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Arbitration of Trust Disputes

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I. Introduction

Trust litigation has increased substantially during the last years¹, not only in common law jurisdictions but also in the civil law world. One reason for this is purely generational: many offshore trusts were set up by settlors in the 1960's and 1970's and these settlors have been dying in recent years. While the settlors often had a personal relationship with the trust-

¹ VOGT, p. 7.

tees they selected, the new generation of beneficiaries has played no part in the creation of the trust and in many cases does not even know about it, which gives rise to mistrust and eventually, disputes. Another reason for the increase in trust litigation is the fact that more and more settlors are leaving substantial fortunes in complex structures covering different jurisdictions. Trusts have also increasingly come under attack by «outsiders» to the trust, such as *forced heirship* heirs, former spouses or creditors of the settlor.

Courts in offshore jurisdictions² where trust litigation usually takes place, have been criticised for not always being the ideal venues to resolve disputes involving family trusts or for overseeing trust administration. Critics say that the courts are over-burdened and not always fit to handle the very complex questions which may arise in the context of such disputes. One example where the shortcomings of the courts became apparent is the *Thyssen* case³.

Already in the 1990's, representatives mainly from the trust industry started discussing the idea of using mediation to resolve trust disputes⁴. Proposals to use arbitration to settle trust issues have also been discussed in a few articles⁵. In practice, however, the idea of arbitration in this field has not taken root as quickly as mediation. Today, the enforceability of arbitration clauses in trust deeds is still largely uncharted territory. This is not really surprising as the traditional objection in the common law world to arbitrate trust matters is that the (state) court's jurisdiction over the administration of trusts to which the law of such jurisdiction applies cannot be ousted. While some progress has been made, there still appears to be a disparity of views among today's UK trust lawyers as to whether trust disputes should be arbitrated, and reference to trust arbitration in the relevant trust literature and leading case books is sparse⁶.

During the last years, active debate about trust arbitration has been reopened⁷. Trust arbitration was also a topic discussed at the 2006 IBA con-

² Such as e.g. Guernsey, Jersey, Cayman, Bahamas, Bermuda or the BVI. HAM.

⁴ Cf. e.g. ARTHUR; HODSON, p. 11-13; KLINEFELTER/GOHN, p. 147-154.

⁵ COHEN/STAFF, p. 203-224; HAYTON, ADR, p. 11-19.

⁶ BSK PILS-VOGT, Preliminary Comments *ad* Art. 149a-e PILS, N 72-76.

⁷ Cf. e.g. BROWNBILL, p. 1-9; LLOYD/PRATT, p. 18-20; VON SEGESSER, Arbitration; VON SEGESSER, Arbitrability, p. 21-30. The 3rd Zurich Annual Conference on International Trust and Inheritance Law Practice of 18 April 2007

ference in Chicago and the ICC set up an International Task Force in 2006 to study the compatibility of its arbitration rules with the peculiarities of trust disputes. The mission of this Task Force is to propose a specific model ICC arbitration clause (and related explanatory notes) to be included in a trust deed.

Switzerland is traditionally an arbitration and trust friendly jurisdiction. This article will examine whether trust disputes are fit for arbitration (particularly in Switzerland) and will discuss some of the concerns that trust and arbitration practitioners have identified as the major hurdles⁸.

II. What is Special about Trust Disputes?

Trusts have gained wide international recognition (in particular since the ratification of the Hague Trust Convention⁹) and have grown beyond their traditional borders. With increasing mobility of individuals in a shrinking world, trusts are no longer confined to the Anglo-saxon world but are also often used in civil law jurisdictions.

Trust disputes are distinctively different from traditional commercial disputes: they usually arise within a family and involve individuals rather than corporations. While substantial amounts of money are often at stake, the parties usually wish to maintain an ongoing relationship (considering that a trust is a long term arrangement¹⁰). Apart from the potential complexity of trust disputes and their multi-party character, the personal dynamics of such cases can be compared to those in divorce disputes.

(«Zürich Trust Arbitration Conference») dealt exclusively with the topic «Trusts and Arbitration».

⁸ This article is not intended to be a comprehensive analysis of all the complex questions which arise in the context of trust arbitration and many of the issues covered are necessarily summary in nature. The focus will be on non commercial (family) trusts but in the author's view similar considerations would apply in relation to business trusts.

⁹ Convention on the Law Applicable to Trusts and on their Recognition of 1985, FF 2006 551.

¹⁰ Under some trust laws, a trust can have a lifespan of up to 150 years (under the so-called Rule against Perpetuities: «beyond lives in being plus 21 years»).

A. The players: «insiders» v. «outsiders»¹¹

Generally, the *settlor* establishes a trust to protect and preserve his assets under the management of a trustee for the benefit of himself and/or the beneficiaries, typically his relatives¹². The *trustee* is either an individual or (preferably) a corporate trustee. Regardless of whether the settlor also benefits under the trust, he usually wants to retain some kind of influence or even control over the investment and the use of the assets. The settlor may also appoint a person known as the *protector*, who is to monitor the trustee's activities and who is often someone well known to the settlor (e.g. a family lawyer or close business colleague). Normally, the protector's consent must be obtained prior to the exercise by the trustee of his specified powers and discretions (i.e. by so-called «veto rights»). In practice, the trust provisions usually foresee that a protector may also replace a trustee. The *beneficiaries* play no part in the creation of the trust, they do not negotiate the trust deed nor do they select the trustee. From their point of view, they are «forced» into a relationship with the trustee and each other, rather than having agreed to be involved. The relationship between the trustee and the beneficiaries is a fiduciary one and trust law imposes certain obligations on the trustee for the protection of the beneficiaries' interests, such as their right to information from the trustee.

Trust disputes arise not only between these «insider» parties but also with «outsiders» to the trust such as (ex)-spouses, (non-beneficiary) *forced heirship* heirs or creditors of the settlor who try to attack the trust or question its validity.

¹¹ For a detailed overview cf. e.g. BSK PILS-VOGT, Preliminary Comments *ad* Art. 149a-e PILS, N 18 *et seq.*

¹² The most common type of family trust is the *discretionary trust*. This type of trust is often irrevocable, meaning that the settlor is unable to alter the provisions of the trust or terminate the trust once it has been established. The trustees are given wide discretionary powers over the assets of the trust and, in particular, a power to appoint trust assets to any one or more beneficiaries. Until the appointment is made, no beneficiary has a vested interest in the trust fund.

B. The supervisory function of the Court¹³

In the context of trust litigation, it is important to be aware of the role of the court of the state whose law governs the trust (often an offshore jurisdiction):

«The essence of a trust is a trustee-beneficiary obligation enforceable in a court with jurisdiction to guide, supervise and control the trustee at the behest of a trustee or a beneficiary»¹⁴.

Apart from its judicial function, the court also has a regulatory or supervisory role in relation to the administration of the trust, mainly to protect the beneficiaries. A trustee may make an application to the court and ask for assistance to ensure that he acts properly and does not commit a breach of trust. To exclude or limit his potential liability *vis à vis* the settlor and/or the beneficiaries, a trustee may for example ask the court for directions as to (i) the interpretation of an unclear provision in the trust deed (*constructive summonses*) or (ii) in relation to the conduct of his trusteeship (*directive summonses*). The court may also remove a trustee who is unfit to act. Some Swiss authors argue that the function of the trust court is akin to that of the Swiss courts which supervise a Swiss executor, the only difference being that the executor may address the Swiss court only in specific situations while a trustee in principle may resort to the court whenever necessary¹⁵.

C. Types of trust disputes: external v. internal disputes

Trusts can be the subject of a variety of different disputes in a variety of ways, where – in addition to trust law – matrimonial property law, inheritance law or bankruptcy law may also play a role. There are three broad categories of trust disputes¹⁶:

¹³ BSK PILS-VOGT Preliminary Comments *ad* Art. 149a-e PILS, N 68-71.

¹⁴ HAYTON, Convention, p. 260.

¹⁵ SEILER, p. 20 FN 89; BREITSCHMID, p. 65 FN 79; BSK PILS-VOGT, Preliminary Comments *ad* Art. 149a-e PILS, N 69 *et seq.* who also refers in this regard to the supervision of the Swiss courts over foundations.

¹⁶ This characterisation is today used by most trust practitioners and is derived from the judgment in *Aisop Wilkinson v. Neary*, [1995] 1 All ER 431; cf. also WOOD, Zurich Trust Arbitration Conference, p. 4.

i) *Third Party Disputes* concerning the trustee's external relationship with third parties such as contracts with investment advisors or insurance and risk managers.

ii) *Trust Disputes* concerning (external) claims by creditors, disappointed heirs or (ex)-spouses trying to attack or vary the trust; an example is the *Thyssen* case where it was argued before the Bermuda court that the trust violated Swiss Inheritance and family law and should be set aside.

iii) *Beneficiaries' Disputes* or so-called *Internal Disputes* concerning either the internal relationship between the beneficiaries or the internal trustee/protector - beneficiary relationship. In these kinds of disputes, which are basically disputes about the terms of the trust, the validity of the trust is not generally questioned but the parties seek to resolve difficulties between them. Such disputes may arise in relation to the beneficiaries' interests under the trust, e.g. if it is not clear whether someone falls within a class of beneficiaries. They may further concern the exercise of discretion by a trustee (e.g. whether a beneficiary received a large enough distribution from the trust), breach of trust claims (e.g. alleged mismanagement by the trustee of the trust assets) or requests for the replacement of a trustee who is unfit for the job. Attempts by beneficiaries to obtain information from the trustee concerning the trust's affairs, applications for directions as mentioned earlier or requests for the variation of the trust deed, also fall within this category.

D. Trust jurisdiction

Most trust deeds contain a choice of law clause¹⁷ but usually no jurisdiction clause. In many offshore trust jurisdictions, there is jurisdiction for trust disputes if the trust is governed by the local law of that jurisdiction even though the parties and the facts of the case have nothing to do with

¹⁷ Trust is a concept developed by English equity courts during the 12th and 13th centuries. The trust is governed by the provisions of the trust instrument and, absent any specific provision, general principles of common law apply, supplemented by local statutory trust law. While many (offshore) trust jurisdictions - mostly former territories or colonies of the British Empire - have developed their own trust law, they often follow the developments in English law. As such, they have adopted many English trust statutes or enacted similar legislation and the decisions of the English courts are highly persuasive for them.

that jurisdiction. The Hague Trust Convention, which became effective in Switzerland on 1 July 2007, covers all types of Internal Trust Disputes, as outlined above, including applications for directive and constructive summonses and requests for the replacement of a trustee¹⁸. Provided the trust contains a Swiss jurisdiction clause, or jurisdiction in Switzerland can be affirmed as a result of a sufficient connection to Switzerland under the new jurisdictional provision Article 149b(3) PILS¹⁹, a Swiss judge would be competent to adjudicate Internal Trust Disputes. Another question, however, is whether the foreign trust court - in particular in its supervisory function - would recognise the jurisdiction of the Swiss courts rather than assert its own jurisdiction in that regard. There is also some doubt that Swiss courts have sufficient know-how in trust law and they may therefore have some difficulties to step into the shoes of the foreign supervisory authority²⁰.

III. Trust Arbitration

A. Is it a good idea?

Increased use of arbitration in trust disputes will mainly depend on whether the idea is embraced by the trustee (companies) and the settlors²¹ in new trust deeds. If one wants to persuade them that they would be better served by arbitration than offshore court litigation, one must ask whether positive features of international arbitration matter equally in trust disputes and how they would measure up against court

¹⁸ Art. 8 of the Hague Trust Convention.

¹⁹ The jurisdictional provisions of the Lugano Convention prevail over the provisions of the new Chapter 9 PILS; cf. BSK PILS-Vogt, ad Art. 149b PILS, N 5 et seq.

²⁰ Cf. GUTZWILER, Commentary, p. 10 N 38 et seq., who proposes organisational measures to overcome potential difficulties of (Swiss) civil law courts in adjudicating trust matters. GUTZWILER in particular recommends to adapt the cantonal court systems and to designate a specific court instance to be exclusively competent to deal with trust disputes in order to facilitate the building up of sufficient know-how and case law. Similar BREITSCHMID, p. 65 FN 80.

²¹ In most cases, the settlor will need to be persuaded of the advantages of arbitration as the trustees - at least in the typical offshore trust jurisdictions - might prefer to litigate in their jurisdiction.

litigation in the traditional offshore trust jurisdictions. There has been an ongoing debate in that regard over the last years.

There appears to be consensus among trust practitioners that the subject matter of trust disputes (the affairs of a family and its fortunes) make them predestined to be tried through the privacy²² of arbitration to avoid potential humiliation and reputation risks associated with such disputes²³. The last thing a settlor wants is that the size and whereabouts of his assets and the names of the beneficiaries of the trust are made public and eventually discussed in the media. Trust companies and protectors certainly also seek to avoid publicity of their management of trusts.

Whether a dispute relates to a breach of trust, the proper understanding of the beneficiaries' rights or the trustee's powers, or whether it affects third parties, such a dispute will generally involve very complex questions of law and fact, with which a panel of arbitrators may be much more familiar than a state court judge. Speed and cost considerations also speak in favour of arbitration, considering in particular that extensive discovery appears to be one of the reasons why offshore trust litigation has become very expensive and typically takes years. In trust litigation in common law jurisdictions, each party needs to involve several lawyers (solicitors and barristers, local and English lawyers) which inevitably increases costs. The courts are also often overburdened as in many (offshore) jurisdictions the courts are understaffed and there are only a handful of (mostly part-time) judges adjudicating the cases (final appeals usually need to be lodged in London).

Some questions do, however, arise. For example, the constitution of the arbitral tribunal may take more time than in ordinary commercial arbitration (cf. B.4(b) below). One may also properly ask whether an arbitrator really has the expertise to step into the shoes of the trust courts, in particular to the extent supervision over the trust administration is concerned²⁴. Considering that in each case a new panel of arbitrators would be appointed and that «precedents» would usually not be known due to

²² The private nature of arbitration does not *per se* ensure confidentiality. The standard of confidentiality which applies depends on the parties' agreement, the choice of (institutional) arbitration rules and the law applicable at the seat of the arbitration.

²³ COHEN, Zurich Trust Arbitration Conference, para. 5; VON SEGESSER, Arbitration, p. 11.

²⁴ GUTZWILER, Commentary, p. 9, 10 and 167.

the private and often confidential nature of arbitration as current arbitration practice dictates, a panel could not rely on a comprehensive body of «trust arbitration case law». This would certainly not make their task easier. If parties ensure that they appoint arbitrator(s) with outstanding trust and arbitration expertise, this may be less of a concern. To help things along, in case of a three member tribunal, for example, the parties could opt for co-arbitrators with extensive trust experience and a chairman with outstanding arbitration experience. To facilitate building up of «trust arbitration expertise», Arbitral Institutions - such as the Swiss Chambers of Commerce administering arbitrations under the Swiss Rules - might consider setting up and maintaining a panel of arbitrators with trust expertise to be appointed by the Institution in case the parties fail to make an appointment²⁵.

The objection by some common law trust lawyers to the concept of trust arbitration generally appears not that trust disputes are not well suited for arbitration but rather that there is doubt as to whether an arbitration agreement (and thus the award) can be made as to bind all of the classes of beneficiaries²⁶.

B. Trust arbitration in Switzerland: does it work?

Switzerland has a leading position in international arbitration²⁷ and it has been the seat of a number of trust arbitrations. In most of the cases, the parties agreed to submit an existing trust dispute to arbitration. Arbitration clauses in trust deeds still appear to be rare. Based on an informal enquiry with a number of Swiss trust companies, their standard offshore family trust deeds do not yet contain arbitration clauses. Nevertheless, the appetite for arbitration - in particular among settlors - appears definitely to be on the increase. It seems settlors, beneficiaries and/or trust companies outside the traditional (offshore) trust jurisdictions, who are not familiar with the dispute resolution process in the jurisdiction whose law governs the trust, would prefer to arbitrate trust matters in an arbi-

²⁵ This is the approach adopted in Art. 13 of the AAA Arbitration Rules for Wills and Trusts of 2003 (www.adr.org); cf. also Art. 7(3) and 8(2) Swiss Rules.

²⁶ COHEN, Zurich Trust Arbitration Conference, para. 4; GUTZWILER, Commentary, p. 167.

²⁷ Since 2000, Swiss cities rank first or second among the chosen venues for ICC arbitration proceedings (ASA Brochure «Advantages of Switzerland for Arbitration» 2007, p. 6).

tration friendly jurisdiction. According to LAWRENCE COHEN QC, one of the pioneers of trust arbitration in the UK, as trusts are no longer governed by English law for tax reasons, it is not English law which will be at the forefront of testing arbitration clauses in trust deeds but rather one of the offshore trust jurisdictions such as Cayman, BVI, the Channel Islands or Gibraltar²⁸. In the author's view, Switzerland would be an equally or even more suitable venue for international trust arbitration considering in particular the little developed arbitration law in the various offshore jurisdictions.

1. General aspects²⁹

Chapter 12 of the PILS – the Swiss *lex arbitri* – applies where the parties have selected (i) a city in Switzerland as the seat of arbitration and (ii) at least one of the parties did not have its domicile in Switzerland at the time of the conclusion of the arbitration agreement³⁰. This means that either the settlor, trustee, protector or a beneficiary – if parties to the arbitral proceedings – must have had their domicile outside of Switzerland when concluding the arbitration agreement for Chapter 12 PILS to apply. The fact that the new Chapter 9a PILS, which contains jurisdictional provisions in relation to the Hague Trust Convention, does not refer to arbitration, does not mean that arbitration is excluded as no such reference to arbitration can be found in the other chapters of the PILS. Trust Disputes can be arbitrated in Switzerland provided they are *arbitrable*.

The Swiss *lex arbitri* must be distinguished from the substantive law applicable to the merits of the dispute, which is the law governing the trust³¹. Questions such as whether a beneficiary of a trust can be compelled to arbitration or whether a trust dispute is *arbitrable* may be answered differently depending on the seat of the arbitration.

General conditions to allow arbitration on the basis of an arbitration agreement in a trust deed are in principle (i) a valid arbitration agree-

²⁸ COHEN, Zurich Trust Arbitration Conference, para. 5d.

²⁹ This article does not seek to examine domestic trust arbitration in Switzerland, i.e. where the only connecting factor to a foreign jurisdiction is the applicable trust law (e.g. settlor, trustee and beneficiaries of a BVI trust have their domicile all in Switzerland).

³⁰ Art. 176 PILS; BERGER/KELLERHALS, p. 38.

³¹ Art. 187 PILS. Art. 7 of the Hague Trust Convention (i.e. «closest connection test») may serve as a guideline absent a choice of law whereby a trust cannot be governed by Swiss law; cf. GUTZWILER, Trusts, p. 156.

ment, binding all the parties in dispute, (ii) the representation of all interested parties (including unborn, minor and unascertained beneficiaries) and that (iii) the subject matter of the dispute is arbitrable.

2. Need for a valid arbitration agreement

A precondition to the ability to arbitrate present and future trust disputes is a valid arbitration agreement (both in form and in substance)³².

(a) The arbitration «agreement» in a trust context

Although a trust can be validly created verbally, for evidentiary purposes, a trust is usually set up in a deed form. The establishment of a trust is not considered as a contractual undertaking between the settlor and the trustee but rather as a unilateral act by which the settlor commits property into the trust and confers rights and obligations on others (i.e. trustee, beneficiary, protector or trust advisors). According to the prevailing English doctrine, even if a trust deed is not a contract as such, it may contain an arbitration agreement provided such agreement is stipulated as an express agreement in the trust instrument³³. In light of the Swiss doctrine, which recognises (unilateral) arbitration clauses in last wills and statutes of foundations (cf. 2(c) below), an arbitration agreement may equally be contained in a trust deed³⁴. From a Swiss perspective, it appears sufficient to simply start the arbitration agreement with «*Any dispute arising out of [...]*», but it could assist if one includes specific contractual language such as «*The settlor and trustee hereby agree [...]*» to ensure enforcement of the arbitration agreement under any applicable law (Art. 178(3) PILS).

As some trust matters may not be arbitrable in some jurisdictions, the question arises whether such disputes should *a priori* be excluded in the arbitration clause to limit the risk of parallel proceedings or problems at the enforcement stage³⁵. Similarly, one may come to the conclusion that

³² Art. 178(1) and 178(2) PILS.

³³ COHEN, Zurich Arbitration Trust Conference, para. 10; HAYTON, ADR, p. 8.

³⁴ Such approach is in line with the *principle of the separability* of the arbitration agreement as recognized in international arbitration practice; cf. also Art. 178(3) PILS.

³⁵ This is the approach adopted in the AAA Rules on Wills and Trusts (cf. FN 25), which provide that questions regarding the capacity of the settlor or attempts to remove a trustee are not *arbitrable*.

some types of trust disputes may not be suitable for arbitration and should be better referred to state courts. Careful drafting will help avoid questions of interpretation and potential jurisdictional problems. The inclusion of a list of possible disputes in the arbitration clause is not recommended as this list could be interpreted as exhaustive even if not so intended.

The arbitration agreement should be contained in the initial trust instrument and any subsequent amendment and not merely in a letter of wishes, as this is not a binding document³⁶. The arbitration agreement must bind all parties to a trust dispute so that court proceedings can be stayed if a party ignores the arbitration clause. Often however, certain (potential and later actual) parties to a trust dispute have not signed the trust deed (containing the arbitration agreement) to which only the settlor and the trustee are parties. Is there a possible mechanism for the settlor to impose his will on the beneficiaries and any other person linked to the trust such as a protector or successor trustee, that such future trust disputes be arbitrated?

(b) Trustees and protectors

Trustees and protectors assume their responsibilities under the terms of the trust deed. Hence, the arbitration agreement could state that by accepting office, they (are deemed to) have agreed to the arbitration agreement in the trust deed. Such an arbitration agreement would cover not only the original trustee and protector but also any trustee or protector succeeding in office. From a Swiss perspective, the original trustee and/or protector should preferably sign the trust deed, and any successor trustee and/or protector should accept office (and the arbitration agreement) in writing³⁷. Where a trustee has not been designated by the settlor in the trust deed but has been subsequently appointed by a court or the protector, this approach may not work to compel the new trustee to arbitration. One may also question in such case whether a beneficiary who consented to arbitration prior to the appointment of the successor trustee by the court, can be considered as having agreed to arbitrate against the new trustee.

³⁶ It is debated whether arbitration clauses could be retrospectively inserted into existing trusts e.g. under a so-called power of amendment; cf. COHEN, Zurich Trust Arbitration Conference, para. 5b.

³⁷ Art. 178(1) PILS.

(c) Beneficiaries

Beneficiaries are usually not parties to the trust deed and often do not even know about the trust. Any beneficiary who is party to a trust dispute and refuses to arbitrate could frustrate the entire arbitration process. A mechanism is needed to bind such beneficiaries to the arbitration agreement.

An arbitrator - when considering whether a beneficiary is bound by an arbitration agreement in a trust deed providing for arbitration in Switzerland - would look at (i) the law governing the arbitration clause, (ii) the law governing the trust and (iii) Swiss substantive law³⁸. If under any of these laws it can be concluded that the beneficiary has validly consented to the arbitration agreement, the arbitrator will affirm his jurisdiction (provided the form requirements are complied with as discussed under 2((e)) below).

Some English authors are of the view that under the English Arbitration Act 1996, a trust deed could be drafted in such a way that benefiting from the trust would be deemed an agreement to submit trust disputes to arbitration. By accepting the gifts or invoking any rights under the trust deed, the beneficiaries would be deemed to agree to settle any dispute in accordance with the arbitration agreement contained in the trust deed (*theory of deemed acquiescence*)³⁹.

A similar approach has been suggested by Swiss doctrine⁴⁰ for the validity of unilateral arbitration clauses in last wills or statutes of foundations⁴¹

³⁸ Art. 178(2) PILS.

³⁹ LLOYD/PRAATT, p. 18 *et seq.*; HAYTON, ADR, p. 18; COHEN/STAFF, p. 221: «Section 82(2) of the Arbitration Act 1996 provides that a party to an arbitration agreement includes any person claiming «under or through» a party to the agreement. The beneficiary of a trust settlement can only claim under or through the settlor, who was a party to the agreement, for the beneficiary's title to the trust fund cannot be better than that of the settlor himself. By seeking to profit from the settlor's bounty the beneficiary must be taken to acquiesce in the arbitration agreement, because an agreement to arbitrate all matters arising out of or in connection with the trust is a condition precedent to benefiting from the trust. This amounts to a theory of deemed acquiescence».

⁴⁰ The majority of Swiss writers submits that unilateral arbitration clauses in last wills or statutes of foundations are valid; cf. BSK PILS-WENGER/MÖLLER, *ad* Art. 178 PILS, N 63 *et seq.*; KISTLER, p. 25 *et seq.*; MAUERHOFER, p. 375-401; VON SEGESSER, Arbitrability, p. 24 *et seq.*; BERGER/KELLERHALS, p. 156 *et seq.*

which should also work in a trust context provided the beneficiary consents to arbitration in the form required under Swiss law⁴² (see 2(e)) below⁴³. This means, the beneficiary (or persons claiming beneficiary status under the trust deed), like an heir, must accept the benefits from a trust subject to certain conditions, such as agreeing to submit any future dispute to arbitration. Under Swiss law, such clauses should not be qualified as immoral or vexatious and should be upheld⁴⁴. One caveat must be made from a Swiss perspective: in accordance with the prevailing doctrine, a beneficiary could not be compelled to arbitration by the settlor to the extent a trust dispute concerns his *forced heirship* portion. A beneficiary claiming that the trust is void because it violated his Swiss *forced heirship* rights may thus be able to successfully contest arbitration and have his case heard by an ordinary court⁴⁵.

Another option for the settlor to compel a beneficiary to arbitration which has been discussed in the last years by trust practitioners, is to give the trustee the power to exclude a beneficiary (i.e. not make the distribution) if the beneficiary refuses to consent to arbitration (so-called *in terrorem* clause). A *forfeiture clause*, according to which a beneficiary loses any entitlement if he resorts to the state courts instead of arbitration in case of a dispute, may have a similar effect. However, as the validity of such

⁴¹ Arbitration clauses in foundations are considered as binding upon the beneficiaries (OGH of 25 November 1985, 3 C 214/79-56, published in LES 1987, p. 14); but see recent decision of the Court of Appeal of Basel of 29 October 2004 in BJM 2007, p. 28 *et seq.* where the court held that an arbitration clause in a Liechtenstein trust is not binding upon the beneficiaries, unless signed by them in accordance with Art. II(2) NYC respectively Art. 7 of the Treaty between Liechtenstein and Switzerland on the recognition and enforcement of judgments and arbitral awards of 1968 (RS 0.276.195.141).

⁴² BSK PILS-WENGER/MÜLLER, *ad* Art. 178 PILS, N 64; MAUERHOFER, p. 390; BERGER/KELLERHALS, p. 157.

⁴³ In the author's view, the practice in Switzerland in relation to arbitration clauses in articles of associations of corporate bodies could not be equally applied in a trust context; similar GUTZWILER, *Commentary*, p. 166 and decision of the Court of Appeal of Basel (FN 41), p. 33.

⁴⁴ Art. 482 CC; BSK PILS-WENGER/MÜLLER, *ad* Art. 178 PILS, N 64; MAUERHOFER, p. 391.

⁴⁵ VON SEGESSER, *Arbitrability*, p. 26. Some authors even argue that a testator cannot impose an arbitration clause on statutory heirs (BSK PILS-WENGER/MÜLLER, *ad* Art. 178 PILS, N 64).

clauses appears to be highly debated under trust law, care needs to be taken with such approach⁴⁶.

While a trust provision, according to which agreeing to arbitration is a condition precedent to benefiting from the trust, should be effective under Swiss law, the issue is really governed by the applicable trust law (*lex causae*) rather than the Swiss *lex arbitri* (i.e. Art. 178(2) PILS)⁴⁷. Similarly, an arbitrator would most likely look to the trust law to assess the validity of a forfeiture clause. On the other hand, provided the arbitrator considers such clauses as valid, the Swiss *lex arbitri* (Art. 178(1) PILS) is relevant to whether the beneficiary needs to explicitly agree to arbitration, in writing or whether claiming or accepting a gift from the trustee could be considered as agreeing to arbitrate (cf. 2(e)) below⁴⁸.

As these theories have not yet been tested - either in common law jurisdictions or in Switzerland - there remains a risk that a beneficiary may successfully oppose arbitration and resort to state court litigation. Only if the (offshore) state courts follow the approach expounded by these theories and refer such parties to arbitration, can lengthy and costly parallel court proceedings be avoided. It may enhance the chances of compelling a beneficiary to arbitration in Switzerland if the arbitration clause - as regards substance - is governed by English law or - even better - if such clause is valid under the relevant trust law⁴⁹.

(d) Third parties

Obviously, third parties such as creditors, heirs or (ex)-spouses of the settlor cannot be compelled to arbitration on the basis of an arbitration clause in a trust deed. Instead, they would have to agree to submit an *existing dispute* to arbitration, which in practice they may be reluctant to

⁴⁶ COHEN/STAFF, p. 19 FN 61; WOOD, *Zurich Arbitration Trust Conference*, p. 4.

⁴⁷ MAUERHOFER, p. 387 *et seq.*

⁴⁸ Cf. also the new jurisdictional provision Art. 149b(1) PILS in relation to trust disputes under the Hague Trust Convention, according to which the settlor or a person empowered under the trust deed by the settlor (e.g. trustee or trustee with the consent of the protector) may (unilaterally) designate the forum for trust disputes («Gerichtsstandswahl»), binding trustees, protectors and/or beneficiaries as the case may be. Unfortunately, the Swiss legislator failed to address the issue of trust arbitration when implementing the Hague Trust Convention and related jurisdictional provisions.

⁴⁹ Art. 178(2) PILS.

do. Provided all concerned parties agree to arbitrate an existing dispute, such a dispute should be arbitrated, as jurisdictional issues are less likely to arise and potential problems at the enforcement stage can be better assessed⁵⁰.

(e) Need for text form

Swiss law provides for a substantive rule of international private law as regards the form of an arbitration agreement and parties may not submit their arbitration agreement to a law other than that of the Swiss seat of the arbitration⁵¹. Swiss law is thus decisive on the question whether trustees, protectors and/or beneficiaries need to explicitly agree in writing to the arbitration clause or whether accepting office or a gift from the trustee could be considered as deemed consent to arbitrate. Under Swiss law, an arbitration agreement providing for international arbitration in Switzerland must be made in writing or evidenced by text⁵². Such writing requirement is according to the prevailing doctrine a prerequisite for the validity of the arbitration agreement. The text of the arbitration clause must, however, not necessarily bear a signature⁵³.

According to Swiss doctrine, it is debatable⁵⁴ whether it is sufficient that an arbitration agreement is drafted by one party and simply accepted orally or tacitly by the other party. In light of the decisions of the Swiss Federal Tribunal⁵⁵, acceptance of the arbitration agreement should also be contained in a document and be notified to the other party. It is thus questionable whether a beneficiary could be compelled to arbitration in Switzerland merely on the basis that he accepted and requested distributions from the trust or claimed beneficiary status. When inserting arbitration agreements into newly created trusts, it is certainly preferable for now to have the arbitration agreement signed by all parties concerned.

⁵⁰ Third Party Disputes (cf. II.C.(I) above) can be submitted to arbitration like any other commercial agreement.

⁵¹ BERGER/KELLERHALS, p. 135 N 394.

⁵² Art. 178(1) PILS, which is in line with Art. 5 PILS.

⁵³ BSK PILS-WENGER/MÜLLER, *ad* Art. 178 PILS, N 15.

⁵⁴ BSK PILS-WENGER/MÜLLER, *ad* Art. 178 PILS, N 17.

⁵⁵ While the Swiss Federal Tribunal has not yet given an express ruling on the necessity of both parties' adhering to the formal prerequisites in direct application of Art. 178(1) PILS, it did take it for granted in DFT 121 III 38, a case concerning the formal requirements of the New York Convention (which the court held to be incidental with those of the PILS), that both parties must fulfill the formal requirements.

Where the beneficiary did not sign the trust deed, such written consent should preferably be obtained from the beneficiary (e.g. by the trustee) after the signing of the trust deed.

3. What trust disputes can be arbitrated?⁵⁶

The fact that the parties can in principle submit a trust dispute by agreement to arbitration in Switzerland does not mean that they can successfully bring any trust dispute they wish to arbitration. There are areas where parties may not be free to oust the jurisdiction of the state courts in favour of trust arbitration. The question of *arbitrability* may arise at various points in an arbitration procedure: *arbitrability* is a condition for the jurisdiction of the arbitral tribunal and it may also be invoked as ground for an appeal. When inserting arbitration clauses into newly created trusts, one must thoroughly examine to which extent the related trust jurisdiction could take a defensive position and view arbitration as an unfriendly attempt to oust its jurisdiction. In addition, in light of Article V(2)(a) NYC, the laws of the country(ies) where the award might have to be enforced need to be considered.

Switzerland has adopted an independent substantive rule for the determination of *arbitrability*, according to which any dispute involving an economic/financial interest may be settled by arbitration, without any need to consider the possible stricter rules of the law applicable to the merits of the dispute or the national law of one of the parties⁵⁷. Apart from purely non-financial matters, *arbitrability* can only be denied in an international arbitration with its seat in Switzerland for claims which have exclusively been reserved for the state courts pursuant to foreign mandatory provisions which have to be taken into account under public policy considerations⁵⁸.

As nearly all types of trust disputes ultimately concern the distribution of private wealth, the majority of such disputes can be arbitrated given the liberal definition of *arbitrability* under Swiss law. An arbitrator may also determine preliminary issues in relation to such (financial) claims such as

⁵⁶ Cf. PERRIN, p. 417; VON SEGESSER, *Arbitrability*, p. 28.

⁵⁷ Art. 177(1) PILS.

⁵⁸ DFT 118 II 193; VON SEGESSER, *Arbitrability*, p. 28, who considers that arbitration may be excluded where the supervision by the state court is needed for the protection of a public interest or the rights of an individual.

(i) the settlor's capacity to settle the trust or (ii) the validity of settlement of property to the trust. Some doubt does arise whether actions of creditors seeking to have allegedly fraudulent dispositions to a trust set aside would be *arbitrable*⁵⁹. Questions regarding a beneficiary's marital status or the appointment of a representative for minor beneficiaries (see 4(a) below) may also be excluded⁶⁰. Some uncertainties also remain with regard to the following types of Internal Trust Disputes:

i) *Directive and Constructive Summonses*: According to the Hague Trust Convention, directive or constructive summonses are qualified as matters subject to non-contentious jurisdiction⁶¹, which according to Swiss doctrine are in principle considered as *non arbitrable*⁶². On the other hand, directive or constructive summonses are within the ambit of the Hague Trust Convention and they will thus also fall under a Swiss trust jurisdiction clause. Applications for directions should thus be *arbitrable*⁶³ from a Swiss perspective provided they are closely connected to a financial claim. Since the proceedings for such directions are rather speedy and usually private, it is questionable whether arbitration is really an alternative.

ii) *Request of beneficiary for provision of Information*: Unless made in relation to a financial claim, such application would be considered as *non-arbitrable* under Swiss law.

iii) *Replacement of Trustee*: Some Swiss authors⁶⁴ are of the view that an action to dismiss an executor of a will is not *arbitrable*, as the executor - for public policy reasons - is under the exclusive supervision of the state courts to ensure the proper administration of the estate. By analogy, it could be argued that a request for the removal of a trustee will not be *arbitrable* in Switzerland due to the bar of public policy. To limit potential

⁵⁹ BERNET, p. 11.

⁶⁰ VON SEGESSER, Arbitrability, p. 29.

⁶¹ *Contra* GUTZWILER, Commentary, p. 161 N 5, who argues that it will need to be decided by cantonal procedural law whether such decisions of declaratory nature are subject to contentious or non-contentious proceedings.

⁶² So far, this question has not really received much attention by the doctrine; cf. VOSER, p. 238.

⁶³ Applications for directions may, however, also be lodged if no particular dispute exists and in such case the question arises whether there is really a «dispute» to be arbitrated.

⁶⁴ MAUERHOFER, p. 384; RÜEDE, p. 145.

arbitrability problems, it might help if the settlor empowers a protector to replace a trustee who is not fit to act.

Similar concerns appear to exist in the UK⁶⁵ or in the US where in some states Internal Trust Disputes seem *per se* not arbitrable⁶⁶. The issue, however, appears to be less one of *arbitrability* but rather one of *practicability*, namely whether an arbitrator has sufficient know-how and competence to step into the shoes of the foreign supervisory authority and to issue directions or replace a trustee in accordance with foreign trust law⁶⁷.

4. Some procedural aspects

(a) Representation of all interested parties

One of the distinctive features of family trusts is that the settlor may designate beneficiaries that are not yet born, ascertained or of full age (such as a future grandchild of the settlor). As an award may have an impact upon the proprietary rights of such beneficiaries, the question arises (i) how such (classes of) beneficiaries can be bound by a trust arbitration agreement and (ii) how their interests can be properly represented in an ongoing arbitration⁶⁸. Both issues are closely related and conflict of law issues may need to be considered. In the UK and relevant offshore trust jurisdictions, it will usually be the trustee - in light of his fiduciary duties *vis à vis* the beneficiaries - who represents the interests of such (classes of) beneficiaries. Alternatively (e.g. in case of a conflict of interest), a protector may act as guardian or the court will appoint a representative or so-called *litigation friend*⁶⁹. Any compromise on behalf of such beneficiaries requires the approval of the court. From a Swiss perspective, a distinction must be drawn between (i) minor beneficiaries and (ii) unborn or unascertained beneficiaries.

⁶⁵ WOOD, Zurich Trust Arbitration Conference, p. 8, 13; cf. also Section 15 Trustee Act 1925.

⁶⁶ FIELD, Zurich Trust Arbitration Conference, p. 9.

⁶⁷ GUTZWILER, Commentary, p. 10, 167, who raises similar concerns.

⁶⁸ HAYTON, Trust Conference, p. 1 *et seq.*, 14; BROWNBILL, p. 5 *et seq.*

⁶⁹ COHEN, Zurich Trust Conference, para. 17; HAYTON, Trust Conference, p. 5.

(I) Minor beneficiaries

The question whether a minor beneficiary has capacity to be a party to an arbitration in Switzerland is decided not in accordance with the law governing the subject matter of the dispute, but rather the law applicable to that person's personal status. On the contrary, in the UK and related offshore trust jurisdictions one tends to apply the trust law to all aspects in relation to a trust dispute, irrespective of the nationalities and domicile of the parties involved⁷⁰.

In case of a minor living in Switzerland, it is the parents who are entitled to represent the child *vis à vis* third parties to the extent they have custody, which they usually have jointly if not separated or divorced. The consent of the parents is not needed where the minor child only benefits from a transaction. The consent of the parents would be needed to bind minor beneficiaries living in Switzerland to a trust arbitration clause with seat in Switzerland as the arbitration proceedings may have financial consequences for them⁷¹. Minor beneficiaries may otherwise be bound by a trust arbitration clause in the same way as adult beneficiaries (cf. 2(c) above).

As regards the representation of a minor beneficiary in an ongoing trust arbitration, the involvement of the Swiss guardianship authorities may be required if there is a potential conflict of interest (e.g. if a parent of a minor beneficiary is also a party to the arbitral proceedings because they are all beneficiaries under the trust). A trustee, protector or arbitrator could not represent the interests of such minor beneficiary living in Switzerland. A trustee or arbitrator would also not be entitled to appoint a representative for the child as this is a matter subject to the exclusive jurisdiction of the Swiss courts. As regards minor beneficiaries domiciled outside Switzerland, an arbitrator in Switzerland would have to look at the national law at the respective residence of that beneficiary in order to determine who can properly represent such minors.

Notwithstanding the above, it is suggested that the settlor may appoint an independent representative (or entrust a third party such as a protector to make such appointment) in the trust deed to protect the interests

⁷⁰ Art. 35 PILS; Art. 15(1) Hague Trust Convention; GUTZWILER, Commentary, p. 48, 78.

⁷¹ Art. 421(8) CC; SCHAETZLE, p. 115.

of minor beneficiaries (including a power to compromise)⁷². It needs then to be ensured on a case by case basis whether such appointment can be made without violating national laws providing for mandatory protection of that minor's interest by a court appointed guardian or other representative.

(II) Unborn and unascertained beneficiaries

In England, a court will usually appoint a representative to represent unborn or unascertained beneficiaries in a pending trust litigation⁷³. In the US, it seems to be possible to provide for such class of beneficiaries in the trust deed by «virtual representation», either by (i) involving adult beneficiaries representing unborn or unascertained beneficiaries with the same interest or (ii) by designating an individual representative or a body to appoint such representative⁷⁴. Such an approach could also work in a trust arbitration in Switzerland⁷⁵. Interestingly, the representation of minor, unborn and unascertained beneficiaries in Swiss trust proceedings was not discussed in Switzerland in relation to the ratification of the Hague Trust Convention. In any event, this appears to be more a question governed by the applicable trust law than the *lex arbitri*, and an arbitrator in Switzerland could proceed in the same way as the trust court would in the relevant jurisdiction.

(b) Multi-party arbitration

As noted before, trust disputes have multi-party character. To avoid a challenge to an award and to enhance its enforcement in relation to all parties concerned, it is important that all relevant persons be parties to the arbitral proceedings. In England, the court - usually on the basis of a proposal of the trustee - notifies the interested parties about an ongoing trust litigation and invites them to join the proceedings⁷⁶. It is recommended therefore that potential beneficiaries should be notified of an arbitration - preferably prior to the constitution of the arbitral tribunal -

⁷² HAYTON, Trust Conference, p. 12, 14.

⁷³ LLOYD/PRAATT, p. 19; COHEN/STAFF, p. 222.

⁷⁴ VON SEGESSER, Arbitration, p. 10.

⁷⁵ HAYTON, ADR, p. 19; HAYTON, Trust Conference, p. 14; cf. also ZR 1984 Vol. 9, N 23, as regards the change of the statutes of a Swiss Foundation adding additional beneficiaries, where the Swiss court took the interests of the future (unborn) grandchildren of the founder into account without appointing a special representative.

⁷⁶ LLOYD/PRAATT, p. 19; COHEN/STAFF, p. 222; HAYTON, Trust Conference, p. 6.

and that the parties should agree to the intervention of such interested persons during the arbitral proceedings. It should not be the duty of the arbitrators to include all interested parties but rather such burden should be upon the claimant (possibly with a related duty of respondent to inform claimant of any known potential beneficiaries). Most rules of the major arbitral institutions⁷⁷ contain provisions for multi-party arbitral proceedings.

5. Potential problems at the enforcement stage

The New York Convention assists in ensuring that an arbitral award can generally be enforced by domestic courts in a relatively straightforward way throughout the world (certainly in countries that are parties to the New York Convention). In the context of trust arbitration, it must be noted that some off-shore trust jurisdictions like Guernsey, Bermuda, the Bahamas or the BVI are not parties to the New York Convention, which could lead to some enforceability problems.

Extending the reach of the arbitration agreement to non-signatories such as beneficiaries is worrisome in view of the New York Convention's insistence that the arbitration agreement be contained in an agreement in writing. In light of Articles V(1)(a) and II(2) NYC, it is not considered sufficient that the arbitration clause is contained in a document drafted by one party (i.e. settlor) and simply accepted orally or tacitly by the other party (i.e. beneficiary)⁷⁸. In addition, the liberal definition of *arbitrability* under Swiss law may have consequences for the recognition of a Swiss award abroad (Art. V(2)(a) NYC). Experience shows, however, that the trust assets are normally not located in the trust jurisdiction and it is to be expected that the enforcement of a Swiss arbitral award at the place where the trust assets are held will most likely not be problematic under the aspect of *arbitrability*. Another question is whether an award issued against a class of unborn or unascertained beneficiaries or against beneficiaries who are minor and who were represented in the arbitral proceedings by the trustee or a guardian appointed by the settlor would, in light of Article V(1)(a) NYC, be enforceable in a place where the interests of such minor, unborn and unascertained beneficiary would have mandatory

⁷⁷ Art. 8 Swiss Rules; art. 10 ICC Rules. Apart from the AAA Arbitration Rules for Wills and Trust - which seem of limited use in practice - there is not yet a set of arbitration rules uniquely directed to trust arbitration.

⁷⁸ BERGER/KELLERHALS, p. 658 N 1889, p. 139 N 404; but see VII(I) NYC.

protection by a court appointed representative or guardian (e.g. in Switzerland).

IV. Conclusion: Trust in Arbitration!

Arbitration is an ideal method for resolving trust disputes, in particular due to its private and (relative) confidential nature. Moreover, from a Swiss perspective, while most types of trust disputes are arbitrable, uncertainties remain in particular as regards requests for the replacement of a trustee and applications for directions, which for reasons of practicability should preferably be resolved by the trust courts. There is nevertheless still a risk of parallel proceedings (and enforceability problems) if arbitration in Switzerland is chosen as the dispute resolution mechanism, as some foreign (trust) jurisdictions take an unfriendly approach as regards trust arbitration and not all of them are members of the New York Convention.

From the range of problems identified in the context of trust arbitration, the crucial question in the author's view is not the issue of arbitrability or the proper representation of minor and unborn beneficiaries (a rather exaggerated debate in any event) but rather the critical issue is whether a beneficiary can be compelled to arbitration on the basis of a (unilateral) arbitration agreement in a trust deed. While there is sound legal basis for such arbitration agreements in a trust deed to be effective, following the English theory of *deemed acquiescence* and the Swiss doctrine in relation to unilateral arbitration clauses in last wills, the waters remain untested.

From a Swiss perspective, it is still also debated whether a beneficiary needs to explicitly agree to arbitration in writing or whether claiming or accepting a gift from the trustee could be considered as valid (deemed) consent to arbitration. Unfortunately, the Swiss legislator failed to address the issue of trust arbitration when implementing the Hague Trust Convention and so lost the opportunity to clarify the uncertainty.

While a number of offshore trust jurisdictions have become active in implementing legislation for trust arbitration, it remains to be seen whether they will succeed. Switzerland's increasing importance as center for trust services and its longstanding tradition in international arbitration makes it a reliable neutral venue for trust arbitration. Practitioners from civil law jurisdictions with trust expertise seem equally well suited to serve as arbitrators in a trust dispute as their common law colleagues.

Whether Switzerland will be at the forefront of trust arbitration and establish itself as a preferred trust arbitration venue is in the hands of the Swiss arbitration practitioners, and arbitral institutions such as the Swiss Chambers of Commerce. The onus is on the trust practitioners to persuade their clients (i.e. settlors) that they are well served by arbitration. Their role in changing long established habits is key. The fact that there is not (yet) much expertise (mileage) in this area should not prevent settlors from trusting in arbitration by inserting arbitration clauses into trust deeds establishing new trusts.