

## **TRADITIONS, TRANSPLANTS AND INEFFICIENCIES: THE CASE OF THE ‘PERUVIAN FIDEICOMISO’\***

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### **ABSTRACT**

This work tries to demonstrate the conceptual inconsistencies of the Latin American trust: the so-called ‘fideicomiso’. Likewise, this work tries to demonstrate that the Peruvian laws on this matter are not only defective in conceptual terms, but also inefficient in economics terms, since these laws ignore the core of the modern trust as well as the cost agency problem that inevitably arises in all kind or organizational forms. The author claims that the current situation is the consequence of the interaction of two opposing forces that tried to dominate the Latin American scenario in the last decades: one represented by the desire to make legal transplants and the other one represented by the desire to maintain certain traditions of the Civil Law. The author advocates for a change based on two ideas: a) to consider the trust as an autonomous estate and the trustee as the manager of that estate, and b) to regulate the trust by paying attention to the different economic realities that are behind the legal categories.

*Fecha de recepción:* 4 de abril de 2006  
*Fecha de aceptación:* 28 de abril de 2006

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\* To DAVID KENNEDY, DUNCAN KENNEDY, STEVEN SHAVELL and ELIZABETH WARREN, for returning my feet to the ground.

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\*\*\* I am very grateful with HOWELL JACKSON, STEVEN SHAVELL and ROBERT SITKOFF for their helpful comments and suggestions on early versions of this work.

I am also very grateful with JEANETTE ALIAGA, BÁRBARA CASTRO, GABRIEL EJGENBERG, HUGO FORNO, CHRISTOPH KERN, PABLO MÁRQUEZ and SILVANA SCHENONE for their constant encouragement and support. Errors are mine alone.

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**Key words:** Peruvian fideicomiso, conceptual inconsistencies, defective in conceptual terms, inefficient in economics terms.

## **TRADICIONES, TRASPLANTES E INEFICIENCIAS: EL CASO DEL FIDEICOMISO PERUANO**

### **RESUMEN**

*Este trabajo intenta demostrar las inconsistencias conceptuales del trust latinoamericano: el así denominado 'fideicomiso'. Asimismo, este trabajo intenta demostrar que las leyes peruanas sobre la materia no son sólo defectuosas en términos conceptuales sino también ineficientes en términos económicos, desde que ignoran la esencia del trust moderno así como la existencia de costos de agencia que inevitablemente surgen en cada forma organizacional. El autor sostiene que el presente estado es consecuencia de la interacción de dos fuerzas opuestas que trataron de dominar el panorama latinoamericano en las pasadas décadas: una representada por el deseo de efectuar trasplantes legales y la otra por el deseo de mantener ciertas tradiciones del derecho civil. El autor aboga por un cambio de rumbo basado en dos pilares: a) considerar al fideicomiso como un patrimonio autónomo y al fiduciario como un administrador de dicho patrimonio y b) regular dicho instituto en función de las diversas realidades económicas que se esconden detrás de cada categoría legal.*

**Palabras clave:** Fideicomiso Peruano, inconsistencias conceptuales, defectuosas en términos conceptuales, ineficientes en términos económicos.

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### I. INTRODUCTION

In the past decade, the Peruvian Congress enacted two laws<sup>1</sup> (hereinafter the “Banking Law” and the “Securities Market Law”) with the purpose to adequate the Peruvian financial market to the ‘*new winds*’. Those laws introduced in Peru the Latin American version of the trust: the so-called *fideicomiso*<sup>2</sup>.

According to the aforementioned laws, the “*fideicomiso*” vests on the trustee the so-called “*dominio fiduciario*” upon the assets transferred to him by the settlor. Taking into consideration the features that such ‘*legal title*’ exhibits, Peruvian authors, following a very particular doctrine created by their Latin American peers, have concluded that the Banking Law as well as the Securities Market Law have created

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1 Law of the Financial System and Insurance System and Organic Law of the Superintendence of Banks and Insurance Companies – Law 26702, and the Securities Market Law – Legislative Decree 861.

2 The Banking Law regulates all kinds of trusts except those related to securitization processes. The Securities Market Law regulates the trusts related to securitization processes.

a new *'real right'*<sup>3</sup>. On the other hand, since the “*fideicomiso*” clearly breaks the rigid structures of the civil law traditional financial tools, Peruvian practitioners have concluded that the adoption of that legal institution is one of the most salient achievements of the Peruvian legislator.

In spite of the prestige of such widely shared opinions, in this work I intend to contradict them. Firstly I intend to demonstrate that “*dominio fiduciario*” and real rights do not belong to the same conceptual category, since contemporary trusts call for the idea of managing assets for the benefit of a third party and therefore for the idea of duty, while real rights call for the idea of acting for one’s own benefit and therefore for the idea of freedom. Secondly I intend to demonstrate that the creation of the “*dominio fiduciario*” was the unfortunate consequence of the opposing forces that represented on the one hand the desire to make legal transplants, and on the other hand the desire to respect certain civil law traditions. Thirdly I intend to demonstrate that the existence of such *'legal title'* provokes inefficiencies not only because it messes up (to some extent) the theoretical consistency of the civil law system, but also because it creates the conditions for ignoring the organizational form that supports every trust and therefore the unavoidable agency-cost problems that affect settlor, trustee and beneficiary. Finally, I intend to demonstrate that even though “*fideicomiso*” plays an important role for the development of some business in Peru, its regulation is far from being optimal.

## II. TRUST AND COMMON LAW

As has been stated myriad times, the trust is the most formidable creation of the Equity system. The true origin of the trust is a complicated matter that I will not address in this work. There is no doubt that the trust derives from the “use”, an old English institution. Nevertheless, it is not clear what the origin of the use is<sup>4</sup>.

I will describe rapidly the most important moments of the trust history, ignoring the dark period related to the ancestral origin of the “use”.

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3 See: ANDRÉS KUAN-VENG & LUIS PIZARRO, *Liquidando las garantías reales tradicionales*, 17 *Ius et Veritas*, 206, 215 (1998).

4 Apparently the use had its predecessors in non-common law systems, since links have been suggested with the Roman law concept of “*fideicommissum*”, with the German law concept of “*salman*” and even with the Islamic law concept of “*waqf*”. See: HILARY LIM, *The Waqf in Trust*, in *Feminist Perspectives on Equity and Trusts* 47, 48 (SUSAN SCOTT-HUNT & HILARY LIM eds., 2001).

Even before the Norman Conquest occurred (1066), English people used to transfer lands to be held by the acquirer “on behalf of” or “to the use of” a third party, but for a limited time and a limited purpose<sup>5</sup>. The paradigmatic case was that of the crusaders, that used to transfer their lands to friends before their departure to the Holly Land. In such a case, the acquirers of those lands had to keep them for the benefit of the transferor’s families, and had to restore them once the transferors returned home<sup>6</sup>.

Widespread use of that practice, however, thrived only in the thirteenth century. Indeed, roughly at that time English people started to use that device for more general and permanent purposes. For different reasons (to evade some of the feudal dues imposed on the holders of the lands, and to avoid seizures by creditors, among others)<sup>7</sup>, landowners used to convey lands through an ordinary common law conveyance to persons called “feoffees to uses”, directing them to hold those lands for the benefit of other persons, called “cestuis que use” (the transferor was included in this category)<sup>8</sup>.

By the end of the aforementioned century, the writ system, that governed the jurisdictions of the common law courts, became rigid and for this reason the creation of new writs was unfeasible. Therefore, common law only offered remedies for cases for which there was a specific writ available. At that time, covenants were not enforceable unless made under seal, and, with the exception of the obsolete legal procedures of the writ of right, the pecuniary award was the only remedy available in a court of law, but only for a very limited number of causes of action<sup>9</sup>.

Due to the fact that “uses” did not fit into the existing categories, the courts refused to take any account of the directions given to the “feoffees to uses”. Therefore, it was considered that they were bound only in honor. The courts thus treated the “feoffees to uses” as the unfettered owners of the conveyed lands and completely disregarded whatever claim the “cestuis que use” submitted against them<sup>10</sup>.

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5 PHILIP H. PETTIT MA, *Equity and the Law of Trusts* 12 (10th ed. 2006).

6 THEODORE F.T. PLUCKNETT, *A Concise History of the Common Law* 577 (1956).

7 “By far the most important reason for creating a *use* was to avoid feudal burdens such as relief, a money payment due to the lord when the land descended to an heir of full age, or the lord’s rights of wardship and marriage when the heir was a minor. The *use* neatly avoided these problems”. See: DAVID WILLIAM GRUNING, *Reception of the Trust in Louisiana: The Case of Reynolds v. Reynolds*, 57 Tul. L. Rev. 89, 93 (1982).

8 PHILIP H. PETTIT MA, *supra* note 5, at 12.

9 HENRY HANSMANN & UGO MATTEI, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. Rev. 434, 439 (1998).

10 PHILIP H. PETTIT MA, *supra* note 5, at 12.

Clearly, the solution was highly unsatisfactory. The possibility that the “feoffees to uses” could disregard the dictates of good faith, honor and justice with impunity was considered outrageous. From the end of the fourteenth century or the early fifteenth century, the Chancellor began to intervene and to compel the “feoffees to uses” to fulfill the directions given to them by the transferors<sup>11</sup>. The Chancellor, however, did not deny that “feoffees to uses” were the legal owners of the lands. He only ordered the “feoffees to uses” to carry out the aforementioned directions, and in case of failure he ordered their imprisonment until they were prepared to fulfill<sup>12</sup>.

During the fifteenth and the early sixteenth centuries, the “use” was employed in a great scale. It seems that at that time the greater part of the land in England was held in “use”. On the other hand, the rights of the “cestuis que use” were so extensive that it was considered that there was a duality of ownership over such lands. One person, the “feoffee to uses”, was deemed the legal owner according to the Common Law, and the other person, the “cestui que use”, was deemed the equitable owner according to the Equity<sup>13</sup>.

A stop to this development, however, was put in 1536. Because the King was losing so many feudal dues by the device of the “use”, the Statue of Uses was passed in order to put an end to “uses” or at least to limit them in a severe way<sup>14</sup>. That statute deprived the “feoffees to uses” of their seisin of the lands, and treated the “cestuis que use” as the legal owners of the lands for full purposes<sup>15</sup>.

Nevertheless, the common law courts interpreted the Statue of Uses quite narrowly. Indeed, those courts held that the statute was not applicable to a “use” wherein the “feoffees to uses” had “active duties” to manage the property, and not simply the duty to hold the property and deliver it to the “cestuis que use”. In

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11 “According to the conventional account, the writ system led to frequent acts of injustice, and when the situation became intolerable, the Chancellor began to grant relief in the form of *in personam* orders to the wrongfully sanctioned defendant. By the fifteenth century, the Court of Chancery had formed and developed its own remedial devices. The dual common law/equity system, typical of Anglo-American law, was born”. See: HENRY HANSMANN & UGO MATTEI, *supra* 9, 440.

12 PHILIP H. PETTIT MA, *supra* note 5, at 13.

13 *Id.*

14 “(...) enforcement of the *use* affirmed the ability of tenants to avoid paying their feudal incidents, thus draining the Crown treasury. Parliament dealt with some of the abuses of the device by enacting statutes to prevent frauds on creditors and to prevent the evasion of the statutes of mortmain. But only when a strong king appeared could a major attack on *uses* be mounted. HENRY VIII passed the Statute of Uses in order to restore the payment of feudal incidents to the Crown. The Statute executed *uses* then in effect by placing legal title in the *cestui*”. See: DAVID WILLIAM GRUNING, *supra* note 7, at 96.

15 THEODORE F.T. PLUCKNETT, *supra* note 6, at 585.

addition, those courts held that the statute was applicable neither to personal property (chattels) nor to “uses upon uses”. This last exception was particularly important.

The “use upon use” was a sale “to *A* to the use of *B* to the use of *C*”. Before 1536 it was decided that *A* had the legal fee simple, *B* the equitable fee simple, but *C* had nothing. After the Statute of Uses, *B* was considered the only one who had a title over the land; *A* and *C* were left with nothing at all. Eventually, however, by unclear reasons and steps, at about the middle of the sixteenth century the Chancellor began to enforce the second use, that is, began to recognize that while *B* had the legal title upon the land, *C* had the equitable title upon it. As a matter of terminology, the “second use” then enforced was called a “trust” and as a matter of drafting English people adopted the following formula: “unto and to the use of *B* and his heirs in trust for *C* and his heirs”. *B* took the legal title upon the land, but the “use” in his favor prevented the “second use” from being reached by the Statute of Uses, leaving such a “use” to be enforced in Equity as a trust. The consequence was obviously the restoration of the division of legal and equitable ownership. The “use”, thus, was resuscitated under the name of “trust”<sup>16</sup>.

Being true that the trust was the old “use” in a new form, the Chancellors however were not bound by ancient doctrine and were free to fashion the trust into an effective instrument for the management and disposition of property. Over the time the trust acquired its own distinctive characteristics, but the underlying concept remained the same: the holder of the legal title to property was under a duty enforceable in Equity to deal with the property for the benefit of the “cestui que trust”, the designated beneficiary<sup>17</sup>. The recognition of the cestui’s equitable rights gave him a kind of ownership in the land parallel to the feoffee’s legal title<sup>18</sup>.

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16 PHILIP H. PETTIT MA, *supra* note 5, at 15.

17 *Id.*

18 “As part of the cautious recognition of a second ownership in the cestui, the law of trusts and uses had to identify the nature of the equitable right. The beneficiary certainly had an *in personam* right to proceed against the trustee for any breach of fiduciary duty with respect to the trust property. But Equity soon began to enforce the beneficiary’s right against third parties who acquired trust property with notice of the existence of the trust. This enforcement was possible because Equity ruled according to the conscience of the parties. Despite the third acquirer’s legal title, he could not in good conscience have acquired a thing in which he knew the beneficiary held an equitable interest. Thus, the beneficiary’s right exceeded a mere right *in personam* and began to take on the characteristics of a right *in rem*. Common law, however, never took the final step of declaring the beneficiary’s right to be one *in rem*. In the beginning, of course, it was essential that the beneficiary and cestui *not* be deemed to have rights in the land whose legal title was in the trustee or the feoffee to uses. The Chancellors knew that a recognition of the rights of the beneficiary as real rights, that is, as rights very close to ownership, would deprive many uses of their *raison d’être*, which was precisely to give to the beneficiaries the advantages of ownership without submitting them to the regime applicable to those with legal title”. See: DAVID WILLIAM GRUNING, *supra* note 7, at 97.

### III. TRUST AND TRADITIONAL CIVIL LAW

If one takes into account the special characteristics of the trust, and fundamentally the protection *in rem* of the beneficiary's interest that it offers, one can fairly state that traditional Civil Law does not contemplate it<sup>19</sup>. Nevertheless, this last system does contemplate an institution, the so-called “*negocio fiduciario*”, that could serve for similar purposes.

Indeed, “*negocio fiduciario*” is a legal act by means of which one party (“*fiduciante*”) transfers the ownership of a certain good to the other party (“*fiduciario*”) with the condition that this last one has to exercise that right in a determined way as well as restore it once some fact occurs (typically, the payment of a debt, or the disappearance of some restriction or danger)<sup>20</sup>. As a consequence of the structure of Civil Law, which does not embrace the distinction between legal and equitable ownership, the “*fiduciario*” becomes the sole owner of the good. It means that he is legally able to transfer his right or to use the good for his own benefit. His promise to exercise the ownership in a determined way does not suppress any of the faculties that shape the content of that right. It is true that in case of breach, the “*fiduciante*” can seek either specific performance or damages. In any case, however, he cannot recover the ownership when the good has been sold by the “*fiduciario*”, even if the acquirer has been aware of the unfaithful behavior of the seller<sup>21</sup>. Therefore, an important difference between trust and “*negocio fiduciario*” arises.

19 MAURIZIO LUPOI has suggested that the English trust owes its origin to “*confidentia*”, an old civil law institution. According to that scholar, in the sixteenth and the seventeenth centuries, testamentary secret and semi-secret trusts, called “*confidentia*”, were well known in many European reigns. The structure and purposes of “*confidentia*” were identical to the structure and purposes of the English trust. Following BARTOLUS, LUPOI states that the rules applied by the “Roman Rota” and other European courts of the time to the aforementioned secret and semi-secret trusts, were originated in the thirteenth and the fourteenth centuries. Taking into consideration the similarities just mentioned between “*confidentia*” and English trust, on the one hand, and the fact that English Chancellors had a civil law background, on the other hand, LUPOI concludes that it is possible to affirm that these last ones drew their rules from the Civil Law without mentioning the sources they were using. See: MAURIZIO LUPOI, *The Recognition of Common Law Trusts and their Adoptions in Civil Law Societies*, 32 Vand. J. Transnat'l L. 967, 967 – 979 (1999). I am not in the position neither to adhere nor to object such a challenging thesis.

20 This figure is basically a creation of German legal scholars, that finds its roots in the Roman institution of “*fiducia*”. This last institution was employed in order to secure debts as well as in order to avoid restrictions and dangerous situations. See: JAMES HADLEY, *Introduction to Roman Private Law* 200 (1999); HENRY JOHN ROBY, *Introduction to Roman Private Law in the times of Cicero and of the Antonines* 97 (1998).

21 HENRY HANSMANN & UGO MATTEI, *supra* note 9, 441; CRISTINA GONZÁLEZ, *El trust. La institución angloamericana y el derecho privado español* 20 (1997); JOAQUÍN DE ARESPOCHAGA, *Trust, fiducia y figuras afines* 22 (2000).



It is true that with the pass of the time, some civil law countries have developed trust-like remedies through which the ownership can be sometimes recovered from a third party who acquired it in bad faith from an unfaithful “*fiduciario*”. However, those remedies generally are not as broad as those afforded by the Common Law<sup>22</sup>. Perhaps the most important difference between common law remedies and modern civil law remedies is marked by the fact that unlike the former ones, the latter ones typically do not protect the “*fiduciante*” against the insolvency of the “*fiduciario*”<sup>23</sup>. Therefore, it is impossible to equal trust and “*negocio fiduciario*”<sup>24</sup>.

#### IV. LATIN AMERICAN TRUST

##### A. Necessary distinction

Before explaining the features of the Latin American Trust, it is important to mention that in Latin America it is possible to find two different institutions that share the same or similar ‘*denominations*’. Indeed, on one hand, there are Civil Codes, such as the Chilean Civil Code or the Brazilian Civil Code, that contemplate the so-called “*propiedad fiduciaria*” (“fiduciary real property”), which is no more than a limited real property right<sup>25</sup>. On the other hand, there are special laws, such as the Peruvian Securities Market Law or the Ecuadorian Securities Market Law, that contemplate the so-called “*fideicomiso*”, which is basically the Latin American version of the trust<sup>26</sup>, since it implies the creation of an autonomous estate that must be managed by the trustee in the benefit of a third party.

In this sense, every single word contained in the following lines should be associated not with the former institution, but with the latter.

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22 HENRY HANSMANN & UGO MATTEI, *supra* note 9, at 444; NICOLO LIPARI, *Il Negozio Fiduciario*, 428 – 429 (1964); CHRISTIAN DE WULF, *The Trust and Corresponding Institutions in the Civil Law* 185 (1965).

23 “Not surprisingly, then, the common response in the civil law countries to the lack of a trust-law-like default rule to govern the Manager’s insolvency is not to try to create the same result through contracting, but rather to employ as Managers only large and stable institutions, such as banks, that are unlikely to go bankrupt”. See: HENRY HANSMANN & UGO MATTEI, *supra* note 9, at 458.

24 JOAQUÍN DE ARESPOCHAGA, *supra* 21, at 21; VINCENZO SALVATORE, *Il Trust. Profili di Diritto Internazionale e Comparato* 35 (1996).

25 ARTURO ALLESANDRI RODRÍGUEZ *et al.*, *Tratado de los derechos reales*, II 87 (6th ed. 1997).

26 Many Latin American scholars have expressly recognized that the trusts of their respective jurisdictions derive from the Anglo-American trust. See for example: JORGE ALFREDO DOMÍNGUEZ MARTÍNEZ, *El fideicomiso* 239 (6th ed. 1996); SATURNINO FUNES, *Fideicomiso* 21 (1996); RAMIRO RENGIFO, *La fiducia* 19 (1984).

## B. Historical framework

During the first years of the twentieth century, Latin American practitioners and scholars started to be deeply interested in the trust. Their interest was motivated by the economic context that some countries of the sub-continent were facing at that time.

As is well known, American investors had been aggressively investing in some Latin American countries<sup>27</sup>, despite their political instability. Those investors were accustomed to make their investments through “*trust companies*”. Latin American countries, however, did not contemplate the possibility of using those kinds of companies. So, two coincident interests, that of the aforementioned investors in having their branches organized as “*trust companies*” and that of the Latin American governments in promoting foreign investments<sup>28</sup>, provoked that practitioners and scholars began to pay attention to the trust for the first time<sup>29</sup>.

As one can imagine, proposals for the adoption of the trust had to face one particular limitation of the Civil Law: the impossibility of having two owners of the same thing. Therefore, attempts to introduce the ‘*new tool*’ had inevitably to deal with this particular issue. In simple words, such attempts needed to find the way of giving the beneficiary of the trust some “real status” –and therefore some “real remedies”– without breaking the traditional model in which there could only be one owner of the thing.

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27 Suffice it to mention that the United Fruit Company, incorporated in 1889, produced in the course of thirty-five years approximately two billion bunches of bananas on its estates in Costa Rica, Panama, Honduras, Colombia, and Ecuador. See: ERIC R. WOLF, *Europe And The People Without History* 323 – 324 (1982).

28 Clearly the first Latin American proposal for adopting the trust appealed to this kind of rationale. Indeed, in 1905 CARLOS LIMANTOUR submitted to the Mexican Congress a project in which he expressed that since Mexico had been receiving important investments from American investors, it was necessary to create a legal framework that helped them to make their investments in the most efficient way. Taking into consideration that those investors used to employ “*trust companies*” as vehicles for their investments, he explained that it was absolutely important to allow them to incorporate those companies in Mexico. It is interesting to note that Limantour’s project treated the trustee as an agent of the settlor. Notwithstanding that, such project contemplated the transfer of the settlor’s assets to the trustee and the creation of a new “real right” over them. The characteristics of that new “real right” would be defined by a complementary law. Limantour’s project, however, was never approved.

29 There was also a third factor. In 1921 the United States of America commissioned a study of the inefficiency of the Latin American banking systems. The report prepared by commissioner Kemmerer established that one of the reasons of the inefficiency of those systems was the lack of the trust. As a consequence of that study, the United States of America promoted a legislative reform in Latin American countries.

In this context, two different models were proposed. The first one was created by RICARDO ALFARO, while the second one was created by PIERRE LEPAULLE.

In his classic book about the convenience of adopting the institution of the trust in Latin America<sup>30</sup>, ALFARO stated that the trustee was basically an agent of the settlor and for this reason the trust was in its essence a kind of “agency relationship”<sup>31</sup>. Nevertheless, unlike the Roman agency relationship, the one created by the trust implied that the trustee had the legal title upon the assets which he had to manage in order to fulfill the settlor’s will<sup>32</sup>. The aforementioned title, however, did not create any kind of right in favor of the trustee. Indeed, the trustee was not able to make use of that title in order to obtain personal benefits from the transferred assets. To the extent that the beneficiary was the only one who could receive those benefits, the trustee had just the position of “depository” of the referred legal title<sup>33</sup>.

ALFARO noted that even though the Roman agency relationship and the trust shared some common features, the first one was not suitable for achieving the goals sought by settlors. Indeed, firstly the Roman agency relationship could be revoked at any time for whatever reason by the principal. Secondly, that relationship did not contemplate the transference of the assets that the agent had to manage in order to generate the benefits expected by the beneficiary. Therefore, the Roman agency relationship only vested on the beneficiary “illusory rights”, that is, rights that could disappear because of the revocation by the settlor (or, more importantly, because of actions taken by the settlors’ creditors)<sup>34</sup>.

Taking into consideration the aforementioned problems, ALFARO concluded that in order to allow individuals to create ‘true’ rights for those who could not manage directly the assets that would generate the expected benefits, it was necessary to adopt the English institution<sup>35</sup>.

With that idea on mind, ALFARO proposed to create a *sui generis* figure: the “*fideicomiso*”. That figure would present the following characteristics<sup>36</sup>:

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30 RICARDO ALFARO, *El fideicomiso. Estudio sobre la necesidad y conveniencia de introducir en la legislación de los pueblos latinos una institución nueva semejante al trust del derecho inglés* (1920).

31 *Id.* at 45.

32 *Id.* at 46.

33 *Id.*

34 *Id.* at 47.

35 *Id.* at 49.

36 *Id.* at 51-81.

- First: it was an agreement executed by the settlor and the trustee.
- Second: that agreement generated two different, but complementary, legal effects. One was a “real effect” and the other one was a “personal effect”.
- Third: the “real effect” implied the irrevocable transference of the assets to the trustee.
- Forth: the “personal effect” implied the creation of the duty to manage the transferred assets according to the settlor’s instructions.
- Fifth: the beneficiary had a personal right against the trustee, and not a real right over the transferred assets.

It is important to mention that ALFARO’s proposal vested on the trustee all the rights and causes of action that were inherent to the ownership. However, the trustee only had to exercise those rights and causes of action according to the settlor’s instructions<sup>37</sup>.

It is also important to mention that even though ALFARO stated that the trustee did not have rights but only duties, his proposal seems to be inconsistent with that conception, since it not only vested on the trustee all the powers that usually are associated with ownership, but also did not vest in the beneficiary the real powers that could justify the idea that the former one was only the “depository” of the legal title over the transferred assets.

In his classic treatise about trusts<sup>38</sup>, LEPAULLE proposed a very different approach. He agreed that the trustee was basically an agent, but unlike ALFARO he believed that the very essence of the trust rested not on the transference of the settlor’s assets in favor of the trustee, but on the creation of an autonomous estate<sup>39</sup>. Indeed,

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37 *Id.* at 71.

38 PIERRE LEPAULLE, *Traité Théorique et Pratique des Trusts en Droit Interne, en Droit Fiscal et en Droit International* (1932). It must be noted that in this work PIERRE LEPAULLE radicalized his previous ideas about the trust. Indeed, in 1927 he published an article (*De La Nature du Trust*, 54 *Journal du Droit International* 966) in which he stated *a)* that the trust fund was an “affected estate” and *b)* that the trustee held all the powers needed for fulfilling the end of the trust. That article was available in Spanish, and therefore influenced to some extent some Latin American legislations. It must be noted, however, that in 1928 he published another article (*An Outsider’s View of Trust*, XIV *Cornell Law Quarterly* 52), where he embraced his ultimate theory. Apparently, this last article was not available in Spanish.

39 *Id.* at 26-27.

LEPAULLE understood that those assets did belong neither to the trustee nor to the beneficiary<sup>40</sup>. It was true that the trustee had to manage those assets and that the beneficiary had the right to receive some benefits from them, but those facts did not contradict the idea that once the trust had been set up, nobody could claim for himself the ownership of the aforementioned assets.

With that idea on mind, LEPAULLE proposed to adopt a civil law version of the English trust. The characteristics of that version would be the following<sup>41</sup>:

- First: there was an agreement executed by the settlor and the trustee.
- Second: that agreement generated two different, but complementary, legal effects. One was a “real effect” and the other one was a “personal effect”.
- Third: the “real effect” implied the constitution of an autonomous estate, that is, an estate without owners.
- Fourth: the “personal effect” implied the creation of the duty to manage the transferred assets according to the settlor’s instructions.
- Fifth: the beneficiary had a personal right against the trust, and not a real right over the transferred assets.
- Sixth: as an autonomous estate, the trust required to have a domicile and a nationality.

The aforementioned models caused different impacts in the Latin American legal community. On one hand, some scholars found that the trustee could not be equaled to the agent, because, unlike the later, the former could not be removed by

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40 PIERRE LEPAULLE was the first French lawyer which obtained a S.J.D. from Harvard. It seems that his studies in that university allowed him to understand that there was a contradiction between the traditional civil law doctrines and the idea of conferring the trustee some real right upon the assets transferred by the settlor. As we shall see, he was right. Nevertheless, some Latin American scholars not only rejected his ideas, but also criticized them on the basis that the Common Law vested on the trustee as well as on the beneficiary “true property rights”. Ironically, those scholars not only ignored what the meaning of “property rights” was in that system, but also harmed the conceptual consistency of their own systems by embracing the ALFARO’s model.

41 PIERRE LEPAULLE, *supra* note 38, at 41-51.

the settlor<sup>42</sup>. As one can easily understand, however, the argument was weak because the possibility to remove the agent was not a definite characteristic of the agency relationship<sup>43</sup>. On the other hand, many scholars found that it was absolutely impossible to conceive the existence of estates without owners. Unlike the former critic, this one seemed to be powerful since it rested on the traditional dogma, imported from Europe, according to which the estate was an extension of the legal capacity of the citizens<sup>44</sup>.

As we shall see, Latin American legislators were first seduced by ALFARO's model, but after some concerns provoked by the failure of that model in avoiding the hazard of the trustee's insolvency, they changed their minds and embraced timidly LÉPAULLE's model. Their attitude, however, was never clear. Tradition always forced them to stop in the middle of the road.

### C. Representative moments

There are two important moments in the history of the Latin American trust. The first one is marked by the adoption of the first Latin American laws on trust. The second one is marked by the opening market policies embraced by some Latin American countries, such as Argentina and Peru, during the last decade of the last century.

Let us take a look at the firsts legislations.

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42 It has been said, for example, that while the principal can replace the agent, the settlor cannot replace the trustee. See: JORGE ALFREDO DOMÍNGUEZ MARTÍNEZ, *supra* note 26, at 148.

43 Many Civil Codes establish that the agency agreement can be irrevocable. See for example: Article 1723 of the Italian Civil Code, and Article 1808 of the Peruvian Civil Code.

44 Even though such conception did not derive from the French civil code, its acceptance in Latin America was the product of a very peculiar phenomenon. As is well known, during the nineteenth century, several Latin American countries got independent from Spain. The leaders of those countries preferred to import European laws instead of working on those that already existed. Because of its prestige and because of the fact that it reflected the ideals of the French revolution, the French Civil Code was chosen as the model for the Latin American new civil codes. As one can imagine, the introduction of those new codes was not a minor task. In order to understand what the aforementioned model meant, and therefore what their own codes meant, Latin American legislators, judges, professors, scholars and lawyers started to study the French treatises. Through those treatises many dogmas were uncritically accepted by Latin American legal community. One of them, authored by AUBRY and RAU, was the dogma which considered the estate as an extension of the legal capacity of individuals and legal entities. It is important to mention that AUBRY and RAU took that idea from the German scholar ZACHARIÄ VON LINGENTHAL. See: KONRAD ZWEIGERT & HEINZ KOTZ, *Introduction to Comparative Law* 103 (3rd ed. 1998).

In 1925, the Asamblea Nacional de Panama enacted the Law 9<sup>th</sup> of 1925<sup>45</sup>. This law, based on the ALFARO's proposal, created the "*fideicomiso*". The following were the main features of that law:

- First: the "*fideicomiso*" was an agency contract.
- Second: that contract generated two different, but complementary, legal effects. One was a "real effect" and the other one was a "personal effect".
- Third: the "real effect" implied the irrevocable transference of the assets to the trustee. Therefore, the trustee had all the rights and causes of action inherent to the ownership. Nevertheless, the trustee only could dispose of those assets if the contract expressly authorized him to do that or if the circumstances required so.
- Fourth: the "personal effect" implied the creation of the duty to manage the transferred assets according to the settlor's instructions.
- Fifth: the beneficiary had a personal right against the trustee, and not a real right upon the transferred assets.

One year later, the Mexican congress enacted the Trust Bank Law (1926)<sup>46</sup>. This law basically followed the line traced by the Panamanian Law. Its main features were the following:

- First: the "*fideicomiso*" was an agency contract.
- Second: that contract implied the irrevocable transference of the assets to the trustee to the extent that the existence of such an effect was deemed necessary in order to fulfill the settlor's will. Therefore, subject to that aforementioned condition, the trustee had all the rights and causes of action inherent to ownership. Nevertheless, the trustee could only dispose of those assets if the contract expressly authorized him to do that or if the circumstances required so.

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45 ALFARO also submitted his proposal to the Third Pan-American Scientific Conference held in Lima in 1924. At this opportunity, attendants of that conference (mainly practitioners and businessmen) applauded his work.

46 This law was enacted as a complementary law of the General Law of Credit Institutions and Banking Establishments (1924), which contemplated the creation of "trust banks".

- Third: the contract imposed on the trustee the duty to manage the assets according to the settlor's instructions.
- Fourth: the beneficiary had a personal right against the trustee, and not a real right upon the transferred assets.

The law under analysis generated many doubts within the Mexican legal community, since it was not clear when one could assume that circumstances required to consider that the assets had been transferred to the trustee<sup>47</sup>. Moreover, it was not clear how one person could simultaneously be agent and owner with respect to the same subject matter<sup>48</sup>. For these reasons, the Mexican legislator sought the opportunity to improve the then current regulation. In 1932 the Mexican President promulgated two different laws that modified considerably the prior legislation. The first one was the General Law of Credit Institutions, and the second one was the General Law of Credit Instruments and Operations.

The General Law of Credit Institutions basically created the new legal framework that would support the new conception of the trust. The General Law of Credit Instruments and Operations introduced such a conception. Indeed, this latter law established the following:

- First: the “*fideicomiso*” was either a contract or a unilateral legal act.
- Second: once the “*fideicomiso*” was set up, the assets became “affected” to the settlor's purposes expressed in the contract or in the unilateral legal act. Therefore, those assets could only be used in order to achieve those purposes.
- Third: the trustee had all the rights and causes of action inherent to the ownership to the extent that this was necessary in order to fulfill the settlor's will.
- Fourth: the “*fideicomiso*” imposed on the trustee the duty to manage the affected assets according to the settlor's instructions.
- Fifth: the beneficiary had a personal right against the trustee, and not a real right upon the transferred assets.

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47 RODOLFO BATIZA, *El Fideicomiso. Teoría y Práctica* 150 (5th ed. 1991).

48 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, 60 (1969).



- Sixth: only the duly authorized institutions (that is, the institutions that had followed the procedures established by the General Law of Credit Institutions) could act as trustees.

As one can note, the change was considerable since the Mexican legislator *a*) eliminated all references that equaled “*fideicomiso*” and agency, and *b*) replaced the “transference of assets formula” by the “affectation of assets formula”, which meant that such legislator abandoned ALFARO’s model and welcomed Lapaulle’s model. Unfortunately, however, the formula used by the Mexican legislator was not satisfactory. Indeed, the meaning of “affected patrimony” was never clear and the obscurity of those words provoked judicial as well as doctrinal controversies. For this reason it was not surprising that while some judicial decisions stated that the trustee did not acquire property rights upon the assets, other judicial decisions stated exactly the opposite<sup>49</sup>.

Why did the Mexican legislator embrace such an obscure position? The explanation is very simple. As Mexicans<sup>50</sup> have expressly recognized, there was a great opposition against the idea of allowing the creation of an estate without an owner. In order to avoid strong criticism, the Mexican legislator preferred to adopt a formula that neither rejected expressly that idea nor expressly embraced it.

Let us now take a look at the last Latin American legislations.

Until the last decade of the last century, Argentina did not have a law for trusts. According to one commentator<sup>51</sup>, the first attempts for adopting the trust in that country were the consequence of the interest that businessmen as well as practitioners had in improving the local legislation for promoting private investment. The efforts made by those businessmen and scholars were rewarded in 1995, when the Argentinean Congress enacted the Law 24.441.

Even though the Argentinean legislator had behind it a rich history of debates between those who believed in the model proposed by ALFARO and those who believed in the model proposed by LEPAULLE, he decided not to pay attention to the irreconcilable features exhibited by such models. Indeed, as we shall see, the Argentinean legislator believed that it was possible to combine the idea of vesting on the trustee the property rights of the assets transferred by the settlor with the idea of creating an autonomous

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49 RODOLFO BATIZA, *supra* note 47, at 154.

50 *Id.* at 153.

51 GIRALDI, PEDRO MARIO, *Fideicomiso* 41 (1998).

estate. Moreover, the Argentinean legislator believed that it was possible to tie the new institution to the provisions of the Argentinean Civil Code. Latin America thus saw the birth of a new model, that unfortunately influenced the legislation of other countries of the region.

Let us analyze with some detail the features of the Argentinean creation.

The Law 24.441 disposes that the “*fideicomiso*” can be created either by contract or by will. By virtue of the “*fideicomiso*”, the settlor transfers to the trustee the fiduciary ownership of particular assets. The trustee commits himself to act for the benefit of whoever is designated in the contract or in the will, and to transfer the fiduciary ownership to the settlor or to the beneficiary upon the expiration of a given term or the fulfillment of a condition.

The Law 24.441 also disposes that upon the aforementioned assets a fiduciary ownership is established. Such an ownership has to be construed under the provisions of the Civil Code. The trustee is authorized to transfer and to encumber those assets if the purposes of the “*fideicomiso*” require so. In any case, the trustee is authorized to exercise the causes of action that are required in order to defend the trust.

The Law 24.441 also disposes that assets under the fiduciary ownership constitute a separate estate, distinct from that of the trustee and that of the settlor.

Finally, the Law 24.441 disposes that the trustee has the duty to manage the assets according to the settlor’s instructions, and to the benefit of the beneficiary.

This Argentinean law is very peculiar for several reasons. Firstly, it eliminates the conception according to which the trustee is an agent of the settlor. As we shall see, this represents exactly the opposite trend followed by American courts, legislations and scholars. Secondly, it establishes that the settlor transfers to the trustee the fiduciary ownership upon certain assets and recognizes that this latter has “real rights” upon those assets<sup>52</sup>. At the same time, however, it establishes that those assets constitute an “autonomous estate”. As we shall see, conceptually it is impossible to understand how one person can be the owner of certain assets that do

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52 The transfer of the fiduciary ownership seems to be impossible in theoretical terms, since the transferor did not have previously such a right. What he had was the ordinary ownership. Therefore, as in the case of the usufruct, the formula should appeal to the word “constitution” instead to the word “transference”.

not belong to him<sup>53</sup>. Finally, it establishes that the trustee has the “duty” to manage the aforementioned assets in the benefit of the beneficiary. As we shall also see, conceptually it is impossible to understand how one person can have a right and at the same time can be obliged to exercise that right for the benefit of another person.

Why did the Argentinean legislator embrace such a strange position? I will propose a possible answer later.

The two moments that I have described are only representative moments in the history of the Latin American “*fideicomiso*”. Between them, some Latin American countries, such as Bolivia, Colombia, Costa Rica, Guatemala, Honduras, Panama, Peru and Venezuela, adopted their own versions of “*fideicomiso*”. With the exception of Panama<sup>54</sup>, Peru<sup>55</sup> and Venezuela<sup>56</sup>, the other mentioned countries regulated that institution in their Commercial Codes<sup>57</sup>. Unfortunately, it is impossible to consider that those legislations followed a unique pattern. Indeed, according to some legislations (Bolivian, Colombian and Guatemalan codes, and Panamanian and Venezuelan laws) the settlor transferred “assets” to the trustee; while according to other legislations (Costa Rican and Honduran codes, and Peruvian law) the settlor transferred the “ownership” of those assets to the trustee. Likewise, some legislations (Bolivian and Colombian codes, and Panamanian law) expressly recognized that the “*fideicomiso*” created a “separate estate”; but other legislations (Costa Rican, Guatemalan and Honduran codes, and Peruvian and Venezuelan laws) kept silence about the existence of that effect. Taking into consideration the profound differences between those legislations<sup>58</sup>, no model or pattern can be construed based on them.

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53 If for whatever reasons one thinks that it is improper to criticize the Argentinean model by employing an argument based on the concept of ownership, I can reformulate my critic and state that it is conceptually impossible to understand how one person can be deemed the owner of certain assets but at the same time be restricted in the disposition of these assets and, more importantly, have these assets shielded from all his personal creditors.

54 The Law 1 of 1984.

55 The Legislative Decree 770 of 1993.

56 The Law 496 of 1956.

57 See: Articles 1409 to 1427 of Bolivian Commercial Code, Articles 1226 to 1244 of Colombian Commercial Code, Articles 633 to 666 of Costa Rican Commercial Code, Articles 766 to 793 of Guatemalan Commercial Code, and Articles 1033 to 1062 of Honduran Commercial Code.

58 Many other differences between the aforementioned legislations can be found. Perhaps the most striking of those differences is that related to the basic model’s dichotomy: “agency” v. “ownership”. There are legislations, such as the Bolivian code, that clearly embraced the first model, and legislations, such as the Peruvian law, that clearly embraced the second one.

On the other side, after the second moment just described, Bolivia<sup>59</sup>, Brazil<sup>60</sup>, Ecuador<sup>61</sup>, Paraguay<sup>62</sup>, Peru<sup>63</sup>, and Uruguay<sup>64</sup> enacted new laws that contemplated different types of “*fideicomisos*”. Bolivian, Brazilian, Paraguayan, Peruvian, and Uruguayan laws basically followed the Argentinean model. Ecuadorian law, however, took an opposite model. I will make further references to that law later.

#### **D. Doctrinal confusions**

If Latin American legislations exhibit erratic positions, Latin American scholars exhibit more than that.

Indeed, it is not unusual to find that Latin American scholars understand the same law in opposite ways. For example, Mexican law has been interpreted *a)* in the sense that it creates an ‘*independent and autonomous estate*’, that is, an estate that does not belong to anybody; *b)* in the sense that it creates a ‘*separated estate*’, that is, an estate that belongs to the settlor but is legally controlled by the trustee since it is affected to certain purposes; and, *c)* in the sense that it creates a ‘*fiduciary relation*’, that is, a relation in which the trustee is the legal owner, while the beneficiary is the economic owner<sup>65</sup>. Likewise, Argentinean law has been interpreted *a)* in the sense that it creates a new real right, different from the ownership; and, *b)* in the sense that it only creates a special kind of ownership<sup>66</sup>. On another level of discussion, that law has also been interpreted in the sense that it creates a second legal regime for the old category of “*dominio fiduciario*”; and, *b)* in the sense that it replaces the legal regime that the Argentinean Civil Code contemplated for that category<sup>67</sup>.

But contradictory interpretations of the same law are not the only consequence of erratic regulations. Even though there is a huge difference between “*negocio fiduciario*” and “*fideicomiso*”, and even though the first Latin American works in

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59 The Law 1834 of 1998.

60 The Law 9.514 of 1997.

61 The Law 107 of 1998 (the Securities Market Law).

62 The Law 921 of 1996.

63 Both the Banking Law and the Securities Market Law were enacted by the Peruvian Congress in 1996.

64 The Law 17.703 was enacted by the Uruguayan Congress in 2003.

65 See: JORGE ALFREDO DOMÍNGUEZ MARTÍNEZ, *supra* note 26, at 158.

66 See: FRANCISCO A. M. FERRER, *Fideicomiso testamentario y derecho sucesorio*, 169-170, 2000.

67 See: CLAUDIO M. KIPPER & SILVIO V. LISOPRAWSKI, *Teoría y práctica del fideicomiso*, 155-166, 1999.

this field made that difference absolutely clear, some authors still think that the latter and the former are basically the same<sup>68</sup>.

This unfortunate landscape is no more than the product of the erroneous way in which the Latin American trust has been conceived along the last century.

### **E. Tradition v. Transplant (the paradoxical outcome)**

At the beginning of the last century Panamanian and Mexican scholars considered that “*fideicomiso*” was a kind of agency relationship. At the end of that century, however, Argentinean and Peruvian scholars considered that such legal institution was a kind of ownership.

On the other side, at the beginning of the last century American scholars still explained the trust in terms of ownership, but at the end of that century those scholars explained such legal institution in terms of organizational form, that is, in terms of a broad category that also includes the agency relationship.

Why did not Latin American scholars follow the American tendency?

It is clear that during the first half of the last century, some Latin American scholars believed that the trustee was basically an agent of the settlor<sup>69</sup>. That conception worked very well with the model proposed by LEPAULLE, since the existence of an autonomous estate excluded the idea of ownership (either legal or equitable) and, therefore, reinforced the managerial role of the trustee.

At the same time, however, many Latin American scholars rejected the possibility of accepting the constitution of an estate without an owner. Indeed, following the French traditional view, according to which the estate was an extension of the legal capacity of the individuals and entities<sup>70</sup>, those scholars stated that the legal system did not tolerate the constitution of an estate without an owner.

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68 See: PEDRO FEDERICO GUTIÉRREZ, *Los fideicomisos y las obligaciones negociables*, 54, 1998.

69 See: RICARDO J. ALFARO, *supra* note 30, at 48.

70 According to the French conception of the estate, it is the total sum of certain pecuniary rights and duties (those that belong to one individual or legal entity). From that conception, Aubry and Rau, two of the most prominent French scholars of their time, derived the following characteristics of the estate: a) it was unique and indivisible, b) it was inherent to the individuals and legal entities, and c) it could not be transferred *inter vivos*. See: JOSÉ LUIS DE LOS MOZOS, *Estudios sobre el derecho de los bienes* 280 (1991). However, as GénY has pointed out, those characteristics were arbitrarily derived from a conception that functionally did not support any of them. See: FRANCOIS GÉNY, *Método de interpretación y fuentes en derecho positivo* 113 (2000).

The different beliefs about the topic under analysis can be represented by the following statements:

*«Resulta económica y jurídicamente fundada la formación de un patrimonio autónomo destinado a un fin lícito, sin que necesariamente tenga como requisito la existencia de un propietario (...). En este caso puede no existir propietario de los bienes afectados al fin perseguido, siendo bastante con que la afectación se organice de modo adecuado para que los bienes cumplan su función de medios de alcanzar los fines de que se trata»<sup>71</sup>.*

[The constitution of an autonomous estate, affected to a legal end and without an owner, makes sense in economic as well as in juridical terms (...) In such a case the existence of an owner it is not necessary because it is enough to organize the affectation of the assets in a suitable way in order to fulfill the given end].

*«A primera vista se advierte que la posición fundamentalmente económica de quienes sostienen la teoría del patrimonio de afectación les ha conducido a pretender aun la existencia del patrimonio de afectación sin titular o sin sujeto, como si fuera posible que algo distinto a la persona realizara las finalidades jurídico-económicas de ese patrimonio cuya naturaleza reclama el ejercicio de los derechos y el cumplimiento de las obligaciones que le corresponden y como si pudiera concebirse que algo distinto también a la persona pudiese tener la facultad de rehacer o incrementar el conjunto de bienes que lo constituyen»<sup>72</sup>.*

[It is possible to note immediately that the economic insight of those who embrace the theory of the affected estate drives them to allege the existence of an estate without an owner, as if it were possible to accept that something different from a person could achieve the legal and economic purposes of such an estate, whose nature claims the exercise of rights and the fulfillment of obligations attached to it, and as if it were possible to conceive that something different from a person could hold the faculty to change and increase the assets that constitute the estate]

The evolution of the Latin American legislations clearly shows that this second point of view prevailed. Therefore, it is possible to affirm that even though Latin American legislators wanted to adopt a version of the English trust in their jurisdictions, the weight of a predominant group of scholars finally prevented those legislators from finding a way in which that institution could properly be fitted in their highly rigid systems.

71 JUAN LANDERRECHE, *Naturaleza jurídica del fideicomiso en el derecho mexicano*, 50 *Revista JUS*, X, 197 (1942).

72 LUIS ARAÚJO VALDIVIA, *Derecho de las cosas y derecho de las sucesiones* 25 (1964). In the same sense: CARLOS YARZA OCHOA, *El derecho de propiedad en el fideicomiso* 21 (1949); JOSÉ URIBE MICHEL, *Naturaleza jurídica del fideicomiso* 47 (1948).

In my intuition, the steps that led those legislators to adopt what I call “the Argentinean model” can be summarized in the following way:

- First: Latin American legislators were aware that the essence of the trust rested on the function that the trustee had to fulfill in order to achieve the settlor’s purposes. For this reason, they imposed on the trustee the duty to manage the assets transferred by the settlor according to the instruction of this last one, and in the benefit of the beneficiary.
- Second: Latin American legislators were convinced that the settlor should not retain the ownership of the assets since that would have meant that trust and agency were basically the same and, what seems to be more important, that creditors of the settlor could have access to the trust estate.

They knew that unlike the Common Law, the Civil Law could not accept the existence of two ownerships (one legal and the other one equitable) upon the same assets. They also knew that the constitution of an autonomous estate was an available option. Unfortunately, the weight of the tradition defeated them. Therefore, they decided to rely on the old formula suggested by ALFARO: “the transference of the assets to the trustee”.

- Third: Latin American legislators were also aware that the powers of the trustee upon the transferred assets required to be limited in order to avoid the ancient problems caused by the imperfect structure of the “*negocio fiduciario*” (mainly its lack of satisfactory response once the “*fiduciario*” became insolvent). For this reason, they decided to rely on the formula suggested by LÉPAULLE: “the constitution of a separate estate”.

Latin American legislators believed that by doing what I have just described, they were conciliating in a harmonious way tradition and change, conceptual consistency and practicality, in sum the virtues of Civil Law and Common Law. Unfortunately, however, they were wrong.

Indeed, most of the Latin American legislations recognize that the trustee holds a ‘*real right*’ (the so-called “*dominio fiduciario*”) upon the assets transferred by the settlor<sup>73</sup>. At the same time, however, those legislations recognize that such

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73 This conclusion is common among Latin American scholars. See: PEDRO FEDERICO GUTIÉRREZ, *supra* note 68, at 74; FRANCISCO A. M. FERRER, *supra* note 66, at 170; ROBERTO MOLINA PASQUEL, *Los derechos del fideicomisario* 179 (1946); SERGIO RODRÍGUEZ AZUERO, *Contratos bancarios. su significación en América*

assets constitute an autonomous estate. Therefore, from a conceptual perspective, the trustee has a *'real right'* upon certain assets that do not belong to anybody. Is this conclusion consistent with the Civil Law concepts of “right” and “estate”? But there is more. The aforementioned *'real right'* is not a common one. It is a *'real right'* that must necessarily be exercised in the benefit, not of its holder, but of a third person (the beneficiary). Is this conclusion consistent with the Civil Law concept of “right”?

As it is easy to understand, the work of most of the Latin American legislators did not protect the tradition of the Civil Law system. To the contrary, that work harmed gravely not only such tradition, but also, which is worse, the consistency of concrete legal systems<sup>74</sup>. I am sure that Latin American literature can provide us with extraordinary examples of unfortunate phrases that intend to conciliate the God and the evil. Until now, however, I have not found a better phrase for summarizing what I have just denounced:

*«El fideicomiso es la transformación del derecho de propiedad de potestativo en obligatorio. Se conserva la esencia del derecho y se cambia su modo de ejercicio»<sup>75</sup>.*

[The “*fideicomiso*” implies the transformation of the ownership from free ownership to mandatory ownership. The essence is kept, but the way in which that right is exercised changes].

Further comments are not necessary.

## V. PERUVIAN TRUST (“*FIDEICOMISO*”)

### A. Legislation

Article 241 of the Banking Law establishes that “*fideicomiso*” is a legal relationship by means of which the settlor transfers a pool of assets to the trustee with the

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*Latina* 633 (1990); EDUARDO ÁLVAREZ-CORREA, *Contratos bancarios* 295 (1991); JUAN CARLOS VARÓN PALOMINO, *Portafolios de inversión* 74 (1994); JUAN M. FARINA, *Contratos comerciales modernos* 379 (1997); JORGE ROBERTO HAYZUS, *Fideicomiso* 47 (2000); MELHIM NAMEM CHALHUB, *Negócio fiduciário* 100 (2000); GUSTAVO ODORQUI CASTILLA, *El fideicomiso* 39 (2003); NURI E. RODRÍGUEZ OLIVERA, *Fideicomiso* 93 (2004).

74 “If the trustee was owner, why was there no power of use and enjoyment – no right of *usus, fructus, and abusus?*”. See: KENNETH G.C. REID, *The Idea of Mixed Legal Systems*, 78 Tul. L. Rev. 5, 32 (2003).

75 The phrase belongs to OSCAR MORINEAU. Nevertheless, it is generally accepted by Latin American scholars. See for example: SATURNINO J. FUNES, *supra* note 26, at 83.



purpose of constituting a fiduciary estate. That estate, according to this article, shall be subject to the “*dominio fiduciario*” held by the trustee, and shall be different from the parties’ estates, that is, settlor’s, trustee’s and beneficiary’s estates.

In its turn, Article 252 of the aforementioned law establishes that the “*dominio fiduciario*”, held by the trustee upon the fiduciary estate, confers this last one full faculties, including the faculties to use, dispose and recover the assets. Those faculties, however, must be exercised according to the purpose of the trust.

Article 301 of the Securities Market Law establishes that, in the context of a securitization, “*fideicomiso*” is a legal act by means of which the settlor obliges himself to transfer certain assets to the trustee with the purpose of constituting an autonomous estate. That estate, according to this article, shall be subject to the “*dominio fiduciario*” held by the trustee, and shall back the rights packaged into securities that would be issued by the trustee.

In its turn, Article 310 of the aforementioned law establishes that the autonomous estate is different from the parties’ estates, that is, settlor’s, trustee’s and beneficiary’s estates.

Finally, Article 313 of the aforementioned law establishes that the “*dominio fiduciario*”, held by the trustee upon the fiduciary estate, confers this last one full faculties, including the faculties to use, dispose and recover the assets. Those faculties, however, must be exercised in order to achieve the settlor’s purposes.

As it is easy to note, both the Banking Law and the Securities Market Law conceptualize in the same way the new institution. Likewise, as it is easy to note, those laws embrace the Argentinean model.

Taking into consideration that Article 923 of the Peruvian Civil Code establishes that ownership is the power to use, enjoy, dispose, and recover the good, it is obvious that the language used by both the Banking Law and the Securities Market Law to describe what “*dominio fiduciario*” is, clearly resembles the language used by the aforementioned code to describe what ownership is.

The idea that “*dominio fiduciario*” amounts to, at least, a kind of “real right” is reinforced by the language of the complementary legislation. Indeed, Article 4 of Fiduciary Act – Resolución SBS 1010-99 literally establishes that “*dominio fiduciario*” is a temporary “right” that grants the trustee powers over the assets that constitute the fiduciary estate. In its turn, Article 27 of Securitization Processes Act – Resolución CONASEV 001-97-EF-94.01 literally establishes that the trustee is authorized to take all the actions that protection of “his right upon the fiduciary assets” requires.

## B. Doctrinal Understanding

In the two Peruvian books dedicated entirely to this topic, one reads as follows:

*«En el fideicomiso, el fideicomitente transfiere la propiedad del bien al fiduciario, en esta forma este último se convierte en el nuevo propietario del bien, estando limitado su accionar sobre el mencionado bien en función de una finalidad determinada por el fideicomitente al momento del acuerdo que dio nacimiento al fideicomiso»<sup>76</sup>.*

[By means of “*fideicomiso*”, the settlor transfers the ownership of the asset to the trustee, and this last one becomes the new owner of the asset, even though his powers are limited by the purpose chosen by the settlor when he decided to set up the “*fideicomiso*”].

*«(...) el fideicomiso, al perfeccionarse, provoca un doble efecto que ha de afectar la relación entre las partes: un efecto real de cargo del fideicomitente, cual es la transferencia de la propiedad; el otro efecto es obligacional, de cargo del fiduciario, consistente en la obligación de usarla en beneficio del fideicomisario (...). La propiedad fiduciaria ha de ser considerada como un tipo de propiedad condicionada tanto por el fin para el cual se ha transferido, como por el plazo al cual queda sometida: es una propiedad exclusiva pero no absoluta, ni perpetua»<sup>77</sup>.*

[(...) once the “*fideicomiso*” has been set up, it provokes two different effects that would affect the relationship between the parties: one is a real effect imposed on the settlor, that consists in the transference of the ownership; and the other one is a personal effect imposed on the trustee, that consists in the necessity of exercising the ownership in the benefit of the beneficiary (...) Fiduciary property must be considered a kind of ownership conditioned by the purpose of its transference as well as by the term agreed by the parties: it is an exclusive ownership, but not an absolute or a perpetual ownership].

The few articles that have been published on this matter do not propose a very different approach. Indeed, one author<sup>78</sup> thinks that the aforementioned conceptions are correct, stating that “*dominio fiduciario*” is just a limited ownership. Others<sup>79</sup>

76 MANUEL DE LA FLOR, *El fideicomiso. Modalidades y tratamiento legislativo en el Perú* 105 (1999).

77 ALBERTO STEWART, *El fideicomiso como negocio fiduciario* 248 – 249 (1996).

78 RAFAEL ALCÁZAR, *La titulación de activos en el Perú*, 15 *Ius et Veritas*, 295, 298 (1997).

79 See: GERARDO SERRA-PUENTE ARNAO, *El mercado de valores en el Perú* 596 (2002); ANDRÉS KUAN-VENG & LUIS PIZARRO, *supra* note 3, at 215; RAFAEL CORZO, *El fideicomiso. Alcances, alternativas y perspectivas*, 35 *Themis*, Segunda Época, 47, 53 (1997); JACQUELINE CHAPUIS, *El fideicomiso, Themis y las frías mañanas de invierno*, 50 *Themis*, Segunda Época, 47, 51 (2005).

believe that “*dominio fiduciario*” and ownership are two different things. Nevertheless, they do not deny that “*dominio fiduciario*” belongs to the realm of the real rights.

Taking into account the aforementioned, it is fair to state that Peruvian mainstream believes that “*dominio fiduciario*” is firstly a “right”, and secondly a “right” that confers faculties upon the assets transferred by the settlor.

### C. Conceptual inconsistencies and problems

First of all, it is important to state that it is impossible to argue that the trustee acquires the real property right of the asset transferred by the settlor. Indeed, the trustee never holds some powers that typically form part of the content of the real property right, such as the power to destroy the object of that right or the power to modify such object. Hence whatever the trustee acquires, it is not, for sure, the real property right that the settlor had upon the assets.

Having made the initial distinction between property real right and “*dominio fiduciario*”, let us see why Peruvian scholars are wrong when they state that both the Banking Law and the Securities Market Law have created a new ‘*real right*’.

A first consideration is related to the theoretical inconsistency of the criticized conception. As one can easily understand, the concept of right calls not only for the idea of freedom but also for the idea of acting in the own benefit<sup>80</sup>. Therefore, it is proper to state that I have a certain right if and only if I am free to perform some activity in my own benefit. The conception defended by Latin American authors ignores the aforementioned features and plainly erases the distinction between “rights” and “duties”, which is not, of course, a minor thing. Indeed, on one hand that conception recognizes that the trustee holds a ‘*real right*’ upon the assets transferred by the settlor, but on the other hand that conception recognizes that the trustee must manage those rights in the benefit of the beneficiary. Therefore, according to the aforementioned conception, the trustee is ‘*obliged*’ to exercise ‘*his own right*’ in a certain way. Obviously, if the trustee failed to do so, he would lose ‘*his right*’ (as a consequence of the resolution of the contract that usually

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80 NICOLA COVIELLO, *Doctrina general del derecho civil* 20 (1938); FAUSTO COSTA, *Tratatto di Filosofia del Diritto* 145 (1947); KARL RENNER, *The Institutions of Private Law and their Social Functions* 81 (1949); FRANCESCO SANTORO PASSARELLI, *Doctrinas generales del derecho civil* 68 (1964); PAOLO ZATTI & VITTORIO COLUSSI, *Lineamenti di Diritto Privato* 71 (1989); ANTONIO ENRIQUE PÉREZ-LUÑO, *Teoría del derecho. Una visión de la experiencia jurídica* 51 (1997).

follows every material breach) and would have to pay damages for breach of contract. With this picture in mind, I do not see any difference between such a 'right' and a proper "duty"<sup>81</sup>. I believe that no further arguments are needed in order to understand why the conception under comment is plainly wrong.

Related to the aforementioned, it is worth to note that the alleged 'real right' held by the trustee conflicts with one of the effects that the "*fideicomiso*" provokes: the constitution of an "autonomous estate"<sup>82</sup>. Indeed, such an estate, by definition, does not belong to anybody. Now, if we follow the traditional conception embraced by civil law countries, according to which an estate is the total sum of all the pecuniary rights and duties that belong to someone<sup>83</sup>, it is impossible to affirm that someone has a real right upon things that do not belong to anybody<sup>84</sup>. The problem, of course, does not disappear if we change "autonomous estate" for "separate estate"<sup>85</sup>. Indeed, a separate estate is still an estate, that is, a conjunction of pecuniary rights and duties that belong to someone. One person for instance may have two different separate estates if all his pecuniary rights and duties are divided in two different groups. The important factor is that that person owns such rights and duties. As we have seen, however, the trustee does not have true rights upon the assets transferred by the settlor. He cannot –in a world of conceptual consistency– state that his personal rights and duties have been divided into two estates: '*his personal estate*' and '*his fiduciary estate*'.

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81 Such a 'right' does not have anything in common with all the rights recognized by the Civil Law. Indeed, every single right contemplated by that system implies the possibility of acting in the own benefit. The fact that one person may act upon a certain good does not necessarily mean that he holds a true real right. There are a bunch of cases where individuals may dispose, hold or otherwise act upon a good without having any real right. Let us think for example in the case of the representative and in the case of the depository. Is the fact that those individuals can legally act upon the good that belongs to the principal enough to consider them as holders of some kind of real right? The answer, on the basis of the traditional concepts, is obviously negative. So why in the case of the "*fiduciario*" the reasoning and the conclusion should change?

82 An "autonomous estate" is the conjunct of entitlements that do not belong, temporarily or permanently, to anybody. See: MAURIZIO LUPOI, *Trusts: a Comparative Study* 379 (2000).

83 JOSÉ LUIS DE LOS MOZOS, *supra* note 70, at 298; UGO NATOLI, *L'Amministrazione dei Beni Ereditari* 109 (1952).

84 It is true that Civil Law recognizes the possibility of acquiring those things (wild animals for example) by performing some specific acts (possession for example). But it is also true that the real right is only acquired once the required act has been performed. And when it happens, the thing becomes part of some estate.

85 A "separate estate" is a conjunct of entitlements that belong to a person. Those entitlements, however, are subject to special rules that make distinctions between the creditors of the person. Thus only those creditors that fulfill certain requirements can seize these entitlements. See: MAURIZIO LUPOI, *supra* note 82, at 378.

A second consideration is related to the misleading description provided by the criticized conception. As is well known, both Common Law and Civil Law systems recognize several real and personal rights. The different possible acts that one can perform for his own benefit serve as a basis for the design of those rights. In this sense, if I am able to perform every possible act upon a certain good, then I hold the ownership upon that good. But if I am only able to perform determined acts upon the certain good, then I hold a limited real right (servitude, for example) upon that good. In its turn, if I am able to require someone's cooperation for whatever purpose, then I hold a credit right. But if I am able to modify unilaterally someone's legal status, then I hold a power<sup>86</sup>.

Common Law recognizes the possibility of transferring to the trustee personal and real property (and in general legal and equitable interests)<sup>87</sup>. Latin American regulations, including the Peruvian ones, also recognize that possibility. Taking into consideration this fact, it is simply wrong to consider that the trustee holds a "real right" since he may not have powers upon goods. Let us think about a "*fideicomiso*" in which the settlor transfers "puts" and "calls". In such a case the trustee can exercise true "powers" in order to execute contracts, but he cannot "use", "enjoy", "dispose" or "recover" a good. Considering that the trustee exercises whatever right the settlor has transferred, it is just wrong to consider that the former only holds "real right faculties". I believe, again, that no further arguments are needed<sup>88</sup>.

As one can easily predict, inconsistencies come along with problems. Having accepted the existence of an autonomous estate, both the Banking Law and the Securities Market Law leave unclear what the destiny of the rights transferred by the settlor is.

In a previous work<sup>89</sup>, I tried to answer this question by stating that those rights, far from disappearing, acquired a new legal condition and became in "like-legal

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86 Wesley Hofeld, *Some fundamental legal concepts as applied in judicial reasoning*, 23 Yale L.J. 16, 49 (1913– 1914); GIOVANNI MIELE, *Potere, Diritto Soggettivo e Interesse*, XLII *Rivista del Diritto Commerciale e del Diritto delle Obbligazioni*, 115, 120 (1944); SALVATORE ROMANO, *Aspetti Soggettivi dei Diritti sulle Cose*, IX *Rivista Trimestrale di Diritto e Procedura Civile*, 1018, 1020 (1955); VIDYA DHAR MAJAN, *Jurisprudence and Legal Theory* 295–301 (1987).

87 "Every trust must have some property as its subject matter or res (...) While the most common types of property held in trust are bonds, stocks, mortgages, titles to land, and bank accounts, any transferable interest, vested or contingent, legal or equitable, real or personal, tangible or intangible, may be held in trust ...". See: GEORGE T. BOGERT, *Trusts* 70 – 71 (6th ed. 1987).

88 Some Latin American scholars have expressed the same idea. See for example: JULIAN BOJALIL, *Fideicomiso* 63-64 (1962).

89 FREDDY ESCOBAR, *Breve ensayo sobre el dominio fiduciario en el sistema jurídico peruano*, 48 *Themis*, Segunda Época, 85, 92-93 (2004).

entities”. Now, however, I do not think that such solution is satisfactory. In order to understand why I have changed my mind, let us consider the following cases. Let us imagine a trust where the settlor ‘*transfers*’ the ownership upon a certain good and a trust where the settlor ‘*transfers*’ a determined credit right. In this first case, once the trust is set up, neither the settlor nor the trustee is able to legally destroy that good. It means, obviously, that one of the faculties that constitute the content of the ownership no more exists here. Now if we consider that the ownership is the result of the conjunction of the faculties to use, to enjoy, to destroy, etc., we will have to conclude that absent one of those faculties the existing right upon the good is not the right the settlor used to have. In the second case, however, once the trust is set up, the trustee is able to require the payment in exactly the same way in which the settlor could have required so. It means, obviously, that the faculties that constitute the content of the credit right still exist here<sup>90</sup>. As a consequence of that, unlike the former case, we will have to conclude that the existing right against the debtor is the right that the settlor used to have<sup>91</sup>.

The conclusion reached in the first case contradicts my previous theory, while the conclusion reached in the second case reinforces it. I am not in the capacity to solve this theoretical problem. Of course, that problem is not out of importance, since many practical consequences may vary depending on the position that one takes about the destiny of the rights transferred by the settlor. Tax matters aside, the rules of prescription, for example, would work in one way if we agree that the rights do not disappear, and in another way if we agree that the rights do disappear.

#### **D. Inefficiencies**

It is plausible to believe that because of the particular conception about the nature of the trust embraced by the legislator, the Peruvian regulation is also defective in

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90 The settlor may not be able to transfer the credit or to release the debtor. This fact, however, does not contradict what I have stated. Indeed, from a conceptual perspective, the faculty to transfer the credit as well as the faculty to release the debtor do not constitute the content of the that right. These faculties are no more than specific dimensions of the “power to dispose”, which allows the owner of whatever entitlement to convey it or to forego it. See: WESLEY HOFELD, *supra* note 86, at 49; GIOVANNI MIELE, *supra* note 86, at 115-120; SALVATORE ROMANO, *supra* note 86, at 1018-1020.

91 In order to keep the conclusion reached in the first case, one may argue that in the second case the existing credit right is a new one because a novation occurred once the trust was set up. That idea, however, may not find any kind of support in the law, since it simply does not contemplate such an effect. Moreover, that idea may contradict the legal regime applicable to the trusts, since every novation is associated with, among other things, the extinction of the rights transferred to the creditor for the purpose of securing the performance of the debtor (collateral), which is excluded by that legal regime.

terms of efficiency. Indeed, with the ‘like-ownership model’ in mind, it is easy to ignore the organizational nature of the trust and therefore to forget that the trust relationship presents problems related to competing interests that are absolutely unknown in the field of the “real rights”. In any case, if there is a better explanation for the regulatory inefficiencies that I will point out, I simply ignore it.

If one analyzes carefully the Peruvian regulation, one will note that it not only ignores the usual tensions that arise within the trust, but also provokes the unawareness of the agency-cost problem. Moreover, as we shall see, such regulation aggravates that problem. Let us examine briefly what those tensions are and what that problem is.

Considering the simple structure of whatever trust, one can note that it involves inevitable tensions between the different interests and tendencies of the parties. In a simple form, those tensions affect the following actors:

- *S* and *T*;
- *T* and the *Bs*;
- *S* and the *Bs*; and
- *B1* and *B2*;

Where: *S* is the Settlor; *T* is the trustee; *B1* is the first beneficiary; *B2* is the second beneficiary; and *Bs* are both the first and the second beneficiaries.

Following closely the work of SITKOFF<sup>92</sup>, here I offer some examples of those tensions and how American law has faced them.

First: Settlor *v.* Trustee. Modern trustees are very often repeat-players, with a high degree of sophistication. On the contrary, some settlors are very often non repeat-players, incapable of understanding the sophisticated terms and formulas used by the financial investors (let us imagine a widow who wants to invest the premium she has received from the life-insurance company). Given the asymmetry in the information, it is reasonable to expect some legal intervention<sup>93</sup>. Facing this issue, American law forces the trustee to disclose some information in a fashionable

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92 ROBERT H. SITKOFF, *An Agency Costs Theory of Trust Law*, 89 Cornell L. Rev. 621, 684 (2004).

93 Unsophisticated settlors who do not read or understand the fine print would present the “standard form contract problem”. According to one prominent scholar, fine print terms in standard form contracts must be considered “invisible” and therefore “unenforceable”. See: TODD D. RAKOFF, *Contracts of Adhesion: An Essay in Reconstruction*, 96 Harv. L. Rev. 1174, 1179 (1983).

way<sup>94</sup>. Moreover, under the umbrella of the “doctrine of unconscionability” American law allows the courts to declare unenforceable those trust agreements in which in the “absence of meaningful choice” on the part of the settlor, the trustee reserves for himself “unreasonably favorable” provisions<sup>95</sup>.

Second: Trustee v. Beneficiaries. Modern trustees are by definition risk-neutral and are able to diversify the risk and to take insurances. On the contrary, some settlors are risk-averse (let us imagine a retired worker who wants to invest his retirement compensation). It means that they will prefer a smaller but a certain sum (\$1000) over the chance to obtain a large sum (\$2000) even if the larger sum, when discounted by its probability (60%), is still larger than the smaller but certain sum (\$1200 versus \$1000). Given the diverse attitudes toward the risks, it is reasonable to expect again some legal intervention. Facing this issue, American Law appeals to the fiduciary duty of care that implies the necessity of acting in the way in which a man of ordinary prudence would act for his own benefits with his own property. As SITKOFF<sup>96</sup> points out, in the trust context that duty counsels caution, which is what undiversified, risk-averse beneficiaries would prefer<sup>97</sup>.

Third: Settlor v. Beneficiaries. Settlors very often decide to confer benefits through the trustee because, tax purposes aside, they plainly do not trust in the beneficiaries. But because of the fact that beneficiaries have natural incentives for improving the trusts’ incomes or because of the fact that beneficiaries may prefer to use directly the assets in order to maximize their subjective values, it is possible that they either want to change the settlor’s design (because they have identified a better way for making investments) or to terminate the trust relationship. In this context, the questions about the unilateral modification and the unilateral premature

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94 See: *Restatement (Second) of Trusts* 222(3) & cmt. d (1959) and 7C *ULA* 226-27 (Supp. 2003) (“Subsection (b) responds to the danger that the insertion of such a clause by the fiduciary or its agent may have been undisclosed or inadequately understood by the settlor.”).

95 ALLAN E. FANWORTH, *Contracts* 301 (4th ed. 2004). See also: Uniform Trust Code, Section 1008, and *Restatement (Second) of Trust*, Section 222.

96 ROBERT H. SITKOFF, *supra* note 92, at 657.

97 It must be noted that the content of the duty of care is not the same in the context of the corporate law. Indeed, corporate law relies on the business judgment rule. As SITKOFF points out, that rule requires “deference to the ordinary business decisions of management unless they are tainted by a conflict of interest or are so unreasonable as to amount to gross negligence”. The business judgment rule makes sense from an agency costs perspective if one takes into consideration that corporate law draws from portfolio theory a paradigmatic shareholder who is diversified. And diversified (risk-neutral) shareholders are advantaged by the business judgment rule because insulating managers from liability in the absence of egregious conduct helps them to offset the managers’ incentives –that generate large investments of human capital and personal wealth in the firm– to avoid risk. Trust law, in contrast, assumes that the beneficiaries are not diversified, so the trustee’s default duty of care is set at the more restrictive reasonable person standard. Viewed in this manner, the different understandings of the duty of care in corporate law and trust law makes sense. See: *Id.*



termination of the trust arise. Obviously, those questions imply the existence of competing and opposing interests, that is, the settlor's interest in preserving his will by avoiding whatever change or premature termination and the beneficiaries' interests in maximizing their welfare by modifying or prematurely terminating the trust relationship. Given the conflict of the parties' interests, it is reasonable to expect again some legal intervention. Facing this issue, American law traditionally relies on the Claffin Rule that seeks to preserve the settlor's original design regardless the beneficiaries' wishes. Recently, however, American courts have begun to liberalize that classic rule, by allowing the deviation from the settlor's specific instructions that conflict with the settlor's general aim of benefiting the beneficiaries. But as LANGBEIN<sup>98</sup> points out, the liberalization trend is designed to advance the settlors' probable intent. In contrast to the American approach, the English approach allows the beneficiaries, if they are all identifiable adults, to force the premature termination of a trust over the dissent of the trustee. The rationale seems to be clear and efficient: if all the beneficiaries would be better off if the trust were terminated (perhaps because its administrative expenses would be eliminated), there is no reason for not allowing them to modify or to terminate the trust relationship. After all, the settlor always wants to maximize the welfare of the beneficiaries, and as we know they are in the best position for determining the way in which that goal can be achieved<sup>99</sup>.

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98 JOHN H. LANGBEIN, *The Contractarian Basis of the Law of Trusts*, 105 Yale L.J. 625, 668 – 669 (1995).

99 When the settlor has died, the analyzed problem forms part of a broader one: the problem of the control of the property by the "dead hand". As SHAVELL points out, if one wants to argue against such control of the property, one cannot rely on the argument that because of the dead is not able to enjoy utility, it would be socially wasteful for the dead to control property and to interfere with it its use, to the detriment of those who are living. Indeed, such an argument fails for two reasons. The first one indicates that individuals who desire dead hand control will in fact suffer utility losses when they are alive, since they anticipate that their property will not be used in the way they wish when they are dead. Thus a social policy of ignoring that wish will in fact hurt the owners when they are alive. The second one indicates that individuals who desire dead hand control do not ignore the detriment to the living caused by their wish. On the contrary, they take it into account when they pay the price for acquiring the good (or when they give up selling the good) since every consumption of goods implies that consumers at least implicitly value their necessities against the necessities of the future generations that will be deprived of the goods by the decision of consumption. Thus the decision to control property after death involves a weighting of the utility of such control against the price, which represents its alternative value to the others into the future. Therefore, such a decision seems to as appropriate as essentially any decision that one can make about consumption. Nevertheless, there are valid arguments against the dead hand control of property. As SHAVELL suggests there are at least two reasons for opposing that control of property. The first one relies on the fact that it is costly and impractical to make highly refined arrangements for dead hand control of property. It means that in the real world it is likely to have contingencies for which no provisions are made, and therefore to have potential claims that can make the enforcement of the dead hand control of property highly costly and therefore inefficient. The second one relies on the inherent inequality in the wealth of the present generation versus that of future generations. As a consequence of the fact that the present generation owns the whole earth and all the things on it, that generation has a greater ability to control property than is socially desirable, assuming that the measure of social welfare accords

Fourth: Beneficiary One v. Beneficiary Two. Beneficiaries very often share the same benefits and therefore are aligned on the same goals. But it is possible that the settlor creates different benefits. Let us imagine that the settlor creates a trust for the lifetime income benefit of *B1* with the remainder principal benefit to *B2*. In such a case the interest of the beneficiaries will not be exactly the same. For example, it is clear that *B1* would prefer income-producing investments while *B2* would prefer capital appreciation<sup>100</sup>. Given the diversity of the interests, it is reasonable to expect again some legal intervention. Facing this issue, American Law appeals to the “duty of impartiality”, that requires the trustee to “act impartially in investing, managing, and distributing the trust property, giving due regard to the beneficiaries’ respective interests”<sup>101</sup>. Therefore, *T* must not justify his actions exclusively in the light of either *B1*’s interests or *B2*’s interests. *T* must take into consideration the aggregate welfare of *B1* and *B2* as a class.

I have stated that Peruvian laws do not pay attention to the tensions that inevitably involved all the parties. What is the evidence that supports my statement? Such evidence is the poor regulation. Indeed, firstly neither the Banking Law nor the Securities Market Law protects non-repeat settlors against repeat and sophisticated trustees. Secondly both the Banking Law and the Securities Market Law impose on the trustee a duty of care. However, both the Banking Law and the Securities Market Law establish that trustee is liable only if he has acted with “gross negligence”, that is, only if he has failed in the way in which a careless person would have failed. Therefore, under that standard, as we shall see, the effectiveness of the aforementioned duty plainly disappears. Thirdly neither the Banking Law nor the Securities Market Law contemplate the possibility of either modifying or terminating the trust when all the beneficiaries think that they would be better off without following the settlor’s will. Finally, neither the Banking Law nor the Securities Market Law contemplates the duty of impartiality in order to avoid preferences that may benefit some beneficiaries and prejudice others.

But there is more. Both the Banking Law and the Securities Market Law not only fail in responding in a satisfactory way to the problems that the aforementioned tensions present, but also resolve in an inefficient way some other problems related

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substantial weight to future generations. Thus, for preserving intergenerational balance, limitations to the ability of controlling property after death seem to be socially efficient. See: STEVEN SHAVELL, *Foundations of Economic Analysis of Law* 67 – 72 (2004).

100 ROBERT H. SITKOFF, *supra* note 92, at 662.

101 See: *Restatement (Second) of Trusts* 183, 232 (1959).

to the natural tensions that affect settlors, trustees and beneficiaries<sup>102</sup>. Here I offer two of the most salient examples of that.

According to Article 252 of the Banking Law, if the trustee violates the settlor's instructions by executing an unauthorized agreement, either the trustee or the other parties, that is, the settlor and the beneficiary, can avoid the aforementioned agreement (unless the other contracting party is able to prove that he acted in good faith).

According to Article 230 of the Civil Code, the party that has the right to avoid a contract has also the right to "confirm" it by accepting its terms. Once the "confirmation" has been executed, the avoidable contract becomes a valid and fully enforceable contract. Taking this into consideration, let us examine how the formula works. Let us suppose that *T* has wrongfully transferred one of the assets under his control to *Y*. Let us suppose also that *Y* did not know about the violation of the settlor's instructions, but could have known it. Therefore, let us assume that the agreement is voidable. What happens if the agreement is declared void? In application of Article 1362 of the Civil Code, *T* will be liable for the harm caused to *Y*. And what happens if the agreement is not declared void? In application of Article 259 of the Banking Law, *T* will be liable for the harm caused to the beneficiary. In order to decide what to do, that is, whether to avoid or to confirm the agreement, *T* has to determine in which scenario he will be better off. What factors will *T* consider? Firstly, *T* will consider that while *Y* can sue him in torts, the beneficiary can sue him for breach of contract<sup>103</sup>. Is that fact relevant? Of course. According to the Civil Code, the tortfeasor must pay all the damages caused to the victim, no matter if those damages are indirect and unforeseeable. However, in application of that code, the breaching party only has to pay the direct and foreseeable damages caused to the non-breaching party. Secondly, *T* will consider that while he cannot use the

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102 Here is a little piece of evidence of that statement: the Banking Law only establishes that the trustee cannot execute contracts upon the assets under his control in his own benefit. This provision follows an old rule that prevent the agent from taking advantage of his particular position. The world, however, is a very complicated place and old rules do not work well anymore. As we shall see, the Banking Law establishes that only certain entities can be appointed as trustees, creating an unnecessary closed market. In the Peruvian real world, most of the trustees belonged directly or indirectly either to banks or to financial groups. This foreseeable reality was not taken into consideration by the legislators. Indeed, the aforementioned law prohibits the trustee to use the assets in his benefit but does not prohibit the trustee to use those assets in the benefit of his related entities. One can argue that the last possibility is foreclosed by the '*spirit*' of the law. True, but Peruvian courts seem to be agnostic. Therefore, spirits do not anymore scare Peruvian judges.

103 Article 1362 of the Civil Code is the ultimate source of the liability that arises when one party creates the problem that determines the voidability of the contract. Such article however does not establish what kind of damages that party must pay. Taking into consideration that the aforementioned problem occurs in the pre-contractual phase, one the hand, and applying the logical reasoning that governs the Civil Law system, on the other hand, one has to conclude that the damaged party has to recover in torts.

“gross negligence” standard in the former case, he can use that standard in the latter case. Given the mentioned factors, it seems likely that *T* would chose not to avoid the agreement. It can be argued that *T* should consider in the analysis the sanctions that the authority may apply and also the bad reputation that his actions may bring. True. But sanctions and bad reputation will only be part of *T*'s costs. It is always possible that *T*'s expected liability in the tort scenario is higher than the sum of the all the aforementioned concepts, that is contractual damages, sanctions and bad reputation.

With this in mind, one can fairly think that the Banking Law incentives or at least permits the opportunistic behavior of the trustee. And that, of course, is inefficient since the goal of the law should be to maximize the welfare of the beneficiaries. Let us now to turn to the second example.

According to Article 298 of the Securities Market Law, the act by means of which the settlor sets up a trust for securitization purposes cannot be declared neither invalid nor unenforceable, whatever the problem is, whoever the harmed parties are. The rationale of the rule is, as the legislator has pointed out in capital letters, to protect the investors. If one thinks of unsophisticated investors, individuals who suffer the lack of reliable information about the risks of the financial market, one could be inclined to sympathize with the provision under analysis. After all, who does not want to protect the widow who wants to invest the premium she has received from the life-insurance company or the retired worker who wants to invest his retirement compensation. But what happens in the real world? Are widows and workers the representative investors?

In Peru the holders of the bonds issued in the context of securitization processes are the so-called “institutional investors”, that is, basically banks and private administration funds. Those investors usually participate actively in the design of those processes through their related companies, and therefore have reliable information about what is going on in the market and (to some extent) what will happen with the national economy. Moreover, those investors are sophisticated and repeat-players. With these features in mind, one can start thinking about the rationality of the Article 298 of the Securities Market Law. But let us go for more.

During the past years, securitization processes have been successfully used in order to avoid the risk of the bankruptcy. Typically, banks had reliable data of the companies that were having problems in paying their debts. Banks used to submit to the board of directors of those companies proposals for solving their problems by using the magical tool of the securitization. Those boards of directors, without much to lose, usually decided to accept the ‘*deal*’. The basic scheme proposed by the banks was very simple: the company *C* had to transfer their most valuable assets to

*T.* Obviously, *T* had to issue securitization bonds. Banks either in private or in public bids had to subscribe those bonds. With the money received from the bond holders, *T* had to pay the banks. So at the end of the day, banks did not do more than replace their unsecured credits (unsecured if we have in mind that the Bankruptcy Law gives preference to labor credits and therefore makes unenforceable the pledges, mortgages and other kinds of secure transactions to the extent that it is necessary). It is true that in public bids other players were able to participate. But for doing so those players needed money, that is, something that was not usually available for everybody.

Now a question becomes crucial: why does the law over-protect such amazing players? Fairness considerations aside, let us examine the economic consequences of the over-protection.

As I have stated, according to Article 298 of the Securities Market Law the act by means of which the settlor sets up the trust cannot be declared invalid or unenforceable. That article expressly establishes that creditors of the settlor cannot bring the traditional action of fraud in order to avoid the disappearance of the sizeable assets. Therefore, if those creditors want to have something for seizing, they must subscribe the bonds. As one can easily note, the over-protection that benefit institutional investors prejudices settlors and settlor's creditors different from those who are able to subscribe the bonds.

With this picture in mind, it is easy to understand what I have proposed, that is, that the Peruvian regulation creates inefficiencies.

Indeed, the possibility of voiding a contract depends on the existence of some problem in the bargain process. Unless that problem is absolutely serious, the law makes voidable the contract only if both parties are aware of that problem or could have been aware of it. Let us work with an example. Let us suppose that because of the wrong calculations made by the financial designers of the deal, the settlor makes a mistake by accepting to transfer more assets than what the financial structure really needs for working very well. According to Article 201 of the Civil Code, only if the trustee is either aware of the mistake or could have been aware of it, the settlor will have the possibility of bringing a suit in order to avoid the transference of the assets. Article 298 of the Securities Market Law however precludes that possibility. Therefore, reasonably two consequences will flow from that. Firstly, trustees and behind them institutional investors will relax their standards of due care, since the trust agreement will not be declared invalid even if they are found grossly negligent. Moreover, trustees and behind them institutional investors will have incentives to behave opportunistically, since they will not have the duty to speak in the bargaining process. Secondly, because of that foreseeable relaxation,

settlers, whose resources are scarce, will have to invest resources in order to avoid mistakes (and other kinds of problems)<sup>104</sup>. And as one can understand, this will simply be a waste of resources. Indeed, if someone is able to avoid mistakes in the bargaining process, that is the trustee and behind him the institutional investor. By revealing information and speaking when they realize that some mistake has been made, these players may easily avoid the risks of having an inefficient agreement. Therefore, it does not make sense to over-protect the least-cost avoiders.

But not only settlers are wrongfully harmed by Article 298 of the Securities Market Law. Creditors different from the banks are also seriously harmed by that provision. Indeed, let us think of the service provider *S* that has credit rights against *C*. Once the banks decide to put the securitization machinery working, *S* faces a serious problem since the assets that he could seize in case of default are going to be transferred to the trust and he cannot make anything for avoiding the legal consequences of that. So in order to keep the possibility of seizing *C*'s assets in case of default, *S* would have to subscribe bonds. As one can easily understand, *S*'s situation is absolutely shaking whatever is the perspective one chooses to look from. For instrumental purposes, let us assume that bond's bid is a public bid, an open bid (it can be a private bid, but in this scenario I will have nothing to argue since the injustice and the inefficiency of the formula will not require any further demonstration). Therefore, *S* would be able to subscribe the bonds and keep his right to seize *C*'s assets in case of default. If *S* had enough money, the necessity of subscribing the bonds would not represent a major problem. But what happens if actually *S* does not have enough money? Does he need to sell his assets in order to get cash and pay for not losing his rights?<sup>105</sup> Maybe there is better formula. Maybe *S* should go to the banks. Probably they would be absolutely glad to do business also with *S*. What is the economic effect that Article 298 of the Securities Market Law provokes? Knowing that there is a risk of losing the possibility of seizing the debtor's assets, creditors will be reluctant to execute the pure executory agreements or will increase their prices in order to have a kind of insurance against the aforementioned risk or will include covenants that certain assets may not be transferred to a trustee or will only enter in fully secured transactions. And as one can understand, in any case the idea of waste of resources appears appealing<sup>106</sup>.

104 As SHAVELL points out, "the fear that one might lose by failing to notice one's mistake may lead to the taking of excessive precautions to reduce the likelihood of mistake. Rather than so inducing parties to reduce the likelihood of mistake, it may be preferable for society to harness the information that turns out to exist about the occurrence of mistake, by doing what the law does – refusing to enforce contracts that are mistakenly made". See: STEVEN SHAVELL, *supra* note 99, at 331.

105 It must be noted that without the possibility of seizing the debtor's assets in case of default, the credit rights lose their value.

106 Nevertheless it is interesting to note that there is an international support for the rule. Let us follow SCHWARCZ's description of the international panorama: "(...) the bankruptcy, insolvency, or related

Against what I have stated, one could argue that without the criticized over-protection the most important creditors of *C* might not be willing to help it in order to avoid the risk of bankruptcy. True. It is plainly undisputable that without some benefits associated to some activity, the incentives to be engaged in that activity diminish. The problem however is not how to incentive one specific activity, but how to maximize the social welfare. I have the intuition that the general welfare is better off if market agents do not have to increase their prices in order to protect themselves against the securitization processes' dangers. I cannot offer however any probe in support for that intuition. Notwithstanding the aforementioned, some further considerations can be made. Firstly, why does not the Securities Market Law (following the Banking Law) establish a short period in which the *C*'s creditors may seek to keep enough assets to seize in case of default? One could argue again that by doing so the harm would be greater than the benefit because if too many actions are brought, *C* might be declared bankrupted. True, again. But in that scenario why do we still need to rely on the Securities Market Law? Why do not we rely on the Bankruptcy Law? Is it because the latter law is not efficient? It seems to me that if at the end of the day *C* needs to be declared in bankruptcy, it should be declared in bankruptcy. And under the regime of the 'natural law' (that is, the Bankruptcy Law) all its creditors should decide, with the limitations imposed by the corresponding policies, the destiny of *C*. In short, it seems to me that bankruptcy needs not be avoided at whatever cost<sup>107</sup>. After all, we want to spread the risk of the bankruptcy, not to concentrate it in the weak markets players. Secondly, what if the purpose of the securitization is just to raise funds in the capital market at a lower cost than raising funds by issuing debt or equity? In this scenario, does it make any sense to avoid the possibility of keeping enough assets to seize in case of default? One could argue once again that without that overprotection the rating of the bonds would not be as high as it could otherwise be. True. But the gains that *C* obtains by issuing A+ bonds instead of A- bonds can perfectly be offset by the losses that its creditors suffer by having credit rights for which the banks will pay 'X - n' instead of 'X' due to the diminution of the *C*'s seizable assets. Having said this, I reaffirm my previous statements.

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laws of some jurisdictions may permit or require a bankrupt company (or its representative) to avoid transfers of assets, or obligations incurred, by the company prior to its bankruptcy. Some of these laws -referred to as preference laws because they avoid preferential transfers- are intended to ensure equality of distribution of the company's assets among all its creditors. Less frequently, transfers made or obligations incurred by a troubled company for less than equivalent value may be deemed to be fraudulent and therefore voidable. In a securitization context, preference and fraudulent transfer laws are unlikely to apply because any transfers of receivables from the originator to a SPV tend to be structured as sales for arm's length consideration". See: STEVEN L. SCHWARCZ, *The Universal Language of International Securitization*, 12 Duke J. Comp. & Int'l L. 285, 296 (2002). The problem is not however the price paid by a SPV; the problem is the great difficulty (almost impossibility) to seize that price instead of the assets transferred by the originator.

107 Where people live, people die. Life without death is not possible. The same is true for business.

The aforementioned inefficiencies are however only a half of the problem. Indeed I have also stated that Peruvian laws do not take into consideration the agency-cost problem. Let us examine firstly what that problem means and secondly what evidences support my statement.

As KRAAKMAN and HANSMANN<sup>108</sup> point out, “an agency problem –in the most general sense of the term– arises whenever the welfare of one party, termed the principal, depends upon actions taken by another party, termed the agent”. The core of the problem lies on the fact that the agent has either better information than the principal or a discretionary and unobservable decision-making authority. As a consequence of that the principal is unlikely to know if the poor outcome was due either to the poor performance of the agent or to an exogenous factor. Thus to the extent that the agent is able to conceal the cause of the poor outcome, he will not have the right incentives to behave efficiently. On the contrary, he will have incentives to act opportunistically<sup>109</sup>. For this reason, as SITKOFF<sup>110</sup> notes,

“unless there is a perfect correlation between the agent’s effort and the project’s observable profits, in which case a good or bad return would conclusively show the level of the agent’s effort, it will be difficult for the principal to prevent shirking by the agent”.

Let us examine a classic example of the agency-cost problem. Consider a real state agent working on a five percent commission. Considering that the property owner cannot easily monitor the agent’s daily activities, it is clear that the agent will not have incentives to spend \$ 10 in additional efforts to increase the sale price by \$ 100, as the extra effort return for him is only \$ 5. However, the \$ 10 of additional effort would benefit the principal. If the parties’ interests were coincident (it would happen for example if the agent were also the property owner), then the agent would have spent \$ 10 in the additional efforts. The agent’s counter-incentive to do so leads to a welfare loss. As SITKOFF<sup>111</sup> notes again

“the losses to the parties that stem from such a misalignment of interests are called agency costs”.

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108 REINIER KRAAKMAN *et al*, *The Anatomy of Corporate Law. A Comparative and Functional Approach* 21 (2003).

109 The term “opportunism” is used here to refer to self interested behavior that involves some element of deception, misrepresentation or bad faith. See: *Id.* at 21.

110 ROBERT H. SITKOFF, *supra* note 92, at 637.

111 *Id.* at 638.



In order to reduce the agency-cost problem, several legal devices have been created. One legal device is to facilitate enforcement actions brought by principals against dishonest or negligent agents<sup>112</sup>. How does it work? Due to the fact that the agent possesses better information than the principal or to the fact that the agent has discretionary and unobservable decision-making authority, he may easily escape from suit since the costs of finding him liable for the poor outcome are extremely high. Therefore, unless the law works out in some formula that facilitates suit against the agent, he will not have the appropriate incentives to behave correctly.

In torts when the injurer is likely to escape from suit, the economic analysis of law suggests to raise the damages. Let us work with some numbers. Let us imagine that the damage is 1000 and the probability of being sued is 50 percent, then the expected liability is 500. If the cost of precautions is 600, the injurer will not take the precautions even if their cost is lower than the harm. In order to restore the incentive to behave efficiently, that is, to spend 600 in order to avoid a harm of 1000, economic analysis of law suggests to increase damages by multiplying them by the inverse of the probability of suit. In the proposed example that means to multiply 1000 by  $1/0.5$  or 2, for then damages will be 2000 and the expected liability will be  $50\% \times 2000 = 1000$ <sup>113</sup>.

In the context of organizational law however the idea of increasing damages or using penalties may not work well. Indeed because it is reasonable to expect that agents will not take on their duties under those conditions or will charge too much for doing so, the tort formula seems to be inefficient.

Some authors<sup>114</sup> suggest not to rely so much in liability rules since for them to be efficient a complete specified contracts or arrangements will be needed and such contracts and arrangements are both highly costly and impractical. The rationale seems to be appealing. Nevertheless, as everybody recognizes<sup>115</sup>, less costly and more efficient tools such as “managerial stock ownership”, “executive compensation agreements” or “independent internal monitoring” cannot entirely eliminate the risk of behaving opportunistically. Indeed, when information is imperfect and costly, the

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112 See: REINER KRAAKMAN *et al*, *supra* note 108, at 22.

113 STEVEN SHAVELL, *supra* note 99, at 244.

114 DANIEL R. FISCHEL & MICHAEL BRADLEY, *The Role of Liability Rules and the Derivative Suit in Corporate Law: A Theoretical and Empirical Analysis*, 71 Cornell L. Rev. 261, 264-266 (1986).

115 FISCHEL and BRADLEY state the following: “(...) no matter how effective the contractual and market mechanisms are, some shrinking is inevitable. Thus, liability rules enforced by derivative suits may operate simply as an additional, albeit imperfect, governance mechanism”. See: *Id.* at 276.

risk of acting opportunistically still exists even though the parties' interests are in some sense aligned. The explanation of that is very simple: the impossibility of monitoring all the agent's activities. To the extent that the principal is unable to control the agent, the latter has incentives to act opportunistically and therefore to harm the former. The result of this is that organizational law needs to rely upon the duty of care, the duty of loyalty and the liability for breach of those duties, at least as complementary tools, if she wants to minimize agency costs.

The duty of due care tries to avoid the risk of negligent mismanagement. It requires the trustee to obtain and process relevant information in order to make a decision that maximizes the value of the assets. Thus, upon the duty of care, the trustee needs to exert an "appropriate level of effort". Trying to figure out what that level means, the Restatement (Second) of Trusts<sup>116</sup> establishes that both paid and unpaid trustees must act with the care and diligence that a person of ordinary prudence employs when managing his own affairs. Some courts, however, consider that if the trustee is a paid professional, he may be held to a higher standard of diligence and care<sup>117</sup>. The terms used by the aforementioned Restatement remain opaque. Economic analysis of law<sup>118</sup> suggests to use both the portfolio theory and the Hand Formula in order to determine the appropriate level of risk and the appropriate level of effort. In the light of the portfolio theory, the trustee is required to use the techniques of diversification and negative correlation that match with the beneficiary's tendencies towards the risk<sup>119</sup>. Likewise, in the light of that formula the trustee is required to exert efforts so long as the cost of doing that does not exceed the resulting benefit to the beneficiary<sup>120</sup>.

In its turn, the duty of loyalty tries to avoid the risk of misappropriation of the trust's assets or incomes. It requires the trustee to restrict his behavior whenever possible conflicts of interests arise between him and the beneficiary. The bundle of principles, doctrines and rules comprised in that duty facilitate the proof of appropriation either by conclusively presuming appropriation or by requiring the fiduciary to prove that he did not misappropriate the beneficiaries' assets or incomes<sup>121</sup>.

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116 See: *Restatement (Second) of Trusts* 174 (1959).

117 See: *Bartlett v. Barclays Bank Trust Co.*, 1 Ch. 515, 525, (Eng. 1980) (professional trustee advertising or holding herself out as having special skill or knowledge in trust management held to higher standard).

118 ROBERT COOTER & BRADLEY J. FREEDMAN, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. Rev. 1045, 1058 (1991).

119 *Id.* at 1062-1063.

120 *Id.* at 1058.

121 *Id.* at 1053-1054.

As one can easily understand, duties do not have any sense if liability does not arise when they are broken. It is true that liability is a delicate tool because it can cause more harm than benefit<sup>122</sup>. If damages are too high, agents may not accept to manage principal's assets or may charge higher fees and require costly insurance. The goal, thus, is to create an adequate level of liability, that is, a level that creates neither under-deterrence nor over-deterrence<sup>123</sup>.

Let us now turn to the problems I have pointed out lines above.

First of all, it must be noted that the agency-cost problem is not present in every trust. Let us imagine for example the case where the trust agreement only serves as a secured transaction. In such a case the economic rationale of the transaction implies that the settlor possesses the assets in order to generate the cash that will allow him to pay the debt. Therefore, it is almost impossible to state either that the trustee has better information than the other parties or that the trustee has a discretionary and unobservable decision-making authority. In most of the cases, however, the trustee has both better information than the other parties and a discretionary and unobservable decision-making authority. For obvious reasons this statement does not need further demonstration<sup>124</sup>.

What is evidence that supports my previous statements, that is, that Peruvian regulation not only ignores the cost-agency problem, but also aggravates that problem? In this case one piece of evidence is again the poor regulation. Most of the previous examples can be categorized as examples of the Peruvian poor regulation. The other piece of evidence is the "gross negligence" standard that governs the trustee's behavior. Let us now to consider this problem.

122 In general terms, every single legal intervention can harm more than benefit. In the context under analysis, in protecting principals against exploitation by their agents, the law paradoxically can benefit agents as much as –or even more than– it benefits the principals. For example, when law inhibits insider trading by corporate managers, it increases the compensation that shareholders are willing to offer the managers. See: REINIER KRAAKMAN *et al*, *supra* note 108, at 22.

123 In order to know what the appropriate level of liability is, one must take into account the different alternative tools that the law applies in order to create deterrence. By doing so, COOTER and BRADLEY, for example, conclude that while the sanction for the break of the duty of loyalty must contain some element of punishment, the sanction for the break of the duty of care must contain no element of punishment. See: ROBERT COOTER & BRADLEY J. FREEDMAN, *supra* note 118, at 1074-1075.

124 "It is probable that both agency and trust arose from the same ill-defined intermediary relation. Agency was molded by courts of law and received one set of characteristics. The trust was fostered by chancery and developed along different lines. Although now quite distinct, each possesses the element of trust and confidence. Both agents and trustees are placed in positions of intimacy, where it is easy to take advantage of those who have trusted them, and therefore are held to a high standard of good faith. Because of this fiduciary element, agents and trustees are under the common prohibition against acting for their private interest when managing the affairs of those for whom they act. For example, neither can purchase the property which is the subject of his dealings, if the principal or the beneficiary objects". See: GEORGE T. BOGERT, *supra* note 87, at 35-36.

As I have pointed out, both the Banking Law and the Securities Market Law establish that the trustee is liable only if he acts with “gross negligence”. Neither the Banking Law nor the Securities Market Law contains a definition of “gross negligence”. Therefore, that standard must be understood in the light of the provisions contained in the Peruvian Civil Code. According to Articles 1319 and 1320 of that code, “simple negligence” implies a situation where the debtor has not taken the precautions that an ‘*ordinary man*’ would have taken, while “gross negligence” implies a situation where the debtor has not taken the precautions that even a ‘*less careful man*’ would have taken. Taking this in mind, it is clear that Peruvian trustees will only be held liable if their performance fails not in the way in which the performance of an ‘*ordinary manager*’ may fail, but in the way in which the performance of ‘*less careful manager*’ may fail.

Let us examine how the aforementioned standard speaks in economic terms.

Let us imagine a situation where  $T$  has invested the assets (money) in  $X$ , who offers a return of 100. Let us assume that making additional efforts,  $T$  could reach  $Y$ , who offers a return of 200. Finally, let us assume that following numbers are true:

Level of effort	Cost of effort	Probability of finding $Y$	Expected return
A	1	3%	5
B	12	10%	8
C	17	20%	23
D	19	25%	31
E	23	30%	37
F	34	35%	36
G	38	36%	34

Since the goal here is to maximize the trust’s profits, it is clear that the optimal level of effort is  $E$ . Therefore, either if  $T$  does not make any additional effort for finding  $Y$  or if  $T$  makes whatever effort for finding  $Y$  below  $E$ , he should be considered inefficient and thus negligent.

However, the concept of “gross negligence” perfectly allows the judge to hold that  $T$  is not liable even if he has acted inefficiently. Indeed, that standard requires the judge to analyze  $T$ ’s behavior in the light of how a ‘*less careful trustee*’ would have acted. And for sure there is no way to consider  $T$  grossly negligent for having chosen the level of effort  $D$  since such a level of effort is without any doubt higher than what a ‘*less careful trustee*’ would have chosen in any given case. Moreover, it would be perfectly possible to exonerate  $T$  from any kind of liability even if he had

chosen the level of effort  $C$ . Therefore, the Peruvian standard seems to be inefficient in the task of facilitating suit against the opportunistic trustee.

In an attempt to find some rationale that supports the aforementioned standard, one could state that the legislator relied on “gross negligence” because of the problem of the court’s information about the trustee’s efforts<sup>125</sup>. Indeed, noting that such information is usually very poor, one could think that is very likely that courts consider wrongly that the optimal level of effort is either  $F$  or  $G$ , that is, a level which is more costly than  $E$ . As a consequence of such a mistake, trustees would hesitate to take on their duties. Thus the use of the “gross negligence” standard would restore the incentives for being involved in fiduciary activities since it would be unlikely that courts confound levels  $C$  or  $D$  with levels  $F$  or  $G$ .

Recognizing that the argument is appealing, I do not think however that it is definite. Indeed, there is no evidence that the judicial mistakes elevate the optimal standard instead of lowering it. One can fairly state that the problem of judicial mistakes affects every market player in the same degree. In this sense, one can expect that market players consider such a problem as if it were a natural risk. Therefore unless compelling reasons exist, regulation should not allocate that risk. Market players should be the only ones who decide how to allocate it.

But for further considerations let us assume that one may fairly expect that in this case judicial mistakes elevate the optimal standard from level  $E$  to either level  $F$  or level  $G$ . I think that even in this situation there is no reason for relying on the “gross negligence” standard. Indeed, the problem examined here can be resolved by using insurance mechanisms. If one thinks about who is in the best position for dealing in the most efficient way with insurance companies, one will necessarily arrive to the conclusion that the trustee is the party who is in that position. Indeed, as a sophisticated repeat-player, the trustee can diversify his risks in the most efficient way, charging the cost of doing so to the fund. It seems reasonable to believe that whatever the insurance cost is, the beneficiaries will always be better off if they are able to rely on a higher standard of care<sup>126</sup>. Therefore, efficiency suggests that

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125 The argument has been suggested by FISCHER and BRADLEY, who recognizing correctly the difficulty of measuring manager’s efforts, assume that courts tend to think that poor outcomes are product of bad actions. See: FISCHER & BRADLEY, *supra* note 114, at 265. Their intuition may be correct in the context of the American legal system, since effectively jurors usually sympathize to the victim. The intuition may not be correct in the context of countries where there are no jurors and where judicial corruption is a dramatic element of the legal landscape.

126 It is important to note that the tradeoff between the relaxation of the standard of care and the cost of the insurance does not benefit the beneficiaries because at the end of the day in any given case they will have to bear directly or indirectly that cost.

the trustee, as the least-cost avoider, uses the insurance tool (and not the relaxation of the standard of care) in order to avoid the risk of judicial mistakes.

Taking into consideration what I have stated above, it is possible to conclude that the “gross negligence” standard aggravates the cost-agency problem since that standard relaxes the effects of the fiduciary duty imposed on the trustee. Two additional facts reinforce this conclusion. Firstly, both the Banking Law and the Securities Market Law oblige settlors to hire only ‘*qualified trustees*’, that is, trustees that have obtained governmental authorizations. It means that in Peru an individual cannot go to the market and hire whoever he wants to hire. It means that in Peru, settlors must necessarily rely on one of the ‘*qualified entities*’ that operate in the ‘*closed market*’. Secondly, as a consequence of the existence of the close market, the few players usually act in the same way in most of the critical issues. For example, all of them collect their fees in the first place.

With the complete picture in mind, one may fairly conclude that the Peruvian trustee has no incentives to act efficiently. On the contrary, he has all the incentives to act opportunistically.

## **VI. THE ESSENCE OF THE MODERN TRUST**

### **A. Managerial function (from ‘nominal holder’ to real manager)**

Why people use trusts? Why do not they rely on property? These questions are related to the first feature of the modern trust: the managerial purpose.

As one can easily realize, modern trust is a mean for conferring determined benefits to the beneficiary. Taking into account this, one can fairly ask why does the settlor prefer to put the assets under the control of the trustee instead of transferring them directly to the beneficiary. One rational explanation can be related to the settlor’s desire either to obtain or to avoid some particular tax effect. Another rational explanation can be related to the settlor’s poor confidence in the beneficiary’s good judgment. In any given case, however, the unquestionable fact is that modern trust implies the existence of an intermediary between the party that wants to confer a benefit and the party that wants to receive it. And it plainly means that modern trust implies the existence of a complex principal-agent relationship.

It is true that during the first years the trustee was basically a ‘nominal agent’ since the beneficiaries used to have the possession of the assets (lands) and to exploit them directly. Today, however, the picture is very different.

As LANGBEIN<sup>127</sup> points out, in the Middle Ages real estate was the principal form of wealth. Due to the feudal restrictions on the transmission of freehold land, landowners used to make conveyances in trust in order to protect themselves and their families against injustices of the legal system. Thus the trust allowed landowners to make provision for their wives, daughters and younger sons. Likewise, the trust allowed landowners to prevent escheat when they were not survived by descendants. Therefore, the trustees of these early trusts were mere stakeholders, little more than nominees, with no serious powers or responsibilities of management. Commonly, the beneficiaries lived on the land and managed it directly. In LANGBEIN<sup>128</sup> words, “the trustees’ only significant duty was to hold until the settlor’s death, and then to put themselves out of business by conveying the freehold to the remainder beneficiaries”. This explains why long into the nineteenth century, the trust remained primarily a branch of the law of conveyancing.

The feudal restrictions on the transmission of real property disappeared from the late seventeenth to the early twentieth centuries. Therefore, the social necessity that gave rise to the conveyancing-type trust also disappeared. Nevertheless, the trust survived. Why? Because it changed its function. Indeed, the trust ceased to be a conveyancing device for holding freehold land and became instead a management device for holding financial assets<sup>129</sup>.

Unlike feudal wealth, modern wealth rests on financial assets, that is, stocks, bonds, mutual fund shares, insurance and annuity contracts, pension plans, bank deposits, etc. Even though there is no necessity of avoiding restrictions on the transference of those assets, simply because such restrictions generally do not exist, there is a necessity of managing them. Indeed, in contrast to lands, portfolios of complex financial assets require active and specialized management. Therefore, it is not surprising that at the beginning of the past century holders of those assets started to use trusts as means of gaining returns that otherwise would not have been obtained. In this way, the old ‘nominal holders’ became in real managers. Moreover, the unpaid and amateur trustees became in fee-paid professionals.

As it was reasonable to expect, the transition from one model to another was closely followed by the law. Indeed, in the first centuries, when trustees were basically

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127 JOHN H. LANGBEIN, *supra* note 98, at 633.

128 *Id.* at 634.

129 *Id.* at 638.

stakeholders for ancestral land, they were disabled from doing much with the trust property. The default law supplied no trustees' powers. Therefore, trustees had only those powers that the trust instrument expressly granted, which were typically few, since the trustees' job was simply to hold the land and then to convey it to the remainder persons<sup>130</sup>. As Judge JOSEPH STORY<sup>131</sup> pointed out in 1836, the trustee had no right (unless express power was given) to change the nature of the estate, as by converting land into money, or money into land.

Today, however, the landscape is totally different. Indeed, the need for active administration of the modern trust portfolio of financial assets rendered obsolete the old scheme. In this sense, a movement towards a maximum trustee's empowerment started in the early twentieth century. The first step was made by professional trustees, who started to draft very complete trust instruments that granted them the required powers for executing every conceivable transaction that might wrest market advantage or enhance the value of trust assets. The second step was made by the legislatures, which have conferred trustees vast managerial discretion as well as the power to transact freely in the market. Therefore, now virtually the modern trustee has been empowered to transact with trust assets on an equal footing with other market actors<sup>132</sup>. In order to safeguard beneficiaries against abuse of this discretion, trust fiduciary law has developed replacements for the former scheme of trustee disability: the duties of loyalty and care<sup>133</sup>.

In the light of the aforementioned, it is possible to state that modern trust is useful for those who for whatever reasons prefer to benefit some people without giving them the control of the sources of the benefits<sup>134</sup>.

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130 *Id.* at 641.

131 JOSEPH STORY, *Commentaries on Equity Jurisprudence, as Administered in England and America* 978 (1836).

132 The Uniform Commercial Code, and the Uniform Trustees' Powers Act provide that the purchaser is no longer under a duty to inquire into the trustees' transactional authority merely because the purchaser has notice that the seller is a fiduciary. Specifically, for example, section 7 of the Uniform Trustees' Powers Act provides that an outsider purchasing or otherwise transacting with trust property "may [assume] without inquiry" both "the existence of trust power and their proper exercise by the trustee." "The Uniform Fiduciaries Act (...)". See also the Uniform Trust Code, Sections 815, 816 and 1012.

133 JOHN H. LANGBEIN, *supra* note 98, at 643.

134 In this sense: PIERRE LEPAULLE, *Civil Law Substitutes for Trusts*, Yale L.J. Supplement, 1126, 1132 – 1133 (1927); J.A. HAWKINS, *The Trust Like Device in English Law, in Trusts and Trust-Like Devices* 3, 3 – 4 (W.A. WILSON ed., 1981); EDWARD C. HALBACH, JR., *The Uses and Purposes of Trusts in the United States, in Modern International Developments in Trust Law* 123, 133 (DAVID HAYTON ed., 1999); KENNETH G.C. REID, *Patrimony not Equity: The Trust in Scotland, in Trusts in Mixed Legal Systems* 19, 26 (J.L. Milo & J. M. Smits eds., 2001).



## B. Insulation of Assets

Why people use trusts? Why do not they rely on contracts? These questions are related to the second feature of the modern trust: the insulation of assets.

As one can easily understand, the main advantage of the trust is the insulation of the assets transferred by the settlor. Indeed, once the trust has been set up, the law prevents the trust property from being seized by the parties' creditors<sup>135</sup>. It means that neither contracting parties' creditors (that is settlor's creditors and trustee's creditors) nor beneficiary's creditors can reach such property<sup>136</sup>. The assets managed by the trustee can only be seized by the trust's creditors. Therefore, it is clear that the trust impedes that the liability that may arise from the personal activities of the parties affects the aforementioned assets<sup>137</sup>.

The situation just described is absolutely strange to the world of the contract law. Indeed, if in the context of an agency contract the principal transferred some assets to the agent, this later would become the legal holder of such assets. As a consequences of that the agent's net worth would include his previous assets as well as the assets transferred by the principal. In this sense, if the agent became insolvent his creditors would be able to reach all those assets. It is true that, at least in theory, both the principal and the agent would be able to make contractual arrangements with third parties in order to prevent that the agent's creditors seize the assets transferred by the principal. Those arrangements, however, would be highly costly<sup>138</sup>, if not impossible<sup>139</sup>. Therefore, the insulation of the transferred assets is without any doubt the main contribution of the trust law<sup>140</sup>.

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135 See: *Restatement (Second) of Trusts* 156, 221, 286, 306–08 (1959). See also: Article 241 of Banking Law, and Articles 310 and 311 of the Securities Market Law.

136 It does not mean that the beneficiary's creditors (or settlor's creditors) cannot reached the interests that the beneficiary (or the settlor) has in the trust property.

137 "... even if the trustee intentionally breaches her duty to the beneficiary, and specifically pledges trust property as security for credit extended to the trustee by a third party creditor who is unaware that the property is held in trust, the creditor will not be permitted to enforce his security interest in the trust property. The trust property instead will remain available only to the beneficiary". See: HENRY HANSMANN & UGO MATTEI, *supra* note 9, at 456.

138 *Id.* at 466.

139 The default rules of property and contract law establish that, absent contractual agreement to the contrary, each of the creditors has an equal-priority floating lien upon the debtor's entire pool of assets as a guarantee of performance. In this sense, if principal and agent wanted to shield the transferred assets from the agent's creditors, they would be forced to obtain waivers from all of the personal agent's creditors, both past and future. Such task seems to be not only highly costly but also infeasible. See: HENRY HANSMANN & REINIER KRAAKMAN, *The Essential Role of Organizational Law*, 110 *Yale L.J.* 390, 408 (2000).

140 *Id.* at 416.

Taking this into consideration, it is possible to state that the settlor relies on trust and not on contracts because he cannot bear the high transaction costs (if not the impossibility) of making the necessary arrangements for insulating the assets he wants to transfer for the benefit of the beneficiary.

Notwithstanding the aforementioned, it is important to note that the trust's feature under analysis does not derive from a particular conception of the true legal nature of the trust. Indeed, the law may *a)* declare that the trust property 'belongs to' the trustee, but at the same time *b)* prevent such property from being seized by the trustee's personal creditors. Under this model, while trustee's personal assets can only be seized by one type of creditors (his personal creditors), the assets he holds in trust for the beneficiary can only be seized by another type of creditors (trust's creditors). But the law may also declare *a)* that the trust property 'does not belong to' the trustee, *b)* that such property integrate an autonomous estate under the trustee's control, and *c)* that the assets transferred by the settlor can only be sized by the trust's creditors. Under this other model the consequences of the first one remain exactly the same<sup>141</sup>.

Of course, as I have argued in this work, conceptually speaking it does not make sense to consider that the trustee is a kind of owner of the trust property. Nevertheless, the conceptual approach is in any given case neutral when facing the insulation effect of the trust.

In the light of the aforementioned, it is possible to state that modern trust is useful for those who for whatever reasons seek to shield assets from claims of the agent's personal creditors<sup>142</sup>.

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141 It is interesting to note, however, that scholars tend to explain the insulation effect through different theories. Reviving the old dispute between FREDERIK W. MAITLAND, who argued that trusts belonged to contract law, and AUSTIN W. SCOTT, who argued that trusts belonged to property law, LANGBEIN, on the one hand, and HANSMANN and MATTEL, on the other, keep different visions about the true source of that effect. The former states that the protection against the trustee's insolvency rests on contract devices. He thinks that the trust is a type of deal that prefers the trust beneficiary over the personal creditors of the manager. Therefore, the source of the insulation effect must be simply found in the privileged contractual interest of the beneficiary (see: JOHN H. LANGBEIN, *supra* note 98, at 669). The latter ones believe that the protection against trustee's insolvency rests on the creation of an entity –the trust– that is separate from the three principal parties. They think that due to the fact that such entity owns assets managed by the trustee, the personal creditors of this last one are not able to seize those assets. Therefore, the source of the insulation effect must be found in the property-like aspect of the trust (see: HENRY HANSMANN & UGO MATTEL, *supra* note 9, at 470).

142 In this sense: HENRY HANSMANN & UGO MATTEL, *supra* note 9, at 466; KENNETH G.C. REID, *supra* note 134, at 23.

### C. Over-Control

Why people use trusts? Why do not they rely on corporations? These questions are related to the third feature of the modern trust: over-control.

As one can easily note, modern trust imposes on the trustee the duty of managing the assets according to the settlor's will. It plainly means that, at least in principle, neither the trustee nor the beneficiary is able to modify the purpose of the trust. Certainly it is possible to argue that, at least in some cases, the beneficiary should be able either to modify or to terminate the trust. Nevertheless, the law of trust requires the trustee to follow the settlor's will to the extent that it does not present gaps<sup>143</sup>. On the contrary if the settlor set up a corporation instead of a trust, it would be always possible either to modify or to eliminate the settlor's will. Indeed, the shareholders would always be able to change the by-laws, to replace it or simply to dissolve the corporation. Therefore, unlike the corporation, the trust avoids the risk of disobeying the settlor's will.

Taking this into consideration, it is possible to state that the settlor relies on trust and not on corporations because he wants to exercise control over the destiny of the assets transferred by him even after death.

In an apparent opposite direction, it has been pointed out<sup>144</sup> that what distinguishes trusts and corporations is the larger flexibility of the formers. Indeed, unlike corporations, trusts do not have to adopt internal governance structures that require the existence of a board of directors, impose the obligation to hold meetings for specific purposes, etc. Obviously, it would be impossible to contradict that trusts are more flexible than corporations. However, it seems that the great flexibility of trusts is just the consequence of the over-control sought by settlors. Indeed, if the law protects the settlors' will and such will implies that, when managing trust properties, trustees should be subject only to the settlors desires, the consequence is the exclusion of the constrains imposed by the governance structure of others legal entities, such as corporations. Therefore, the flexibility showed by trusts can be simply considered as one particular effect of the protection to the settlor's wishes.

In the light of the aforementioned, it is possible to state that modern trust is useful for those who, for whatever reasons, seek to exercise over-control upon the

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143 See: *Restatement (Third) of the Law of Trusts* 61, 65, 68 (2001).

144 HENRY HANSMANN & UGO MATTEI, *supra* note 9, at 472.

way in which the benefits should be obtain as well as the way in which beneficiaries should receive them<sup>145</sup>.

## VII. ECONOMIC APPROACH

Trusts create fiduciary relationships. As other kinds of fiduciary relationships, those created by trusts present three important features.

Firstly, trust relationships derive from incomplete agreements<sup>146</sup>. Indeed, not only because it would be highly costly but also inefficient, the parties in this case do not execute completed agreements. In fact, the settlor and the trustee would only be able to identify all possible contingencies as well as the appropriate responses if they spend considerable time, effort and resources in the respective task. Likewise, both the trustee and the beneficiary would be worse off if the former had to act in accordance to a set of complete contractual provisions instead of following what the specific circumstances advice in the light of new information and new expertise.

Secondly, trust relationships imply the separation of enjoyment from control or management. Indeed, whatever his reasons are, the settlor chooses not to transfer the assets to the beneficiary but to put them under the trustee's control.

Thirdly, trust relationships present asymmetrical information concerning acts and results. Indeed, either because of the fact that available information is always imperfect or because of the fact that the trustee possesses unobservable decision-making authority, the beneficiary is usually unable to know what the cause of the outcome is.

Each one of the aforementioned features creates different problems, but all of them contribute to generate the agency cost problem, which seems to be the most important problem in the present situation. Indeed, in practical terms what makes different the modern trust from the old trust is not the kind of assets that the settlor transfers now, but the possibility for the trustee to take personal advantage of those

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145 In this sense: DAVID HAYTON, *Anglo-Trusts, Euro-Trusts and Caribbo-Trusts: Whither Trusts?*, in *Modern International Developments in Trust Law* 1, 16 (DAVID HAYTON ed., 1999).

146 A complete agreement exists when the parties explicitly contemplate an exhaustive list of conditions on which their actions shall be based. In other terms, a complete agreement exists if it provides responses for each and every possible condition (in the relevant universe of conditions). In the real world, agreements are not complete because *a)* the high cost of anticipating all kind of possible contingencies, *b)* the high cost of enforcing terms related to some contingencies, *c)* the impossibility of verifying some facts, and *d)* the irrelevance of some responses. See: STEVEN SHAVELL, *supra* note 99, at 299-301.

assets. That possibility, created by the open-ended agreements, the separation of enjoyment from control, and the impossibility of knowing the true cause of the poor outcomes, is without any doubt the center of the legal preoccupation<sup>147</sup>.

In order to understand the complexity of the cost agency problem, it is crucial to consider that the trust is more than a simple contract between private parties. Indeed, as SITKOFF<sup>148</sup> points out, the trust is an organizational form with *in rem* as well as *in personam* dimensions. The first dimension derives from the fact that the trust insulates the assets transferred by the settlor, creating a patrimony that is different from the parties' patrimonies. The second dimension derives from the fact that the trust is primarily governed by the (open-ended) terms that settlor and trustee agreed on. Therefore, just like the corporation and other organizational forms, the trust exhibits external *in rem* asset partitioning with internal *in personam* contractarian flexibility.

Once one recognizes this reality, one can figure out how complex the universe of the trust is, as well as how and why the different and opposite interests that inhabit that universe try to survive<sup>149</sup>.

By considering that the trust is an organizational form where one can find, among others conflicting interests, the interest of the settlor in controlling the way in which the benefits must be obtained, the interest of the beneficiary in maximizing his welfare, the interest of the trustee in behaving opportunistically and the interest of the parties' creditors in trying to reach the trust property, one makes a step further in the road towards efficiency and justice. For reaching the end of that road another step however must be taken.

If the law wants to resolve at least in part the agency cost problem, it needs to abandon the legalistic approach, that is, the approach that only takes into consideration the legal situation of each of the parties. Why? Because it is not wise to create solutions based exclusively on legal categories since behind the same legal category one can find individuals with different profiles, skills, incentives and needs. If the law just ignores the differences between the individuals that belong to the same legal category, it can overprotect strong and sophisticated players and unprotect weak and non-sophisticated players. And that is plainly inefficient as well as unjust.

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147 "The trust relationship of necessity puts the beneficiaries of a trust at the peril of the trustees' misbehavior (...) The central concern of modern trust law is to safeguard against those dangers." See: JOHN H. LANGBEIN, *supra* note 98, at 641.

148 ROBERT H. SITKOFF, *supra* note 92, at 639.

149 "(...) greater insight into the nature and function of trust law will come from a conception of the trust as a de facto entity that serves as the organizing construct for an aggregation of contractarian relationships". See: *Id.* at 639.

The economic approach provides the law with a powerful tool for identifying the correct incentives that each player needs in order to maximize the “total welfare”, that is, the sum of the each parties’ welfare. That approach takes into account the different types of trusts as well as the different types of players. In this sense, optimal outcomes suggested by economic approach vary depending on several grounds, such as the purpose of the trust (charitable trust v. securitization trust), the attitude towards the risk (risk-averse beneficiaries v. risk-neutral beneficiaries), and so forth.

As SITKOFF<sup>150</sup> points out, principal-agent economics has great potential to offer further insights about the nature of the trust as well as the goals that the law should achieve. Particularly, the agency costs analysis demonstrates how complicated the usual agency problem is in this context. That analysis offers fresh insights of the competing interests of the parties as well as of the different incentives needed in each case. As I have stated, without economic insights, the law can wrongly overprotect the strong and sophisticated player, and unprotect the weak and unsophisticated player. In short, without economic analysis, the law can harm more than help.

## VIII. PROPOSAL

Taken into consideration the ideas exposed along this work, I think that Peruvian legislation should be reformed in order to eliminate not only the conceptual inconsistencies that I have denounced, but also to address the agency cost problem. The following are the basic characteristics that the new regulation should exhibit:

- First: the Peruvian “*fideicomiso*” should create an autonomous estate, different from those of the parties. Such an estate should have legal capacity<sup>151</sup>.
- Second: the Peruvian trustee should be considered as a manager of the aforementioned estate<sup>152</sup>. For this reason he should have the powers that corporation’s managers usually have, to the extent that the settlor’s purpose requires so. Therefore, all his faculties must be considered precisely “faculties” but not “rights”, with the theoretical and practical consequences that such a distinction implies.

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150 *Id.* at 684.

151 Some Latin American scholars have taken the same position. See for example: JULIAN BOJALIL, *supra* note 88, at 64; PEDRO MARIO GIRALDI, *supra* note 51, at 33.

152 His view is shared again by JULIAN BOJALIL, *supra* note 88, at 64.

- Third: the Peruvian trustee should be liable for breach when he fails to act with ordinary negligence, that is, when he fails to take the precautions that would have been taken by an ordinary person when dealing with his own affairs.
- Forth: the regulation should take into account the different types of trusts as well as the different types of persons that are behind each legal category.

Additionally, and recognizing that this topic has not been addressed in this work, I think that there are no reasons for regulating the trust in laws that are supposed to regulate only certain economic activities. The institution under analysis should be adopted in the broadest sense and therefore should be regulated in a general law. Likewise, there are no reasons for closing the market by requiring governmental authorization in order to execute and perform trust agreements. I accept, however, that in some cases such an authorization is desirable (let us think in a securitization process oriented to raise public savings).

Some of these proposals have already been contemplated by the new Securities Market Law of Ecuador, which establishes *a)* that the trust is an autonomous estate with legal capacity, and *b)* that the trustee is just the legal representative of such estate. We should follow its wise steps.

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