DIVERGENCES AND CONVERGENCES OF COMMON LAW AND CIVIL LAW TRADITIONS ON ASSET PARTITIONING: A FUNCTIONAL ANALYSIS

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I. INTRODUCTION

The purpose of this study is to bring insight from the civil law tradition to the corporate debate on asset partitioning, which has developed over the last decade in the common law literature. Exposing common law scholars to legal solutions that are rooted in civil law systems will potentially transform the traditional approach taken by comparative civil law scholars in this field. In fact, civil law scholars have produced an extensive body of literature on the feasibility of transplanting one of the most successful products of equity—trust law—to the civil law tradition.[1] In comparative law studies, scholars have overlooked the possibility that the common law legal system could benefit from solutions developed under the civil law tradition with respect to the partitioning of assets.

Therefore, this Article intends to create a two-way dialogue between the common law and civil law traditions regarding this particular area of law, and to reveal efficient solutions developed in continental Europe.

Asset partitioning can be defined either as the segregation of an owner's assets from a firm's creditors, or the segregation of an organization's assets from its owners' personal creditors. Henry Hansmann and Reinier Kraakman have emphasized the latter aspect, in particular, suggesting that an organization is truly characterized by such a protection of its assets.[2] These authors have noticed that the legal effect of this

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1. *See, e.g.,* MAURIZIO LUPOI, TRUSTS: A COMPARATIVE STUDY 268 (2000) (discussing the development of the transition of trust law into the civil law framework in Europe).

2. Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*,

characterization of asset partitioning cannot be effectively achieved by contract alone. A special rule of law is necessary in order to exclude claims by owners' personal creditors on a firm's assets without those creditors' consent.[3]

This Article will identify, from a functional perspective, the costs and benefits of different legal methods used to partition assets. The comparative analysis of these various partitioning devices will help us understand the economics of achieving affirmative asset partitioning through the creation of a new legal entity, as opposed to doing so through a property law which grants "asset independence" within the boundaries of the same entity.

While American legal scholars conceive asset partitioning exclusively through the formation of a new legal entity, the civil law tradition allows this legal effect to be achieved within the boundaries of the same legal subject. This tradition avoids the creation of multiple legal entities.

In the common law system, there is a sharp trade-off between the costs avoided due to asset partitioning (e.g., lower monitoring costs for specialized creditors), and the benefits lost by not having legal integration take place within a single entity (e.g., information economies of scale). In contrast, by allowing a legal subject to partition these assets not only outside but also within the boundaries of the same legal subject, the "asset independence" doctrine of the civil law tradition successfully overcomes this trade-off.

The analysis is organized as follows: Part II provides a description of the current debate on asset partitioning in the U.S., i.e., the corporate theory debate. Part III describes the doctrine of "asset independence" rooted in the civil law tradition. Part IV discusses the historical evolution of asset partitioning in civil and common law traditions. Part V examines the costs and benefits of civil and common law regulations on asset partitioning, with regard to different business transactions (including asset securitization and the organization of a mutual fund). Finally, Part VI offers concluding remarks describing how financial transactions are the driving power behind the current convergence between civil and common law traditions on asset partitioning.

II. THE CORPORATE THEORY DEBATE ON ASSET PARTITIONING IN THE U.S.

In 2000, Hansmann and Kraakman published an essay entitled *The Essential Role of Organizational Law* in the *Yale Law Journal*.[4] Since

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110 YALE L.J. 387 (2000).

3. *Id.* at 394.

4. *Id.* at 387.

then, a lively doctrinal debate has developed over the notion of asset partitioning and its attributes.[5]

The fundamental question posed by these two authors is: what essential role did organizational law play in modern society?

Hansmann and Kraakman offer an answer that diverges from the traditional position, which singled out limited liability as the defining characteristic of several business organizations.[6] Instead, according to Hansmann and Kraakman, what truly characterizes an organization is precisely the reverse of limited liability: assigning to the organization's creditors a pool of assets that is shielded from the claims of the creditors of that entity's owners and managers.[7]

More specifically, asset partitioning is characterized by two symmetrical sides. The first side, which these authors label as "defensive asset partitioning" or "owner shielding," is the most traditional and well-explored.[8] By these terms, they mean the protection of the personal assets of a firm's owners from the firm's creditors: what traditionally is called limited liability.[9] The second side, "affirmative asset partitioning" or "entity shielding," represents the reverse of defensive asset partitioning, where the terms refer to the protection of a firm's assets from the claims of personal creditors of its owners and managers.[10]

The law governing business corporations is one of the clearest examples of affirmative asset partitioning. Through incorporation, an individual is able to commit a pool of assets to a specific business and specified group of creditors. The assets, in coming under the ownership of

5. John Armour & Michael J. Whincop, *The Proprietary Foundations of Corporate Law*, 27 OXFORD J. LEGAL STUD. 429 (2007); Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387 (2003); Edward M. Iacobucci & George G. Triantis, *Economic and Legal Boundaries of Firms*, 93 VA. L. REV. 515 (2007); Paul G. Mahoney, *Contract or Concession? An Essay on the History of Corporate Law*, 34 GA. L. REV. 873 (2000); Lynn A. Stout, *On the Nature of Corporations*, U. ILL. L. REV. 253 (2005).

6. *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporations*, 52 U. CHI. L. REV. 89, 97 (1985) (finding that "limited liability facilitates optimal investment decisions. . . . The increased availability of funds for projects with positive net values is the real benefit of limited liability"); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 41 (1991) ("The instances of 'unlimited' liability are few . . . . Limitations on liability turn out to be pervasive.").

7. Hansmann & Kraakman, *supra* note 2, at 394.

8. *Id.*

9. *Id.* at 393-94, 423; Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and Rise of the Firm*, 119 HARV. L. REV. 1335, 1339 (2006) (relabeling as "owner shielding," the phenomenon that, in their previous work, was labeled "defensive asset partitioning").

10. Hansmann, Kraakman & Squire, *supra* note 9, at 1359 (discussing "entity shielding in Roman *peculium* businesses").

the corporation, achieve the desired goal of partitioning them from the personal creditors of the corporation's shareholders. The same mechanism could be chosen by a company that wishes to separate the creditors along two distinct lines of business. Creating two distinct subsidiary corporations allows a single parent company to partition the assets in separate pools, each one committed to a specified group of creditors.

Until Hansmann and Kraakman's article, corporate literature had traditionally overlooked the affirmative side of asset partitioning. Subsequently, several corporate studies have focused more on this characteristic, pointing to it as the key peculiarity of legal personality. Using various terminologies (e.g., "forward partitioning,"[11] "capital lock-in,"[12] "asset separation from shareholders,"[13] "resource commitment"[14]), corporate scholars have agreed with Hansmann and Kraakman that the essential—if traditionally overlooked—contribution of business organization law is to permanently commit owners' contributions to a firm so that those assets cannot be suddenly withdrawn from the firm by either the owners' creditors or the owners themselves.

One of the merits of Hansmann and Kraakman's article is not simply to have shifted the attention of corporate scholars to this less-explored, affirmative side of asset partitioning, but to have prompted a reconsideration of the common notion of a firm as a mere "nexus of contracts," and of corporate law, however specialized, as a mere branch of contract law.[15]

In the seventies, the economic model which recognized a firm as nothing more than a complex set of contracts became the dominant approach, thanks to the contributions of Alchian and Demsetz[16] and, a few

11. Mahoney, *supra* note 5, at 876-77 (using "forward partitioning" to designate the reverse of limited liability, which is, in turn, referred to as "reverse partitioning").

12. Blair, *supra* note 5, at 387 (referring to the ability to commit capital to a specific investment, with no possibility for shareholders and their creditors to extract assets from the firm as "capital lock-in." The same terminology has been used by Stout, *supra* note 5, at 254.

13. WILLIAM A. KLEIN & JOHN C. COFFEE, BUSINESS ORGANIZATION AND FINANCE: LEGAL AND ECONOMIC PRINCIPLES 108 (9th ed. 2004).

14. Blair, *supra* note 5, at 392 (explaining her terminology by noting that "perhaps as important as protecting the assets of the enterprise from participants' creditors . . . was the role played in establishing a pool of assets that was not subject to being liquidated or dissolved by any of the individual participants who might want to recover their investment.").

15. Bernard S. Black, *Is Corporate Law Trivial? A Political and Economic Analysis,* 84 NW. U. L. REV. 542, 549 (1990) (discussing Ralph Winter, Henry Butler, Frank Easterbrook and Dan Fischel's view of the "corporate charter as a freely chosen contract between shareholders and managers").

16. Armen A. Alchian & Harlod Demsetz, *Production, Information Costs and Economic Organization*, 62 AM. ECON. REV. 777 (1972).

years later, Jensen and Meckling.[17] If a firm is nothing more than the sum of contracts binding different stakeholders (e.g., shareholders, officers, directors, debtholders, employees and suppliers), corporate law risks becoming trivialized, since it would only serve to introduce a set of default standards for business organizations that could also be introduced, at a higher cost, by commercial actors.[18]

Hansmann and Kraakman show in their essay that the contractarian theory of corporate law is not in itself sufficient to explain the role played by organizational law. They observe that, in the universe of business organizations, there are outcomes which cannot be practicably established by contract alone, one of which being "affirmative asset partitioning."[19]

Without a special rule of law to limit the rights of owners' personal creditors over firms' assets, it would be necessary for each owner of a firm to negotiate a waiver with these creditors regarding the seizing of the firm's assets, or an agreement subordinating their claim to those of the firm's creditors. Such affirmative asset partitioning through the use of contracts would not only impose prohibitively high transaction costs (since each owner would have to convince all of his individual creditors to accept this waiver), but also create obvious moral hazards and, consequently, excessive monitoring costs. Each waiver, in fact, by improving the position of a firm's creditors, creates a collective benefit for all of its owners by reducing the cost of credit. But, at the same time, such a waiver increases the personal cost of credit to individual owners. As a consequence, each owner has a clear incentive to act as a free rider, and omit the waiver from his personal contracts. This opportunistic behavior, which improves the position of the free rider's personal creditors to the detriment of the firm's creditors, effectively reduces the free rider's personal borrowing costs while imposing an increase in the firm's borrowing costs to the rest of the owners. The possibility for this type of opportunistic activity, which would increase with the number of owners, leads to excessive monitoring costs that render a successful partitioning

17. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

18. The classic approach of Alchian and Demsetz, and Jensen and Meckling, has been further developed. Easterbrook & Fischel, *supra* note 6, *passim*. The Law & Economics approach views corporate law as a tool for "filling gaps" by introducing the default rules that would be desired by the parties had they been able to contract without transaction costs. *See* Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83 (1977) (commenting on the doctrines of impossibility, impracticability and frustration in contract law). On the significance of corporate law in the light of the "nexus of contracts" theory, *see* Bernard S. Black, *supra* note 15, at 549.

19. Hansmann & Kraakman, *supra* note 2, at 406; Hansmann, Kraakman & Squire, *supra* note 9, at 1340-41.

practically impossible without a special rule of law.[20]

Under corporate law—or more generally, organizational law—excluding claims of personal creditors over a firm's assets without their consent allows owners to create an affirmative asset partitioning, without incurring the transaction and monitoring costs highlighted above, simply by using a property law—a rule that is "good against the world".[21] This rule of law, which according to Hansmann and Kraakman is the essential contribution of organizational law, challenges the perspective that views corporate law as a mere branch of contract law, recovering a proprietary foundation for it.[22]

Hansmann and Kraakman's analysis has two essential merits to be stressed: first, it recognizes the affirmative side of asset partitioning as the core defining characteristic of an organization and second, it labels this attribute as one of property, made possible only by a special rule of law. From these two main ideas, a functional analysis of the benefits and costs of asset partitioning has followed in the corporate theory literature.[23]

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20. Hansmann & Kraakman, *supra* note 2, at 406-11; Hansmann, Kraakman & Squire, *supra* note 9, at 1340-41.

21. *See* Henry Hansmann & Ugo Mattei, *Trust Law in the United States: A Basic Study of Its Special Contribution*, 46 AM. J. COMP. L. 133, 134 (1998) (reaching the conclusion that the contribution offered by the law of trusts is "that it facilitates the partitioning of assets into bundles that can conveniently be pledged separately to different classes of creditors"). These authors believe that the classic literature focusing on fiduciary duties as the main characteristic of trust law overlooks the point that these aspects could be achieved even without a special property rule by simply using the basic tools of contract and agency law. *Id.* at 136. *But cf.* John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625 (1995) (discussing the contractarian underpinning to trust law). *See also* Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 69 CORNELL L. REV. 621, 627 (2004) (advancing the claim that trust law blends features that are familiar from both property and contract law).

22. *See* Hansmann & Kraakman, *supra* note 2, at 422 ("[B]oth organizational law and the law of security interests are at bottom, in important part, forms of property law: They define the types of property interests that can be created and made binding against third parties."); *see also* Iacobucci & Triantis, *supra* note 5, at 569 (emphasizing the concept that legal partitioning can be realized only by way of a property law and that, consequently, a corporation is more than a nexus of contracts); Blair, *supra* note 5, at 407 (noting that an understanding of separate entity status under the law is key to understanding how incorporation changes the relationship between stakeholders into something different from a simple agency relationship); Armour & Whincop, *supra* note 5, at 431 (stating that the allocation of property rights to firm assets is significant for governance of the enterprise). This position, while recognizing the role of corporate law as a tool to provide a set of standard organizational forms (contractarian perspective), stresses a "Coasean" idea of the firm as an instrument to eliminate market transactions. Ronald H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 388 (1937); OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM (1985); OLIVER HART, FIRMS, CONTRACTS AND FINANCIAL STRUCTURE (1995).

23. The benefits of affirmative asset partitioning include the reduction of monitoring costs and preservation of beneficiaries' assets. Hansmann & Kraakman, *supra* note 2, at

This Article aims to bring a comparative perspective to the analysis developed up to this point in the U.S. legal literature and, in particular, the European civil law tradition, with respect to asset partitioning. Bringing the latter into the current debate not only serves to broaden the more limited American version of the doctrine but, on a more pragmatic level, points to the revision of conclusions reached by American scholars in their functional analysis of this legal phenomenon.

III. ENHANCING THE UNITED STATES DEBATE ON ASSET PARTITIONING IN LIGHT OF THE CIVIL LAW TRADITION

In the civil law tradition, affirmative asset partitioning captured the attention of legal scholars in the late nineteenth and early twentieth century when the notion of juridical person was fully distinguished from that of "asset independence" (also termed asset autonomy). At this stage in the civil law system, it became clear that in order to create an affirmative asset partitioning it would not be necessary to form a new legal entity or juridical person. Legal scholars began to acknowledge the possibility that a fixed number of property laws (known in the civil law tradition as *numerus clausus*) could enable a legal subject (either a natural person or a legal entity) to be the owner of multiple, separate pools of assets, each committed to a different purpose and pledged to a specified group of creditors ("asset independence" doctrine).[24]

The possibility that a legal subject could operate as the owner of multiple funds or patrimonies, which are committed to different groups of creditors, without necessarily forming a new legal entity, is, in a nutshell, what distinguishes the "asset independence" doctrine of civil law countries from the affirmative asset partitioning doctrine developed in the United States.

Even though the juridical person doctrine has been much less influential in the United States than in Europe, American legal scholars nevertheless seem unwilling to conceive of an asset partitioning effect without the formation of a new legal entity.

According to Hansmann and Kraakman, a firm has two fundamental attributes: a well-defined decision-making authority and the ability to bond

398-405. The benefits of defensive asset partitioning include reduction of monitoring costs as well as providing economies of transfer and risk sharing. *Id.* at 423-27. *See also* Hansmann, Kraakman & Squire, *supra* note 9, at 1343-54 (describing the benefits of entity shielding); Iacobucci & Triantis, *supra* note 5, at 515 (examining the relationship between economic integration and legal partitioning).

24. In Germany, this phenomenon is well-known as *Zweckvermögenstheorie*. ALOIS BRINZ, LEHRBUCH DES PANDEKTENRECHT (2d ed. 1879); ERNST IMMANUEL BEKKER, SYSTEM DES HEUTIGEN PANDEKTENRECHT (1886). In Italy, the contribution of FRANCESCO FERRARA, TRATTATO DI DIRITTO CIVILE ITALIANO (1921) is fundamental.

its contracts with an existing pool of assets.[25] Since a natural person has both these attributes, he or she can be defined as a firm. However, since a natural person is liable for his or her contracts involving all of his or her assets (personal liability), in order to insulate these assets from his personal creditors and pledge them to a specified group, it is necessary to employ a separate legal person. Accordingly, since a debt is a firm-wide obligation,[26] if a firm wishes to separate its assets from the personal assets of its owners and managers and commit them to a specific business purpose, it is necessary to create a juridical person or a separate legal entity.[27]

Since the "firm's boundaries define the set of assets that are subject to the personal obligation of the firm to pay its debts,"[28] if the individual or juridical person (e.g., a corporation) wishes to shield some of its assets from personal creditors and pledge them to a specified group of creditors, it is necessary to create a new legal subject, thereby multiplying the number of legal entities employed.[29]

In other words, according to this view, it is not possible to conceive of a juridical person or an individual owning more than one pool of assets without employing some kind of organizational form, since each separate pool is itself a distinct legal entity.[30] As a consequence, given that legal entities incur debt on a firm-by-firm basis by pledging all their assets to bond their contracts, affirmative asset partitioning is conceivable only outside the boundaries of the same firm by partitioning assets among multiple legal entities.[31]

This is not the lesson learned from the civil law tradition where, as this Article will explain, it is possible to achieve affirmative asset partitioning—or, to use a terminology closer to civil law, "asset independence"—within the boundaries of the same legal entity.

The use of trust law certainly represents a boundary between common law and civil law traditions surrounding affirmative asset partitioning, and explains the divergence in the evolution of this doctrine. It is evident that the existence of the trust device facilitated acceptance of the assets partitioning principle by the common law tradition. In civil law countries, on the other hand, this involved a complicated doctrinal debate that added to the notion of partitioning the idea of the same patrimony for multiple and

25. Hansmann & Kraakman, *supra* note 2, at 391.

26. Iacobucci & Triantis, *supra* note 5, at 529.

27. Hansmann & Kraakman, *supra* note 2, at 393, 416. The authors maintain that trust-created affirmative asset partitioning creates functionally separate juridical persons.

28. Iacobucci & Triantis, *supra* note 5, at 525.

29. Hansmann, Kraakman & Squire, *supra* note 9, at 1337.

30. Accordingly, an individual can be considered the owner of distinct pools of assets when he owns shares (and not the assets) of distinct legal entities, but cannot segregate his own patrimony in different pools of assets without creating new legal entities.

31. Iacobucci & Triantis, *supra* note 5, at 525.

separate pools of assets. Conceptually, it is easier to conceive of asset partitioning when it is achieved through transfer of assets to a different entity (e.g., the trust), than when accomplished within the same patrimony.

Also, in civil law countries, the default rule governing the relations between debtor and creditors is that all of a person's property (his or her entire patrimony) is available for seizure and sale to satisfy the claims of judgment creditors (so-called "universal patrimonial liability").[32]

This principle was first introduced in modern codifications by Article 2092 of the French *Code Napoléon*,[33] and can be found nowadays in many civil codes such as the Italian Civil Code[34] and the Civil Code of Québec.[35]

This principle resembles the concept of the firm-wide character of debt examined with regard to the American debate on asset partitioning: all of the debtor's property represents the common pledge of creditors. Nonetheless, in civil law countries, in addition to the principle of "universal patrimonial liability," the law expressly provides that, in a *numerus clausus* of circumstances, a legal subject is allowed to make a division or partitioning of his patrimony. As an illustration, Article 2645 of the Civil Code of Québec states that the common pledge does not extend to "property[,] which is the object of a division of patrimony permitted by law".[36]

In civil law countries, even if all the property normally constitutes the only patrimony of an individual and is pledged to bond all his performances, the law allows a legal subject to partition his patrimony among several pools of assets without creating a new legal entity. In particular, "asset independence" must be recognized when a pool of assets is subtracted from the common pledge of personal creditors, and committed to a specialized group. Consequently, each pool of assets is bonded to a different purpose and pledged only to creditors whose claim is connected with that purpose.[37]

32. Hansmann, Kraakman & Squire, *supra* note 9, at 1337. The same is true for an entrepreneur. *See* Hansmann & Kraakman, *supra* note 2, at 407 (explaining the if there is no contractual agreement to the contrary, an entrepreneur's creditors have a right to attach all of his or her assets).

33. Art. 2092 C. civ. ("Whoever is bound is held to fulfill that duty in dealing with all fixed and liquid assets both now and in the future).

34. *See* Art. 2740 C.c. ("The debtor is responsible for his obligations with all his present and future assets.").

35. Art. 2644 Civil Code of Québec states that "The property of a debtor is charged with the performance of his obligations and is the common pledge of creditors." Art. 2645 Civil Code of Québec states that "Any person under a personal obligation charges, for its performance, all his property, movable and immovable, present and future."

36. Art. 2645 Civil Code of Québec.

37. For a description of "asset independence" in the Italian literature, *see* Durante, *Patrimonio (diritto civile), in* 22 ENCICLOPEDIA GIURIDICA 1, 3 (1990) (describing the purpose of "asset independence" and its most significant legal effects); Lina Bigliazzi Geri,

What is clear from the studies of civil law scholars is that only the law, through a property rule, is capable of achieving "asset independence." Accordingly, only in a *numerus clausus* of circumstances, provided by property laws, is a legal subject able to partition his patrimony in separate funds.[38]

It must be noted that these separate pools of assets are not considered new legal entities. Therefore, the "asset independence" doctrine and formation of a new legal entity represent alternative and sometimes competing legal devices to achieve affirmative asset partitioning.

Unlike the practice followed in the United States, the "asset independence" doctrine of the civil law tradition allows a legal subject to accomplish a partitioning not only externally (through the formation of a new legal entity), but also within the boundaries of the same legal subject.

This distinction is not merely semantic. As this Article will show, the formation of a new legal entity and the articulation of a patrimony in separate pools of assets are two distinct legal techniques. Both techniques can result in affirmative asset partitioning, yet they are not equivalent in terms of costs and benefits.

It is also worth clarifying why the "asset independence" of civil law does not coincide with the floating lien device used in the United States. A floating lien is a security interest that a creditor holds on a debtor's set of assets, and that covers any additional property obtained by the debtor. In contrast to the creditor of a segregated pool of assets, the secured creditor still has recourse as an unsecured creditor against the general patrimony of the debtor (the assets not included in the floating lien). Furthermore, all of the unsecured creditors have recourse against the assets covered by the floating lien once the secured creditor has been fully paid. In short, neither a defensive asset partitioning nor a strong affirmative asset partitioning is achieved through a floating lien.[39]

The functional analysis conducted in Part IV will examine, from a comparative perspective, a series of business transactions which, in order to achieve their effects, require use of the affirmative asset partitioning mechanism.

In particular, this Article will compare the common law and civil law systems with regard to the use of a corporate subsidiary *as opposed to* the

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Patrimonio autonomo e separato, *in* 32 ENCICLOPEDIA DEL DIRITTO 280 (1982) (summarizing the doctrine and its application); *See* FRÉDÉRIC H. SPETH, LA DIVISIBILITE DU PATRIMOINE ET L'ENTREPRISE D'UNE PERSONNE (1957) (affirming the presence of "asset independence" in French literature).

38. FERRARA, *supra* note 24, at 875.

39. On the notion of "floating lien," see ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, THE LAW OF DEBTORS AND CREDITORS: TEXT, CASES, AND PROBLEMS 633-36 (4th ed. 2001); STEVEN L. HARRIS & CHARLES W. MOONEY, JR., SECURITY INTERESTS IN PERSONAL PROPERTY: CASES, PROBLEMS AND MATERIALS 469-76 (4th ed. 2005).

use of "funds committed to a specific purpose" created within the boundaries of the same legal entity; the regulation of asset securitization; the organization of mutual funds; and the differences between trust law and the recent regulation of fiduciary relations adopted by French legislators.

IV. THE HISTORICAL EVOLUTION OF THE ASSET PARTITIONING DOCTRINE

A. *The Historical Evolution of the "Asset Independence" Doctrine in the Civil Law Tradition*

1. The Unity and Indivisibility of the Patrimony Doctrine in the Eighteenth and Nineteenth Centuries

In the late eighteenth and early nineteenth centuries, a metaphysical concept of patrimony prevailed in civil law countries which conceived of assets or property according to an anthropocentric vision. Viewed this way, patrimony was the external manifestation of an individual and tangible expression of the human personality. Patrimony, in other words, was considered to represent nothing more than that same human personality as related to objects. This idea, rooted in natural law, developed out of the philosophical thought of the Enlightenment and the Romantic Movements.[40] Such an indissolvable bond between the "individual and his patrimony shifted from a philosophical to a legal doctrine during the first half of the nineteenth century.[41] In that era, patrimony was considered to be an attribute of the human personality. Since human attributes were indivisible and intangible, the patrimony was also considered indivisible and intangible. Since an individual had only one personality, this meant, likewise, only one patrimony, which could not be partitioned among distinct pools of assets (singleness of patrimony doctrine).[42]

40. The idea that the bond between the individual and his patrimony is rooted in natural law is pointed out by Francesco Ferrara, *La teoria della persona giuridica*, *in* RIVISTA DI DIRITTO CIVILE 638, 664 (1911). In the French literature, *see* HEINRICH AHRENS, COURS DE DROIT NATUREL OU DE PHILOSOPHIE DU DROIT, COMPLETE, DANS LES PRINCIPALES MATIERES, PAR DES APERÇUS HISTORIQUES ET POLITIQUES 71 (1892), where, adopting the absolute idealist philosophy of Hegel, he says: "Thereafter, the law is developed through the various degrees of the spirit's objective reality. First, free will is manifested from an *individual* standpoint, that is as a *person*; the liberty created by a person is *property*."

41. This shift is normally ascribed to a French law handbook written by a German scholar, K.S. Zachariae, and subsequently updated and augmented by two French scholars, CHARLES AUBRY & CHARLES RAU, COURS DE DROIT CIVIL FRANÇAIS, D'APRES L'OUVRAGE DE M. C.S. ZACHARIE (1856-1858).

42. *Id.* at 573.

2. The Estate as an Entity Doctrine and the Commitment of Assets to a Specific Purpose

If an individual could only be the owner of one pool of assets, how did civil law scholars justify those circumstances where the law conceived the existence of autonomous pools of assets, committed to specific groups of creditors?

It is worth mentioning three different cases in civil law systems that serve as examples in which pools of assets are exclusively committed to creditors whose claim is related to the same pool. First, in the civil law tradition, inheritance law provides that if a devisee accepts the devise under benefit of inventory (i.e., a public officer is in charge of singling out and describing the property of the decedent), he is not personally liable for the decedent's debts (defensive asset partitioning). Also, his personal creditors hold junior claims to the probate estate that are subordinate to the senior claims of decedent's creditors (weak affirmative asset partitioning). Second, Italian family law provides that spouses, together or separately, can constitute a "family fund" whose assets are committed to satisfy the family's needs. Spouses' creditors who are aware that their claim is related to a purpose different from the family's need have no recourse against the assets of the "family fund" (affirmative asset partitioning).[43] Third, in the absence of trust law, civil law countries expressly regulate special funds committed to pension purposes. In particular, the employer has to maintain a portion of his/her employees' salary and assign this portion to the special funds. The assets of these funds are separate from the general patrimony of the employer, and are unavailable to satisfy the employer's obligations to his personal creditors (affirmative asset partitioning).[44]

In the late nineteenth century, German and Italian scholars developed two different theories to justify the legal existence of pools of assets that, because they were committed to a specific purpose and pledged to a specified group of creditors, were separate from the general patrimony of an individual.

According to the first theory, since an individual can be the owner of only one patrimony, any time the law provides for the existence of an autonomous pool of assets, the legal system introduces a new patrimony that has no owner. The specific purpose to which the assets are committed assures unity in this autonomous patrimony.[45]

43. In Italy, the "family fund" is currently regulated by arts. 167-171 of the Italian Civil Code.

44. In Italy, the partitioning between the pension funds created by employers and their general patrimony is provided by art. 2117 of the Italian Civil Code.

45. BRINZ, *supra* note 24, at 202. In Italy, this theory, first developed in Germany, has been further analyzed by Gustavo Bonelli, *La teoria della persona giuridica*, *in* RIVISTA DI

According to the second theory, any time the law provides for the existence of a pool of assets that is separate from the general patrimony of the individual, the legal system recognizes the presence of a new legal entity. If any separate pool of assets is considered a distinct legal entity, the idea that each individual can be the owner of only one patrimony is preserved.[46]

If an individual has only one patrimony, then in order to partition his assets he can only participate as a residual claimant to the ownership of a distinct legal entity. This latter theory recalls the view held by common law scholars examined above, according to which the estate separateness doctrine is absorbed into the concept of a juridical person.[47]

3. The Substitution of the Indivisibility of the Patrimony Doctrine with the *Numerus Clausus* of "Asset Independence" Principle

In the early twentieth century, civil law scholars began to question the singleness and indivisibility of patrimony doctrine (i.e., an individual can be the owner of one and only one patrimony, which cannot be partitioned in separate pools without the creation of a new legal entity). The basis of this approach—the metaphysical conjunction between the human personality and its patrimony—was increasingly rejected by scholars.[48]

At this stage, assets were no longer viewed as an external expression of an individual. This is reflected by the very simple objection to the singleness of patrimony doctrine: what is single and indivisible is not the patrimony itself, but rather the right to have a patrimony, which belongs to any individual as an external expression of his personality. As a consequence of this new viewpoint, an individual was no longer identified with his patrimony, nor was the latter considered a unique attribute of the

DIRITTO CIVILE, 445-508, 593-673 (1910).

46. *Id.* at 657-58.

47. A juridical person is traditionally defined as a legal subject distinct from the individuals who compose or promote it. As a distinct legal subject, a juridical person may have its own legal relations with third parties, exercised through organs whose activity is not attributed to the individuals, but directly attributed to that juridical person. Therefore, it is the juridical person, not its members, that enters into a contract, undertakes an obligation, acquires a claim, is summoned before a court, or brings a suit against a third party. In the civil law tradition, there are different theories that try to explain this concept: One, the juridical person is a fiction: for economic and functional purposes, the legal system created the fictional subjectivity of entities different from individuals. Two, the juridical person as reality: the legal system simply recognizes a phenomenon that exists in social life. Three, the juridical person as a device of legal language: the juridical person is only a legal term used to summarize a complex body of legal rules regulating relations between individuals (this can be likened to the "nexus of contracts" theory of the firm). *See* Ferrara, *supra* note 40, *passim* (discussing the concept of the juridical person in the civil law tradition).

48. *Id.* at 665, 675.

human personality.[49]

Since the patrimony is no longer necessarily indivisible, it is also no longer necessary to recognize a new legal entity each time the law provides for autonomous pools of assets. At this stage, scholars began to acknowledge the possibility that a legal subject can be the owner of multiple, separate pools of assets, each one committed to different purposes and pledged to a specified group of creditors ("asset independence" doctrine). In its acknowledgment that a legal subject can be the owner of multiple funds, the "asset independence" doctrine reacquires its force from the juridical person concept.

What is clear from civil law scholars' studies is that only the law, through a property rule, is capable of achieving "asset independence." Accordingly, only in a *numerus clausus* of circumstances, provided by property law, is a legal subject able to partition his patrimony in separate funds.[50]

In the light of this historical evolution of the concept of patrimony, the default rule adopted in civil law countries regulating the relations between debtors and creditors becomes more clear. On one side, there is a universal patrimonial liability (which stems from the idea of the indivisibility of the patrimony) and, on the other side, there is the possibility that only property law allows a division through a partitioning of the patrimony itself.[51]

B. The Historical Evolution of Affirmative Asset Partitioning in the United States

In civil law countries, the modern concept of asset partitioning has its origins in the early nineteenth century. During that period, demand increased for business organizations that were able to separate the firm's assets from the owners' personal assets.[52] The ability to commit assets to a specific business purpose, without the threat of the firm's assets being liquidated either by an owner or his personal creditors, was regarded as a fundamental attribute for businesses of substantial dimensions.[53]

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49. *Id.* at 665-80; NICOLA COVIELLO, MANUALE DI DIRITTO CIVILE ITALIANO: PARTE GENERALE 252 (4th ed. 1929).

50. FERRARA, *supra* note 24, at 875.

51. It would be useful to read Art. 2645 of the Civil Code of Québec once again, in light of what has just been described: "Any person under a personal obligation charges, for its performance, all his property, movable and immovable, present and future, except property . . . which is the object of a division of patrimony permitted by law."

52. *See* Blair, *supra* note 5, at 413 (describing efforts in the nineteenth century to strengthen business institutions through the creation of joint stock companies and specially chartered corporations).

53. The restriction on the ability of a firm's owners "to force the payout of an owner's share of the firm's net assets" has been referred to by some authors as "liquidation

In the nineteenth century, before corporate charters were issued on a widespread basis in the U.S., attempts to achieve affirmative asset partitioning were made where there was a compelling necessity to gather significant capital assets. In the seventeenth century, two key developments in this direction occurred in England: 1) in 1683, the Chancery Court ruled that partnership creditors enjoy priority over partners' personal creditors in the event of a bankrupt partnership (weak affirmative asset partitioning);[54] and 2) the English Crown began granting charters to joint stock companies in order to assure an existence longer than a single trade mission for these companies.[55] To compensate the restrictions on merchants to withdraw their capital at the end of each voyage, the right to sell shares of the company without the consent of other owners was introduced.[56]

In the eighteenth century, because the English Parliament only granted a limited number of charters, merchants and other business people tried to achieve affirmative asset partitioning through partnership and trust law. The unincorporated joint stock company became the entity used by merchants to accomplish both affirmative asset partitioning and share tradability.[57] The latter was achieved through complex contract clauses and the former by placing the assets into a trust.[58] Only in 1844 did the English Parliament enact a statute admitting incorporation as a general right.[59]

In the first half of the nineteenth century in the U.S., incorporation was still restricted to a fixed range of business purposes. In order to achieve affirmative asset partitioning, business people used unincorporated joint stock companies together with trust law.[60] Despite the fact that many states passed general incorporation statutes during this time period, in the early twentieth century, the use of the trust—in particular, the business trust (also known as the Massachusetts trust)—was a strong competitor to the corporation in this regard.[61]

protection." Hansmann, Kraakman & Squire, *supra* note 9, at 1338 (citing Hansmann & Kraakman, *supra* note 2, at 403-04). This method has also been referred to as "locking in capital." Blair, *supra* note 5, at 387.

54. Hansmann, Kraakman & Squire, *supra* note 9, at 1381 (citing (1683) 21 Eng. Rep. 664 (ch.)).

55. *Id.* at 1376-77.

56. *Id.*

57. Hansmann, Kraakman & Squire, *supra* note 9, at 1383-84.

58. Blair, *supra* note 5, at 414–16; Hansmann, Kraakman & Squire, *supra* note 9, at 1383. Merchant law has been viewed as "an excellent place to look for voluntary solutions to asset partitioning problems . . . ." Mahoney, *supra* note 5, at 880.

59. Hansmann, Kraakman & Squire, *supra* note 9, at 1386.

60. Blair, *supra* note 5, at 414.

61. "Trust's salience as a form of business organization during this era explains why today we have antitrust law, not competition or monopoly law, as it is known abroad." Robert H. Sitkoff, *Trust as "Uncorporation": A Research Agenda*, 2005 U. ILL. L. REV. 31,

The use of trust law represents a boundary between common law and civil law traditions on affirmative asset partitioning and explains the differences in the evolution of this doctrine. The existence of the trust device facilitated the acceptance of the "asset independence" principle in the common law tradition. In the civil law countries, on the other hand, a complicated doctrinal debate was required in order to establish the practice of partitioning the same patrimony in multiple and separate pools of assets. Intuitively, it is easier to conceive of asset partitioning when it is achieved through transfers of assets to a different entity (e.g., the trust), than when it is accomplished within the same patrimony.

The rise of the corporate form as a general device to achieve asset partitioning has been a subject of great interest to many American scholars. However, some have neglected to explain why, in operating enterprises, corporations have prevailed over statutory business trusts that are used only in specific cases, such as mutual funds and structured finance.[62]

The history of asset partitioning and the differences between the common law and civil law systems in this area set the framework for understanding why these two legal systems employ different devices in important business transactions where affirmative asset partitioning is required.

V. AFFIRMATIVE ASSET PARTITIONING AND "ASSET INDEPENDENCE": A FUNCTIONAL ANALYSIS

As explained above, while in the U.S. scholars consider affirmative asset partitioning to represent one—and, according to the most recent studies, the most significant—characteristic of a juridical person[63] (together with limited liability, perpetual life, centralized management and free tradability of shares), in civil law countries there is a clear distinction between the concepts of "asset independence" (which can be likened to the concept of affirmative asset partitioning) and the juridical person.

32 (2005).

62. *Id.* at 42–44. While there are benefits to some of the empirical data already discovered, there are overarching concerns. In particular, when discussing the success of corporations relative to trusts by only highlighting the fact that in the twentieth century regulatory limits in state corporate codes disappeared, there is a presumption of superiority of the corporate form in the absence of any real explanation.

63. John Armour & Michael J. Whincop, *The Proprietary Foundations of Corporate Law*, 27 OXFORD J. LEGAL STUD. 429 (2007); Margaret M. Blair, *Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 387 (2003); Edward M. Iacobucci & George G. Triantis, *Economic and Legal Boundaries of Firms,* 93 VA. L. REV. 515 (2007); Paul G. Mahoney, *Contract or Concession? An Essay on the History of Corporate Law*, 34 GA. L. REV. 873 (2000); Lynn A. Stout, *On the Nature of Corporations*, U. ILL. L. REV. 253 (2005).

This distinction has practical consequences, and is not merely semantic. A comparative analysis of different asset partitioning devices is conducted in this section in order to understand the economics of affirmative asset partitioning through the use of a new legal entity, as opposed to doing so through a property law granting "asset independence" within the boundaries of the same entity.

A. *The "Funds Committed to a Specific Purpose" of the Italian Civil Code v. a Corporate Subsidiary*

1. Preliminary Considerations

In a recent study, Edward M. Iacobucci and George C. Triantis presented a general capital-structure theory for the legal partitioning of assets. They explored when it is more efficient to partition assets into distinct organizations and achieve the efficiency gains that result from tailoring as compared to cases where it is more efficient to group assets within a single entity to benefit from the economies deriving from integration. In keeping with the affirmative asset partitioning doctrine, the analysis is conducted based on the assumption that a debt is always a firm-wide obligation and that partitioning can be achieved only through the formation of multiple legal entities.[64]

According to this logic, since it is not possible to accomplish a partitioning of assets within the same entity, there is a consequential trade-off between the efficiency gains that result from asset partitioning and the economies that derive from integration into a single entity. This conclusion does not appear to be necessarily true in a civil law country where the foundational legal principle of this analysis has been disproven.

The "asset independence" doctrine allows a legal subject to partition its assets within its own boundaries, enabling a firm to limit its obligation to a subset of its assets without having to form a new legal entity. Thus, a firm could avoid the trade-off described by Iacobucci and Triantis by

64. In particular, Iacobucci & Triantis, *supra* note 5, assume that a subdivision of a person may not own property:

> [A] corporation is a legal person that may own property, but a division or branch of the corporation may not. . . . Although the corporation itself might enter into a contract that attempts to limit its exposure to only a subset of its assets, we show that such segmentation is difficult to achieve under current law. . . . To fully match groups of assets with appropriate financing and governance features, an entrepreneur . . . must partition the groups into distinct entities. . . . The practical consequence of legal restrictions on asset-specific financing is that entrepreneurs and managers seeking to tailor financial and governance rights to different asset types must do so outside corporate boundaries by partitioning assets among multiple firms. *Id.* at 518–20.

simultaneously achieving the benefits of partitioning and maintaining the economies of integration.

2. The Italian "Committed Funds"

The clearest example of this approach is the regulation of the "funds committed to a specific purpose" introduced in 2003 into the Italian Civil Code by arts. 2447 *bis* - 2447 *decies*.[65]

This set of rules provides that a corporation may partition up to 10 percent of its assets in order to commit it to a specific business purpose. This separate fund is pledged only to those creditors whose claim is related to the specific purpose ("specialized creditors"), while the "general creditors" have no recourse against these assets (affirmative asset partitioning). Meanwhile, the firm's assets that are not committed to the specific business purpose and are not part of the committed fund are protected from each group of specialized creditors (defensive asset partitioning).[66]

Through a property law which is "good against the world,"[67] the Italian Civil Code allows a corporation to partition its assets into different pools (a general one, and one or more that are committed to a specific purpose) and to distinguish its creditors in different categories ("general creditors" and "specialized creditors") without creating a new legal entity (e.g., a corporate subsidiary).[68]

The correct way of analyzing this legal device, imposed by the Italian Civil Code, from a cost and benefit perspective is to make a comparison with its closest functional equivalent: the corporate subsidiary. In particular, there is significance in exploring differences, if any, between achieving the affirmative asset partitioning within the boundaries of the same entity (committed funds) and achieving the partitioning through the formation of a new legal entity (corporate subsidiary).

65. C.C. art. 2447 bis–2447 decies.

66. The asset partitioning effect is regulated by C.c. art. 2447 quinquies.

67. *See, e.g.*, Thomas W. Merrill & Henry E. Smith, *What Happened To Property In Law And Economics*, 111 YALE L.J. 357, 358 (2001).

68. This legal device has captured the attention of several corporate scholars in Italy. Among the many authors on this subject, *see* Andrea Zoppini, *Autonomia e separazione del patrimonio, nella prospettiva dei patrimoni separati della società per azioni*, 48 RIVISTA DI DIRITTO CIVILE 545 (2002) (comparing the partitioning of assets with the effects of incorporation), Gianvito Giannelli, Commentary, *Artt. 2447 bis - 2447 decies c.c.*, *in* 2 SOCIETÀ DI CAPITALI: COMMENTARIO 1210 (Giuseppe Niccolini & Alberto Stagno d'Alcontres eds. 2004) (distinguishing committed funds from other types of asset divisions).

3. Lower Monitoring Costs

Both the committed fund and corporate subsidiary are able to pledge separate pools of assets to specific lines of business. In both cases, affirmative asset partitioning enables a corporation to group its creditors into distinct categories, defined only by those assets committed to a specific line of business. Since each group of creditors is not concerned with the success of other lines of business and is instead exploiting its monitoring specialties, a lower cost of credit is achieved.[69]

4. Matching Capital Structure and Asset Type

The possibility of moving assets into a separate pool or into a corporate subsidiary facilitates a better match between capital structure and the nature of the assets. If two asset groups differ in certain aspects, corporate finance literature has argued that it is efficient to locate these assets in distinct corporations so that the optimal capital structure between debt financing and equity financing can be achieved.[70] Since regulation of committed funds provides that the corporation can issue different securities for each fund (i.e., securities that are only attached to the specific assets committed to the fund), in the Italian legal system it seems plausible to argue that an optimal capital structure can be achieved without the formation of different legal entities.[71]

5. Agency Costs

Integrating several lines of business into a unitary entity poses a managerial agency cost. In an internal market, managers "may allocate resources so as to enhance their private benefits rather than overall profitability."[72] To limit opportunistic behavior by management, the

69. This topic has been discussed in various articles. *See, e.g.*, Hansmann & Kraakman, *supra* note 1, at 399-401 (exploring the advantages of sub-partitioning assets and lines of business within a company by creating corporate subsidiaries); Hansmann, Kraakman & Squire, *supra* note 9, at 1344-45 (using a hypothetical situation to demonstrate how entity shielding may reduce monitoring costs incurred by creditors).

70. Iacobucci & Triantis, *supra* note 5, at 523, 544.

71. The majority interpretation of the Italian Civil Code art. 2447-*ter* (e), which allows a corporation to issue asset-specific securities, argues that a corporation can issue common stocks that attach to the committed fund's assets, debt securities and hybrid securities. *See* Carlo Comporti, *Commento all' articolo 2447 ter Cod. civ.*, *in* 2 LA RIFORMA DELLE SOCIETÀ 973-975 (Michele Sandulli & Vittorio Santoro eds. 2003).

72. Iacobucci & Triantis, *supra* note 5, at 562. *See also* George G. Triantis, *Organizations as Internal Capital Markets: The Legal Boundaries of Firms, Collateral, and Trusts in Commercial and Charitable Enterprises*, 117 HARV. L. REV. 1102, 1123-26 (2004) (exploring the effects and corporate boundaries related to the control of liquidity

formation of a corporate subsidiary has been proposed as a possible solution.[73] While in a single corporation a director's decisions are protected by the business judgment rule in order to make it more difficult to second-guess transfers of assets between different lines of business, in a parent-subsidiary structure, minority shareholders can challenge such transfers by designating them as related-party transactions which need to be intrinsically fair. Where the parent wholly owns the subsidiary such that there are no minority shareholders, creditors of that subsidiary can, through covenants, restrict the shifting of capital between the two entities.[74]

Even if the partitioning of assets between two entities reduces the risk of opportunistic behavior, a parent-subsidiary structure or a group of subsidiaries under common control will not be able to completely eliminate managerial agency costs.

At first glance, the committed funds device creates a greater risk for opportunistic asset shifting since the fund is managed by the same directors as the corporation. However, a fundamental aspect of this legal device is that the assets of committed funds must be registered in public records as being bound to a specific purpose.[75] If real property is committed to a separate fund, the fund's specific purpose must be registered in the same public record where the real property is registered.[76] With regard to personal property, the resolution constituting the committed fund must report all assets that are part of the fund and the resolution must be registered in the same public record where the corporation is recorded.[77] Since the commitment to a specific purpose is made public (i.e., "good against the world"), any use of the committed assets contrary to the specific purpose (i.e., *ultra vires*) is considered void.[78] Thus, the committed funds device appears to be a more effective solution to the managerial agency problem than the formation of a corporate subsidiary.[79]

within a corporation).

73. Iacobucci & Triantis, *supra* note 5, at 561.

74. Iacobucci & Triantis, *supra* note 5, at 563.

75. C.C. art. 2447 *quinquies*, co. 2 (It.).

76. See *id.* (stating that "[t]he resolution must be deposited and filed according to art. 2436 c.c.," which provides that the notary overviewing the resolution must file the resolution in the firm's public record).

77. See C.C. art. 2447 ter (b) and 2447 quater co. 1 (It.)

78. Giannelli, *supra* note 68, at 1243-46.

79. Hansmann, Kraakman & Squire, *supra* note 9, at 1346. In an internal market, managers could be tempted to borrow too much since they can bond the assets of the whole entity. Asset partitioning reduces this risk, since managers will be able to borrow only against the assets of the separate entity. With regard to this agency problem, corporate subsidiaries and committed funds appear to be perfectly equivalent solutions.

6. Value of Switching Options and Hold-Up Problem

Resolving the management agency cost associated with asset shifting imposes an inversely correlated cost where once a pool of assets has been allocated to a separate legal entity it becomes costly to reallocate capital among different projects. The reason is that, while managers of a single entity can readily redeploy capital by authority, two separate entities must enter into a contract and bear the transaction costs of moving capital between projects.

Both the corporate subsidiary and committed funds reduce the value of "switching options." However, this value is enhanced when the managers are free to switch capital between ventures.[80] With a corporate subsidiary format the two legal entities have to enter into a contract to capture the surplus generated by their synergy, but managers of committed funds do not have such a requirement. Managers of corporate subsidiaries, though, may not redeploy assets when the new use is inconsistent with the purpose originally pursued by the funds.

In both cases, it is plausible that some stakeholders will make the opportunistic attempt to hold-up the transaction over the surplus generated by the synergy.[81] In the case of the parent subsidiary structure, the minority shareholders can threaten the parent company with a challenge to the contract as a related-party transaction.[82] Creditors of a committed funds structure can threaten to challenge the decision of the management as one contrary to the specific purpose of the fund.[83] Unlike a committed fund, a wholly-owned subsidiary is not able to overcome these costs of partitioning.[84] "If a parent attempts to strengthen, ex ante, its control over a subsidiary in order to avoid transaction costs and hold-up activity, it invites judicial veil piercing or enterprise liability under state corporate law or substantive consolidation in bankruptcy."[85]

7. Tracking of Value

Securities rights are attached to all of a corporation's property, not to specific assets.[86] In order to track the progress of a particular asset, corporations can issue tracking stocks that try to reflect the asset's value.[87]

80. Iacobucci & Triantis, *supra* note 5, at 521-23, 561-63; Triantis, *supra* note 72, at 1105-06.

81. Iacobucci & Triantis, *supra* note 5, at 561-63.

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.* at 563.

86. *Id.* at 535.

87. *Id.* at 536-37.

The effectiveness of tracking stocks is limited by two factors: 1) the inability of directors to "announce a dividend payable out of the profits of a single division if the firm as a whole has failed to meet the statutory threshold" (a minimum capital surplus); and 2) the inability to link a tracking stock's dissolution rights to the tracked assets rather than to the value of the entire firm.[88]

To overcome these limitations, a corporation can establish a distinct legal entity to oversee a specific line of business. In such a case, securities rights are attached only to assets related to the specific business venture.[89]

Committed funds enable firms to overcome the limitations of tracking stocks by permitting the firms to issue asset-specific securities. As a result, dividends are payable only by considering the profits of the separate fund, and upon dissolution, the stockholders of the asset-specific securities receive a fraction of the value of the fund without sharing the losses suffered by the general patrimony of the firm.[90] Therefore, the residual claims of asset-specific stockholders are linked only to the assets of the tracked fund. This legal device enables a corporation to achieve the benefit of partitioning without the costs of establishing a new legal entity.

8. The Asset Partitioning Effect

As explained earlier, both a committed fund and a corporate subsidiary can accomplish affirmative asset partitioning. While the subsidiary achieves what has been called "strong entity shielding," the committed fund accomplishes what has been called "complete entity shielding."[91]

Strong entity shielding restricts the ability of both shareholders and their personal creditors to seize the assets of the corporation.[92] However, the shares of a corporate subsidiary also represent an asset of the parent corporation. This creates a paradoxical situation where, on the one hand, creditors cannot seize the subsidiary's assets, but on the other hand, creditors can still seize the shares of the subsidiary and, if the seized shares constitute the majority, the creditors can force the subsidiary's liquidation.

In contrast, a committed fund creates an effective wall between the corporation's general creditors (corresponding to the parent corporation's creditors) and the assets transferred into the fund. The corporation does not own any share representing the fund so any claim to those assets is

88. *Id.* at 535-37.
89. *Id.*
90. *Id.*
91. *See* Hansmann, Kraakman & Squire, *supra* note 9, at 1337-38 (stating that the phrase "entity shielding" is the equivalent of affirmative asset partitioning).
92. *Id.*

denied.[93] At the same time, asset partitioning through committed funds resembles that which is achieved in the U.S. through a trust. Thus, the relative costs and benefits of this solution are debatable.

9. Informational Economies

Partitioning allows firms to attract investors with specialized expertise in particular assets. Segregating these investors' assets from the rest of the patrimony lowers investigation and monitoring costs.[94] Similarly, some investors may wish to invest in multiple groups of assets. Integrating these assets into the same entity has the advantage of creating information economies of scale. Investors dealing with a single entity only need to investigate the structure of one board of directors, one set of takeover defenses, and one corporate governance structure.[95]

In a system that conceives affirmative asset partitioning only through the formation of a new legal entity, there is a trade-off between the costs avoided through asset partitioning (lower monitoring costs for specialized creditors) and the benefits achieved through legal integration (information economies of scale). The use of committed funds can overcome this trade-off. Committed funds allow a corporation to attract investors with specialized expertise who are willing to invest in particular assets bound to a specific purpose. At the same time, maintaining the corporation's unity creates information economies of scale and attracts those investors seeking the benefits of diversification.

B. Asset Securitization

1. Overview of Asset Securitization

In a typical asset securitization transaction, a corporation (the originator) transfers some of its assets (normally the receivables) to a distinct legal entity (the special purpose vehicle or SPV)that is either a new corporation or a trust.[96] The SPV issues securities backed by the receivables and uses the raised capital to pay the originator the price of the receivables.[97]

Through such a transaction, the originator is able to separate the risk associated with its general activity from the risk associated with the

93. *Id.*
94. *Id.* at 1344-45.
95. *Id.* at 1343-48.
96. Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133, 135-36 (1994).
97. *Id.*

receivables.[98] Since the receivables are transferred to the SPV, investors are concerned only with the securitized assets and not with the general financial condition of the originator.[99] Asset securitization accomplishes an asset partitioning which is affirmative and defensive. The originator's creditors have no claims against the receivables that have been sold to a third party and pledged to the exclusive satisfaction of the investors (affirmative asset partitioning).[100] The investors, meanwhile, as creditors of the SPV, cannot seize any assets of the originator (defensive asset partitioning).[101]

The partitioning of assets between two distinct legal entities also enables the originator to lower the cost of credit. Since the SPV, also called a "bankruptcy remote" vehicle, is unaffected by the originator's incidental bankruptcy, investors are willing to pay a higher price for securitized assets.[102]

In light of the discussion above, it is not surprising that, in the United States, asset securitization accomplishes partitioning through the formation of a new legal entity.[103] The originator often creates a separate entity (either a corporation or a trust) for each securitization transaction to avoid co-mingling asset pools related to different transactions. The logic of achieving asset partitioning through duplication of legal entities is therefore corroborated.[104]

2. Asset Securitization in Italy

The regulation of asset securitization in Italy offers another example of the "asset independence" doctrine or, put differently, an affirmative asset partitioning achieved within the boundaries of the same entity.

Law No. 130 of April 30, 1999 provides two different possibilities for achieving asset securitization. The first possibility is reminiscent of the scheme described above with regard to the United States, and it is accomplished through the formation of an SPV, typically as a new corporation.[105] The second possibility allows a corporation to perform an

98. *Id.*
99. *Id.*
100. For a discussion on "affirmative asset partitioning," see Hansmann & Kraakman, *supra* note 2, at 394-95.
101. "For a discussion on "defensive asset partitioning," see Hansmann & Kraakman, *supra* note 2, at 395-96."
102. Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: a Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434, 468 (1998).
103. *See* Schwarcz, *supra* note 96, at 136–144 (examining the structure and benefits of asset securitization).
104. *Id.*
105. Law No. 130 of April 30, 1999, art. 3.

asset securitization, then transfer the receivables to a mutual fund.[106]

With regard to the first scheme, Italian regulation provides for different levels of asset partitioning. First, the SPV, a new legal entity, creates segregation between the general assets of the originator and the securitized assets. Second, and more significantly, a property law provides for two additional levels of partitioning: 1) between the incidental personal assets of the SPV and the receivables ("vertical partitioning");[107] and 2) between different pools of securitized assets, each related to different transactions ("horizontal partitioning").[108]

In Italy, the SPV is normally organized as a corporation. In addition to the securitized property, the special entity owns the legal capital required by law. Having its own patrimony in addition to the pool of securitized assets implies that an SPV engages in a managing activity and undertakes obligations with third parties different from the securities holders. As described above, a property law is intended to insulate the securitized assets of the SPV from its personal creditors, thereby departing from the principle that a debt is necessarily a firm-wide obligation and that partitioning can be achieved only through the formation of multiple legal entities.

The law grants segregation not only between the SPV assets and receivables, but also between different pools of securitized assets that are held by the same SPV but related to different transactions. The segregation between these asset pools is thus achieved within the boundaries of a single SPV, avoiding the creation of multiple legal entities.

3. Asset Securitization in the United States

In the United States, in order to avoid the SPV's pledging the securitized property to bond obligations different from the ones undertaken with securities holders, its business purpose is limited to owning and operating the pool of securitized assets; no new property may be acquired. Furthermore, the SPV is prevented from incurring additional debt.

In the United States, to reinforce the segregation between claims by different categories of creditors, it is common to organize the SPV in the form of a trust.[109] The receivables are committed to the trust fund, and they

106. *Id.*, art. 7, ¶ 1.

107. *Id.*, art. 3, ¶ 2.

108. *Id.* Whether these pools were commingled in a single patrimony, investors with different degrees of risk would be exposed to the outcomes of others' portfolios. Without a property law that grants horizontal partitioning, an originator would need to create a new SPV for each asset securitization transaction.

109. *See, e.g.*, David Hayton, *The Uses of Trusts in the Commercial Context*, *in* MODERN INTERNATIONAL DEVELOPMENTS IN TRUST LAW 145 (1999) (discussing the various uses of trusts to protect assets).

are consequently insulated from claims of the settlor (the originator) and claims of the trustee's (the SPV's) personal creditors. While the originator's personal creditors cannot seize the trust fund because it is owned by a third party (the trustee),[110] in the common law of trusts, if the trustee becomes insolvent, the trust property he or she administers is unavailable to satisfy the trustee's obligations to his or her personal creditors.[111]

4. The Case of Multiple Transactions

As mentioned above, the Italian legal system provides that, in the case of multiple asset securitization transactions, the same entity can hold different and separate pools of assets. A property law ensures that each pool of receivables is committed only to the corresponding group of securities holders.

It is important to distinguish the case of multiple, separate, and unrelated transactions under one SPV from the multiple issue of certificates under the master trust that is common practice in the United States. In the latter case, when a corporation or a financial institution has a substantial amount of receivables that belong to the same category, and are therefore difficult to separate in order to obtain a different rating, a practical solution is for the corporation to transfer these receivables to a master trust (an SPV). This trust will then issue different classes of trust certificates at different points in time. Each class of certificates can be fashioned in a distinct way, with different substantive rights (e.g., different interest rates) and diversified subordination rights.[112]

Even though a series of covenants and subordination agreements are designed to keep each class of certificates separate, it must be stressed that each debt assumed by the master trust is a firm-wide obligation; that is, all the receivables of the trust fund are the common pledge of all investors.

110. This is true to the extent that the substantive consolidation doctrine does not apply in the event of the originator's bankruptcy. According to this doctrine, all assets and liabilities of two different entities are consolidated as if they were one entity. As a consequence, the originator's personal creditors can seize the receivables transferred to the SPV. This doctrine applies after the court's consideration of several factors including: (1) presence or absence of consolidated financial statements; (2) unity of interests and ownership between the various corporate entities; (3) existence of parent and inter-corporate guarantees on loans; (4) degree of difficulty in segregating and ascertaining individual assets and liability; (5) existence of transfers of assets without the observance of corporate formalities; (6) commingling of assets and business functions; and (7) profitability of consolidation at a single physical location. In re Vecco Construction Industries, Inc., 4 B.R. 407, 410 [Bankr. E.D. Va. 1980].

111. Hansmann & Mattei, *supra* note 21, at 141.

112. *See* STEVEN L. SCHWARCZ & ADAM D. FORD, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION, 3.18 (3rd. ed. 2003) (explaining the master trust).

Therefore, each claim is backed by the same pool of receivables. It is true that a junior investor only has recourse against the pool of assets that remains after senior creditors have been fully paid. Since all receivables are in the same pool of assets, if the trustee breaches a covenant or does not respect the seniority of one class of certificates, senior investors will have only contractual remedies at their disposal.

To be sure that each class of investors is completely shielded by the others' claims, the SPV must hold wholly separate pools of assets containing separate classes of securities for each pool. Under the same SPV, multiple transactions must be structured so that securities backed by one pool do not have rights to other pools. This outcome would be especially complicated were there not a statutory rule to enable asset partitioning within the boundaries of the same entity.[113] In the absence of a property law ensuring that different pools of assets under one entity are kept wholly separate, it would be necessary for an SPV to negotiate a waiver with each investor to seize the assets of a pool backing a separate class of securities. Making certain that each investor accepts this waiver would not only raise transaction costs, but would simultaneously impose higher monitoring costs on other investors, since the contractual nature of such an agreement exposes it to moral hazard and potential breaches.

The practical response to these difficulties of realizing separate and unrelated transactions under one issuing entity is to create multiple issuing entities, each related to a different category of investors. Once again, the common law experience seems to confirm the general principle that distinct pools of assets are conceivable only as separate legal entities.

5. Cost and Benefit Comparison of the Two Systems

Describing the differences between the Italian and American legal systems with regard to asset securitization is not only a theoretical exercise, but reveals different functional outcomes.

The possibility of an SPV's holding multiple and wholly separate pools of assets, each backing a different asset securitization transaction, has been identified by representatives of U.S. issuers as a way to reduce the costs of creating multiple issuing entities.[114] On the other hand, the lack of

113. On this reasoning, see *supra* Part II.

114. *Practicing Law Institute, Tax Classification of Segregated Portfolio Companies, 869 PLI/Tax 381, 390-91 (May-June 2009*).

> It often happens that an investment bank or other sponsor wishes to create, for sale to investors, debt or equity securities that are backed by identified assets. For repeat business with various asset pools and investors, it is cheaper, easier and quicker to use as the securities issuer segregated portfolios within a single company rather than multiple companies. Companies need to be formed and

a property law in the United States that would grant an affirmative asset partitioning within the same entity imposes this result only through a complex series of covenants and subordination agreements. Consequently, it seems reasonable to conclude that the transaction costs of managing multiple asset securitization transactions within one SPV outweigh the benefits of not having to create multiple issuing entities.[115]

As described above, the Italian legal system provides that an SPV can hold multiple, wholly separate pools of assets backing different asset securitization transactions. Article 3, paragraph 2 of Law No. 130 of April 30, 1999 provides that each pool of assets is segregated from both the SPV's legal capital required by law and from other pools committed to a different asset securitization transaction.

This law means that each investor, in the absence of his previous consent, has limited recourse against the pool of assets corresponding to his transaction; therefore, he is banned from seizing either assets of the corporation's patrimony (normally corresponding to the minimum legal capital required by law) or assets committed to different categories of investors. Essentially, this property law reduces the transaction costs of asset partitioning compared with the partitioning achieved either through a complex series of waivers, covenants and subordination agreements, or by multiplying legal entities.

Nonetheless, this legal structure is not free of risk. As is the case in the United States, the SPV's business purpose is limited to operating the pool of securitized assets.[116] Unlike the United States, however, its patrimony is not limited to securitized assets; in fact, each SPV is compelled to own the minimum legal capital required by law. Therefore, it will be engaged not only in asset securitization transactions but, at the same

> cared for. They must have a board of directors or managers and stockholder or member meetings. It is better to form a company once rather than 100 times if there is a commercial desire to create 100 series of securities backed by distinct asset pools. *Id.*

115. *See* PRACTISING LAW INSTITUTE, NUTS & BOLTS OF FINANCIAL PRODUCTS: UNDERSTANDING THE EVOLVING WORLD OF CAPITAL MARKET & INVESTMENT MANAGEMENT PRODUCTS 115 (2007)

> [T]he more fundamental issue with the use of multiple, separate and unrelated transactions under one issuing entity for asset-backed securities is that it raises concerns that deviate from the core principle that investors of a particular asset-backed security should look solely to the related pool of assets for primary repayment. With a series trust structure, instead of only analyzing the particular pool, an investor also may need to analyze any effect on its security, including bankruptcy remoteness issues, if problems were to arise in another wholly separate and unrelated transaction in the same issuing entity. These concerns are exacerbated if new unrelated transactions are created after the original transaction involving the investor.

116. Law No. 130 of April 30, 1999, art. 3, ¶ 1.

time, in managing its own patrimony. The latter activity implies the possibility of undertaking obligations with third parties, and therefore also involves reducing the bankruptcy remoteness of these entities.

Even if the property law described above successfully segregates the corporation's patrimony from the other pools of assets, the managerial activity of this patrimony increases the risk of commingling different funds, as well as the chance of default.[117] On this point, the U.S. approach seems to lower the risks of commingling and defaulting. In fact, especially when the SPV is structured as a trust, trust law ensures that trust property is unavailable to satisfy the trustee's obligations to his personal creditors. Furthermore, the fact that the trust is limited not only in its business purpose but also in the sense of owning only the securitized assets reduces the risk of undertaking and defaulting on obligations with third parties.[118]

Asset securitization represents another example of the dichotomy between common law and civil law countries regarding asset partitioning. The alternative between performing multiple but separate asset securitization transactions either through the formation of multiple legal entities or within the boundaries of the same SPV leads to contradictory outcomes. While on one hand Italian regulation lowers the transaction costs of this partitioning, on the other hand, managing multiple pools of assets together with the SPV's legal capital increases the risk of eliminating the bankruptcy remoteness quality of the vehicle.

C. Mutual Funds

1. Overview of Mutual Funds

Another set of legal instruments that deserve special attention from any research comparing asset partitioning devices are mutual funds. These

117. Clementina Scaroni, *Il patrimonio separato della società veicolo per la cartolarizzazione dei crediti*, *in* CONTRATTO E IMPRESA 1075, 1084, n. 25 (2005); Francesco Di Ciommo, *La securitization tra diritto ed economia, tra normativa nazionale e modelli stranieri*, *in* LA CARTOLARIZZAZIONE DEI CREDITI IN ITALIA 1, 99 (Roberto Pardolesi ed., 1999) (noting that, in Italy, unlike in the United States, a Special Purpose Vehicle can continue to operate as a corporation, possibly outside of its original scope).

118. Some attention has been devoted to verifying the difference between creating an SPV as a corporation or as a trust. *See* John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 YALE L.J. 165, 182 (1997) (discussing the potent fiduciary duties that inhere in trust law); Hansmann & Mattei, *supra* note 100, at 468-69 (outlining the benefits of trusts over corporations in partitioning assets); Steven L. Schwarcz, *Commercial Trust as Business Organizations: Unraveling the Mystery*, 58 BUS. L. 559, 582-83 (2003) (describing the clarity corporations law provides regarding bankruptcy remoteness and the benefits of trust law where bankruptcy remoteness is not a concern).

entities are very different from the ones analyzed so far. In a corporate subsidiary or asset securitization, asset partitioning is used to segregate different risks and to attract specialized investment at a lower cost of credit.[119] The purpose of a mutual or pension fund is essentially to serve as a mediating device between an investor and securities secondary markets. To this end, investors transfer some of their assets to an intermediary that becomes the manager of the fund.

One fundamental priority for investors is to shield the managed assets from claims of the manager's personal creditors (vertical partitioning).[120] In the U.S., a trust is one of the two devices used to manage a mutual fund (along with the corporation), and is considered by ERISA to be mandatory for managing a pension fund.[121] Unlike other legal entities, a trust is able to assure that the fund's assets are shielded from claims of the manager's personal creditors.[122] It is a well established rule that "although a trustee becomes insolvent or bankrupt, the beneficiary retains his interest in the subject matter of the trust and, accordingly, the beneficiary is entitled [to retain that interest] as against the general creditors of the trustee."[123]

It is widely known that, in most European countries, a body of trust law has not developed.[124] Nonetheless, as stated above, in a *numerus clausus* of circumstances the law admits asset partitioning through the "asset independence" doctrine.[125] Mutual funds are included in these well-defined circumstances.

In Italy, there are two different types of mutual fund regulation. In the first, a fund's assets are treated as being under joint ownership of the investors and are managed by a specialized third party. Vertical partitioning is a direct consequence of this ownership structure; the assets are not owned by the manager and consequently cannot be seized by its personal creditors. In the second, assets are transferred to a new entity that acquires the ownership and manages the fund. In this case, investors are considered residual claimants of the corporation managing the fund, and no vertical partitioning is granted.[126]

119. *See* Hansmann & Kraakman, *supra* note 2, at 401 (explaining how asset partitioning can lower credit costs).

120. *Id.* at 398.

121. Hansmann & Mattei, *supra* note 102, at 467.

122. *See id.* ("If it were otherwise—if, for example, a pension fund were just an investment account maintained by the corporation within its corporate shell—the employees' pensions would always be subject to the risk of the corporation's insolvency.").

123. Langbein, *supra* note 118, at 179 (citing the RESTATEMENT (SECOND) OF TRUSTS § 12 cmt. F (1959) (internal quotations omitted)).

124. Hansmann & Mattei, *supra* note 102, at 434-35.

125. *See supra* pp. 13-18.

126. *See* PAOLA IAMICELI P., UNITÀ E SEPARAZIONE DEI PATRIMONI, PADOVA 376-78 (2003) (providing an overview of the mutual fund structure in Italy).

2. Mutual Series Funds in Italy

Property laws that grant asset partitioning are not only relevant for shielding managed assets from claims of the manager's personal creditors; they also allow a single mutual fund to be structured into several sub-funds in which contributions from investors are pooled separately. Both the joint ownership and the new entity schemes described above enable the mutual fund to segregate the assets among separate portfolios.[127]

Offering multiple portfolios within the same entity allows investors to choose the sub-fund that best matches their risk profile and to switch all or part of their investment from one sub-fund to another easily. Issuing more than one class of shares is not sufficient to segregate different sub-funds fully. In order to shield each class of investors from other classes' risks, a property law is necessary.

Without a property law granting the segregation between sub-funds, each class of shares would be affected by the losses suffered by another series. In the law's absence, the extent of the rights to participation in the capital property or distribution account would be the same for each class of shares, according to the general principle that each share represents a portion of the general capital of the entity, and not a portion of a sub-fund. As explained in the course of this Article, without property law enforced asset partitioning, any creditor or residual claimant of an entity would share the risks of that entity's consolidated activity, according to the principle that each debt is a firm-wide obligation. Consequently, in order to insulate one pool of assets from investors of a different pool (or series), it is necessary to establish "asset independence" statutorily.[128]

In particular, the Italian regulation on mutual funds states that when a fund is structured as a number of sub-funds, each sub-fund is for all intents and purposes separate from the others.[129] Accordingly, liabilities incurred with respect to a particular sub-fund are enforceable only against the assets of that fund, and not against the general patrimony of the mutual fund or the assets of other sub-funds (defensive asset partitioning). On the other hand, liabilities incurred with respect to the general activity of the mutual fund are enforceable only against its general patrimony, and not against the assets of the sub-funds (affirmative asset partitioning).[130]

127. *See* Legisl. Decree. No. 58 of Feb. 24, 1998, art. 36, ¶ 6 and art. 43, ¶ 8 (dictating each group of assets must be independent).

128. *See* Lucia Picardi, Commentary, *Art. 43, d.lg. 58/1998*, *in* TESTO UNICO DELLA FINANZA 380, 390 (Gian Franco Campobasso ed., 2002) (clarifying that sub-funds are not automatically separated from the general investment portfolio).

129. Legisl. Decree. No. 58 of Feb. 24, 1998, art. 36, ¶ 6.

130. *Id.*

3. Mutual Series Funds in the United Kingdom and the United States

Wholly separate investment portfolios attract diversified investors at lower monitoring costs because each class of investors has recourse only to the assets attributable to their segregated portfolio. This beneficial structure can be achieved within the same mutual fund, or through a family of separate entities. Absent a statutory provision granting asset partitioning, one might predict a preference toward creating a family of entities, due to the prohibitively high costs of partitioning assets through contracting.[131]

Departing from the traditional approach of the common law system, which conceives asset partitioning only through the creation of a new legal entity, the United Kingdom has regulated the so-called Umbrella Company. In 1997, the Financial Services (Open-Ended Investment Companies) Regulations introduced the possibility for a mutual fund to issue different classes of shares, each linked to a separate sub-fund.[132] Contributions from shareholders would be pooled separately, so that property and distribution rights of each class of investors are exclusively backed by the corresponding sub-fund.[133]

The United Kingdom regulation reinforces the intuition that without a property law—a statutory rule "good against the world"—it is effectively impossible to achieve asset partitioning within the same entity. The U.S. experience offers further confirmation of this.

In the United States, pursuant to rule 18(f)(3) of the Investment Company Act of 1940, mutual funds can issue more than one class of shares.[134] In accordance with the fundamental principle that a debt is a firm-wide obligation, all shareholders' claims lie on the same investment portfolio. Consequently, a multi-class structure, while facilitating the diversification of shares with respect to expenses and distribution, administration and shareholder services, does not assign different property and distribution rights to distinct classes of investors.[135]

In order to insulate the claims and distribution rights of one class of

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131. *See* Hansmann & Kraakman, *supra* note 2, at 406-11 (discussing the high costs of achieving asset partitioning through contracting).

132. *See* FINANCIAL SERVICES AUTHORITY, FINANCIAL SERVICES (OPEN-ENDED INVESTMENT COMPANIES) REGULATIONS, 1997, Part 11, at 87 (explaining a proposed umbrella company does not qualify unless each of its proposed sub-funds were a separate company).

133. *Id.*

134. 17 C.F.R. §270.18f-3 (2009).

135. *See* Laurin B. Kleiman & Carla G. Teodoro, *Forming, Organizing and Operating a Mutual Fund—Legal and Practical Considerations*, *in* THE ABCS OF MUTUAL FUNDS 13, 48 (2008).

shares from other classes, the two typical legal forms of mutual funds, the trust and the corporation, can create within their boundaries distinct funds having different investment objectives.[136] This structure, normally named "mutual series funds," aims to assign a separate pool of assets to each series so that each class of shares tracks only those assets.[137] The ultimate goal of the series structure is to shield the assets of one series from claims arising out of, or in connection with, another series.[138]

Consistent with the fundamental principle that all assets are the common pledge of creditors, both the common law of trusts and conventional corporate statutes do not provide a rule allowing assets of one series to be wholly insulated from creditors of another series. Absenting a statutory recognition of asset partitioning, the mutual series funds structure requires each class to monitor the overall financial condition of the mutual fund. As has been asserted in the case of multiple asset securitization transactions, the costs of creating fully separate sub-funds through contracting would seem to outweigh the benefits of avoiding the creation of multiple legal entities.

4. The Delaware Series Regulation

In order to give the series structure a statutory foundation, in 1990 the Delaware Business Trust Act recognized that the governing instrument of a trust may establish a series of trustees, beneficial interests or beneficial owners, which have separate rights, powers, or duties with respect to separate property or obligations of the statutory trust, as well as profits and losses associated with specific series.[139] This reform indicates the awareness that, without a statutory rule (i.e., property law), the power to create a wholly separate series without investors' consent is absent. The statutory language ensures that with appropriate "records and notices" the debts, obligations, liabilities, and expenses associated with these particular series are enforceable only against that series, and not against other series of the trust or the trust generally.[140]

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136. Some scholars have tried to understand why the trust structure seems to be dominant in comparison to the corporate structure by focusing their attention on the agency problem between investors and managers, and exploring the characteristics of fiduciary duties in trust law as compared to corporate law. Langbein, *supra* note 21, 625-28; Sitkoff, *supra* note 61, at 37-38; Schwarcz, *supra* note 118, at 573-81. *Compare* Hansmann & Mattei, *supra* note 102, at 469-72 (pointing out the proprietary characteristics of trust law).

137. *See* Practicing Law Institute, *supra* note 114, at 412-14.

138. *Id.*

139. DEL.CODE. ANN. tit. 12, § 3806(b)(1)(2) (2009).

140. *See* Ann E. Conaway, *A Business Review of the Delaware Series: Good Business for the Informed*, *in* WHAT ALL BUSINESS LAWYERS MUST KNOW ABOUT DELAWARE LAW DEVELOPMENTS 647, 653 (2008).

It is worth noting that, even if the series structure were conceived to allow a single mutual fund to operate different investment portfolios under a centralized board of directors and a single registration as required by the Investment Company Act of 1940, this reform has expanded the use of such a structure to any business purpose.[141]

In 1996, the Delaware Limited Liability Company Act was amended to include the series structure. Section 18-215(b) provides that:

> [T]he debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to a particular series shall be enforceable against the assets of such series only, and not against the assets of the limited liability company generally or any other series thereof, and, unless otherwise provided in the limited liability company agreement, none of the debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to the limited liability company generally or any other series thereof shall be enforceable against the assets of such series.[142]

In the same year, the Delaware Revised Uniform Limited Partnership Act included Section 17-218, which allowed the creation of a series in a Delaware limited partnership.[143]

VI. Conclusions: Convergences Between Civil Law and Common Law Traditions

A. *Broadening Horizons of the Common Law Tradition*

A statutory foundation is nececcesry to create an asset partitioning within the boundaries of the same legal entity. The Delaware law reforms, which have been followed by seven other States and Puerto Rico,[144] together with the proliferation of the so-called Segregated Portfolio Companies (SPCs) throughout non-U.S. jurisdictions,[145] confirm this

141. *See id.* at 652-53.

142. DEL. CODE ANN. tit. 6, § 18-215(b)(1996).

143. DEL. CODE ANN. tit. 6, § 17-218 (1996).

144. *See* DEL. CODE ANN. tit. 6, § 18-215 (2009) (providing for asset partitioning within limited liability companies); 805 ILL. COMP. STAT. 180/37-40 (2009); IOWA CODE § 490A.305 (2009); NEV. REV. STAT. §86.296 (2009); OKLA. STAT. tit. 18, §2054.4 (2009); TENN. CODE ANN. 48-249-309 (2009); UTAH CODE ANN. § 48-2c-606 (2009); P.R. LAWS ANN. tit. 14, § 3426(p) (2004). In addition to Segregated Portfolio Companies legislation (which deals with limited liability companies), a number of states provide for the creation of series within a trust. *See* CONN. GEN. STAT. §34-517(b)(2) (2009); DEL. CODE ANN. tit. 12, § 3806(b)(2) (2009); MD. CODE ANN., CORPS. & ASS'NS. § 12-207(b) (2009); NEV. REV. STAT. § 88A.280 (2009); N.H. REV. STAT. ANN. § 293-B:7, II(d) (2009); VA. CODE ANN. §13.1-1219 (2009); WYO. STAT. ANN. §17-23-108(b)(ii) (2009).

145. In particular: Bermuda, the British Virgin Islands, the Cayman Islands, Guernsey,

determination. This Article has given such a statutory provision the label of property law.

The possibility of separating assets between different investment portfolios without the investors' consent spares the costs of achieving the same result through contracting and, alternatively, the costs of creating multiple legal entities. Multiple legal entities implicitly necessitate the duplication of governance structures, expenses, agreements with service providers, prospectuses, periodic reports, and other regulatory filings.[146] A single entity that offers segregated investment portfolios can eliminate the costs of duplication while benefiting from the efficiencies of attracting diversified categories of creditors.

In conclusion, the specific case of mutual funds could signal a global trend toward the recognition of asset partitioning within the boundaries of the same legal entity. While this structure is familiar to the civil law tradition thanks to the "asset independence" doctrine, it seems to have been less explored in the common law tradition. In the future, it will be important to observe whether the legal reforms implemented in Delaware, which expanded the possibility of using the series structure for any business purpose within the boundaries of a business trust, limited liability company or limited partnership will lead to a similar alignment between the common and civil law traditions for other business practices.

To this end, a critical factor will be whether, in the future, the series structure is also considered in corporate statutes. The suggested reform appears to be the necessary step for filling some of the gaps between the common law and civil law traditions that this Article has attempted to describe. Allowing for asset partitioning within the same entity has proven an efficient way to overcome the tradeoff between the economies of scale that derive from operating multiple transactions under one entity (integration), and the efficiency gains that result from asset partitioning (tailoring).

B. Broadening Horizons of the Civil Law Tradition

Comparative studies on asset partitioning have traditionally focused on the possibility of transferring trusts law to a civil law environment. Notwithstanding the fact that this Article has come at the matter from the opposite perspective, by inquiring as to whether the civil law tradition can offer insight to the common law debate on asset partitioning, it seems relevant to describe the most recent impacts of trusts law on civil law

Luxembourg, and Mauritius.

146. *See* Victoria E. Schonfeld & Thomas M.J. Kerwin, *Organization of a Mutual Fund*, 49 BUS. LAW. 107, 116 (1993) (discussing the costs and benefits of creating multiple legal entities).

countries.

At this stage, we would be well served to remember that, in the civil law tradition, only in a *numerus clausus* of circumstances provided by property laws is a legal subject able to partition his patrimony into separate funds. Here, what civil law countries have traditionally lacked is a general legal scheme able to provide for the partitioning of assets under an indefinite number of circumstances.

The common law tradition has developed trusts law, which has turned out to be an extremely flexible device capable of granting asset partitioning for a virtually indefinite set of purposes. In contrast, civil law countries have taken an opposite path, granting specific property laws which allow asset partitioning for highly scrutinized purposes.

This pattern began to shift in 1985, thanks to the adoption of The Hague Trusts Convention, which has been ratified thus far by Italy, The Netherlands,[147] Malta, Luxembourg and Switzerland. This Convention is aimed at providing for the recognition of foreign trusts, through the application of foreign trust laws, in countries where the trust concept is completely unknown.[148]

Thus far, many European countries have been reluctant to ratify the Hague Convention which, nevertheless, has stimulated a debate in many countries over the prospect of a legal device that would share the characteristics of a common law trust. While the small Republic of San Marino has decided to fully regulate the trust,[149] Luxembourg, Lichtenstein, France and Italy, who refuse to introduce such an alien instrument into their legal systems, have decided instead to reshape domestic devices for the purpose of achieving an outcome functionally resembling that of the trust.[150] All of these countries, with the exception of Italy,[151] preferred to

147. Notwithstanding the ratification of the Hague Convention, in 1992 the Dutch legislator struck down the proposal to introduce a regulation of a national trust. In particular, the Legislator added one provision that seems incompatible with the common law trust structure: "A juridical act which is intended to transfer property for purposes of security or which does not have the purpose of bringing the property into the patrimony of the acquirer, after transfer, does not constitute a valid title for transfer of that property." Burgerlijk Wetboek art. 84, ¶ 3, ch. III.

148. *See* Jonathan Harris, THE HAGUE TRUSTS CONVENTION: SCOPE, APPLICATION AND PRELIMINARY ISSUES 81 (2002) (discussing the scope and aims of The Hague Trusts Convention); Donovan W.M. Waters, *The Hague Trusts Convention Twenty Years On*, *in* COMMERCIAL TRUSTS IN EUROPEAN PRIVATE LAW 56 (Michele Graziadei et al. eds., 2005).

149. *See* Trust Act, Law No. 37, art. 63 of March 17, 2005 (San Marino) (finding that trusts are "regulated by the law of the Republic of San Marino").

150. Serena Meucci, *Contratti di fiducie, destinazione e trust: l'evoluzione dell'ordinamento francese nel quadro europeo*, *in* RIVISTA DI DIRITTO PRIVATO 829, 835 (2007).

151. The Italian civil code has been amended in order to introduce a legal device that resembles a trust's essential features with respect to asset partitioning. *See* art. 2645 *ter c.c.* (allowing real and personal property registered for specific interests to be protected from

amend the *fiducia,* a device which originates from ancient Roman Law in the concept of *fideicomissa,* and is deeply rooted in the civil law tradition.[152]

The *fiducia* is a contract between the "constituent" (i.e., the settlor) and the *fiduciario* (i.e., the trustee), where determined property is transferred to the *fiduciario*. The transferred property is dedicated to the benefit of a third party (and/or to the benefit of the "constituent") or to a specific purpose, and the *fiduciario* has the obligation to manage the property according to the instructions of the "constituent". Upon expiration of the contract, the *fiduciario* must return the property either to the "constituent" or to the beneficiaries. In contrast to the trust, the *fiducia* does not distinguish between legal ownership and equitable/beneficial ownership. Consequently, the *fiduciario* has full disposal of the property and both the constituent and beneficiary after accepting the beneficial provision have only a contractual claim toward the *fiduciario*.

According to trusts law, if the trustee becomes insolvent, the trust property he administers is unavailable to satisfy the trustee's obligations to his personal creditors.[153] In contrast, in the *fiducia*, there is no segregation of assets between the dedicated property (transferred by the constituent to the fiduciario) and personal property of the *fiduciario*. Therefore, the traditional civil law *fiducia* does not provide any asset partitioning.[154]

In keeping with the civil law tradition where asset partitioning is only granted by a specific property law in a limited number of business transactions, the *fiducia*, which can serve an indefinite number of purposes, normally lacks the ability to segregate assets without the consent of different categories of creditors (the beneficiaries and the *fiduciario's* personal creditors).[155]

Luxembourg, Lichtenstein and France decided to intervene in order to provide the *fiducia* with a property law that would enable a partitioning between the managed assets and the personal property of the *fiduciario*. In particular, the French legislator, through Article 2025 of the French civil code provided that the managed assets are the common pledge of only

third party claimants). A detailed description of this device would be beyond the scope of this study. For further details, see Giacomo Rojas Elgueta, *Il rapporto tra l'art. 2645-ter c.c. e l'art. 2740 c.c.: un'analisi economica della nuova disciplina*, *in* BANCA, BORSA, TITOLI DI CREDITO 185 (2007).

152. *See* Michele Graziadei, *The Development Of Fiducia In Italian And French Law From The 14th Century To The End Of The Ancien Régime*, *in* ITINERA FIDUCIAE. TRUST AND TREUHAND IN HISTORICAL PERSPECTIVE 327 (Richard Helmholz & Reinhard Zimmermann eds., 1998) (discussing the historical development of the fiducia in Italy and France).

153. Blair, *supra* note 5, at 392.

154. Hansmann & Mattei, *supra* note 102, at 443-44 and 456.

155. *Id.* at 456.

those creditors whose claim is related to the managed property.[156] This rule, by acknowledging that it would be effectively impossible to create an affirmative asset partitioning through contracting, shifts the traditional contractual nature of the *fiducia* device to a new proprietary foundation.[157] Using Hansmann and Kraakman's terminology, it could be said that the French *fiducia* is a new example of organizational law.

Notwithstanding the new direction marked by the French law reform toward continental acceptance of a legal device which offers affirmative asset partitioning to an open-ended set of purposes, there is still a remarkable resistance to introducing something as general as the trust. In fact, according to the new French regulation: A) the *fiducia* comes to an end within the durational limit of ninety-nine years, while the duration of a trust is often unlimited;[158] B) the *fiducia* can be constituted only by contract, while the trust may be the result of a unilateral declaration by an owner of property either during the settlor's lifetime or by will;[159] C) the role of *fiduciario* is reserved only for certain entities having legal personality (investment and insurance companies) and for attorneys at law.[160]

The French reform illustrates the resistance to adopting legal devices that diverge from a country's tradition. The field of asset partitioning offers an interesting case in which financial transactions are becoming the primary motivating force in breaching these obstacles and dictating uniform global solutions.

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156. Art. 2025 of the French civil code states that "[t]he trust fund's assets can only be seized in a legal proceeding by the holders of claims arising from the underlying assets of the trust or holders of claims related to the management of the trust."

157. On the new regulation of the French *fiducie, see* Claude Witz, *La fiducie française face aux expériences étrangères et à la Convention de La Haye relative au trust*, RECUIL DALLOZ 1369 (2007); Christian Larroumet, *La loi du février 2007 sur la fiducie. Propos critique*, RECUIL DALLOZ 1350 (2007). Similar legal reforms have occurred in Latin America. The segregation of assets has been provided for, for example, in the Uruguayan law regulating the *fiducia*. Normas Sobre Fideicomiso 17.703, ch. I, art. 7. For further information about trusts in Latin American legal systems, *see* Dante Figueroa, *Civil Law Trusts in Latin America: Is the Lack of Trusts an Impediment for Expanding Business Opportunities in Latin America?*, 24 ARIZ. J. INT'L COMP. L. 701 (2007).

158. C. civ. art. 2018. On the tendency of abolishing the Rule Against Perpetuities in the U.S., see Max M. Schanzenbach & Robert H. Sitkoff, *Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust,* 27 CARDOZO L. REV. 2465 (2006).

159. On the testamentary trusts, *see* Langbein, *supra* note 21, 636-37.

160. C. civ. art. 2015.