

Asset Protection Trusts: How to Break Them

Asset Recovery: Fraud Litigation, Enforcement and
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Overview

1. Swiss law of trusts
2. Recognition of foreign trusts by Swiss courts
3. Application of foreign law to the trust
4. Cases of application of Swiss law
5. Forfeiture of trust assets in criminal proceedings

Swiss law of trusts

No Swiss law of trusts
(parliamentary motion 18.3383 pending, though)

Hundreds of trustees in Switzerland,
thousands of trusts administered

No regulatory framework
(except for anti-money laundering rules since 2000 and
Financial Services Act and Financial Institutions Act from 2020)

Recognition of foreign trusts

Switzerland is party to The Hague Convention of 1st July 1985 on the Law Applicable to Trusts and on their Recognition (HCT) since 1st July 2007

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Situation prior to 2007

Before 2007, Swiss courts already recognised express trusts since 1994 and deemed them to be “*organised estates*”, to which provisions applicable to foreign companies were applied by analogy (150 of the Private International Law Act - PILA)

159 PILA (principle of incorporation):

“Companies are governed by the law of the state under whose law they are organised”

OD-Bank in Liquidation v. the Bankrupt Estate of WKR [Werner K Rey] District Court of Zurich 30 November 1994 (ZR 1999 225 n° 52, 229)

Qualification of a trust as an organised estate (150 PILA)

Application of Guernsey law to the trust's validity (159 PILA)

Application of the Royal Court of Jersey case law *in re Abdel Rahman v. Chase Bank (CI) Trust Co Ltd*, June 6 1991 [1991 JLR 103] regarding subsequent behaviour

Trustee's tolerance of settlor's interference with the trust's affairs amounted to breach of trust and led to the conclusion that trust was a sham under Guernsey law

Consequently, the trust assets belonged to the settlor's bankrupt estate

Situation since 2007

The law designated by Chapter II of The Hague Convention on Trusts determines the law applicable to trusts, irrespective of whether the country of the law governing the trust is a party to the convention (149c PILA).

No reported new case law on the challenge to the validity of a trust under its governing law.

Application of Swiss law

Cases of application of Swiss law:

1. Challenge validity of transfer of property
2. Exceptions of non-derogable rules, notably:
 - a) Insolvency rules: the claw-back action
 - b) Protection of good faith – theory of transparency (*Durchgriff*)

Challenge transfer of property

The validity of a transfer of property to a trust is not governed by The Hague Convention (4 HCT). Consequently, such transfer may be challenged under Swiss law (or other applicable law) under notably the following grounds:

Incapacity of the transferor (17-18 CC)

Matrimonial rules (201 CC)

Transfer was void if it was an illicit act (20 CO)

Non-derogable rules

Article 15 HCT expressly reserves non-derogable rules of the law designated by the conflicts rules of the forum, in particular:

- a) the protection of minors and incapable parties;
- b) the personal and proprietary effects of marriage;
- c) succession rights, testate and intestate, especially the indefeasible shares of spouses and relatives;
- d) the transfer of title to property and security interests in property;
- e) the protection of creditors in matters of insolvency;
- f) the protection, in other respects, of third parties acting in good faith.

Claw-back action

Purpose of claw-back action is, in the context of insolvency proceedings (Debt Collection and Bankruptcy Act - DCB), to submit to enforcement the assets excluded from the debtor's estate as a result of one of the following transactions (285 DCB):

1. Gifts made in the year preceding the debtor's bankruptcy or seizure (286 DCB).
2. Constitution of security in the year preceding the debtor's bankruptcy or seizure (287 DCB).
3. Acts effected by the debtor in the five years preceding his bankruptcy or seizure with the intention of prejudicing his creditors or favouring some creditors to the detriment of others, in a manner "apparent to the other party" (288 DCB). This condition is realized in the case of the constitution of a trust if the settlor's intention was apparent either to the trustee himself, or to the beneficiaries, even without the trustee's knowledge.

Statute of limitations of two years after bankruptcy or seizure (288 DCB)

Protection of good faith

Article 2 of the Civil Code provides for a general duty to act in good faith, which applies to all areas of the law:

“1. Every person must act in good faith in the exercise of his rights and in the performance of his obligations.

2. The manifest abuse of a right is not protected by law.”

Invoking the duality of identities between a company or a trust and the debtor of an obligation may, under certain circumstances, amount to the manifest abuse of a right (theory of transparency or *Durchgriff*).

Protection of good faith is part of Swiss public policy and may thus be raised at the moment of registration of a foreign judgment.

Application of transparency to trusts

The ownership of property by a trust may be disregarded when:

1) the attribution of a property to the trust was effected in bad faith, e.g. to protect such property from the settlor's creditors

and

2) the debtor is effectively the sole and ultimate beneficial owner of the trust assets, leading to an economic identity between the debtor and the trust

Hangartner v. Port Pregny S.A.

Federal Court of 31 August 1976 (ATF 102 III 165)

Attachment by a creditor of Bernie Cornfeld of a Geneva real estate property registered in the name of Port Pregny S.A., which bearer shares were held by a US trust

Port Pregny S.A. had no independence from Cornfeld but was a mere instrument to his service, with which he had concluded a 50 year lease and had effected at his own costs works for several millions of Swiss francs.

There was a perfect economic identity between Cornfeld and Port Pregny S.A., as he was the sole real beneficial owner and creditor of the company.

“By withholding the shares of Port Pregny S.A. from his creditors and by having the company intervene in the attachment proceedings to claim the ownership of the property, Cornfeld acted fraudulently, in the manifest goal to have a substantial asset escape from his creditors. This behaviour is manifestly abusive in the meaning of art. 2 CC.”

Consequently, for the sake of the attachment proceedings, Cornfeld was declared the owner of the property.

Rybolovlev v Rybolovleva - Interim freeze orders

Geneva Court of Appeal 4 March 2010 (ACJC/223/2010)

Federal Court 26 April 2012 (5A_259/2010)

Freeze orders issued by Geneva Court of Appeal in the context of divorce proceedings in regard of Cyprus trusts settled weeks after the wife refused to enter into a postnuptial agreement, of which the husband remained beneficiary, protector and kept management and administration powers.

The Court of Appeal applied Swiss law, because these were interim measures. Furthermore, the provision on the prohibition of abuse of law is considered to be Swiss public policy (Art. 15 THC).

Trusts recognized, but trustees considered by analogy as a strawmen acting for husband. Order against husband under penalties of law the freeze of assets held by BVI companies which shares were held by the trustees.

Upheld by Federal Court.

Criminal actions

In Switzerland, criminal proceedings remain a better option than civil proceedings to identify, freeze and recover crime proceeds:

- Right of the victim to fully participate in the investigation with access to the file, and to use it as evidence in support of civil and/or foreign proceedings
- Production orders with automatic lifting of banking secrecy
- Freeze orders by generic designation (beneficial owner, etc.)
- Right of the to obtain from the criminal court award of damages against the offender and attribution of forfeiture proceeds
- Plea bargain mechanisms favouring compensation

Forfeiture of assets

- 70 Swiss Penal Code (SPC): compulsory forfeiture of crime proceeds or assets intended to reward or bring about an offence, even in the absence of a conviction
- 71 SPC: when crime proceeds can no longer be forfeited, a replacement claim of the State must be ordered against assets that are unconnected to the crime
- 73 SPC: forfeiture proceeds and compensatory claim must be attributed to the person harmed by the crime, up to the amount of damages set by judgment or settlement

Protection of third parties

A third party is only protected from criminal forfeiture or replacement claim of the State when:

1. it was ignorant of the criminal origin of the assets
and
2. it provided adequate consideration for the assets

Application to trusts

As the trustee, as a general rule, did not provide consideration for the assets received in trust, such assets, when they directly or indirectly (including through tracing of assets) constituted crime proceeds, are not protected from forfeiture, even though the trustee may be in good faith.

When the trust assets are unconnected to the crime, they may still be the object of the replacement claim of the State if the civil rules described above may lead to the attribution of the property of the trust assets to the offender (sham trust under applicable foreign law or application of the transparency theory).

Conclusion

Even though claw-back actions and the application of transparency theory to trusts may be used to challenge foreign trusts under Swiss law, criminal proceedings shall remain a tool of preference in the case of transfer of crime proceeds to a trust.

However, changes to Swiss law since 2011, such as the civil courts' new powers to issue production orders lifting banking secrecy, including in the context of execution of a foreign request for the obtaining of evidence, and the Lugano Swiss-wide attachment orders, make Switzerland an attractive jurisdiction to take steps in support of foreign proceedings against trust assets.