

# Perspectives on Modern Trust Law

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## I Introduction

Japanese Trust Law has made a great development in recent years, especially in the field of commercial use of trusts. This trend should continue. But at the same time we think that this development was in a sense “distorted”. What I mean by distorted is this.

First, trust law in Japan was distorted by regulations, such as regulations imposed by the Trust Business Act or tax regulations. Under these restrictions trust law in Japan did not enjoy full freedom to develop itself for the new era. For example, discretionary trust has not been discussed seriously, because the tax law is unfavourable against it. Or a relation in a property management which is better to be explained by trust had to seek a different legal explanation because the Trust Business Act restricts the use of trusts in the course of business only to trust banks. What we need now is deregulation of trust law and a free development of trust ideas for the next century.

Second, the development of trust law in commercial business meant also decline of basic or traditional trust conceptions. This is especially serious for Japan because there is only a few example of private trusts which would be the basis and cradle of traditional trust ideas. The developments of commercial trusts should be reviewed from the basic theory of trust. The tension between commercial needs of trust and the basic trust theory is a necessary framework for the future

development of trust law. Therefore it is becoming more important to discuss the basic trust law seriously.

From these concerns we selected three basic problems of trust law to discuss. It is obvious that trust property and duties of trustee are the indispensable components of a trust. The third topic we chose was the modification of trust which is also important when we look at trust as a long term relation which needs adaptation to the changing circumstances during the time.

(Yoshihisa Nomi)

## II Trust Property

(1) Article 36(2) of the Trust Act gives the trustee the preferential right to be indemnified from the trust property. The trustee can be indemnified from the trust property even if the trust property cannot afford to satisfy the trust creditors' claims. However, the real effect of this preference is the protection not of the trustee but of the personal creditors against the trustee, because the trustee is also personally liable against the trust creditors.

If the trustee can be really protected, it can be reasonable to give him the preferential right which is ranked above the trust creditors who have the security interests in the trust property. However, the point is whether the secured trust creditors should be equally treated with the unsecured personal creditors against the trustees. The trustees' preferential right must be interpreted to be inferior to the secured creditors' rights.

(2) Article 36(2) of the Trust Act gives the trustee to be indemnified from the beneficiaries. This right must not be placed in the mechanism of trusts. It should be qualified as the right of the mandatary against the mandator.

(3) Article 17 of the Trust Act negates the personal creditors the right

of set-off against the claim which belongs to the trust property. However, the personal creditor who does not know that the claim against him belongs to the trust property and reasonably expect set-off with his claim should be protected by the analogy of article 478 of the Civil Code.

Also, the right to levy the trust property should be given to the personal creditor who reasonably believe that he is a trust creditor. This interpretation can be supported from the spirit of article 31.

(4) The segregation of the property must be approved as the method of the perfection of the trust.

(Hiroto Dogauchi)

### III Duties of a trustee

According to Japanese Trust Act, a trustee have a duty to follow the term and purpose of the trust, and to act in good faith and light of fiduciary principles.

The list of the duties of a trustee is as follows :

(a) a trustee shall administer the trust by exercising reasonable care and skill;

(b) a trustee who has special skills has a duty to the use those special skills;

(c) a trustee shall administer solely in interest of the beneficiaries (a trustee has a duty of loyalty to the beneficiaries).

(Seiichi Yamada)

### IV Modification of Trust

1 As mentioned in the introduction, modification of trust is important if the trust created by the settlor should adapt itself to the changing circumstances. If a trust does not succeed in this, the administration of trust assets could become ineffective or the settlor's purpose can not be

of set-off against the claim which belongs to the trust property. However, the personal creditor who does not know that the claim against him belongs to the trust property and reasonably expect set-off with his claim should be protected by the analogy of article 478 of the Civil Code.

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achieved and the trust may have to cease.

## 2 Modification based on terms of trust

A simple way to adapt trust to the changing circumstances is to give trustee or some other person the power to modify or terminate the trust. The so-called discretionary trust is a useful method. But because the tax law in Japan imposes tax either on the beneficiaries or on the settlor, the advantages of discretionary trust can not be used. It is unreasonable to impose income tax on the beneficiaries of the discretionary trust because their proportion to the trust assets may change by the discretion of the trustee. The tax law in Japan then imposes income tax on the settlor. But this is even more unreasonable. It is important to stress the basic trust idea that trust property is nobody's property, at least until the beneficiaries receive actual income.

## 3 Modification based on other principles

Even if there was no terms of trust giving the trustee or others the power to modify trust, trust can be modified based on other principles of trust law.

First, modification can be based on agreement. There is no problem if all the parties, settlor, trustee and beneficiaries, agree to change trust. Difficult problem arises when not all the parties can come to an agreement. Who has the initiative in modifying a trust in such a case? Whose interest should have the priority? Classifying trusts in some categories may help to answer these questions.

Functionally, there are three basic models of trust. The first type of trust can be called "property transfer model." Family trust is the typical example. The settlor uses trust to transfer his property to his family members. In this model intention of the settlor plays the critical role. To whom and in what terms the property should be transferred are decided by the settlor alone. Trustee has no interest of his own. But after the trust is created beneficiaries' interest becomes important. Whether

the beneficiaries can modify or terminate the trust without consent of the settlor is a well known problem. The second type of trust is the "contract model." Trust is created by negotiation and agreement between the settlor and the trustee. The so-called land trust in Japan is an example of this model. Not only the interest of the settlor but that of the trustee is important and reflected in the trust terms. And because the trustee has his own interest which should be protected, trust can not be modified without consent of the trustee. Also beneficiaries' interest should be considered. This is important because beneficiaries can not reflect their interest in trust terms like settlor or trustee. The third model is what I call "institution model." Once a trust is created it becomes independent from all parties. It has its own purpose to achieve. The settlor can not modify trust just because he is the creator of the trust. Nor can an simple agreement between the settlor and the trustee justify a modification of the trust. In this sense trust is like an institution. Common investment trust fund is an example of this model. To modify the trust of this kind we must question ourselves what is the reasonable method of decision making in an institution. Probably it is the meeting of the beneficiaries which has the power to modify the trust.

Second principle of modification is "*clausula rebus sic stantibus*". This well known principle of contract law can be applied also in trust. Japanese Trust Act provides in article 23 that in an unforeseeable change of circumstances the court has the power to modify trust administration. This seems to be too narrow. My proposal is to widen this power of the court. Not only can the court modify the method of the administration of trust but also modify other terms of trust or even terminate the trust.

#### 4 Special types of modification

Termination of trust, removal of trustee and combination or division of trusts are all specific type of modification. It is better to discuss these problems in the same context. But here I would only

mention the problem of combination and division of trust. In USA these methods are usually used in a family trust. But combination of trusts is also important in pension trusts or common investment trusts. It pursues efficiency in trust management which is also an advantage for beneficiaries.

(Yoshihisa Nomi)