



# CREaTE

Canterbury Research and Theses Environment

Canterbury Christ Church University's repository of research outputs

<http://create.canterbury.ac.uk>

Please cite this publication as follows:

Zhang, D. (2018) Certainty of subject matter: what China can learn from English trust law. *Trusts and Trustees*, 24 (10). pp. 1020-1030. ISSN 1363-1780.

Link to official URL (if available):

<https://doi.org/10.1093/tandt/tty154>

This version is made available in accordance with publishers' policies. All material made available by CReaTE is protected by intellectual property law, including copyright law. Any use made of the contents should comply with the relevant law.

Contact: [create.library@canterbury.ac.uk](mailto:create.library@canterbury.ac.uk)



# Certainty of subject matter: what China can learn from English trust law

By *Daoning Zhang*\*

Abstract: China transplanted English trust law in 2001. This article examines the judgment of a recent case delivered by the Supreme Court of People's Republic of China on the issue of the certainty of subject matter of trusts. It analyses the reasoning and judgment of the Court in the light of English trust law and considers what China may learn from the well-established English trust law principles and doctrines.

## 1. Introduction of Chinese trust law

Since last a few decades, trust law was widely used for commercial purposes, whereas traditional trusts were donative trusts.<sup>1</sup> China, as a new learner of trust law, directly enacted Chinese trust law for financial institutions to make investments. The history of the modern Chinese trust law can be traced back to 2001 when the Trust Law of People's Republic of China (TLoPRC) came into effect.<sup>2</sup> Since then, trusts had been used as a popular vehicle for collective investment purpose by financial institutions named as 'trust companies'. Later, three other pieces of regulation— Measures for the Administration of Trust Companies 2007,<sup>3</sup> Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds 2009<sup>4</sup> and Measures for the Administration of Net Capital of Trust Companies<sup>5</sup>—together with the TLoPRC, constitute the legal framework of Chinese trust law.

---

\* Daoning Zhang is a lecturer in law at the Canterbury Christ Church University.

<sup>1</sup>Traditionally, a trust is a gift. By contrast, though a commercial trust relies on the protection offered by trust law, it is a deal. John H. Langbein, 'The Secret Life of the Trust: The Trust as an Instrument of Commerce', 107 Yale L.J. 165 (1997) p186

<sup>2</sup> Trust Law of People's Republic of China 2001 available at [http://www.npc.gov.cn/wxzl/wxzl/2001-05/30/content\\_136770.htm](http://www.npc.gov.cn/wxzl/wxzl/2001-05/30/content_136770.htm) (accessed on 01 September 2018)

<sup>3</sup>Measures for the Administration of Trust investment Companies 2007 (Enacted according to the Order of China Banking Regulatory Commission No.2)

[http://www.cbrc.gov.cn/chinese/home/docDOC\\_ReadView/2007020146C75FE4EC42DAA9FFADADCB71D8A300.html](http://www.cbrc.gov.cn/chinese/home/docDOC_ReadView/2007020146C75FE4EC42DAA9FFADADCB71D8A300.html) For an English version, see

<http://www.lawinfochina.com/Display.aspx?lib=law&Cgid=83588> (accessed on 01 September 2018)

<sup>4</sup> Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds 2009 (enacted according to the Order of China Banking Regulatory Commission No 1)

[http://www.cbrc.gov.cn/chinese/home/docDOC\\_ReadView/200909155AD71D59AFD82FB5FFA27E225216B800.html](http://www.cbrc.gov.cn/chinese/home/docDOC_ReadView/200909155AD71D59AFD82FB5FFA27E225216B800.html) For English version see

<http://www.lawinfochina.com/display.aspx?lib=law&id=5883&CGid=>> (accessed on 01 September 2018)

<sup>5</sup> Measures for the Administration of Net Capital of Trust Companies 2010 (enacted according to the No.5 Order of the China Banking Regulatory)

[http://www.cbrc.gov.cn/chinese/home/docDOC\\_ReadView/20100909E006F4BD02BCBECEFFF57B9E1D928500.html](http://www.cbrc.gov.cn/chinese/home/docDOC_ReadView/20100909E006F4BD02BCBECEFFF57B9E1D928500.html) For an English version, see <http://www.lawinfochina.com/Display.aspx?lib=law&Cgid=137689> (accessed on 01 September 2018)

Similar to other civil law jurisdictions where the dichotomy of legal and equitable interests does not exist, TLoPRC has to deal with the difficulty arising from the nature of trusts. Under Chinese property law, if settlors transfer the ‘legal title’ to trustees to manage certain assets, there is no ‘equitable right’ left for beneficiaries. In other words, trustees would become the ultimate owners of the trust assets. This is not the position under English trust law where the beneficiaries are the ultimate owners in equity.<sup>6</sup>This is true as it is well established that, if all beneficiaries are *sui juris* and entitled to all the trust assets, they can work consistently to request trustees to return the trust assets to them or provide instructions with regard to the disposition of assets.<sup>7</sup>

The legislators of Chinese trust law by no means would like to replicate agency law. China has recognised that trust law as a way to give effect to assets partitioning for settlors, beneficiaries and trustees.<sup>8</sup>The assets under a trust are not trustees’ assets available for their creditors; solvent settlors, after creating a trust by transferring assets to trustees, effectively make the trust assets out of reach of settlor’s future creditors.<sup>9</sup> The essential nature of trust in China is controversial, while China takes a pragmatic way by emphasizing the independence of the trust assets. Under the Chinese trust law, the subject matter of the trust, i.e. the assets subject to the trust is separated from the assets of trustees.<sup>10</sup>It is unclear whether the nature of the beneficiaries’ interests is *right in rem* or *right in personam* or *sui generis*. What is clear is that the beneficiaries are the ultimate owners of the trust assets. Under English insolvency law, equitable interests of beneficiaries are available for the trustee when the beneficiaries are bankrupt.<sup>11</sup>The TLoPRC takes a similar approach by prescribing that the interests held by the bankrupt beneficiaries are available to pay their debts; those interests can also be assigned and inherited.<sup>12</sup>

A possible way to understand trusts in China is by analogy with companies. The trust assets, even if have no corporate status, have been put inside ‘an entity’ which is separate from the assets of trust companies; trust companies act as trustee/director and provide investment service to the trust while the beneficiaries are similar to shareholders of the ‘entity’. Besides recognition of the independence of trust assets which offer the bankruptcy remoteness function to beneficiaries, the TLoPRC 2001 also provides that, among other things, the

---

<sup>6</sup> Alastair Hudson, *Equity and Trusts* (Eighth Edition, Routledge, 2015) p182

<sup>7</sup> *Saunders v Vautier* (1841) 4 Beav 115

<sup>8</sup>Robert Sitkoff, ‘An Agency Costs Theory of Trust Law’, 89 *Cornell L. Rev.* 621 (2004) P641

<sup>9</sup> Art 15,16 of TLoPRC 2001

<sup>10</sup> Art 16 of TLoPRC 2001

<sup>11</sup> Ian Fletcher, *The law of insolvency* (Sweet & Maxwell, 5<sup>th</sup> Edition 2017) p212

<sup>12</sup> Art 47, 48 of TLoPRC 2001

requirement of certainty of subject matter of trust assets must be met, for any trust to be valid.<sup>13</sup>The next section will examine the requirement of certainty of subject matter.

## 2. The certainty of subject matter

Under common law, for a trust to be valid, the requirements of three certainties must be met—the certainty of intention, the certainty of subject matter and the certainty of objects.<sup>14</sup> The purpose of the requirement for three certainties is to ensure that the enforceability of the trust.<sup>15</sup> For example, without certainty of subject matter, it is impossible to know what assets are put in the hands of trustees. This creates difficulty for either the beneficiaries and the court to determine whether the trustees have fulfilled their duties. Chinese trust law follows the same suit. The TLoPRC provides that a trust will be invalid if trust assets are uncertain or the beneficiaries or the scope of beneficiaries are uncertain.<sup>16</sup>The law does not mention the certainty of intention, as trusts in China invariably exist of contracts. In other words, there is almost always investment contracts between settlors(in many cases, they are also beneficiaries) and trustees, so it would be adequate to prove the intention of settlors.

This article focuses on one of the certainties—the certainty of subject matters, i.e. the trust assets. Under a trust, the beneficiaries enjoy the equitable ownership of the trust property. Such equitable ownership is one type of proprietary rights. For a proprietary right to be valid, certainty of the scope of the trust property must be ascertainable as the nature of a proprietary right is a right excisable against a thing, irrespective of tangible or intangible.<sup>17</sup>Moreover, the certainty of subject matter requires that not only the assets should be ascertainable, but also the interest of each beneficiary is ascertainable.<sup>18</sup>A general rule is that the description of the trust assets should be clear enough for trustees and the court to interpret; it should not have varying meaning in the eyes of different people.<sup>19</sup>

One question is what property could be made as the subject matter of a trust. The general rule is that almost all categories of assets can be the subject matter of a trust as long as the law allows the settlors to do so.<sup>20</sup>For example, a

---

<sup>13</sup> Art 11(2) TLoPRC 2001

<sup>14</sup> Knight v Knight [1840] 3 Beav. 148

<sup>15</sup> Robert Pearce and Warren Barr, *Pearce & Stevens' Trusts and equitable obligations* (7<sup>th</sup> Edition OUP 2018)P69

<sup>16</sup> Art 11 of the TLoPRC

<sup>17</sup> Michael bridge, 'Certainty, identification and intention in personal property law' in Paul Davies and James Penner *Equity, trusts and commerce* (Harting publishing 2017) p87

<sup>18</sup> Boyce v Boyce (1849) 60 ER 959

<sup>19</sup> Richard Edwards and Nigel Stockwell, *Trusts and equity*, (12<sup>th</sup> Edition Pearson 2015) p101

<sup>20</sup> Lynton Tucker and others, *Lewin on trusts* (Sweet & Maxwell 2015) p47

property of a personal nature such as peerage and pensions cannot be the subject matter of a trust as the law does not allow the transfer of such interests enjoyed by settlors to others.<sup>21</sup> As long as the law or the contracts allow the property to be transferred, that property is able to be subject to a trust irrespective of its nature and scope.<sup>22</sup> Interests to receive any ascertainable and identifiable properties in the future can be the subject matter of a trust as they are present interests to future enjoyment.<sup>23</sup>

Another requirement of certainty of subject matter is regarding the separation of trust assets. It is useful to recall a trilogy of English cases which are most cited to illustrate the English standpoint on the certainty of subject matter of an express trust.<sup>24</sup> These cases together articulate another key rule of the requirement—separation of the trust assets from the bulk of assets of the same nature. This requirement is a corollary of the above general rule, as otherwise one cannot ascertain which specific assets belong to the trust and in turn the proprietary interests of trustees and beneficiaries cannot attach to ascertainable properties. In both *West London* and *Re Goldcorp* cases, the key issue is whether the buyers of bottles of wine or gold bullions can acquire the equitable rights of goods if sellers did not separate their goods from the bulk. The Sale of Goods Act makes it clear that the title of the goods can only be transferred to the buyers if the goods can be ascertained.<sup>25</sup> The corollary of it is that, since the beneficiaries' interests are proprietary rights, they attach to assets only after they are ascertained. The result of these two cases are the same: to the extent that the sellers did not separate goods of buyers from the bulk, no buyers could be treated as beneficiaries under a trust so as to be protected from the insolvency of sellers.<sup>26</sup> The main rationale is that since seller failed to separate the goods from the bulk, the subject matter of the purported trusts was uncertain. Therefore, no trust was created.<sup>27</sup>

By contrast, in *Hunter v Moss* case, it seems the separation requirement is relaxed for intangible things such as shares.<sup>28</sup> In this case, even though the 50 shares that the employer promised to give one employee was not separated from

---

<sup>21</sup> Lynton Tucker and others, *Lewin on trusts* (Sweet & Maxwell 2015) p47

<sup>22</sup> David Hayton and others, Underhill and Hayton, *Law of trusts and trustees*, (18<sup>th</sup> Edition, LexisNexis 2010) p252

<sup>23</sup> Lynton Tucker and others, *Lewin on trusts* (Sweet & Maxwell 2015) p48

<sup>24</sup> *Re London Wine Co (Shippers) Ltd* [1986] P.C.C. 121; *In re Goldcorp Exchange Ltd.* [1994] 2 All ER 806; *Hunter v Moss* [1994] 1 WLR 452

<sup>25</sup> Sale of Goods Act 1979 c.54 part iii art 16

<sup>26</sup> *Re London Wine Co (Shippers) Ltd* [1986] P.C.C. 121; *In re Goldcorp Exchange Ltd.* [1994] 2 All ER 806

<sup>27</sup> *Re London Wine Co (Shippers) Ltd* [1986] P.C.C. 121; *In re Goldcorp Exchange Ltd.* [1994] 2 All ER 806

<sup>28</sup> *Hunter v Moss* [1994] 1 WLR 452

the total 950 shares, the court held that the employer held those 50 shares on trust for the employee.<sup>29</sup>

Things may be more complicated in commercial settings. In practice, financial institutions may need to pool clients' money together and collectively make investments for them. This will give rise to uncertainties, as the money received from different investors are mixed together so that it is unclear which part of the total cash pool belongs to a specific client. One case which is particularly relevant to this situation involving financial institution is Lehman Brothers international(Europe) (hereafter LBIE).<sup>30</sup> In the aftermath of the collapse of Lehman brothers Holdings Inc., a subsidiary of Lehman Brothers Holdings Inc–LBIE–entered into administration in the UK. The activities of LBIE are regulated by Financial Services and Markets Act 2000 (FSMA)<sup>31</sup>and Client Assets Sourcebook (CASS).<sup>32</sup>

CASS 7.13 requires financial institutions to separate clients' money from their own by directly depositing clients' money into a client bank account rather than their own accounts.<sup>33</sup> An alternative way is to transfer clients' money into a House account which is the institution's own business account and after a reconciliation process on the second day, the institution will make sure that the money will be transferred to the client money account.<sup>34</sup> The latter approach was adopted by the LBIE.<sup>35</sup> The effect is that the clients' money is held by the financial institutions on trust on behalf of clients.<sup>36</sup> The clients' money, which had been pooled together in a client money account, is subject to a statutory trust protected under the CASS.<sup>37</sup>

When LBIE entered into insolvency proceeding, the clients' money was left in danger if the money was not protected by a trust. Therefore, the key issue was whether the money saving in company's House Account prevented the statutory trust to be formed even though the purpose of the CASS is to protect clients' money by trusts.<sup>38</sup> According to *Hunter v Moss*, it is largely accepted that the requirement for separation of assets is relaxed for intangible things, so one may

---

<sup>29</sup> *Hunter v Moss* [1994] 1 WLR 452

<sup>30</sup> *Lehman Bros International (Europe) v CRC Ltd (SC(E))* [2012] Bus LR

<sup>31</sup> Financial Services and Markets Act 2000

<sup>32</sup> Financial Conduct Authority (FCA) Client Assets Sourcebook

<sup>33</sup> CASS 7.13

<sup>34</sup> CASS 7.4

<sup>35</sup> *Lehman Bros International (Europe) v CRC Ltd (SC(E))* [2012] Bus LR p667

<sup>36</sup> CASS 7.17

<sup>37</sup> Section 137B(1) of Financial Services and Markets Act 2000 and chapter 7 of the CASS.

<sup>38</sup> *Lehman Bros International (Europe) v CRC Ltd (SC(E))* [2012] Bus LR

argue that the CASS by no means aims to make the alternative way of saving clients' money a more dangerous option. That is to say, even though clients' money may be saved in the House account for a short period of time, the institution needs to provide a buffer so that the balance of the House account is always more than the total account of money from clients.<sup>39</sup> More importantly, recognition of the statutory trust for the alternative approach, before the client money is separated, can provide clients tracing mechanisms in the event of insolvency of that institution. The supreme court held that, according to the purpose of CASS and FSMA, investors should be protected by such a statutory trust.<sup>40</sup> As a result, the trust will be formed as soon as the financial institution receives clients' money irrespective of it is separated from their House account or not.<sup>41</sup> This indicates that for intangible assets such as money, the rule for separation may not be as stringent as tangible assets.

From the above four cases, one may summarise the common understanding of the requirement for the certainty of subject matter, in terms of separation of trust assets. For tangible assets, the assets of a trust have to be separated from the rest of the stock of similar assets. In some cases, even though the assets are almost identical, such as bottles of beer of the same brand, they need to be separated from the others which are not subject to a trust.<sup>42</sup> In terms of fungible and intangible assets such as money and shares, it seems the requirement of separation is relaxed as the law is ready to accept that beneficiaries form a tenancy in common relationship and share the bulk of the shares or money proportionately.<sup>43</sup> It has been a common practice to pool clients' money together for investment purposes. Trust law is flexible enough to deal with this practical issue by recognising that all clients form a tenancy in common relationship with regard to the pool of clients' money.

The next section will examine the view of the Supreme court of China as to how to understand the requirement of separation and certainty of subject matter.

### **3. The Chinese Supreme Court case**

As previously explained, in China, trust law as an organisational law, is frequently exploited by investment companies or funds to make collective

---

<sup>39</sup> See Lord Neuberger's analysis at Court of Appeal. *Lehman Bros International (Europe) v CRC Ltd (CA)* [2011] Bus LR p350

<sup>40</sup> *Lehman Bros International (Europe) v CRC Ltd (SC(E))* [2012] Bus LR

<sup>41</sup> *Lehman Bros International (Europe) v CRC Ltd (SC(E))* [2012] Bus LR

<sup>42</sup> *Re London Wine Co.(Shippers) Ltd* [1986] PCC 121

<sup>43</sup> *Hunter v Moss* [1994] 1 WLR 452

investments. Trust companies or funds set up trust plans to attract investment from investors who will also be beneficiaries. The trust plans of assembled funds are collective investment schemes where the trust companies act as trustees with the role of collectively managing more than two investors/beneficiaries' investments.<sup>44</sup>The Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds 2009 provides a clear rule with regard to trust plans. It requires the qualified investors to be the beneficiaries of the trust plan with specific investment projects and strategies; each trust plan consists of a number of units with the total amount of value reflecting the borrowers' financing demand so that investors may choose how many units they would like to purchase.<sup>45</sup>Furthermore, trustees must maintain the independence of trust assets belonging to different trust plans.<sup>46</sup>

In recent years, disputes with regard to investments made by trust companies are rising. In 2016, the Supreme Court of China provided its influential judgment with regard to the certainties of subject matter of a trust under Chinese trust law. The name of the case is Shixinronghe company v. Chang'an International trust.<sup>47</sup>The next section will provide an overview of this case.

### 3.1 Facts of the case

To make a long story short and easy to comprehend without changing the nature of legal issues involved in this case, I will provide a brief account of a modified version of this case. The investor, settlor and beneficiary were all S company in this case. It appointed C Trust company as the trustee to establish a trust investment plan of which the main investment was that the trustee C, after receiving cash transferred from the settlor S and X bank respectively, according to their trust contract, purchased the 'right to receive dividends' of the shares of H company from two investment funds D1 and D2, which held the shares of H company at that time. The total rights to receive dividends are further divided into units under the trust plan where S company would purchase junior tranche of the units, whereas X bank would purpose the senior units. This meant that once a default of financial products happened, S company would be ranked lower than X bank and bore higher risks. The interest of beneficiary S company would be affected by the share price as the share price would determine the value of right to receive dividends. The contract stipulated that when the share

---

<sup>44</sup> Art 2 of Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds 2009

<sup>45</sup> Art 5 of Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds 2009

<sup>46</sup> Art 21 of Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds 2009

<sup>47</sup>Shixinronghe investment company v Chang'an International trust company and others, trust contract disputes (2016)Supreme Court Civil Final No.19 available at

<<http://gongbao.court.gov.cn/details/ce26ed23e276a4af04509bed31d259.html>>(accessed on 06 September 2018)



price went down, unless junior beneficiary determined to pay extra money to maintain the units they held, they would be seen as giving up certain amount of units on behalf of senior beneficiaries. D1 and D2 also provided a share pledge on behalf of the trustee as security.

What made things more complicated was that H company signed a valuation adjustment mechanism contract with the two funds D1 and D2 and the agreement provided that if H company did not make profits at the required level within 3 years since the transfer of shares to D1 and D2, H company had right to buy back shares from D1 and D2 at a certain price. The purpose was to reduce the outstanding shares and improved the overall performance; this is a way to protect the minority shareholders of the H company. This share buyback agreement worked similar to a call option for H company so that D1 and D2 funds had contractual obligations to comply with it; also, these two funds also bound by an anti-assignment of shares clause within the three years. In China, there are two situations where the transfer of shares may be restrained. One situation is that the liquidity of original shares of the founders, directors or other senior managers of companies in the secondary market are restrained for some years after IPO; the second situation is due to some historical reason, that many shares of state-owned shares were not transferable but now those shares gain full liquidity subject to some restrictions.<sup>48</sup> Some shares of H company held by D1 and D2, due to the above reasons, cannot be transferred within three year.

After three years, in 2014, as the share price kept going down and value of rights to receive dividends was lower than the investment made by X Bank. As a result, the senior beneficiary decided to release the share pledge and sell the shares according to the contract with the result that the S company did not receive anything in return. The S company, as the junior beneficiary, was not happy with the losses and proposed to sue the trustee and D1 and D2 together on the basis that, among other things, the trust contract was invalid due to uncertainty of subject matters.

The S company argued that the trust properties—right to receive dividends— was subject to a share buyback agreement which might potentially be executed (in this case, it did not happen). This possibility made the trust assets uncertain.<sup>49</sup>

---

<sup>48</sup> Chen Dun, 'On Legal Risk and Effect of Pledge on Restricted Stock of Listed Company' Journal of Regional Financial Research (2010) vol7 P20

<sup>49</sup> Shixinronghe investment company v Chang'an International trust company and others, trust contract disputes (2016) Supreme Court Civil Final No.19 available at

In the first instance, Shan'Xi High Court held: this share buyback event did not happen, so the uncertainty asserted by S company did not exist. Also, the trust assets in this case only referred to the cash paid to the trustee, not including the right to receive dividends.<sup>50</sup>S company appealed. S claimed that the right to receive dividends should be considered as the trust assets and the uncertainty of subject matter should refer to the certainty of ownership. As the ownership of shares was potentially uncertain, the trust contract was invalid.<sup>51</sup>Trustee defended that certainty of subject matter was a requirement that only carried weight in the stage of the constitution of a trust; after a trust was constituted, there was no need to maintain the certainty of subject matter. The ownership was certain as trustee had the share pledge which conferred on the trustee the priority over the holder of the contractual buyback right. Also, even though the shares were bought back, the D1 and D2 could purchase the shares in the secondary market to main the trust properties.<sup>52</sup>

The case finally came to the Supreme Court and the Court held that: a).besides the cash paid to the trustee at the beginning, any assets purchased by the cash were part of the trust assets. It was acceptable to make 'right to cash flow right' as trust properties. b). Assets certainty required the assets are separated and designated to the trust investment, and the number and scope should be clarified, for the purpose of administration and disposition by trustees according to the purpose of investment. According to the 'Right to receive dividends transfer agreement', the contents of such right to cash flow are clearly defined in terms of their scope and number. As a result, they met the certainty of subject matter requirement for any trust to be valid. <sup>53</sup>c). As to the uncertainty arising from the valuation adjustment mechanism contract, it is a different legal relationship from the uncertainty of subject matter. As trustee had acquired the share pledge right, it had the priority in terms of shares, never mind the fact that the right of share buyback had never happened and had no effect to the right to receive dividends in this case. Therefore, the trust contract was valid.<sup>54</sup>

---

<<http://gongbao.court.gov.cn/details/ce26ed23e276a4af04509bed31d259.html>>(accessed on 07 September 2018)

<sup>50</sup> Shixinronghe investment company v Chang'an International trust company and others, trust contract disputes (2016)Supreme Court Civil Final No.19 available at

<<http://gongbao.court.gov.cn/details/ce26ed23e276a4af04509bed31d259.html>>(accessed on 06 September 2018)

<sup>51</sup> ibid

<sup>52</sup> ibid

<sup>53</sup> ibid

<sup>54</sup> ibid

### 3.2 Standard of certainty of subject matter

Under Chinese trust law, a broad range of properties could be the subject matter of trusts. Measures for the Administration of Trust investment Companies 2007 provides that the subject matter of a trust may include cash, personal properties, real properties, securities and other property interests.<sup>55</sup>

The first lesson China could learn is that future properties should be excluded outside of this list. The reason is simple to explain: future properties such as the possibility to win the lottery does not exist now. Therefore, no trust and beneficiary could gain any proprietary rights in the non-existent property. However, the right to receive dividends, in this case, is not a future property but a present right even though it only allows holders to receive properties in the future. Some Chinese cases have confirmed that the right to receive dividends, as a chose in action derives from a share consisting of rights and burdens, is a valid subject matter for trust purpose.<sup>56</sup>

Secondly, since the beneficiaries' money may be pooled together, this may give rise to future disputes with regard to separation of trust assets. In fact, the main content of certainty of subject matter is to require separation between trust assets and other assets.<sup>57</sup> Chinese trust law also requires the separation of trust assets, especially from the trustees' own assets. Measures for the Administration of Trust investment Companies 2007 requires the trust companies to separate their own assets from the clients' assets; also, assets belonging to different clients need to be separated.<sup>58</sup> Trust contracts need to clarify the scope, category and condition of trust assets; rights and obligations of relevant parties and the scope of trustees' powers and the way of administration of trust assets and methods of calculation of interests of beneficiaries and the way to return trust assets to them and the way to calculate service fees.<sup>59</sup> Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds 2009 requires that trust assets are independent of the assets of trust companies; the assets acquired after the establishment of the trust belongs to the trust assets; the trust assets can not be used to pay creditors of the trust companies should the companies enter into insolvency.<sup>60</sup>

In China, trust companies are similar to the Unit Trust Schemes in the UK, which are collective investment schemes (CIS) where the property is held on

---

<sup>55</sup> Chapter 2, art16 of Measures for the Administration of Trust investment Companies 2007.

<sup>56</sup> Zhao Lianhui, 'The certainty of trust properties and validity of trust' (2018) SJTU Law review p170.

<sup>57</sup> Alastair Hudson, *Principles of equity and trusts* (Routledge 2016) P57

<sup>58</sup> Art 29 of Measures for the Administration of Trust investment Companies 2007

<sup>59</sup> Art 32 of Measures for the Administration of Trust investment Companies 2007

<sup>60</sup> Art 3 of Measures for the Administration of Trust Companies' Trust Plans of Assembled Funds 2009

trust for the investors according to FSMA art.237(1).<sup>61</sup> There are two outstanding features of a CIS: '1. *The polling of investors' funds and 2. The management of those funds by someone other than the investors.*'<sup>62</sup> All the money received from the investors are pooled and the proceeds are paid out of a common account.<sup>63</sup> The trustees would make decisions for all clients to take advantage of the economy of scale; all clients rely on the overall performance of the trust products and the quality of the management.<sup>64</sup> Under a trust plan in China, the contribution of each investor/beneficiary will be clearly defined; so is the interest of each beneficiary. In most of the cases, the requirement of certainty of subject matter will be met.

The Chinese approach with regard to separation of trust assets is largely in line with English cases. From the *Hunter v Moss* case and *Lehman Brother* case, one may argue that since intangible assets are fungible in nature, to facilitate administration of clients' money or units in the same class, it is possible to pool them together and allow them to be protected by a single trust or a couple of trusts. The clients can enjoy the pool together as they co-own the pooled asset by tenancy in common. However, one caveat is that if clients hold assets in different classes or tranches, or invested in different trust plans with different rates of returns, their money or substitute products should be deposited in different accounts as they are not fungible.

Thirdly, in this case, courts were of different opinions with regard to the timing of certainty of subject matter. In other words, whether the certainty of subject matter is a requirement which is only relevant at the stage of creation of a trust or a requirement that needs to be complied with throughout the life of a trust? Before discussing this issue, one needs to note that no matter which approach is reasonable, the assets acquired by trustees by spending trust assets should form part of the trust assets. The Shan'Xi Court in the first instance might make a mistake to argue that the rights to receive dividends were not trust assets. If this argument is held true, it would cause beneficiaries losing trust assets along with the investment of trustees. Assets subsequently purchased by the trustees would not be protected by the trust as they are not the trust assets.

However, it is possible to argue that the uncertainty of trust assets that are subsequently obtained by trading will never render an already validly

---

<sup>61</sup> George Walker, Robert Purves and Michael Blair QC, *Financial Services Law* (Third Edition OUP 2014) p873

<sup>62</sup> Simon Morris, *Financial services regulation in practice* (OUP 2016) p70

<sup>63</sup> *ibid* p75

<sup>64</sup> Simon Morris, *Financial services regulation in practice* (OUP 2016) p76

constituted trust invalid.<sup>65</sup> Imagine that at the beginning, the trust properties were the cash with adequate certainty; nonetheless, as soon as the trustees made their investment decisions, the nature of the trust properties would change from cash to other types of properties, such as choses in action.<sup>66</sup> Would the fluctuation of values and forms of trust assets render a trust invalid? Or even though they are unascertainable, would it affect the validity of the trust?

It is easy to answer the first question: the change of values and forms of trust properties will not cause a trust invalid. This change will not make the trust property uncertain, to the extent that the nature, scope and value of the substitutes are ascertainable. If this change affects the certainty of subject matter required by trust law, it is tantamount to mean that trust cannot be used for investment purposes at all. Allowing the value and nature of trust property to change is a sine qua non for trustees to be able to invest the property. Chinese trust law follows this view by prescribing that the trust property can change form and value in the subsequential investment, but all the properties acquired later should form part of the trust properties.<sup>67</sup>

It is tricky to answer the second question: would certainty of subject matter only be relevant at the time of creation of a trust? Taking an extreme example, if there is no trust property, there is no trust.<sup>68</sup> However, if depletion of the trust funds is due to a breach of trustees' duties, the trust will not be considered as terminated; the law will take the view that the trustees have distributed their own properties mistakenly so that they need to make good of the trust properties.<sup>69</sup> The supreme court left it unanswered as to whether the certainty of subject matter only take effect at the time of constitution of a trust, or it does not matter whether the subject matter becomes unascertainable later.

One argument is that from the judgment of this case, the Supreme Court submitted that after-acquired assets are part of trust assets, this seems to indicate that the trust assets are dynamic and the requirement for certainty should be complied throughout the life of a trust.<sup>70</sup> Another argument is that the certainty

---

<sup>65</sup> Zhao Lianhui, 'The certainty of trust properties and validity of trust' (2018) SJTU Law review P169

<sup>66</sup> Chose in actions includes a broad range of miscellaneous intangibles such as rights under a contract or cause of action, securities, debts, intellectual property and leases. Marcus Smith and Nico Leslie, *The law of assignment* (3<sup>rd</sup> Edition OUP 2018)p33

<sup>67</sup> Art 14 TLoPRC 2001

<sup>68</sup> David Hayton and others, Underhill and Hayton, *Law of trusts and trustees*, (18<sup>th</sup> Edition, Lexisnexis 2010) p413.

<sup>69</sup> *ibid* p414.

<sup>70</sup> You Yang, King & Wood Mallesons LLP 'Certainty of fruits of special assets-from the perspective the case of Supreme Court' (2017) available at <https://www.kwm.com/zh/cn/knowledge/insights/see-earnings-certainty-on-specific-assets-from-the-supreme-court-s-cases-20170210> (accessed on 16 September 2018)

of subject matter only matters at the time of constitution of a trust. The issue of subsequent transactions is a different legal issue from the issue of the validity of a trust.<sup>71</sup>The fluctuation of values or even complete losses of the subject matter may work as a referencing point to examine the breach of duties of trustees.<sup>72</sup>

As with an obligation which must be clearly defined, a trust as an obligation must meet three certainties so as to make it enforceable.<sup>73</sup>From an English law perspective, the requirements to meet three certainties seem to be generally imposed in the stage of creating a trust.<sup>74</sup>If later the trust assets are mixed with other assets, the English trust law has developed well-established principles and approaches with regard to tracing rules. Even though the trustees of the trust misappropriate the trust assets by selling them or mixing them with their own assets or someone else's, there are rules to trace them and find the substitute properties or values. For example, equity has developed rules to deal with the situations where the trust property is mixed with the trustee's own properties or innocent volunteers' properties.<sup>75</sup>Equitable tracing is also able to trace into the mixed bulk or funds or bank accounts.<sup>76</sup>

Also, the certainty of subject matter requirement may not be absolutely rigid, for example, the executor of a will may not find out how much precisely that a dead testator owns before he manages the assets.<sup>77</sup>This can be seen as an example of initial uncertainty but the trust is still valid. By contrast, in *Boyce v Boyce*, the testator appointed his wife as trustee on behalf of two daughters and allowed one girl to choose one house and the rest of properties will be left to another girl.<sup>78</sup> Since the girl who had the power to choose was dead without choosing the house, the trust failed. This can be seen as an example of subsequent uncertainty. Furthermore, in *Re Golay WT* case, the settlor provided that the beneficiary can enjoy his house in the lifetime and receive a reasonable income from other assets. The uncertain 'reasonable income' subject matter is held to be valid as the court is able to calculate the account of money with some objective reference.<sup>79</sup>From the cases examined, it seems fair to argue that, there should be some flexibility to define the certainty of subject matter in different

---

<sup>71</sup> Zhao Lianhui, 'The certainty of trust properties and validity of trust' (2018) SJTU Law review p171

<sup>72</sup> Li Lei, 'On Particularity of Trust Property in the Trust of rights to return and Its Solutions' (2018) Journal of Business Research p166

<sup>73</sup> Robert Pearce and Warren Barr, Pearce & Stevens' *Trusts and equitable obligations* (7th Edition OUP 2018) P69

<sup>74</sup> Alastair Hudson, *Principles of equity and trusts* (Routledge 2016) p45; Professor Hudson mentioned that three requirements need to be met for the creation of an express trust.

<sup>75</sup> Robert Pearce and Warren Barr, Pearce & Stevens' *Trusts and equitable obligations* (7th Edition OUP 2018) p778-780

<sup>76</sup> Ibid p776-777

<sup>77</sup> *Hunter v Moss* [1994] 1 WLR 452

<sup>78</sup> *Boyce v Boyce* (1849) 16 Simons 476 60 E.R. 959

<sup>79</sup> *Re Golay's WT* [1965] 1 WLR 969

situations. However, one principle may be that uncertainty of subject matter would not cause a serious problem so far as the court is able to administer the case, protects beneficiaries and monitors the performance of trustees.

On the other hand, it is correct to argue that the certainty of subject matter should be maintained after a trust is duly created in the sense that the trustees should manage trust assets with their duties in mind and they should not mix the trust assets with their own assets or someone else's assets. However, even if the trust assets have been mixed by negligent trustees, the tracing rules may trace them and help beneficiaries claim them back. Should the assets are mixed, the compelling issue is not whether the trust is valid or invalid; the issue is how to compensate beneficiaries and how to restore the trust assets. Where the trust property is completely used up or destroyed, the trust will come to an end while this will not exempt trustees from their breach of duties, if any.<sup>80</sup>

However, since China may not have developed equally effective tracing rules, there is a case to argue that subsequent uncertainties of subject matters of a trust, such as a mix of funds or bulk goods, may render a trust invalid in China, as the court have no clear rules and discretion to locate and restore the trust assets from the bulk goods or mixed money.

### 3.3 Trust properties subject to contractual obligations

The third issue arising from this case is whether the uncertainty of ownership of trust properties passes the certainty of subject matter test. S firm asserted that the trust assets-rights to receive dividends- fail to meet the certainty test, since the test requires ownership of the trust assets are certain. In this case, shares were subject to a valuation adjustment mechanism agreement which allowed the H company to buy back shares from D1 and D2 within 3 years at a fixed price. On this basis, S company argued that the ownership of rights to receive dividends, sold by D1 and D2 within 3 years, were uncertain and the trust contract was invalid.

The Supreme Court held that: as to the uncertainty arising from the valuation adjustment mechanism contract, it is a different legal issue from the uncertainty of subject matter; also, as trustee had acquired the share pledge, it enjoyed the priority over H company's contractual buyback right over shares; never mind

---

<sup>80</sup> Robert Pearce and Warren Barr, Pearce & Stevens' *Trusts and equitable obligations* (7th Edition OUP 2018) p78.

the fact that the event of share buyback had never happened and so nothing affected the rights to receive dividends in this case.<sup>81</sup>

The Supreme Court was right to point out that that trust assets subject to a contractual obligation is a legal issue different from the issue of uncertainty of subject matter. As trustee is able to place a security over the trust assets on behalf of a third party, the ownership of the trust assets theoretically is uncertain; should the trustee default, the third party is able to sell the trust assets subject to the security. Also, the trustee may have the power to sell the trust property, so in this sense, the ownership of the original trust property is always uncertain. The risks from the transactions where the trustee is a party will not render a trust invalid. Even if the trustee cannot successfully gain the title of the rights to receive dividends, it is a commercial risk which has nothing to do with the certainty of subject matter.

A hidden issue here is whether the rights to receive dividends can be successfully assigned by D1 and D2 to the trustee so as to constitute part of the trust properties. If the rights to receive dividends do not belong to the trustee and beneficiaries who have proprietary rights in the trust assets, it is pointless to discuss the issue of certainty of subject matter. In other words, the compelling issue here is whether D1 and D2 have the right to make the assignment of those in action to the trustee. One important fact is that D1 and D2 funds assigned the right to receive dividends of the shares subject to anti-assignment clause for three years to the trustee; D1 and D2 also pledged the shares to the trustees within the 3-year prohibition assignment period.

The Supreme Court seemed to confirm the validity of the effect of the share pledge as it held that the pledge gave the trustee priority over H company. However, in practice, given the presence of an anti-assignment clause, the effect of these arrangements may be subject to challenges. The Chinese property law provides that pledgors can only pledge the properties that they have rights to dispose of as collaterals.<sup>82</sup> Therefore, one may argue that D1 and D2 have no right to pledge shares to the trustee. One exception is that, if the pledge is registered as a *fait accompli*, the mainstream view in China is that the pledge of shares is effectively created while the enforcement of such pledge must be

---

<sup>81</sup> Shixinronghe investment company v Chang'an International trust company and others, trust contract disputes (2016) Supreme Court Civil Final No.19 available at <<http://gongbao.court.gov.cn/details/ce26ed23e276a4af04509bed31d259.html>> (accessed on 06 September 2018)

<sup>82</sup> Art 223 Property law of China.



postponed until the prohibition period expires.<sup>83</sup> Therefore, the trustee would only gain priority over the H company after the prohibition period.

Since the H company forbid D1 and D2 to sell shares to a third party within 3 years, the D1 and D2 circumvent this clause by assigning only the rights to receive dividends of the shares to the trustee. Under a contract, there are a number of choses which are available to be assigned<sup>84</sup>, the right to receive dividends should be one of them. Whether this circumvention is successful depending on the interpretation of anti-assignment clause. As a share is a combination of rights and obligations, strictly speaking, it can only be novated to a third party. In this sense, the assignment of rights in the shares may not be prohibited. However, in *Linden gardens* case, Lord Brownie-Wilkinson interpreted anti-assignment of a contract as anti-assignment of all benefits under the contract, which may include the rights to receive dividends.<sup>85</sup>

Nevertheless, English trust law still offers a method to allow the D1 and D2 to circumvent the anti-assignment clause. The rationale is that the fruits of the choses in action and the benefits under the contract are different properties.<sup>86</sup> A series of authorities had made this distinction.<sup>87</sup> Under English law, the effect of anti-assignment clause is generally interpreted as prohibiting the transfer of benefits under a contract to a third party. Therefore, if D1 and D2 would like to assign the rights, which are subject to an anti-assignment clause, to the trustee, the legal consequence may be that such transfer is ineffective.<sup>88</sup> However, the English law has long recognised the distinction between a contractual promise to hold future interests under a contract on trust for a third party and a declaration of trust of current rights under the contract for a third party.<sup>89</sup> As an outright declaration of trust of the benefits under a contract is functionally equal to an equitable assignment of the rights to the third party, the law should not permit the anti-assignment to be circumvented in this way.<sup>90</sup> By contrast, the promise to hold future interests under the contract on trust will postpone the time to create such trust until the interests will have been received in the future. The fruits generated by the rights to receive dividends are not prohibited to be

---

<sup>83</sup> Chen Dun, 'On Legal Risk and Effect of Pledge on Restricted Stock of Listed Company' *Journal of Regional Financial Research* (2010) vol7 P21

<sup>84</sup> Marcus Smith and Nico Leslie, *The law of assignment* (3rd Edition OUP 2018)P77

<sup>85</sup> *Linden Gardens trust ltd v Lenesta Sludge Disposal Ltd* [1994] 1 AC 85 (HL 104) p106

<sup>86</sup> Alastair Hudson, *Principles of equity and trusts* (Routledge 2016)p63

<sup>87</sup> *Linden Gardens Trust Ltd v Lenesta Sludge Disposal Ltd* [1994] 1 AC 85 (HL); *Don King Productions Inc v Warren* [1998] 2 ALL ER 608 (ChD); *Barbados Trust Company Ltd v Bank of Zambia*[2007] EWCA Civ 148 (CA)

<sup>88</sup> *Linden Gardens trust ltd v Lenesta Sludge Disposal Ltd* [1994] 1 AC 85 (HL 104)

<sup>89</sup> Marcus Smith and Nico Leslie, *The law of assignment* (3rd Edition OUP 2018) p587

<sup>90</sup> *Ibid* p586

assigned. D1, D2 and the trustee may enter into a contract, where D1 and D2 would agree that any money generated by the rights to receive dividends will be held on trust for the trustee. In this situation, the D1 and D2 will not breach the 3 year prohibition period as they dispose of a different chose of action—the fruits of the right to receive payment. And the trust will only be created after the money has come into being, so subject matter is not future properties.

#### 4. Conclusion

This article examines a case of the Supreme Court of China on the certainty of subject matter of a trust in the light of common law doctrines. It explores the requirements of certainty of subject matter and analyses the reasoning of the Court. The article exposes trust law issues in China to common law scholars and lawyers to debate and illustrates what China can learn from well-developed English trust law rules.

This is a pre-copyedited, author-produced version of an article accepted for publication in *Trusts and Trustees* following peer review. The version of record D. Zhang, 29 October 2018, *Certainty of subject matter: what China can learn from English trust law*, *Trust and Trustees*, Vol 24 No.10, pages 1020-1030 is available online at: <https://doi.org/10.1093/tandt/tty154> .