the purpose of the trust and disposes of the trust property, or handle the trust affairs improperly in violation of his administration duty, . . . the settlor has the right to apply to the court for setting aside such disposal, and has the right to request the trustee to restore the property to its original state or make compensation. If the transferee of the trust property knows of such violation but accepts the property, she shall return the property or make compensation. The right . . . shall be lost if the settlor does not exercise it within one year since she has come to know or should have known the reason for setting aside such disposal." The beneficiary is conferred with the same rights by Article 49.

102. Rebecca Lee, *Conceptualizing the Chinese Trust*, 58 INT'L & COMP. L. Q. 655, 666 (2009) (arguing the standard incidents of ownership in civil law jurisdictions, including the right to possess, the right to use, the right to the benefits, etc., have been surpassed the necessary requirement for a common law trust).

103. *Id.* at 665-66 (arguing the standard incidents of ownership in civil law jurisdictions, including the right to possess, the right to use, the right to the benefits, etc., surpassed the necessary requirement for a common law trust).

104. LI XIHE, LUN FALU SHANG DE GUI SHU [STUDY OF THE LEGAL ATTRIBUTION] 28 (SIFA, Di 5 Ji, Di 1 Juan [5(1) Private Law] 2005).

105. For a fuller account of the beneficiary's right of retrieval, see *infra*, notes 102-106 and accompanying context.

106. Basically, in the common law trust, the tracing is a process that allows the beneficiary to trace and identify the trust assets transferred by the trustee who breaches the trust to a third party. Unless, however, the third party is a bona fide purchaser without notice of the breach and requests the court to restore the traced assets or their substitute to the trust. See PETTIT, *supra* note 3, at 551.

107. YUHUA ZHOU, XIN TUO FA XUE [TRUST LAW] 231 (2001); Article 74 of the Contract

beneficiary's right does not contain all the attributes of a property right and so it is better to treat it as a right *in personam* under the Chinese legal system.¹⁰⁸

The first view is vulnerable. First, it conflicts with the principles of *numerus clausus* and indivisible ownership in the Chinese legal system.¹⁰⁹ The *numerus clausus* principle is fleshed out in Article 5 of the Property Law, which states: “[t]he categories and contents of the property right shall be stipulated by law.”¹¹⁰ The property rights only have three types according to the Property Law: ownership, right of usufruct, and security interest.¹¹¹ Notably, the beneficiary's right is not any one of them, Trust Law also does not label it as a property right.¹¹² The principle of indivisible ownership used has the same meaning as *dominium*, meaning there is only one title vested in one property, and this title is not dividable. As previously clarified, either the settlor or the trustee has been the owner of trust assets pursuant to the Trust Law. If the beneficiary's right is characterized as a property right or a right *in rem*, then there would be two owners of the same trust assets. This would be contrary to *dominium* (absolute ownership), which is a fundamental principle of the Property Law.¹¹³

Second, Lee's observation confuses the meaning of ownership in the common law context with that in the civil law context. The common law trust has a dual ownership structure, by which the trustee has a legal title to the trust assets prevailing against the whole world while the beneficiary holds an equitable title only prevailing against volunteers and those who have notice of the trust.¹¹⁴ The concept of equitable title

Law of China (1999) stipulates: “If a debtor disclaims its due creditor's rights or transfers gratis its property and thus causes losses to the creditor, the creditor may apply to a people's court to rescind the debtor's action. The creditor may also apply to a people's court to rescind the debtor's action if the debtor causes losses to the creditor by transferring its property at a low price evidently unreasonable and with awareness of the transferee.”

108. HEYUAN LAI & ZHICHENG WANG, XIAN DAI XIN TUO FA LUN [MODERN TRUST LAW] 99 (2002).

109. For more details of the principles of *numerus clausus* and indivisible ownership in civil law, see Avihay Dorfman, *Property and Collective Undertaking: The Principle of Numerus Clausus*, 61 U. TORONTO L. J. 467 (2011); Peter Birks, *The Roman Law Concept of Dominium and the Idea of Absolute Ownership*, ACTA JURIDICA 1 (1985).

110. Property Law of China, *supra* note 95, art 5.

111. See generally Property Law of China, particularly arts. 39, 117, 170.

112. See generally, Trust Law 2001 (China), *supra* note 18.

113. See generally LIMING WANG, WU QUAN FA YAN JIU (SHANG JUAN) [PROPERTY LAW RESEARCH (VOLUME I)] 178-86 (3rd ed. 2013) [hereinafter WANG, PROPERTY LAW RESEARCH].

114. HAYTON ET AL., *supra* note 2, at 74-75.

is different from the concept of ownership in China,¹¹⁵ which is the greatest possible interest in a thing and combines a cluster of rights that together amount to a monopoly over the thing.¹¹⁶ These rights include right to possess, right to use, right to benefit, right to alienate, right to exclude infringement, and right to create usufruct and security interest.¹¹⁷ Honoré states when the ownership is divided, as in the case of the trust that one person manages and another benefits, the monopoly no longer exists.¹¹⁸ The beneficiary's right of enjoyment and right of exclusion may constitute the equitable title in the common law trust, but it is too aggressive to treat these rights as ownership under the Chinese law.

Third, Xu's opinion regarding the beneficiary's right of retrieval is problematic. China's Property Law stipulates the right to retrieve property, by which no matter how the property is transferred and who the *prima facie* transferee is, the original owner can reclaim the property and that the transferee shall return the property unless she pays value in good faith.¹¹⁹ However, the beneficiary's right of retrieval in the Trust Law is different in three scenarios.¹²⁰ First, it has to be implemented with the aid of court, which is not necessary for the right of retrieval in the Property Law.¹²¹ Second, the Trust Law does not stipulate whether the trust assets in the possession of the transferee are segregated from the transferee's private assets. If the transferee goes bankrupt, the beneficiary will be an unsecured creditor and rank after other creditors with priority in partition of the bankruptcy estate.¹²² Third, the beneficiary's right of retrieval vanishes after one year since she knows or should have known about the transfer.¹²³ It is apparently inconsistent with the counterpart in the Property Law, where no time limitation is imposed. The beneficiary's right of retrieval is designed more like a remedial right in the Contract Law where the obligee normally has one year to set aside improper behavior of the obligor.¹²⁴ In conclusion, it is

115. Chen, *supra* note 33, at 88.

116. See generally WANG, PROPERTY LAW RESEARCH, *supra* note 113, at 393-97.

117. Property Law of China, *supra* note 95, at arts. 4, 39, 40.

118. Tony Honoré, *Trusts: The Inessentials*, in RATIONALIZING PROPERTY, EQUITY AND TRUSTS: ESSAYS IN HONOUR OF EDWARD BURN 10 (Joshua Getzler ed. 2003) [hereinafter Honoré, *Trusts: The Inessentials*].

119. Property Law of China, *supra* note 95, arts. 34, 106.

120. The beneficiary's right of retrieval is stipulated in Article 22 of the Trust Law.

121. Property Law of China, *supra* note 95, art. 106.

122. HO, TRUST LAW IN CHINA, *supra* note 24, at 175-76.

123. *Id.*

124. Contract Law of China, *supra* note 36, at arts. 55, 75, 192.

vulnerable to deem the beneficiary's right of retrieval as the right *in rem*.

It appears that the main intention of some scholars to interpret the beneficiary's right as the right *in rem* is not to sweep away impediments in practice. One reason is that creating a dual ownership architecture neatly aligns with the orthodox common law trust. As Lawson remarks, the greatest difficulty of transplantation is "an English peculiarity logically detachable from the trust, namely, the distinction between the legal and the equitable estate."¹²⁵ The other reason is that the beneficiary's right to exclude third parties and to retrieve trust assets could be justified under the theory of the right being *in rem*. These justifications, however, are questionable.

On the one hand, dual ownership is a historical result of several centuries' evolution of the trust institution rather than a necessary precondition for introducing the trust institution. Although the prevailing view treats the beneficiary's right as the right *in rem*,¹²⁶ this view has not been invariable throughout the trust's historical development. In its infant stage, common law courts viewed the trustee as the legal owner of trust assets.¹²⁷ The trustee bound herself to hold the assets for the beneficiary, whose right wholly depended on the conscientious performance by the trustee.¹²⁸ In order to protect the beneficiary's right, the equity court, as the spokesman of the King's conscience, considered it unconscionable for the trustee to ignore her self-binding obligations.¹²⁹ Therefore, it segregated the trust assets from the trustee's personal assets and delegated the beneficiary correlative rights and remedies against the trustee.¹³⁰ Equity did not stop here but extended the beneficiary's right to external parties.¹³¹ First of all, the heir and doweress of the trustee were regarded as sustaining the trustee's *persona* and thus bounded to continually perform the trustee's obligation to the beneficiary.¹³² The next step was to put the trust assets out of the reach of the trustee's creditors, though it had been more difficult to establish this rule.¹³³ After this, the beneficiary was able to

125. F. H. LAWSON, A COMMON LAWYER LOOKS AT THE CIVIL LAW 201 (1953).

126. Scott, *supra* note 98, at 289-90.

127. MAITLAND ET AL., *supra* note 4, at 111-12.

128. *Id.* at 112.

129. *Id.* at 29.

130. *See generally id.* at 23-42.

131. *Id.*

132. *Id.* at 40-41.

133. *See generally id.*, at 23-42.

enforce its right against a volunteer who came to the assets through or under the trustee.¹³⁴ Finally, equity confirmed the beneficiary's right against the transferee who acquired the trust assets in bad faith.¹³⁵ However, equity did not touch upon a bona fide transferee who purchased the trust assets for value without notice of the trust. Consequently, the evolution of trust makes the beneficiary's right have a misleading resemblance to a right *in rem*, but essentially it is a *jus in personam*.¹³⁶ Common law creates the trust not by changing the concept of property or any decision to split ownership into legal and equitable titles but by an enormous and gradual expansion of obligations.¹³⁷ Milson asserts that "equity has proved that from the materials of obligation you can counterfeit the phenomena of property."¹³⁸ The dual ownership is just a conceptual façade and therefore, as Honoré and Lupoi confirm, the transplantation of trust should not be hampered due to lack of dual ownership tradition in civil law jurisdictions.¹³⁹

On the other hand, although pursuant to the Trust Law, tracing is not available to the beneficiary, and the transferee of trust assets cannot become a constructive trustee as the common law counterpart,¹⁴⁰ there are alternative remedies in other Chinese laws. One available remedy is unjust enrichment, by which if assets are acquired improperly and without a lawful basis and result in another person's loss, the assets shall be returned to the person who suffered the loss.¹⁴¹ Honoré argues

134. *Id.* at 39-41.

135. *Id.* at 112-17.

136. *Id.* at 107; Lionel Smith, *Trust and Patrimony*, 28 *EST., TR., & PENSIONS J.* 332, 343-44 (2009) [hereinafter Smith, *Trust and Patrimony*].

137. Lionel Smith, *Transfers, in BREACH OF TRUST* 213 (Peter Birks & Arianna Pretto eds., 2002). Also see Neil Jones, *Trusts in England after the Statute of Uses: A View from the 16th Century*, in *ITINERA FIDUCIAE: TRUST AND TREUHAND IN HISTORICAL PERSPECTIVE* 173, 190 (Richard Helmholz & Reinhard Zimmermann eds., 1998) (stating that "[t]he creation of a trust is a process of cumulation, and not division [of titles]").

138. STROUD F. C. MILSOM, *HISTORICAL FOUNDATIONS OF THE COMMON LAW* 6 (2nd ed. 1981).

139. Honoré, *Trusts: The Inessentials*, *supra* note 101, at 16 (stating that "[t]here is certainly a distinction between common law and equitable interests in property, but there is no need for a trust beneficiary to be given a proprietary interest in the trust assets."); Maurizio Lupoi, *The Civil Law Trust*, 32 *VAND. J. TRANSNAT'L L.* 967, 970 (1999) (listing five elements of an appropriate definition of the trust in comparative terms, which do not include the dual ownership or the beneficiary's right *in rem*).

140. In the common law trust, when the trust assets are wrongfully transferred to a third party, the third party is treated as a new trustee holding the assets in the interest of the beneficiary. However, this rule has some caveats. See HAYTON ET AL., *supra* note 2, at 541.

141. China GPCL, *supra* note 35, at art. 92. In addition, Lupoi argues that every civil activity is bound by a "far wider and more penetrating notion of good faith," which can be a useful and

that the unjust enrichment can protect the beneficiary who “does not therefore possess, and need not be given, a real right in the trust assets.”¹⁴²

The second view, the beneficiary's right as a right *in personam*, seems reasonable in China through foregoing analyses, but its two peculiarities certainly cannot be overlooked. The first is the “relative nature” of the beneficiary's right against the trustee. As the theory of rights in civil law has shown, the obligatory right is not absolute against indeterminate persons in the world but still absolute against the determinate counterparty. The counterparty shall perform her obligations by use of all her assets, movable and immovable, present and future, unless she is incapable or goes bankrupt. Using a contract for the sale of goods as an example, the seller, after goods are delivered, can require the buyer to pay money out of all the cash and bank accounts the buyer owns until the debt is fully paid off. However, according to Article 34 of the Trust Law, “[t]he trustee shall have the obligation to pay the beneficiary [the] benefits from the trust with limits of the trust property,” and Article 16 says “[t]he trust property shall be segregated from the property owned by the trustee, and may not [be] included in, or made part of” the trustee's own property.¹⁴³ Both articles emphasize the segregation of trust assets and prohibit the beneficiary from claiming the trustee's private assets, therefore, the beneficiary's obligatory right is relative against the trustee. The beneficiary's right is only absolute against the trustee within the spectrum of trust assets.

The second peculiarity is called “bankruptcy remoteness.” If a debtor is bankrupt, the bankruptcy procedure first freezes the debtor's business, including the performance of obligations.¹⁴⁴ All the properties she owns become bankruptcy estate¹⁴⁵ and her creditors cannot realize their interests unless they claim interests to the liquidator and wait for the distribution of liquidated assets. This asset distribution process is governed by the *pari passu* rule, where all debts rank equally, and all creditors are distributed in proportion to the size of their admitted

flexible tool to protect the beneficiary. See Lupoi, *The Civil Law Trust*, *supra* note 139, at 971.

142. Honoré, *Trusts: The Inessentials*, *supra* note 118, at 20.

143. Trust Law 2001 (China), *supra* note 18, art. 14, 36.

144. Zhonghua Renmin Gongheguo Qiye Pochan Fa (中华人民共和国企业破产法) Enterprise Bankruptcy Law of the People's Republic of China (promulgated by the People's Republic of China, Aug. 27, 2006, effective Jun. 1, 2007), art. 20 [hereinafter Bankruptcy Law of China].

145. *Id.* art. 30.

claims.¹⁴⁶ If debts have priorities, such as set-off, preferential debts, liquidation costs, employees' salaries, and debts with securities,¹⁴⁷ the obligatory right is subordinated until all prior claims have been fully paid off. The trustee declaring bankruptcy, however, does not affect the beneficiary's right. Article 16 of the Trust Law provides that "[w]here the trustee dies or the trustee as a body corporate is dissolved, removed, or is declared bankrupt . . . the trust property shall not be deemed his legacy or liquidated property."¹⁴⁸

V. CONCEPTUALIZING CHINA'S TRUST LAW

China's trust institution has three characteristics: the indeterminate title to trust assets, the settlor's extensive rights, and the beneficiary's right *in personam* with two peculiarities. In retrospect of the legislation of China's Trust Law, the impediments on its rocky path are two-fold. On the one hand, the Trust Law is supposed to be designed for easy reception since it is a novel regime to the general public and most people have no recognition of the concept, functions, virtues, or vices of the trust. This reason was a major consideration of why politicians and legislators adopted the indeterminate ownership model and conferred such extensive powers to the settlor. On the other hand, the common law trust, as a result of such a model, is incompatible with the civil law system in China. The Trust Law has to deal with the technical feasibility of embedding the trust regime into the Chinese legal system without legal objections. The notion that the beneficiary's right is a right *in personam* broadly accords with China's legal architecture, particularly the principles of *numerus clausus* and indivisible ownership, though its two derivative peculiarities need more elaboration.

These characteristics bring about many unintended debates, confusion in theory, and obstacles in practice. The amendment of the Trust Law is of course a direct and thorough way,¹⁴⁹ but it is the last resort due to the difficulty and costliness to open amendment procedure. Even though the law will likely be revised, the conceptual foundation of the trust institution still needs clarification, especially the two peculiarities of the beneficiary's right. As scholars point out, China's

146. ROY GOODE, PRINCIPLES OF CORPORATE INSOLVENCY LAW 235 (4th ed. 2011).

147. See generally *id.* at 247-57.

148. Trust Law 2001 (China), *supra* note 18, art. 16.

149. As the Chairman of the Drafting Committee of China's Trust Law, Wang said that the ambiguous ownership would be the first to be rectified in the future amendment of the Trust Law. See generally Qin, *Trust Law: the Impediments*, *supra* note 57.

Trust Law merely copies some articles, but the conceptual basis on which these articles are fleshed out is lacking.¹⁵⁰

A. Contract Theory

Contract theory (well-recognized and well-established in China) has been heavily relied upon by legislatures to incorporate the common law trust in its laws. As mentioned, a Chinese trust takes effect depending on the effectiveness of its underlying contract rather than the transfer of trust assets. Currently, most trusts in China are business deals instead of gratuitous transfers like the traditional common law trust.¹⁵¹ Therefore, it is near instinctual for those in China to reference to contract law when attempting to conceptualize trust law. Some scholars treat Chinese trusts as a form of entrusted agency, meaning that an agent performs civil juristic acts within the ambit authorized by the principal in an entrustment contract.¹⁵² Because the principal does not need to transfer the ownership of relevant assets to the agent in the entrusted agency,¹⁵³ it comfortably fits the indeterminate ownership model. Moreover, the principal has extensive rights in the entrusted agency, similar to that of the settlor in a trust.¹⁵⁴ For instance, the agent must “handle the entrusted affairs in accordance with the instructions of the principal,” and the instructions cannot be modified without the consent of the principal.¹⁵⁵

The similarities between the entrusted agency and trust only mean that “agents and trustees have something in common,” but that does “not necessarily mean that an agent is a trustee or that a trustee is an

150. Reid, *Conceptualizing*, *supra* note 43, at 212 (stating China's Trust Law says what happen by presenting necessary rules but does not say why because “the concepts that must underpin them are often absent”); Lee, *supra* note 88, at 656 (stating “a conceptual framework is indispensable to the resolution of many trust issues and explanation of the core features of a Chinese trust”).

151. John Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 YALE L. J. 165, 166-67 (1997) (advocating the contractarian basis of trust law on the ground that the traditional explanation of the trust bases on gratuitous transfers while most of trusts today are used in commercial fields, and the commercial trust is “the easiest case for the view that trusts are deals”).

152. China GPCL, *supra* note 35, at arts. 63-65; Contract Law of China, *supra* note 36, at art. 396.

153. Lee, *supra* note 102, at 660.

154. *Id.*

155. Contract Law of China, *supra* note 36, at art. 399; see GAO FUPING, MING FA XUE [CIVIL LAW] 287-94 (Beijing: Fa Lu Chu Ban She, Di 2 ban [2nd ed.] 2009 [hereinafter GAO, MING FA XUE]).

agent.”¹⁵⁶ They differ in some considerable aspects. First, the trustee acts in her own name¹⁵⁷ rather than in the name of the principal as that in the entrusted agency.¹⁵⁸ The trustee, as mentioned in previous sections, has initiative and discretion to manage trust assets subject to the trust instrument. An agent, on the contrary, has a less independent position because the agent’s behavior must strictly comply with the principal’s instructions.¹⁵⁹ Second, the entrusted agency is terminated when the agent resigns or when the agent or the principal dies or goes bankrupt.¹⁶⁰ A trust is different in that it continues to exist in the scenarios where an agency relationship is terminated.¹⁶¹ Third, there is no segregation of the property in the entrusted agency even if the property is under the control of the agent. The agent must “hand over to the principal any property acquired in handling the entrusted affairs”¹⁶² whereas the trust assets are always segregated from the private assets of the settlor or of the trustee.¹⁶³ Finally, the entrusted agency fails to explain non-self-benefit trusts. The entrusted agency is set up by a bilateral entrustment contract.¹⁶⁴ If the agent was the trustee and the principal was the settlor, then who is the beneficiary in the entrustment contract? The principal here would also serve as the beneficiary because the agent handles entrusted affairs for the benefit of the principal. Put differently, the entrusted agency may only explain the self-benefit trust where the settlor is the beneficiary at the same time.

In order to explain the non-self-benefit trust, a third-party-beneficial contract (*stipulatio alteri*) is proposed, which refers to a trilateral contract established in favor of a third party who has not

156. RAPHAEL POWELL, LAW OF AGENCY 25 (2nd ed. 1961).

157. Trust Law 2001 (China), *supra* note 18, at art. 2.

158. In the GPCL, the agent must disclose that she acts in the name of the principal. However, the rule of agent identity disclosure is relaxed by the Contract Law, which on exceptional basis recognizes the effectiveness of the entrusted agency where the agent acts in her own name. *See* Contract Law of China, *supra* note 29, at arts. 402-03; GAO, MING FA XUE, *supra* note 155, at 229.

159. PETTIT, *supra* note 3, at 29.

160. China GPCL, *supra* note 35, at art. 69; Contract Law of China, *supra* note 36, at art. 411.

161. Article 52 of the Trust Law stipulates: “A trust will not be terminated due to the facts that the settlor or trustee dies, loses his civil capacity for civil conduct, the trusteeship is dissolved or canceled according to law or he is declared bankrupt according to law, neither will it be terminated due to the fact that the trustee resigns.”

162. Contract Law of China, *supra* note 36, art. 404.

163. Trust Law 2001 (China), *supra* note 18, arts. 15-16.

164. Contract Law of China, *supra* note 36, art. 396.

assented but has been provided a legal right to enforce the contract.¹⁶⁵ Lawson points out that “the three-cornered relation [in a trust] . . . is easily explained in the modern law in terms of a contract for the benefit of a third party.”¹⁶⁶ Langbein, comparing doctrines and functions of the trust with that of a third-party-beneficial contract, also concludes that the trust, a deal between the settlor and the trustee, is “functionally indistinguishable from the modern [day] third-party-beneficiary contract.”¹⁶⁷ Under the third-party-beneficial contract, the creditor has rights to require the debtor to perform obligations on behalf of the third party, and so does the trust’s settlor. The debtor owes obligations to the third party, and the third party has rights but not obligations, just like the trustee and the beneficiary in a trust. Moreover, the third party only has a right *in personam* against the debtor, similar to the nature of the beneficiary’s right.

There are, however, criticisms against this theory by many common law scholars.¹⁶⁸ There are significant obstacles to it being used as a conceptual basis of Chinese trust. First, the legitimacy of the third-party-beneficial contract is still controversial in China. The Contract Law describes a circumstance resembling the third-party-beneficial contract but is silent over the third party’s right of action against the debtor.¹⁶⁹ It is therefore unclear whether the third party can demand the debtor’s performance directly and, in the case of non-performance, also claim damages.¹⁷⁰ Second, the position of the third party is not identical

165. EWAN MCKENDRICK, *CONTRACT LAW* 175-76 (9th ed. 2011).

166. LAWSON, *supra* note 125, at 200.

167. John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 *YALE L. J.* 625, 627, 657-60 (1995) (arguing the trust and the third party beneficiary contract are the closest of substitutes).

168. LAU, *supra* note 78, at 21-35 (pointing out seven anatomical differences between trusts and contracts and arguing that Langbein’s account only address some of them, none of which is particularly satisfactory); David Hayton, *The Distinctive Characteristics of the Trust in Anglo-Saxon Law*, *King’s College London Teaching Material* (2005) 1-8, http://www.kcl.ac.uk/depsta/law/students/grad/llm/study/trust_law/resources/distinctive_characteristics_of_the_trust_paper1.pdf (last accessed on Nov. 1, 2013) (arguing that the concept of third-party-beneficial contract misleads civil lawyers to consider the Anglo-Saxon trust as a glorified form of the third-party-beneficial contract).

169. Contract Law of China, *supra* note 36, art. 64 (“Where the parties agree that the debtor shall discharge the debts to a third party and where the debtor fails to do so . . . , the debtor shall bear the liability for breach of contract to the creditor.”).

170. BING LING, *CONTRACT LAW IN CHINA* 254 (2002) (arguing that the third party has right of action against the debtor for performance, but the third party cannot exercise certain remedies such as rescission or termination of contract); Liwei Guo and Xiaodong Liu, *Hetongfa Yingdang Mingque Guiding Disanren Liyi Hetong [The Contract Law Should Expressly Stipulates the Third-Party-Beneficial Contract]*, 7(5) *J. SOUTHWEST U. POL. & L.* 121, 123-24 (2005) (arguing

to that of the beneficiary. The third party is like a donee, whose right under the contract is like a gratuitous gift from the obligee (donor). According to the Contract Law, the position of the donee is unstable and the protection on her right is quite weak because the obligee, the so-called donor, may cancel the donation within her own determination prior to the transfer.¹⁷¹ On the contrary, the settlor cannot individually revoke the beneficiary's right.¹⁷² Finally, this theory is unable to explain the indeterminate ownership of trust assets as well as the two peculiarities of the beneficiary's right.

In spite of notable doctrinal discrepancies between contract and trust, many Chinese judges have still discerned trust by virtue of contract, which has caused confusion of the two institutions in practice. In the case *Shanghai Pubei v Qingtai Trust*,¹⁷³ the plaintiff (Shanghai Pubei) transferred funds to the defendant (Qingtai Trust) and entrusted the defendant to buy treasury bonds. According to their agreement, the plaintiff owned the funds, but the defendant could use them; treasury bonds were owned by the plaintiff but under the custody of the defendant.¹⁷⁴ Apparently, an entrustment contract was created—the plaintiff was the principal while the defendant was the entrusted agency.¹⁷⁵ The Shanghai No. 2 Intermediary Court appreciated this fact and made its decision by invoking the Contract Law and, astonishingly, the Trust Law as well. In another case, *Huabao Trust v Shanghai Yanxin*,¹⁷⁶ the appellee (settlor/Shanghai Yanxin) transferred funds to the appellant (trustee/Huabao Trust) and required the trustee to buy and hold shares in the interest of the settlor (a self-benefit trust). When the settlor transferred her beneficial right on shares to a third party (Shanghai Zhizhen) without prior consent from the trustee, the trustee refused to alter the beneficiary of shares to the third party. The trustee

the third party has no right of action against the debtor or the creditor according to current Contract Law).

171. Contract Law of China, *supra* note 36, at art. 186.

172. Unless the beneficiary commits a serious tort against the settlor or other co-beneficiaries, or the beneficiary so consents, the settlor cannot deprive the beneficiary's right. *See* Trust Law 2001 (China), *supra* note 18, at art. 51.

173. Shanghai Pu Bei Ranqi Youxian Gongsi v. Qing Tai Xintuo Touzi Youxian (上海浦北燃氣有限公司v慶泰信託投資有限) [Shanghai Pubei Gas Co. v. Qingtai Trust Investment Co.], (Shanghai Intern. People's Ct. Feb. 25, 2005).

174. *Id.*

175. *Id.*

176. Hua Bao Xintuo Touzi Youxian Zeren v. Shanghai Yan Xin Shiye Touzi Youxian Gongsi (華寶信託投資有限責任v上海岩鑫實業投資有限公司) [Huabao Trust Investment Co. v. Shanghai Yanxin Shiye Investment Co.], (Shanghai High Ct. 2004).

argued that the transfer was not an assignment of the beneficiary's right but a general assignment of all the rights and obligations of the settlor and beneficiary (the settlor is the beneficiary concurrently), so the transaction should be re-characterized as a novation of contractual party, which required consent of the contractual counterparty—the trustee.¹⁷⁷ Regrettably, the Shanghai High Court, applying the contract theory to explain the trust transaction, agreed with the trustee's argument.¹⁷⁸

B. Special Patrimony Theory

Patrimony is an old terminology potentially dating back to the ancient Roman law.¹⁷⁹ The old patrimony theory deems a patrimony as a collection of a person's assets: "each person has a patrimony, but only one; the patrimony is indivisible; and the patrimony cannot be transferred, *inter vivos*, as a whole."¹⁸⁰ The old patrimony theory, however, becomes unsatisfactory and even unworkable as the juristic doctrine evolves.¹⁸¹ The modern patrimony theory treats the patrimony as the totality of a person's assets and liabilities.¹⁸² The patrimony looks

177. *Id.*

178. China's Trust Law neither clarifies whether the settlor's right is transferable nor indicates the replacement of settlor. Therefore, the Shanghai High Court opined that the status as settlor could be transferred because of no prohibition in the Trust Law. Actually, the Shanghai High Court misunderstood the trust institution. The settlor is the person who creates the trust, and her status cannot be changed. In common law, the settlor is generally out of the trust relationship once the trust is successfully constituted, and it is absurd that the settlor can transfer her rights and obligations to a third party. Because the Shanghai High Court comprehended the trust by virtue of doctrines of contract law, it wrongfully concluded that the settlor's status and her rights and obligations could be transferred along with the transfer of beneficial interests on trust assets. In the above-mentioned case *Beijing Haidian v Shenzhen Xinhua*, the Chongqing High Court holds the same view with the Shanghai High Court. For a fuller commentary on *Beijing Haidian*, see generally Ho, *Trust Laws in China: History*, *supra* note 54, at 203-06.

179. George Gretton, *Trusts without Equity*, 49 INT'L & COMP. L. Q. 599, 608-09 (2000) [hereinafter Gretton, *Trusts without Equity*]; Ross Anderson, *Words and Concepts: Trust and Patrimony*, in JUDGE AND JURIST: ESSAYS IN MEMORY OF LORD RODGER 354 (Andrew Burrows, David Johnston & Rein Zimmermann eds., 2013) (stating that "it is unlikely that the Romans ever worked out a consistent separation between individual assets – *bona* – and a university of individual assets: the whole patrimony . . . But the fundamentals [of patrimony] are there").

180. Anderson, *supra* note 179, at 356 (summarizing the old patrimony theory formulated by Charles Aubry and Frederic-Charles Rau).

181. *Id.*; George Gretton, *Up There in the Begriffshimmel*, in THE WORLDS OF THE TRUST 534 (Lionel Smith ed. 2013) (refuting the 'one person, one patrimony' doctrine by stating that it is "not a doctrine of the civil law tradition in general, but rather a doctrine developed for French law by Aubry and Rau in the nineteenth century").

182. Kenneth Reid, *Patrimony Not Equity: the Trust in Scotland*, 3 EUR. REV. PRIVATE L. 427, 432 (2000) [hereinafter Reid, *Patrimony Not Equity*]; Gretton, *Trusts without Equity*, *supra*

like a container that treats the liabilities and assets as a fluctuating whole unit; this way, the specific contents in the container are not treated separately and individually.¹⁸³ Moreover, the modern patrimony theory acknowledges divisible patrimony in some circumstances where a person may own “both his own general or private patrimony and at the same time a special patrimony dedicated to some specific purpose.”¹⁸⁴ The two patrimonies are kept distinct by independent labeling and accounting. The assets of one patrimony cannot be transferred to the other.¹⁸⁵

French jurist Pierre Lepaulle was the first to use the theory of special patrimony (also known as “the theory of separate patrimony”) to interpret the common law trust in the civil law context.¹⁸⁶ Lepaulle argued that the trust could be explained as a legal institution, consisting of a special patrimony “independent of any legal person, whose unity [was] defined by an appropriation.”¹⁸⁷ Lepaulle’s statement raised two notions. First, the trust assets are separated from the general patrimony of the settlor and become a special patrimony (called “trust patrimony”). Second, the trust patrimony can be appropriated to a trust purpose with the result that it is not owned by any legal subject.¹⁸⁸ Although Lepaulle’s explanation of trust may be wanting, his first notion has been influential in the civil law world. Mexico, as the pioneer, applied the special patrimony theory in drafting its trust statute in 1932.¹⁸⁹ Luxembourg recognized the special patrimony theory and took it as the conceptual basis of its transplanted trust regime in 2003,¹⁹⁰ so were France in 2007,¹⁹¹ and Romania in 2011.¹⁹² The special patrimony theory

note 179, at 608.

183. Smith, *Trust and Patrimony*, *supra* note 136, at 335.

184. Reid, *Conceptualizing*, *supra* note 43, at 225.

185. Reid, *Patrimony Not Equity*, *supra* note 182, at 432.

186. Ho, *Trust Laws in China: History*, *supra* note 54, at 1 (explaining that “The French jurist Pierre Lepaulle argued that the common law trust could be best understood, in civilian terms, as a patrimony by appropriation. This argument has been influential in some civilian receptions of the trust.”).

187. Smith, *Trust and Patrimony*, *supra* note 136, at 334.

188. *Id.* at 337.

189. Roberto Molina Pasquel, *The Mexican Fideicomiso: The Reception, Evolution and Present Status of the Common Law Trust in a Civil Law Country*, 8 COLUM. J. TRANSNAT’L L. 54, 62-67 (1969).

190. Thibaut Partsch & Jeremie Houet, *Article: Country Report: Luxembourg*, 18 COLUM. J. EUR. L. ONLINE 55, 59 (2012).

191. The Law 2007-2011 in 19 February 2007 introduced the notion of “*fiducie*” and inserted it into Article 2011 of the French Civil Code (stating that in a *fiducie* a special patrimony is created which is not part of the settlor’s patrimony and does not form part of that of the trustee

is also recognized in Latin America.¹⁹³ In spite of no domestic trust code in Italy, the Italian law has already used the special patrimony theory to perceive business trusts like securitization and pension funds.¹⁹⁴

Lepaulle's second notion in fact answers the question of the title locus of the trust patrimony. Although the special patrimony as *bona vacantia* can be seen in some jurisdictions such as Québec,¹⁹⁵ it has been widely accepted that it is better for the trustee to act as the owner of the special patrimony.¹⁹⁶ If the special patrimony is ownerless, then many uncertainties may occur in practice, such as who will register the property, who will be taxed, who has *locus standi* to bring an action, and who can acquire the residual interests after the termination of trust. All these uncertainties require specific rules to clarify in the ownerless model, but that is not the case in the trustee-owned model, where the trust patrimony is vested in the trustee but also segregated from the general patrimony of the trustee. The beneficiary has an obligatory right against the trustee within the scope of the trust patrimony.¹⁹⁷ The trust patrimony contains trust assets as well as liabilities, where trust assets are only answerable to trust liabilities.¹⁹⁸

The trustee-owned special patrimony is a native species in Scotland, a mixed jurisdiction with public traditions in its property law.¹⁹⁹ This notion has also been followed by some model laws. The

either). See Valerio Forti, *Comparing American Trust and French Fiducie*, 17 COLUM. J. EUR. L. 28-29 (2011).

192. Article 773 of the New Civil Code of Romania states "the fiducia is the legal operation whereby one or more grantors transfer various patrimonial rights or a group of such patrimonial rights, present or future, to one or more trustees, who administer those with a given purpose, to the benefit of one or more beneficiaries. These rights constitute an autonomous patrimony, separate from the other rights and obligations in the fiduciary's own patrimony." See Luminita Tuleasca, *The Concept of the Trust in Romanian Law*, 6(2) ROMANIAN ECON. & BUS. REV. 150, 157 (2011); Codul Civil [Civil Code] art. 773.

193. Dante Figueroa, *Civil Law Trusts in Latin America: Is the Lack of Trusts an Impediment for Expanding Business Opportunities in Latin America?*, 24(3) ARIZ. J. INT'L & COMP. L. 700, 703-07 (2007).

194. James Koessler, *Is There Room for the Trust in a Civil Law System? The French and Italian Perspective*, 18 (March 2012), <http://www.jameskoessler.com/wp-content/uploads/2012/08/Trust-in-Civil-Law.pdf>.

195. Civil Code of Québec, S.Q. 1991, c. 64, arts. 1260-61 (Can.).

196. Reid, *Conceptualizing*, *supra* note 43, at 229.

197. Magda Raczynska, *Parallels between the Civilian Separate Patrimony, Real Subrogation and the Idea of Property in a Trust Fund*, in THE WORLDS OF THE TRUST 480 (Lionel Smith ed. 2013) (concluding that in civil law "a mere existence of a separate patrimony . . . is not sufficient to say that the beneficiary of such an arrangement has a proprietary right").

198. Smith, *Trust and Patrimony*, *supra* note 136, at 341.

199. George Gretton, *Trusts*, in A HISTORY OF PRIVATE LAW IN SCOTLAND (VOLUME 1:

Draft Common Frame of Reference (DCFR), which tries to provide common principles, definitions, and model rules of the European private law, drafts that “the trustee is the person in whom the trust fund becomes or remains vested,”²⁰⁰ and “the trust fund is to be regarded as a patrimony distinct from the personal patrimony of the trustee and any other patrimonies vested in or managed by the trustee.”²⁰¹ The Draft of the EU Directive on Protective Funds, based on the Principles of European Law 1999, is very close to the DCFR regarding the trust definition. In the Draft Directive, “assets are owned by an administrator [*i.e.* trustee] for the benefit of one or more beneficiaries,”²⁰² and “the assets of a protected fund form a patrimony separate from the private patrimony of the person who is administrator and from the patrimony of any other protected fund held by that person.”²⁰³

The special patrimony theory, with increasing reception in the civil law world, certainly has remarkable values for China.²⁰⁴ Although none of articles in the Trust Law directly mention the special patrimony, the theory deserves close attention when conceptualizing China’s Trust Law.²⁰⁵ Indeed, the Trust Law can be reasonably conceptualized by this theory. First, many articles in the Trust Law illustrate the segregation of trust assets. The trust assets “shall be segregated from the property owned by the trustee”²⁰⁶ as well as non-trust properties owned by the

INTRODUCTION AND PROPERTY) 480-517 (Kenneth Reid & Reinhard Zimmermann eds., 2000) (elaborating the origination and development of the unique trust institution in Scotland as well as influences from English law); M.J. de Waal & R.R.M. Paisley, *Trusts, in MIXED LEGAL SYSTEMS IN COMPARATIVE PERSPECTIVE: PROPERTY AND OBLIGATIONS IN SCOTLAND AND SOUTH AFRICA* 839-42 (Reinhard Zimmermann, Daniel Visser & Kenneth Reid eds., 2004) (introducing the trustee-owned special patrimony regime in Scots law).

200. DCFR X. – 1:203: Parties to a trust (2). See PRINCIPLES DEFINITIONS & MODEL RULES OF EUROPEAN PRIVATE LAW: DRAFT COMMON FRAME REFERENCE 502 (Christian von Bar et al. eds., 2009) [hereinafter PRINCIPLES DEFINITIONS & MODEL RULES].

201. *Id.*; DCFR X. – 1:202: Special legal effects of a trust (1).

202. Article 3.1, Draft EU Directive on Protected Funds. See TOWARDS AN EU DIRECTIVE ON PROTECTED FUNDS (S.C.J.J. Kortmann et al. eds., 2009), available at <http://www.globalcoe-waseda-law-commerce.org/activity/pdf/26/06.pdf> (last visited on Nov. 1, 2013).

203. Article 3.2, Draft EU Directive on Protected Funds.

204. Some Chinese scholars have shown preliminary interest in the separate patrimony theory. See Yan, *supra* note 43, at 60-68; Qingchi Li, *Zuwei Caituan de Xintuo: Bijiaofa shang de Kaocha he Fenxi [The Trust as Patrimony: Analyses from a Comparative Perspective]*, 43(4) J. PEKING U. 130 (Phil. & Soc. Sci. ed. 2006) 130 (China).

205. Reid, *Conceptualizing*, *supra* note 43, at 228-29 (arguing that the fact that the Trust Law does not clearly mention the special patrimony is not a sufficient reason to deny the patrimony theory).

206. Trust Law 2001 (China), *supra* note 18, art. 16; see also *Xintuo Gongshi Guanli Banfa (信托公司管理办法 [Measures for the Administration of Trust Companies])* (promulgated by China Banking Regulatory Commission, Jan. 23, 2007, effective March 1, 2007) art. 3 [hereinafter

settlor.²⁰⁷ The trustee must administer the trust assets separately from her personal assets with separate accounting books.²⁰⁸ Correspondingly, the obligatory right, which occurs due to the trust administration, cannot be set off against the trustee's private debts.²⁰⁹ The trustee is prohibited from appropriating the trust assets or commingling them into her personal assets.²¹⁰ Without contrary provisions in the trust instrument or consent from the settlor or beneficiary, both the self-dealing between the trustee's personal assets and the trust assets as well as the cross-dealing between different trust assets managed under different trust schemes by the same trustee, are not allowed, the dealing is "conducted at fair market price."²¹¹ At last, new assets obtained in the course of trust management, such as transaction considerations and investment revenues, are also trust assets.²¹² It works in concert with the doctrine of real subrogation in the patrimony theory—a new asset exchanged by the original asset in the patrimony still belongs to that patrimony.²¹³

Second, China's Trust Law stipulates the segregation of trust liabilities. The trustee may incur debts both in her private life and in the course of trust management, so she has private creditors (due to private liabilities) and trust creditors (due to trust liabilities). In the common law, however, trust liabilities do not exist.²¹⁴ The trustee is always personally liable for debts incurred in handling trust affairs. She pays trust creditors out of her personal assets and then has an equitable right to reimburse herself out of the trust assets. Unpaid trust creditors can only execute against the trustee's equitable right of reimbursement, and they have no direct claim against the trust assets.²¹⁵ This principle,

MATC].

207. Trust Law 2001 (China), *supra* note 18, art. 15.

208. *Id.* art. 29.

209. *Id.* art. 18.

210. *Id.* art. 27; Article 26 of the Trust Law provides if the trustee violates the Law and "seeks for interests for himself by using the trust property, the interests gained therefrom shall be integrated in to the trust property."

211. *Id.* art. 28.

212. *Id.* art. 14.

213. Gretton, *Trusts without Equity*, *supra* note 179, at 609-10.

214. See Lionel Smith, *Mistaking the Trust*, 40 HONG KONG L. J. 787, 797-98 (2010) (arguing the common law trust is "a way of holding property," not liability and the trustee never holds liabilities in trust, only assets).

215. See Lionel Smith, *Scottish Trusts in the Common Law*, (Dec. 7, 2010) (Paper of the 2010 W.A. Wilson Memorial Lecture) 6, available at <http://ssrn.com/abstract=2241330> (forthcoming in 17(3) EDINBURGH L. REV. (2013)) [hereinafter Smith, *Scottish Trusts in the Common Law*] (explaining that "In the common law trust, the trustee is always personally liable for obligations incurred in the course of administration of the trust.").

articulated in the leading case *Jennings v Mather*,²¹⁶ can be paraphrased as that the common law trustee only has a segregation of assets (private assets and trust assets) but not liabilities (personal liabilities only).²¹⁷ In contrast, China's Trust Law separates both assets and liabilities. Trust assets are answerable to trust liabilities. When trust creditors require the trustee to fulfill her trust liabilities, they can request the court to execute the trust assets directly.²¹⁸ If this direct execution right was not stipulated, then trust creditors may not receive sufficient protection under China's Trust Law. Although trust creditors in China, as their common law counterparts, may indirectly realize their rights through the trustee's reimbursement from the trust assets,²¹⁹ the trustee will be divested the right of reimbursement when she commits a breach of trust.²²⁰ Of course, the trustee is required to pay trust creditors out of her personal assets in this case, but the problem is that when the trustee in breach of trust goes bankrupt or incapable, the successive trustee has no liability to cover the original trustee's fault.²²¹ This problem, sensibly

216. *Jennings v. Mather* [1902] 1 KB 1 (Eng.). In this case, Jennings was a trust creditor of the trustee Mather when he was carrying on the business in accordance with the trust. Jennings, being unable to obtain payment, sued Mather and got a judgment to execute the trust assets. In the meantime, Mather had been adjudicated bankrupt, and his liquidator claimed the trust assets seized by Jennings to be the bankruptcy estate of Mather. The county court believed that the trust assets seized by the trust creditor for debt redemption did not pass to the bankruptcy liquidator of the trustee, and therefore gave judgment for Jennings. When the case was appealed to the Queen's Bench and then the King's Bench, both Benches disagreed with the county court. Kennedy J. in the Queen's Bench said that the trustee had a right to an indemnity from the trust assets to repay trust creditors, and this right was equitable or a lien over the trust assets. When the trustee went bankrupt, his lien or equitable right on behalf of the trust creditor was transferred to the liquidator. *See Jennings v. Mather*, [1902] 1 Q.B. 108, 117 (Eng.). In the King's Bench, Mathew L.J. said "It would be obviously impossible that the execution creditor should be entitled to have property which was vested in Mather upon the trusts of the deed taken in execution for a debt for which Mather was personally liable." *Jennings*, 1 K.B. 1 at 7-8. In conclusion, judges asserted that the trust creditor could not satisfy his claim by directly seizing the trust assets but by realizing the trustee's equitable right to reimburse out of the trust assets. *See also* Philip Pettit, *EQUITY AND THE LAW OF TRUSTS* 413-14 (12th ed. 2012); *Perring v Draper* [1997] EGCS 109 (Eng.).

217. Smith, *Scottish Trusts in the Common Law*, *supra* note 215, at 5-6.

218. Trust Law 2001 (China), *supra* note 18, at art. 17.

219. *Id.* art. 37 (explaining that "The charges paid and the debts owed to a third party by the trustee in the course of handling trust business shall be borne by the trust property. Where the trustee effects such payment in advance with his own property, he shall have the priority right to be paid with the trusted property.").

220. *Id.* art. 36 (emphasizing that "Where the trustee disposes of the trust property against the purpose of the trust or causes losses to the trust property due to his departure from his administrative duties or his improper handling of trust business, he may not ask to be paid before he restores the property to its former state or makes compensation.").

221. *Id.* art. 41 (If the former trustee is dissolved or declared bankrupt, he shall "[hand] over

handled by virtue of the separation of liabilities in China, has been a concern in the world of common law.²²²

Third, the separate patrimony theory can explain the relative nature of the beneficiary's right, which requires the trustee to transfer benefits to the beneficiary only within the value of trust assets.²²³ The beneficiary cannot extend her right to the private assets of the trustee or of the settlor.²²⁴ Furthermore, in the event that the trustee simultaneously manages several trust schemes, the beneficiary of one trust scheme cannot acquire benefits from another trust scheme.²²⁵ These scenarios are consistent with the separate patrimony theory, where the beneficiary only has interests in the specific trust patrimony.²²⁶

Fourth, the separate patrimony provides a sound theoretical base to the hallmark of bankruptcy remoteness of the beneficiary's right. Pursuant to the bankruptcy rule, when the trustee is bankrupt, her private creditors, trust creditors, and the beneficiary may lay claims to her assets. The Trust Law, however, overrides the bankruptcy rule. The trust assets do not belong to the liquidated assets of either the settlor or the trustee.²²⁷ The trust continues to exist for the benefit of the beneficiary.²²⁸ The private creditors cannot attach the trust assets for debt payoffs. The trustee's liquidator should fully preserve the trust assets prior to a new trustee taking over the trust affairs.²²⁹ Why are the trust assets immune from the bankruptcy? Why are the private creditors unable to attach trust assets? Neither the entrusted agency nor the third-

the trust property and affairs to the new trustee . . . [and] shall be exempted from the liability for issues listed in the report, *except for the illegitimate acts committed by him.*") (emphasis added).

222. Professor Smith states that in the common law trust, the trust creditor loses any access to the trust property if the trustee has lost his right of indemnity against the trust assets. This problem has resulted in reforms in many common law jurisdictions, such as the United States and Jersey. Professor Smith observes that "[t]his represents a significant change to the common law trust's original structure," and the common law trust, to some extent, is moving towards the Scottish trust, which is conceptualized by the separate patrimony theory. For a fuller account, *See* 2010 W.A. Wilson Memorial Lecture, *supra* note 215, at 29-35.

223. Trust Law 2001 (China), *supra* note 18, art. 34.

224. *Id.* art. 15.

225. *Id.* art. 29.

226. Gretton, *Trusts without Equity*, *supra* note 179, at 612. As an exception, the beneficiary can acquire interests of the private assets of the trustee when the trustee breaches the trust instrument. *See id.* art. 37.

227. Trust Law 2001 (China), *supra* note 18, at arts. 15-16; Xintuo Gongshi Guanli Banfa (信託公司管理辦法) [Measures for the Administration of Trust Companies] (promulgated by China Banking Regulatory Commission, Jan. 23, 2007, effective March 1, 2007) art. 3 [hereinafter MATC].

228. Trust Law 2001 (China), *supra* note 18, at art. 52.

229. *Id.* art. 39.

party-beneficial contract could provide a desirable explanation. Yet the separate patrimony makes sense. If the trustee is presumed as the owner of the trust patrimony, the liabilities and assets in the trust patrimony are distinct from the trustee's private patrimony. "In this way there is segregation not only of assets . . . but of liabilities as well," says Reid.²³⁰ "Each patrimony thus has its own creditors."²³¹ Only the private patrimony can be used to pay the private creditors, and only the beneficiary and trust creditors can claim from the trust patrimony. Therefore, the beneficiary and trust creditors exclude the private creditors' attachment on the trust assets "not because they have a right which is real or quasi-real but because they have a right in a different patrimony."²³² The conclusion is no different when the settlor, under China's indeterminate ownership model, is the owner of the trust patrimony.

Fifth, the separate patrimony theory may work well even when the ownership of trust assets is indeterminate. The trust patrimony is segregated from the settlor's private patrimony as well as the trustee's private patrimony. The trust patrimony is like a juristic person to some degree. Perhaps this is why the trust patrimony can exist as *bona vacantia* in some jurisdictions, such as in Quebec.²³³ Although it is preferential to vest the trust patrimony in the trustee, the ownership actually is not significant according to the nature of trust patrimony. The really important element is the administration of trust patrimony in the best interest of the beneficiary.

Sixth, the separate patrimony theory may ameliorate the Trust Law by restraining the settlor's extensive rights when she owns the trust assets. Under the special patrimony theory, the owner of assets in the trust patrimony will be automatically bound by liabilities in it.²³⁴ The fiduciary duty and duty of care imposed on the trustee by Article 25 of the Trust Law are not only the trustee's liabilities but also liabilities contained in the trust patrimony. Therefore, when the settlor is the owner of the trust patrimony, it may be reasonable to infer that the settlor also bears the fiduciary duty and duty of care, although the Trust Law does not incorporate such requirement directly.²³⁵ The fiduciary

230. Reid, *Conceptualizing*, *supra* note 43, at 226.

231. *Id.* at 225.

232. *Id.* at 226.

233. *Id.* at 226, 228.

234. *See id.*

235. Professor Kenneth Reid thought that this argument might be bold. On the basis of the patrimony practice in Scotland, he doubted that the idea of a separate patrimony, at least by itself,

duty and duty of care restrain the settlor from abusing her extensive rights arbitrarily and compel the settlor to behave in the interest of the beneficiary. Of course, the settlor can simply shirk the fiduciary duty and duty of care by abstaining from owning the trust assets. Therefore, such inference, if appreciated, may generate a windfall—settlor-owned trusts are to some extent reduced in practice. Because the constructive trust is not permitted in China,²³⁶ however, such inference cannot be further extended to the third party acquiring the trust patrimony. Once the trust patrimony is transferred out of the trust, the trust patrimony no longer exists. The third party only gets trust assets but no trust liabilities because trust liabilities are premised on the trust relationship and there is no such relationship between the third party and trust parties. In addition, the special patrimony theory does nothing to circumscribe the settlor's extensive rights when the trustee is the owner of trust assets. In this case, trust liabilities are only imposed on the trustee, and the settlor bears no such burden.

Finally, the biggest challenge to take this theory as the conceptual foundation of the Trust Law may be its novelty in China, but the patrimony's pivotal notion—a consolidation of assets and liabilities—is nothing new within the Chinese legal system. It can be reflected by at least three patrimony-analogous institutions. The first is the bankruptcy estate. Not only does the bankruptcy estate contain assets of a bankrupt entity, it also contains liabilities to liquidate assets and then distribute to stockholders (mainly creditors).²³⁷ The bankruptcy administrator takes over the assets and assumes the liabilities.²³⁸ This particularity has been

was sufficient to impose additional duties on the settlor. See E-mail from Kenneth G.C. Reid, Professor of Law at University of Edinburgh (on file with author). Professor Reid's discretion on this notion is understandable on the background of Scotland where it is very clear that the trustee owns the special patrimony. However, if the settlor could own the special patrimony in Scotland, just like that in China, Scottish trust law might have already imposed some duties on the settlor by virtue of the special patrimony theory. Of course, this is not a provable hypothesis, but my point is that the unworkability of this notion in Scotland may not sufficiently subvert its application in China. *Id.*

236. Article 8 of the Trust Law requires all trusts in China to be in writing, so there is no room to accommodate the constructive trust in the Trust Law. In fact, most civilian jurisdictions, if not all of them, do not accept the constructive trust when transplanting the trust institution. Trust Law 2001 (China), *supra* note 18, at art. 8.

237. Bankruptcy assets refer to all the assets belonging to the debtor prior to the bankruptcy proceeding and assets obtained by the debtor during the bankruptcy proceeding. See Zhonghua Renmin Gongheguo Qiye Pochan Fa (中华人民共和国企业破产法) Enterprise Bankruptcy Law of the People's Republic of China arts. 30, 111-19 (promulgated by the People's Republic of China, Aug. 27, 2006, effective Jun. 1, 2007) [hereinafter Bankruptcy Law of China].

238. The bankruptcy administrator shall perform duties such as taking over all the assets,

well acknowledged by Chinese academia.²³⁹ Another analogous institution is a foundation that is a not-for-profit legal person to manage donation for public purposes.²⁴⁰ Unlike the company or other social associations, a foundation has no shareholders or members, it only has a collection of donated assets.²⁴¹ It is very similar to the charitable trust except that the foundation has a legal personality, so many Chinese scholars have argued that a foundation is a patrimony with a legal personality.²⁴²

The third institution is the decedent's estate. It is a patrimony in essence, despite China's Law of Succession not using the name. Once a person is dead, all her lawful assets, as well as taxes and debts, become an estate. The testamentary executor may deduct payable liabilities up to the value of assets before making any distribution to successors.²⁴³ If the testamentary executor does not make a complete payoff of liabilities, successors must pay debts up to the value of successive assets unless they relinquish the successive right.²⁴⁴ When the succession is arranged as the testamentary trust, the special patrimony theory is more comprehensive than the contract theory in conceptualizing China's Trust Law because the special patrimony theory also covers the testamentary trust. In contrast, the conceptualization by contract is only limited to the contract-based *inter vivos* trust. Although nearly all the trusts in China are business trusts established by contracts at present, the special patrimony theory is really for the booming of testamentary trust in the future, along with the expanding wealthy group in China.

In sum, the separate patrimony conceptualizes China's Trust Law well and even improves the Law to some extent. Above analyses

investigating into the financial status of the debtor, deciding the internal management of the debtor, managing and disposing the debtor's assets, participating law suits on behalf of the debtor, etc. See *id.* art. 25.

239. See YONGJUN LI, PO CHAN FA LU ZHI DU: QING SUAN YU ZAI JIAN [BANKRUPTCY LEGAL SYSTEM] 224 (2000) (stating that the bankruptcy estate is viewed as a subject with specific purpose and relative independence, and some Chinese scholars even treat it as a quasi-juristic person).

240. Regulation on Foundation Administration, art. 2 (effective Mar. 8, 2004).

241. Qingxin Gao, *Dui Goujian Caituan Faren Zhidu de Sikao* [Thought on the Establishment of Patrimony with Legal Personality], 35(4) J. HENAN NORMAL U. 126, 127-28 (2008) (China).

242. See Yan Hu, *Bijiaofa Shiye xia Caituan Faren Gainian Bianxi* [Anatomy of the Patrimony with Legal Personality from the Comparative Perspective], 5 J. COMP. L. 66 (2011) (China); Jiangfeng Bian, *Woguo Caituan Faren Zhidu Yanjiu* [Study of Patrimony with Legal Personality in China], 1 LEGALITY VISION 198 (2013).

243. Succession Law, arts. 33 (China) (effective Oct. 1, 1985).

244. *Id.* arts. 3, 33, 34.

demonstrate that many articles in the Trust Law have implied the special patrimony, so there shall be few technical impediments to fit the Trust Law with the special patrimony theory. It can appropriately explain most characteristics of the Trust Law. Under this theory, the identity of the owner of the trust patrimony is not an important issue, as long as she could perform the liabilities to the beneficiary. Therefore, the special patrimony theory works well in the context of the ambiguous ownership. The segregation of the trust patrimony from the private patrimonies of both the settlor and the trustee soundly explains the peculiarities of the beneficiary's right. Meanwhile, the settlor's extensive rights may have a kind of checks and balances when she is the owner of trust patrimony because the liabilities within the trust patrimony may be automatically imposed onto the settlor.

These characteristics of the Trust Law are designed by legislators who (mistakenly) understand the trust institution based on contract law and politicians who intend to enhance the acceptance and popularity of the trust institution. If the contract account was continuously followed to explain China's Trust Law, theoretical puzzles and practical uncertainties may never be swept out. The special patrimony theory does not completely expel the contract out of the trust; rather, it replaces the role of the contract to conceptualize the trust and keeps the role of the contract to establish the *inter vivo* trust. The testamentary trust, out of the coverage of the contract theory, can also be accommodated by the special patrimony theory. Once the puzzles and uncertainties regarding the trust regime are eliminated, its wide use by the general public is just a matter of time. Although the special patrimony theory is the right direction forward, it still deserves more research and even time before it can be extensively recognized in China. Those patrimony-analogy institutions that have already existed within the China legal system will certainly make the recognition easier.

VI. CONCLUSION

China's Trust Law was born with three characteristics. The first is the special model of indeterminate ownership of trust assets. The Law formulates an ambiguous definition of trust, and the transfer of the title to trust assets is not a precondition to a valid trust, so the trust assets may be owned by either the settlor or the trustee. The second is the extensive rights enjoyed by the settlor, which is not an intrinsic feature of the common law trust. The third is shared by many trust-recognizing civilian jurisdictions. The beneficiary's right is essentially a right *in*

personam rather than a right *in rem*, but at the same time it is peculiar in two aspects: it is against the trustee merely within the spectrum of trust assets; and the trust assets are shielded by the Trust Law away from bankruptcy rules. The considerations of easy reception and technical feasibility mainly give rise to these characteristics. However, they are not only confusing in theory, but difficult in practice.

Conceptualization is indispensable to deal with these characteristics and problems. The contract theory has been widely perceived as the conceptual basis of China's Trust Law. However, it fails to explain the characteristics very well after careful comparison with the trust regime. In contrast, the special patrimony theory, with a fundamental notion of segregation of assets and liabilities, broadly serves this purpose. Many articles in the Trust Law have implied the special patrimony. Meanwhile, it can to a great extent clarify the three characteristics, by which the special patrimony theory removes theoretical confusions and practical uncertainties of the trust institution and makes it more popular among the general public. Although it provides the right orientation to conceptualize the Chinese trust, admittedly, the special patrimony theory is not flawless, and it needs more time for the Chinese to comprehensively recognize it.