Update

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Case review: Swiss court's findings relating to Trusts and ownership in a divorce context

On 26th April 2012 the Swiss Supreme Court issued its ruling in connection with interim measures ordered by the Geneva courts within the framework of divorce proceedings between two Russian citizens domiciled in Geneva. The case is of particular interest to the Swiss trust industry as the Swiss courts considered the extent to which assets held in trust may be subject to interim freezing orders within the framework of divorce proceedings initiated in Switzerland. This is the first such decision since Switzerland's ratification of the Hague Trusts Convention in 2007. Regretfully, for a first attempt, we find the judgment of the court to be inconsistent. This may be explained by the fact that it is not always easy to comprehend the findings as only the final appeal Court's decision has been published. In this Update you will find the background to the matter, the judgment of the court and our initial analysis, based on the published decision.

Details of the case heard by the Courts

Although only the decision of the Swiss Supreme Court has been published, that decision contains some indications as to the factual elements of the case and aspects of the reasoning behind the decisions rendered first by the Geneva Tribunal of First Instance and then by the Geneva Court of Justice.

The husband ("H") and wife ("W") concerned in the case were Russian nationals who had been domiciled in Geneva since 1995. They had been married in Russia in 1987, at which time they had not put a pre-nuptial agreement into place. Subsequent to the marriage, H acquired substantial wealth.

In June 2005, shortly after W had refused to enter into a post-nuptial marriage agreement that had been proposed by H, H established two irrevocable Cypriot discretionary trusts (the "Trusts"), into which he settled shareholdings in certain companies. Those companies held the vast majority of H's business assets. H's explanation of his decision to settle the property onto the Trusts was that he wished to give such property protection from various creditors and foreign pressures. H retained certain managerial powers in respect of the Trusts' underlying property and was named as the principal discretionary beneficiary under the Trusts, alongside his daughters, as well as protector. W was excluded from the class of discretionary beneficiaries, but H expressed in his Letter of Wishes to the trustees of the Trusts that this was on the basis that W would benefit substantially under the terms of his Will.

In December 2008, W filed for divorce in Geneva and requested that the matrimonial property regime be liquidated; as interim measures within the framework of such proceedings, W requested that the Geneva Courts should order the seizure of various assets held by H (whether directly or indirectly and whether through trusts or companies) under the threat of a criminal fine according to Article 292 of the Swiss Criminal Code (comprising a fine of up to CHF 10'000).

Tribunal of First Instance, Geneva

By order dated 31st August 2009, the Tribunal of First Instance in Geneva refused to order the requested seizure measures.

Court of Justice, Geneva

W appealed the decision of the Tribunal of First Instance, and the Court of Justice heard the parties' submissions in 2010.

According to the summarized elements contained in the Swiss Supreme Court decision, the Geneva Court of Justice noted that the Swiss matrimonial property regime of participation in acquired property ("*participation aux acquêts*") applied to the marital estate, by which each spouse was entitled to a monetary claim amounting to half the value of the property acquired for consideration during the period of marriage (excluding gifts, inherited or other assets qualifying as excluded property ("*biens propres*"), see Art. 198 of the Swiss Civil Code).

The Court confirmed its ability to make orders over assets held by bona fide third parties, including assets located outside of Switzerland. It was the Court's view that it would be contrary to the Swiss prohibition against abuses of law ("*abus de droit*") to refuse to order the seizure of assets that had been transferred under circumstances to which Articles 208 and, potentially, 220 of the Swiss Civil Code would apply (that is, cases where the 'claw-back' provisions of those Articles could be invoked). The Court of Justice extended the prohibition to dispose of assets to the underlying companies as well as to the trusts and the trustees. In this regard, the Court of Justice considered that the potential application of Arts. 208 and 220 (matrimonial claw-back mechanism) would mean that H remained the economical owner of such assets, even though the argument that the assets could be subject to a claw-back must inherently mean that the assets had been effectively transferred out of H's ownership. The Court seemed to accept that two discretionary trusts had been established, although this is perhaps one of the findings which is unclear, as it is not, at least in the published decision, fully analysed.

The Court took comfort from the nature of the prior freezing injunctions obtained by W in Cyprus and in London, each of which related to certain of the assets within the Trusts and – in the latter case – were stated as applying to assets over which H had the power to dispose as if they were his own, whether directly or indirectly; indeed, based on its analysis of H's powers under the trusts, the Court viewed this language as being applicable to the assets within the Trusts.

The Court of Justice thus ordered the seizure of various assets it is considered to be held directly or indirectly by H, including through trusts and/or companies (*in rem* measure). The Court of Justice further prohibited H from disposing of the seized assets (*in personam* measure) and extended such prohibition to the trustees, the trusts (sic!), and the underlying companies. All such orders were made under the threat of criminal sanction according to Article 292 of the Swiss Criminal Code.

Swiss Supreme Court

H filed an appeal against the Court of Justice decision on 6th April 2010. After more than two years, the Swiss Supreme Court has now issued its ruling denying H's appeal and thus confirming the measures ordered by the Geneva Court of Justice.

In view of the fact that the decision of the Geneva courts concerned interim measures, and had thus been rendered in summary proceedings, the Swiss Supreme Court's considerations were limited to the potential violation of H's constitutional rights and whether the Geneva court's decision was arbitrary in nature; the Swiss Supreme Court could thus only reverse a ruling that it judged to be in contradiction to the facts or to the correct application of the law. On the other hand, it could not reverse the decision simply because another possible solution appeared to be legally preferable.

As to the standing to appeal, the Swiss Supreme Court emphatically held that H had sufficient standing to file an appeal against the orders relating to assets held directly by him, but expressed doubts in respect of his standing to appeal from the orders relating to assets purportedly held by third parties (even if the orders were made under the threat of criminal sanctions).

In relation to the assets held by third parties (trustees or companies), the Swiss Supreme Court refused to overrule the solution found by the Geneva Court of Justice – even though in contradiction with its previous case law, at least as regards assets located abroad –finding that H had no standing to appeal, since he claimed no longer to own such assets and therefore could not be seen to be party to the measure. As a result, the fact that the measure was also directed against third parties in relation to assets located out of the Swiss jurisdiction was not overruled.

The Swiss Supreme Court further considered that the Court of Justice's reasoning was neither unsustainable nor unjustifiable given that it had jurisdiction and power, within the framework of Swiss divorce proceedings, to order the seizure of assets belonging to third parties and located abroad. The Swiss Supreme Court, however, noted that the question of the enforceability of the measures ordered against third parties in relation to assets located abroad was uncertain.

In view of the circumstances of the case (in particular H's reserved management powers over the underlying assets and the fact that H was protector and beneficiary of the trusts), the Swiss Supreme Court held that the Court of Justice's reasoning was not arbitrary when it considered that, notwithstanding the formal existence of the trusts and the fact that they were discretionary and irrevocable, they could be disregarded for the purposes of seizing the underlying assets to guarantee W's expectancies within the divorce proceedings.

Conclusions

The treatment given to the present matter as appearing in the published decision leaves some notable gaps from a trust law perspective. Although the Swiss Supreme Court confirmed the pre-emptive measures ordered over the Trusts' assets, the exact reasoning behind this action does not appear to be as obvious as one may have wished; given the limited scope of examination of the interim measures, it cannot be said that the Swiss Supreme Court fully agreed with the decision rendered by the Geneva Court of Justice, but only that it considered that such decision was not manifestly unsustainable.

In particular, even though the Swiss Supreme Court did not overrule the Geneva Court of Justice's decision but instead confirmed the order to seize assets located abroad and held by third parties, it noted that the question of whether and how such measures could be enforced remained open. Accordingly, without reversing the cantonal decision, the Swiss Supreme Court still noted that the effectiveness of the orders made by the cantonal Court was uncertain.

In this regard, it should further be noted that one may question the enforceability (or even the validity) of an order directed against third parties that were not party to the proceedings. In particular, the extension of the seizure orders and prohibition to dispose of assets so as to apply to the trustees and the underlying companies appears to be highly questionable to the writers.

Further, on the face of it, it would seem that Article 178 of the Swiss Civil Code only permits the matrimonial judge to seize assets belonging to one of the spouses and not assets belonging to third parties; to decide otherwise, the Geneva Court of Justice should in our opinion have declared the trusts to be sham trusts (in application of the relevant trust law), or at the very least explained in a detailed manner how H could be considered to have remained the economic owner of the assets without a decision as to the validity of the trusts in accordance with the Hague Trusts Convention. Rather than applying the law applicable to the trusts pursuant to Article 6 of the Hague Trusts Convention, the Swiss courts applied Swiss law, justifying such application by the fact that, as regards interim measures (where the need for protection is imperative) the Swiss judge could apply Swiss law rather than the law otherwise applicable. This solution, even if it can be justified in given cases and when the law otherwise applicable to the trust would be similar to Swiss law, appears highly questionable with regard to trusts in a Swiss context, given that there is no Swiss substantive law, and does not seem to be a correct application of Article 15 of the Hague Trusts Convention.

In addition, the reasoning of the Geneva Court of Justice contains an inherent contradiction, as it acts to protect W's claims in respect of the assets transferred into the trusts pursuant to the claw-back provisions of Arts. 208 and 220 SCC, and thereby confirms (at least impliedly) that the assets had been validly transferred out of H's ownership. However, the Court subsequently seemed to disregard such transfers when it ordered the seizure of the assets transferred into the trusts and therefore into third party ownership.

The Court did not satisfactorily consider the implications for H in the event that the trustees subsequently failed to comply with the Court's order. The implication of the Court's assertion that the assets under the Trusts are to be treated as H's own assets for the purposes of the marital estate and awarding the requested relief is that H may be criminally in contempt of court if the assets are not administered in line with the Court's order, despite H having no legal power to prevent the trustees from dealing with the assets. In particular, even though Article 292 of the Swiss Criminal Code can be the basis for criminal sanctions against H only for acts breaching the Court's order that are

committed by H (or with his assistance), the implication of the Court's findings appears to be that the burden of proving an effective transfer of assets may rest with H as the purported transferor. Such an implication seems to be contrary to the presumption of innocence in criminal matters, which is protected both by the Swiss constitutional law and by the European Convention on Human Rights.

With these important considerations outstanding, the impact of the judgement on the treatment of trusts in Swiss courts is not fully clear. Whereas the Court did not make a statement to attack the security of trusts or nature of settlors' and/or beneficiaries' interests thereunder, neither did it take the opportunity to reinforce the commonly-held traditional views in relation to the nature of a transfer of assets into trust or the nature of the ownership of trust assets. With such uncertainties in mind, it may be reasonable to assume that the judgment rendered in this case depended very much upon the facts specific to the matter, notably a Swiss resident settlor and beneficiaries, a Swiss resident protector, a concern that Swiss marital law may be eluded through the use of the trust in an "*abus de droit*".

As such, it should not therefore signal an ominous future for trusts in Switzerland, although it does reinforce the commonly-held view that trusts established by Swiss residents should be carefully analysed and may be prone to unforeseen consequences as the Swiss Courts get to grips with the Hague Trusts Convention.

In any case, given that the Swiss Supreme Court could only reverse the cantonal decision for very limited reasons, the findings of the case at hand cannot be considered as clearly established case law. In particular, it cannot be excluded that other cantonal authorities, more keen to apply the Hague Trusts Convention and to take into account the fact that assets transferred into trust do not belong to the settlor any longer, would decide otherwise and refuse to extend their orders to third party trustees holding assets located outside Switzerland.

Please do not hesitate to contact us in case of any questions.

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