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ABSTRACT

For an American lawyer to practice effectively in a transnational setting, he or she needs to have culturally internalized common law doctrine. I buttress this thesis by examining two ongoing matters—the sub-
prime mortgage securitization unwind and the Madoff Ponzi scheme unwind—and three completed matters (1) the German Bundestag’s delegation to the U.S. to scope out the legal structure of the American mutual fund, (2) the tax case decided by England’s House of Lords that involved a New York trust, and (3) the failed effort to get the U.S. federal bankruptcy court in Texas to assert jurisdiction over Yukos, the erstwhile Russian oil and gas conglomerate. In the last analysis, American counsel brings to the table in Berlin, London, Moscow, or anywhere else for that matter, his or her cultural mastery of the common law as it has been enhanced by Equity. Even the American academic who holds himself or herself out as a serious legal comparatist, needs a working knowledge of common law doctrine. Knowing about the common law is not sufficient.

Today, about the only common law doctrinal courses that are required as part of the typical American law school curriculum are Contracts, Torts, and a policy-focused course about Property. More and more, it is all about some facets of the common law. The neglected facets, namely the equitable property interest, the agency and trust relationships, as well as the fiduciary principle generally, and, of course, Equity, have all been relegated to the elective side, or tossed out of the ivory tower altogether. This process of marginalizing the core fiduciary relationships in the American law school is now all but complete, notwithstanding the fact that “our society is evolving into one based predominantly on fiduciary relations.” Globalizing the American law school curriculum would be tantamount to making it even more provincial, parochial, and irrelevant than it has already become, if doing so would entail any further crowding out of the common law.

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2 See generally William B. Powers, A Study of Contemporary Law School Curricula 12 (1986) (confirming that by the 1970s, discrete courses in the agency and the trust relationships were no longer required in most American law schools).


INTRODUCTION

In November of 2008, The Harvard Law School sponsored a symposium on the “Globalization of the Legal Profession.” The premise of the exercise essentially was this: while “legal practice historically has been a largely parochial endeavor,” the American legal community must now confront the phenomenon of the “emerging global bar.”

What besides attending a globalization symposium should the earnest academic do to accommodate and adapt to this phenomenon? Conform the curriculum, of course, at least that was what one academic specializing in things global had proposed a month earlier in a roundtable discussion on preparing law students for a “global practice” held at Boston College Law School. The academic said:

I think the law schools themselves maybe have to stop forcing students to memorize the Mailbox Rule or the Rule Against Perpetuities and think more in terms of larger themes that they could pursue across the years, if we’re going to maintain the three-year model approach . . . and I would like to see more emphasis on the sort of comparative understanding of big schemes and systems on the part of students . . . So I think more emphasis on comparative, more emphasis on injecting a global sort of awareness and making law students as sort of capable professionals, to go out and deal with law reform internationally.

Leave it to the Harvard Law School, however, to get out ahead of the globalization curve:

In our first-year curriculum now every 1L doesn’t get to become a 2L unless they (sic) have taken one of our international legal studies courses. We commissioned . . . seven faculty members in five courses . . . to each come up with courses aimed at 1Ls, that would engage interest issues, that would expose students in what we hoped

6 Id.
7 The National Law Journal and the Association of American Law Schools co-sponsored the roundtable discussion on preparing law students for global practice at Boston College Law School on Oct. 7, 2008. Co-moderators were AALS President John H. Garvey and NLJ Associate Editor Leigh Jones. The panelists were William Alford, professor, Harvard Law School; Frank Burch Jr., joint chief executive officer, DLA Piper; Sara Dillon, professor, Suffolk University Law School; Frank Garcia, professor, Boston College Law School; and Paul Wickers, partner, Linklaters, available at http://www.law.com/jsp/nlj/PubArticleNLJ.jsp?id=1202426208843.
would be a very engaging manner in a legal culture, a legal system, other than the United States . . . It’s exciting, at least for the faculty.  

My immediate reaction to all of this is that those who would “globalize” the law school curriculum at the expense of the common law courses would not be doing students who aspire to practice law in a transnational setting any favors.  “As for the philosophers . . . [of the law],” wrote Francis Bacon derisively centuries ago, “they make imaginary law for imaginary commonwealths; and their discourses are as the stars, which give little light because they are so high.”  

An experienced transnational scholar-practitioner on the panel at the Boston College event several times endeavored with limited success to bring the discussion down to earth: “I still think it’s important that what you primarily come out of law school with, even with . . . [a global or transnational] . . . focus, is a real grounding in solid American law.”  

His frustration must have been palpable.  

This article is an amicus brief in support of the scholar-practitioner’s position. For an American lawyer to practice effectively in a transnational context, he or she needs to have culturally internalized common law doctrine. When all is said and done, American counsel brings to the table in Berlin, London, Moscow, or anywhere else for that matter, his or her cultural mastery of the common law as it has been enhanced by Equity.

Even the American academic who holds himself or herself out as a serious legal comparatist needs a working knowledge of common law doctrine. Knowing about the common law is not sufficient. The fiduciary principle, for example, is not a single universal concept. It is very jurisdiction specific, as the scholar-practitioner at the Boston College event made clear:

If you’ve had your corporations law, in the first page it says the directors owe their fiduciary duties to their shareholders . . . Period . . . Full stop . . . Go to the next chapter . . . That’s a very strange notion

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9 William Alford, Roundtable, supra note 8. 
11 Paul Wickes, Roundtable, supra note 8. 
12 The more ubiquitous equity has become in the real world, the less attention it has received in the legal academy. For a discussion of this phenomenon see Charles E. Rounds, Jr., The Common Law Is Not Just About Contracts: How Legal Education Has Been Short-Changing Feminism, 43 U. RICH. L. REV. 1185, 1191 (2009) [hereinafter The Common Law Is Not Just About Contracts] (also containing within it an equity primer). 
in Germany, for example, where governing boards are made up of representatives of unions, workers, and stockholders.\textsuperscript{14}

Or take the Anglo-American common law trust. Civil law jurisdictions such as Germany have not developed trust regimes, or at least regimes that are anywhere near as “protean” as the common law’s.\textsuperscript{15} This occasioned Professor Maitland, the great Cambridge legal comparatist, to muse on how a complete English lawyer in 1900 would likely have reacted upon first encountering the Civil Code of Germany. “This,” he would say, “seems a very admirable piece of work, worthy in every way of the high reputation of German jurists. But surely it is not a complete statement of German private law. Surely there is a large gap in it. I have looked for the Trust, but I cannot find it; and to omit the Trust is, I should have thought, almost as bad as to omit Contract.”\textsuperscript{16}

Again, the American lawyer needs to know the common law, not know about the common law. A foreign law appreciation survey course will not cut it in the real world, even in a world that has been “globalized.” The historian Arthur Schlesinger, Jr. made a similar point in his case against “multiculturalizing” the undergraduate curriculum: “[A]nd let us understand that no culture can hope to ingest other cultures all at once, certainly not before it ingests its own.”\textsuperscript{17}

\textsuperscript{14} Paul Wickes, Roundtable, \textit{supra} note 8.


\textsuperscript{16} Maitland, \textit{SELECTED ESSAYS} 142-143 (H.D. Hazeltine et al. eds., 1936).

\textsuperscript{17} Arthur Schlesinger, Jr., \textit{The Opening of the American Mind}, N.Y. TIMES, July 23, 1989, § 7, at 1, available at: http://www.nytimes.com/books/00/11/26/specials/schlesinger-opening.html?scp=1&sq=the%20opening%20of%20the%20American%20Mind&st=cse. Prof. Schlesinger somewhere also made the practical point that a human being no matter how accomplished can only hope to know one, perhaps two other “cultures,” in his or her lifetime. A legal regime, which in the last analysis is a cultural institution, is no exception. Should the day ever come when we have a fully globalized legal environment, we suggest that there will only be a handful of lawyers at any given time who will be able comfortably to swim about unaided in more than one jurisdiction. Attaining true language proficiency is easier said than done, and without a mastery of the language of a particular jurisdiction one cannot possibly be a master of its jurisprudence. Ultimately all things cultural, whether it is music or sculpture or law, is about communication.
This article is the fourth in a series of articles that consider the implications of the marginalization of the fiduciary relationship in the American legal academy. In *Publicly-Traded Open End Mutual Funds in Common Law and Civil Law Jurisdiction: A Comparison of Legal Structures*, 18 we explained how the Investment Company Act of 1940, which regulates mutual funds, tweaks the common law of agency and trusts at the margins, but otherwise leaves it undisturbed. In other words, the Act would be gibberish without the common law. Securities lawyers take note.

In *Lawyer Codes Are Just About Licensure, the Lawyer’s Relationship with the State: Recalling the Common Law Agency, Contract, Tort, and Trust Principles That Regulate the Lawyer-Client Fiduciary Relationship*, 19 I questioned why instruction in the lawyer’s Code of Professional Conduct is mandatory in most law schools while instruction in the law of agency is generally not, particularly in light of the fact that the lawyer-client relationship is first and foremost one of agency.

In *The Common Law Is Not Just About Contracts: How Legal Education Has Been Short-Changing Feminism*, 20 I endeavored to make the case that the private side of the legal ledger, the common law side, has been chronically under-examined by feminist scholars, particularly as a vehicle for empowering and protecting women economically. I laid the blame for this under-utilization of existing legal doctrine squarely at the doorstep of the American law school, whose core curriculum is now structured around the simplistic, one-dimensional “private contract versus state regulation” narrative.

I. THE METHODOLOGY

I buttress the thesis of this article—namely that the farther a law school curriculum drifts from the common law, the more provincial, parochial, and irrelevant 21 it becomes—by considering five “global” matters

18 Rounds & Dehio, supra note 15.
19 Rounds, supra note 4.
20 Rounds, supra note 12.
21 See generally Edwards, *The Growing Disjunction Between Legal Education and the Legal Profession*, supra note 4; see Edwards, *Postscript*, supra note 4 (bemoaning the fact that the American law school in straying from its principal mission of professional scholarship and training is inflicting on the law student classroom instruction that has little relevance to the actual practice of law); Cf. Rounds, supra note 4 (focusing on critical doctrinal gaps in the curriculum of the modern American law school).
in which the two equity-based facets of state common law, that is to say the agency and trust relationships, were particularly and profoundly implicated. The last two matters are ongoing: The sub-prime mortgage securitization unwind and the Madoff Ponzi scheme unwind. As to the former, the common law trust relationship played a critical role in “globalizing” the debacle. As to the latter, the state common law agency relationship was the vehicle that enabled the Madoff Ponzi scheme to go global, and which will likely play a critical role in affording equitable remedies to its overseas victims.

In order to lay the groundwork for my discussion of these high profile ongoing matters, however, I begin with a discussion of three completed matters (1) the tasking, by the German Bundestag soon after the Second World War, of two delegations to travel to the United States (U.S.) to study the legal underpinnings of its relatively mature mutual fund industry; (2) the tax case decided by England’s House of Lords in 1932, which involved a New York trust; and (3) the federal bankruptcy filing in Texas in 2003 that ultimately failed to thwart the Russian Federation’s looting of the Yukos oil and gas conglomerate. Warming up with the three completed matters allows me to introduce some critical common law doctrinal themes that will resurface with a vengeance in my discussions of the high profile ongoing matters.

With respect to each matter, I lay out the facts and the applicable state common law doctrine, and then invite the reader to contemplate how a firm of American lawyers unschooled in all the facets of the common law could possibly have been of much help, no matter how many foreign law appreciation survey courses they may have taken in their law schools.

In Section II of this Article, I explain the nature and extent of the common law’s marginalization in the American law school. In Section III, I lay out the five matters, three completed and two ongoing, in support of my thesis that the farther a law school curriculum drifts from the common law, the more provincial, parochial, and irrelevant it becomes. I conclude by suggesting that, when all is said and done, American counsel brings to the table in Berlin, London, Moscow, or anywhere else for that matter, first and foremost his or her cultural mastery of the common law as it has been enhanced by Equity.
II. LEGAL ACADEMIA’S MARGINALIZATION OF THE COMMON LAW GENERALLY

Before fleshing out with real world examples my thesis—that mastering the common law of one’s jurisdiction is by far the best way to prepare one for practicing in a transnational setting—I need to debunk once and for all the myth that law schools today are still about imparting common law doctrine, such as the rule against perpetuities. Were that only the case.\textsuperscript{22} The common law, as enhanced by Equity, has been under sustained attack in the ivory tower since the 1960s.\textsuperscript{23} This is unfortunate, as the agency, the contract, duties of care incident to the law of torts, the legal property interest, and the trust are facets of the same gem. Each offers a perspective of the Anglo-American common law. Together, they make up its periodic table. Statutes either fill gaps in the common law (e.g., the will and the corporation), modify the common law (e.g., the durable power of attorney), or embellish the common law (e.g., the tax-qualified employee benefit plan). Even the federal Investment Company

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\footnote{See Cameron Stracher, \textit{Taste: Meet the Clients}, \textit{Wall St. J.}, Jan. 26, 2007, at W11. Stracher took a swipe at the much-maligned rule against perpetuities, which at one time was the bane of every law student’s existence. He was on target when he suggested that law schools are not adequately preparing their graduates to be lawyers, to make the balanced practical judgments that seasoned lawyers on the front lines must make every day in the course of representing and advising their clients. His solution was to take a page from the medical schools and put in place something like an external clinical rotation system. \textit{Id.} This is not a bad idea. Nothing focuses the mind like a heavy dose of live fire. There is also a collateral benefit: busy real world practitioners would now have to start paying some serious attention to what has been going over the last several decades in their alma maters. There are not many small business transactional legal clinics currently available at United States law schools. I must respectfully disagree, however, with some of Mr. Stracher’s explanations as to why law schools are in this condition. He places some of the blame on the Socratic case method, and presumably the traditional core common law curriculum in which its magic was worked, particularly Agency, Trusts, Property, Contracts, Torts, and Evidence. \textit{Id.} The problem is that Agency is no longer a required course in most law schools and has not been for years. The same goes for Trusts. Property is also taught quite differently than it used to be. Equity is ancient history. Evidence is reduced to a “menu course” that might be taken. As for the Socratic method itself, to the extent it is now employed at all, it has largely been defanged by grade inflation and sensitivity concerns. The rule against perpetuities, which was the tried and true way to get a law student not so much to think as a common law lawyer but to reason as one, was long ago abandoned. My point is that maybe part of the reason why law schools are in this fix is because the old required doctrinal common law courses in the law have over the period in question been crowded out by courses about the law. In a professional school, a balance needs to be struck between book-learning and real-world experience. The American law school now deserves failing grades in both departments.}
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\footnote{See generally E. Gordon Gee & Donald W. Jackson, \textit{Following the Leader? The Unexamined Consensus in Law School Curricula} 6, 14-15, 22-25, 47-48 (1975) (comparing core law school curricula from the 1950s, 1960s, and 1970s).}
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Act of 1940, which regulates mutual funds on this side of the Atlantic, is perched on an edifice of state common law.\textsuperscript{24}

Today, about the only common law doctrinal courses that can still be found on the required side of the typical American law school curriculum are: Contracts, Torts, and a policy-focused course about Property.\textsuperscript{25} More and more courses are only about some facets of the common law. The neglected facets, namely the equitable property interest, the agency and trust relationships, as well as the fiduciary principle generally, and, of course, Equity, have all been relegated to the elective side, or tossed out of the ivory tower altogether. This process of marginalizing the core fiduciary relationships in the American law school is now all but complete, notwithstanding the fact that “our society is evolving into one based predominantly on fiduciary relations.”\textsuperscript{26} That the core business of a law school is to turn out agent-fiduciaries has carried little weight.\textsuperscript{27} And now, to accommodate the real or perceived globalization phenomenon, the Harvard law faculty has reduced even further the few remaining required hours that it had allotted to common law doctrine. Like lemmings, the other law school faculties are sure to follow, at least if past practice is any guide.\textsuperscript{28} Make no mistake about it, in the American law school the rule against perpetuities, for some time now, has been on

\textsuperscript{24} See Rounds & Dehio, supra note 15, at 491.

\textsuperscript{25} It is unfortunate that Property casebooks nowadays give short shrift to the equitable property interest, particularly as equitable ownership plays such a critical role in today’s global financial system. A share of a trusteed mutual fund, for example, is an equitable property interest, as is a participation in a trusteed pool of subprime mortgages. One popular Property casebook we perused devoted only three out of 1171 pages to the equitable property interest. See Joseph William Singer, Property Law: Rules, Policies, and Practices 503-05 (4th ed. 2006).

\textsuperscript{26} Frankel, supra note 3, at 798.

\textsuperscript{27} Back in 1908 when the American Bar Association adopted the original Canons of Professional Ethics, instruction in the core equity-based relationships of agency and trust, as well as the core law-based relationships of contract, tort, and property, was mandatory in most if not all the law schools. It most certainly never occurred to those who had been encouraging the bench and bar to endorse and adopt a lawyer code that by the end of the century instruction in the two private fiduciary relationships would no longer be required in most American law schools. Back then lawyer codes presumed a bench and bar that were thoroughly grounded in the common law, as the focus of such codifications was on licensure, the lawyer’s relationship with the state. Licensure is still the focus of the typical lawyer code. There has been no appreciable expansion in the scope and coverage of the Canons of Professional Ethics, or its successor codifications. On the other hand, we have seen a considerable pedagogical undermining over time of the common law foundations upon which those regulatory edifices were and are constructed. See supra note 5.

\textsuperscript{28} Gee & Jackson, supra note 23, at 4 (noting “the degree to which Harvard law School provided the model and impetus for legal education, especially between the last quarter of the nineteenth century (when legal education was foundering and readily followed Harvard’s lead) and the institutionalization of legal education following the adoption of the Root resolution by the ABA in 1921”).
When the plug is finally pulled, the anti-doctrinalists will have lost their favorite straw man.

III. FIVE ILLUSTRATIONS OF WHY A LAWYER NEEDS A WORKING KNOWLEDGE OF THE COMMON LAW AGENCY AND TRUST RELATIONSHIPS TO EFFECTIVELY PRACTICE LAW GLOBALLY

Taking up the three completed matters allows me to first introduce some critical common law and equitable doctrine that is covered only tangentially, if at all, in most American law schools today—doctrine that I will invoke later in my discussion of the two high profile ongoing matters, namely the unwinds of the sub-prime mortgage securitization debacle and the Madoff Ponzi scheme. If one is to be equipped to systematically and exhaustively sort out the rights, duties, and obligations of the parties to a transaction that implicates the fiduciary principle, and most do nowadays, one needs to have encountered this material somewhere. This is no less the case for a matter that is playing itself out in a transnational setting.

A. THE GERMAN BUNDESTAG SENDS TWO DELEGATIONS TO SCOPE OUT OUR TRUSTEED MUTUAL FUNDS

A trust is a fiduciary relationship with respect to property, arising from a manifestation of intention to create that relationship and subjecting the person who holds title to the property to duties to deal with it for the benefit of charity or for one or more persons, at least one of whom is not the sole trustee.31

On this side of the Atlantic, the first open-end mutual fund opened its doors in 1924.32 The American mutual fund was then, and still is, little more than a tangle of common law legal relationships:

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29 See Stracher, supra note 22, at W11.
30 See Frankel, supra note 3, at 798 (confirming that “our society is evolving into one based predominantly on fiduciary relations”).
32 “MFS Massachusetts Investors Trust began operation in 1924, making it America’s first mutual fund. Also started that year was State Street Research Investment Fund. And the other three possible answers listed certainly aren’t spring chickens: Pioneer Fund, Vanguard Wellington Fund, and Fidelity Fund all opened for business in 1930 or earlier.” Quarterly Mutual Funds Review—Know It All? Try Our Quiz, WALL ST. J., Apr. 7, 2003, at R21.
namely the trust, the agency, and the contract. In the case of a mutual fund that is sponsored by Fidelity, Vanguard, or the Bank of America, legal title to the underlying assets is held jointly by individual trustees who have contracted with the sponsor for investment management agency services. Even in the case of a mutual fund that has been packaged as a corporation, the directors in Equity are for all intents and purposes trustees of the underlying assets. Both the trustees of an American mutual fund and its sponsor owe direct fiduciary duties to the investors, who are essentially the beneficiaries of a common law trust. A share of a mutual fund is a vested equitable property interest.

Again, a mutual fund is a creature of state law, not federal law. The Investment Company Act of 1940 merely preemptively tweaks state common law at the margins. It, for example, makes the mutual fund sponsor-advisor a per se fiduciary vis-a-vis the investors with respect to the setting of its compensation. “Under state common law principles, whether or not the sponsor-advisor has fiduciary or quasi-fiduciary duties with respect to the setting of its own compensation would hinge on the degree to which the sponsor-advisor actually controls the trustee and/or has actual or constructive knowledge that the title-holder is in breach of trust.” The sponsor’s fiduciary status is no longer dependent upon the particular facts and circumstances. As common law fiduciaries, mutual fund trustees and sponsors owe investor-beneficiaries a duty of undivided loyalty, that is to say an affirmative duty to act solely in their interest.

There are some attributes of the American mutual fund that are uniquely common law, that are difficult to replicate in civil law jurisdictions such as Germany. They are the following:

- While legal title to the underlying fund assets is in the trustees, the equitable property rights are in the investor.

33 Rounds & Dehio, supra note 15, at 483.
34 Id.
35 Id. at 490.
37 Rounds & Dehio, supra note 15, at 506.
38 See id. at 503.
39 Id. at 475.
40 Id. at 514.
41 Id.
42 Bogert & Bogert, supra note 36, at §247(U).
43 See Rounds & Dehio, supra note 15, at 506.
other words, the rights of the investor are more than just contractual.

- While legal title to the underlying fund assets is in the trustees, the assets are insulated from the personal creditors of the trustees. It should be noted that the Germans by statute have gone a long way towards insulating the underlying property of a mutual fund from the claims of the creditors of the fund managers.

- The trustees and the fund sponsor owe the investors fiduciary duties that are intense, proactive, elastic, and free-ranging. All that the federal Investment Company Act of 1940 does is invoke pre-existing state common law fiduciary principles.

- The trustees and the fund sponsor share co-fiduciary liabilities, that is to say, the trustees may not sit idly by while the sponsor commits a breach of fiduciary duty that adversely impacts the investors, and vice versa. In Germany, a liability wall is generally erected contractually between the bank that sponsors a mutual fund and the KAG entity that administers it.

In Germany, the closest approximation to a common law trust is the civil law treuhand where a treugeber transfers title to property to a treuhänder for the benefit of someone. There are several critical differences, however, between the two relationships. The first is that while a common law trust creates equitable property rights in its beneficiaries, a civil law treuhand creates only contractual property rights as against the treuhänder. The second is a corollary to the first. In the event of the treuhänder’s personal insolvency, the treuhand property becomes subject

45 See Investmentgesetz [Investment Act], at § 2 LII, § 30 LII (F.R.G.); see generally GERHARD WALTER, DAS UNTERTIELBARKEITSPRINZIP BEI DER FIDUZIARISCHEN TREUHAND (1974).
47 Id. at 502.
48 Id.
49 See Investmentgesetz [Investment Act], Jan. 1, 2004, at§§20 ff. (F.R.G.) (defining the role of the Depotbank and outlines its duties); The kapitalanlagegesellschaft or KAG is a special type of corporation whose sole purpose is to administer a mutual fund. Rounds & Dehio, supra note 15, at 488.
50 Henry Christensen, III, Foreign Trusts and Alternative Vehicles, SH032 ALI-ABA 81, 95 (2002).
to the claims of the *treuhänder’s* creditors.\textsuperscript{52} As I have noted, the personal bankruptcy of a common law trustee should be a non-event as far as the beneficiaries are concerned.\textsuperscript{53} Even were the trustee is a corporation, there would be no problem as a trust shall not fail for want of a trustee.\textsuperscript{54} Finally, as I have also noted, the fiduciary relationship between the *treuhänder* and those to whom the *treuhänder* owes contractual-type obligations is less intense and proactive than the common law fiduciary relationships of agency and trust. The principle of co-fiduciary liability, for example, could make a trustee liable for harm done to the trust by the acts of the trustee’s agents, whereas a *treuhänder* may well not be liable for the acts of his, her, or its agents, absent special facts.\textsuperscript{55}

The percentage of U.S. households investing in mutual funds increased dramatically between 1980 and 2005, actually from 5.7 percent in 1980 to 47.5 percent in 2005.\textsuperscript{56} But even by the end of World War II, the United States had already had a fair amount of experience with the open-end mutual fund. In the 1930s there had been some industry abuses.\textsuperscript{57} The congressional response was the Investment Company Act of 1940, which, in tandem with the common law fiduciary principle, had turned the product into something as standardized and plain vanilla as an investment product can be, bearing in mind the old adage: “Do what you will, the capital is at hazard.”\textsuperscript{58} Thus, in the early 1950s, as West Germany was getting back on its feet economically, it naturally turned to the U.S. for guidance in fashioning commingled investment products. Before the war, Germany had had some experience with the mutual fund concept, but nothing on the scale of what the British and Americans had logged between the wars. After the war, the West German parliament, known as the Bundestag, twice sent a fact-finding delegation across the

\textsuperscript{52} Id.
\textsuperscript{53} 4 A. W. SCOTT, W.F. FRATCHER, & M. L. ASCHER, SCOTT AND ASCHER ON TRUSTS § 24.26 (5th Ed. 2006) [hereinafter “SCOTT & ASCHER”].
\textsuperscript{54} See generally ROUNDS & ROUNDS, supra note 51, at § 3.4.
\textsuperscript{55} See generally Rounds & Dehio, supra note 15, at 509.
\textsuperscript{58} Harvard Coll. v. Amory, 26 Mass. (9 Pick.) 446, 461 (1830) (Putnam, J.). Putnam’s opinion in this case is also the source of the Harvard College prudent man rule of fiduciary investing.
Atlantic to see how the Americans were structuring and regulating their open-end mutual funds.\footnote{See Jurgen Thiel, Der Schutz der Anleger von Wertpapierfonds im deutschen und amerikanischen Recht, in EUROPAISCHE HOCHSCHUFLSCHRIFTEN 1982, at 53 (Reihe 2: Rechtswissenschaft Vol. 300, 1982).}

While the American mutual fund legal structure had evolved over time with minimal legislative input, the essentials of Germany’s current mutual fund legal structure came into the world fully formed one day in 1954, thanks to the efforts and actions of the Bundestag. A cursory reading of the legislation will reveal that the civil law lawyers who drafted it were influenced by the Anglo-American experience with commingled investment products.\footnote{Rounds & Dehio, supra note 15, at 488.} The classic Anglo-American common law definition of the fiduciary’s duty of loyalty, for example, was translated almost verbatim into German and incorporated into the legislation’s text.\footnote{Investmentgesetz [Investment Act], Jan. 1, 2004, at § 9 II (F.R.G.).} While the letter of the definition may have been incorporated by reference, it could not be said that the spirit of the definition, the culture of the fiduciary principle, as it were, had been as well.\footnote{See Rounds & Dehio, supra note 15, at 501-10.} Thus, there is no wonder that the Securities and Exchange Commission has been reluctant since to approve the sale of German mutual participations within the U.S.\footnote{See generally Christopher B. Bernard, Towards an International Market in Mutual Funds, 36 VA. J. INT’L L. 467, 475-77 (1996).}

In any case, back to the thesis of this article, namely that any globalizing of the American law school curriculum is tantamount to provincializing it. I ask the reader to imagine what things would have been like had the American lawyers who received one of the Bundestag delegations had had little or no grounding in the common law agency relationship, the trust relationship, the common law fiduciary principle, Equity, the differences between legal property interests (e.g. a share of corporate stock), and equitable property interests (e.g., a participation in a mutual fund). Imagine if all they had had under their belts in the way of formal instruction was Contracts, a course in the Investment Company Act of 1940, and a foreign law appreciation survey course. Assuming the German lawyers were in the dark as to common law doctrine, as well, it would be the blind leading the blind. It would be amateur hour, a mad hatter’s tea party. The American lawyers would be in no position to explain what a vested transferable share of beneficial interest is to the visiting German lawyers, who would find the equitable bifurcation of title...
and economic interest with respect to a given item of property bizarre and unsettling. This, by the way, accounts for Germany’s general reluctance to introduce by statute the trust into its law, or to at least recognize trusts established elsewhere. At a regional meeting of the London-based Society of Trust and Estate Practitioners (STEP), which was held in Milan in 2002, it was reported that Germany is unlikely to soften its aversion to the trust concept anytime soon:

As a comparison to Italy, Dr. Christian Von Oertzen presented the reception of trusts in Germany, another civil law country. If the trust in Italy could be characterized as largely unknown but being considered, in Germany, the reception is more hostile. The German Federal Supreme Court even ruled in 1985 that a legal trust relationship is incompatible with German public policy for structural reasons. Germany has not signed the Hague Convention on Trusts and probably won’t in the near future.64

Such a transatlantic mutuality of ignorance of what a vested share of beneficial interest is would be unfortunate as the share of an American mutual fund is essentially just that, a vested transferable share of beneficial interest in an entrusted basket of assets. The American lawyers would also be in no position to assist the Germans in sorting out the critical differences between the common law fiduciary principle and its civil law counterpart.65 It would be better if the Germans had stayed at home.

B. THE ENGLISH HOUSE OF LORDS DECIDES A TRUST CASE INVOLVING A NEW YORK TRUST

Trusts have been creatures of English law since the 14th Century... At the beginning... trusts were used for dividing estates in real estate, and facilitating the donor’s testamentary plan in the face of the laws of primogeniture and other restrictions imposed by the Crown on transfers of land, which constituted most of the wealth of medieval society. Scholars suggest that the French Revolution ended similar efforts at dividing ownership in France, and ultimately throughout

64 Howards S. Simmons reporting on STEP Conference held at the Villa D’Este, Milan, on 27-29 October 2002. See STEP J., Dec. 2002, at 21. The “structural reasons” alluded to in the excerpt relate to the so-called Numerus Clausus, which catalogs the types of property interests that are allowable under German law. With a few exceptions, e.g., the administration of the property of a decedent, German law does not recognize the severance of legal title to an interest in property from its ownership. Such a severance, of course, is the hallmark of the common law trust.

65 See generally ROUNDS & ROUNDS, supra note 51, at § 8.12.1 (discussing such civil law trust analogs as the fiducia, usufruct, fideicommissum, emphyteusis, treuhand, and anstalt).
Europe and South America through the influence of the subsequent Napoleonic Code, because “divided property rights came to be considered characteristic of feudalism.”

It is settled law that a trust beneficiary’s equitable interest is a property interest. Whether, however, a trust beneficiary has some definable right in the very property that is the subject of a trust, or merely the equitable right to seek judicial enforcement of the terms of the trust as against the trustee, the one who holds the legal title to the subject property, has been the subject of debate among legal scholars for over a century. The nature of a trust beneficiary’s interest in the underlying property can have real world transnational consequences. In 1930, the House of Lords, having been persuaded that it was the law of New York that a trust beneficiary had no interest in any particular item of trust property, that the beneficiary “only may enforce the performance of the trust in equity,” held in the case of *Archer-Shee v. Garland* that the income thrown off by the property of a New York trust that had not been remitted to the United Kingdom (UK) was not subject to UK tax. The House so held notwithstanding the fact that the beneficiary was domiciled in the UK and married to a UK subject. Had the House been persuaded that under New York law the beneficiary has some definable right in each underlying trust asset, as would have been the case under UK law, the House of Lords would have ruled that the income was subject to UK tax.

The House took and found convincing the un-contradicted evidence of two expert witnesses who testified for the taxpayer on the applicable New York law—one an academic and the other a seasoned practitioner:

Mr. Richard Powell, a professor of Law at Columbia University Law School in the City of New York, stated that the provision of the law which directs who shall hold and own the property of a trust was as follows: “Every express trust valid as such in its creation, except as herein otherwise provided, shall vest the whole estate in the trustees in law, and in equity, subject to the execution of the trust period. The persons for whose benefit the trust is created shall take no estate or

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67 See generally ROUNDS & ROUNDS, supra note 51, at § 5.3.1.
68 Id.
interest in the lands, but may enforce the performance of the trust in equity."\textsuperscript{70}

The practitioner’s opinion was fully in accord with the professor’s. What is remarkable about the case is that several years earlier, the House in a case with identical facts involving the same parties had held that there was a UK tax liability, it having assumed that the applicable trust law in New York and the UK was the same.\textsuperscript{71}

My purpose in briefing Archer-Shee v. Garland is not to enlighten the reader on the nature of a trust beneficiary’s interest in the underlying property. In fact, one learned commentator is convinced that Professor Powell had it all wrong:

It may well be doubted, however, whether the effect of the New York legislation is to deprive the beneficiary of the trust of a property interest in the subject matter of the trust and to relegate him to the position of a mere claimant against the trustee. At any rate it is believed that the prevailing view in the United States as well as in England is that a beneficiary of a trust has a property interest in the subject matter of the trust and not merely a chose in action.\textsuperscript{72}

Instead, I bring the case to the attention of the reader as yet another example of why a thorough grounding in the common law of one’s own jurisdiction is all the more necessary if one intends to practice in a transnational setting. The House of Lords looked to the distinguished American legal academic and to the seasoned American practitioner, not for their musings on law and society in a transnational setting, but to resolve a particular tax dispute. It needed to have their considered opinions as to what was actually going on in this particular corner of New York property and trust law. The question was whether a New York statute had or had not in some way altered New York’s common law of trusts. An American tax lawyer ungrounded in all the facets of New York common law as enhanced by Equity and tweaked by statute would have been totally unqualified to step into the breach, no matter how many specialized courses in international taxation the lawyer had completed. He or she would be in the dark even as to what questions to ask.

\textsuperscript{70} Id.
C. The Russian Federation Loots Yukos, a Newly Privatized Oil and Gas Conglomerate: The Role of the Common Law Trust in the Texas-Based Litigation Counter-Strategy

The arrangement at which the Sherman Antitrust Act was directed was a business application of the trust form. The Standard Oil Company, for example, induced stockholders in various enterprises to assign their stock to a board of trustees and to receive dividend-bearing trust certificates in return.\footnote{73}{Columbia Encyclopedia 2793 (5th ed. 1993).}

The Yukos Oil Company was an open stock holding company organized under the laws of the Russian Federation.\footnote{74}{See In re Yukos Oil Company, 321 B.R. 396, 400 (Bankr. S.D. Tex. 2005).} It was the parent of 200 subsidiary legal entities of which one was a Texas corporation.\footnote{75}{Id.} The assets of the conglomerate “[were] . . . massive relative to the Russian economy, and, since they . . . [were] primarily oil and gas in the ground, [were] . . . literally a part of the Russian land.”\footnote{76}{See id. at 399.} Yukos became fully privatized during 1995 and 1996.\footnote{77}{Id. at 400.} In a last ditch effort to thwart the efforts of the Russian government to loot by retroactive tax assessments the conglomerate, elements of the Yukos management and its foreign investors on February 11, 2005 filed a Chapter 11 plan of reorganization in the United States Bankruptcy Court in Houston, Texas. The purpose of which was to effect a subordination of the Yukos tax debt and the transfer of causes of action into a common law trust to facilitate the continuation of defensive litigation.\footnote{78}{See id. at 403.} It was the largest bankruptcy case ever filed in the United States.\footnote{79}{Id. at 399.} Those aggrieved by the actions of the Russian government had sought refuge in the institution of the trust, which, in the opinion of Professor Maitland has been the greatest achievement of English jurisprudence, the most important of Equity’s exploits.\footnote{80}{W. Maitland, Equity: A Course of Lectures 23 (A.H. Chaytor & W.J. Whittaker eds., 2d ed. 1936).}

Alas, however, it was Equity’s less accommodating, more cold-blooded side that ultimately proved to be their undoing:

The Yukos saga encompasses many legal cases and claims where jurisdiction matters. Even more importantly, the reach of extra-territorial jurisdiction, perhaps most dramatically of U.S. bankruptcy
law with specific reference to Chapter 11 concerning the global stay of creditor proceedings, comes up against the rails of equitable and discretionary judicial doctrine of forum non conveniens. The inconvenient transnational legal lesson of Yukos is that from a practical litigation standpoint, whether or not there is sufficient nexus in rem or in personam, last minute preferential forum shopping is a desperate move unlikely to prove successful in any court of law where the claim concerns equitable distribution of existing assets, especially where the home government would be required to cooperate in the reorganization of the enterprise.\footnote{Dmitry Gololobov & Joseph Tanega, \textit{Yukos Risk: The Double-Edged Sword—A Case Note on International Bankruptcy Litigation and the Transnational Limits of Corporate Governance}, 3 N.Y.U. J. L. & BUS. 557, 568-570 (2007).}

I would not presume to judge here or elsewhere the wisdom of the heroic last ditch litigation strategy of the lawyers for those who were financially aggrieved by the Yukos looting. For my purpose, the Yukos saga is simply one more example of why the fledgling American lawyer who aspires to be a player on the international legal stage needs to have a thorough grounding in all facets of the common law as it has been enhanced by Equity and tweaked by statute. A foreign law appreciation survey course would not have been much use to those lawyers in the pressure cooker of legal combat that winter down in Houston. It was all local common law as enhanced by Equity and supplemented by provisions of the federal Bankruptcy Code. There was no time to muse over globalization’s larger themes.

Today, Russia’s Gazprom and Rosneft are state energy companies, the latter entity having been “cobbled together from Yukos assets once partly owned by foreign investors.”\footnote{Andrew E. Kramer, \textit{Gazprom Pays for Aggressive Growth}, \textit{Int’l Herald Tribune}, Dec. 31, 2008, at 1.} In 2006, it was a Russian court that finally declared Yukos itself bankrupt.\footnote{Gregory L. White, \textit{Europe Court to Hear Yukos Case}, \textit{Wall St. J.}, Jan. 30, 2009, at A8.} The Yukos shareholders, which include “numerous” foreign investors, are now seeking more than $42 billion in damages against the Russian government in the European Court of Human Rights, in Strasbourg, France, for the constructive expropriation of their equity interests in the looted enterprise.\footnote{\textit{Id.}}
D. The Sub-Prime Mortgage Securitization Global Unwind: Highlighting the Property Aspects of the Common Law Trust

Securitization is the sale of equity or debt instruments, representing ownership interests in, or secured by, a segregated, income-producing asset or pool of assets, in a transaction structured to reduce or reallocate certain risks inherent in owning or lending against the underlying assets and to ensure that such interests are more readily marketable and, thus, more liquid than ownership interests in and loans against the underlying assets.\(^85\)

At the close of the nineteenth century, Henry Adams found trusts charged with “vigorous and unscrupulous” energy.\(^86\) He saw them as “revolutionary, troubling all the old conventions and values, as the screws of ocean steamers must trouble a school of herring.”\(^87\) As the first decade of the twenty-first century drew to a close, the common law trust was still churning things up, as evidenced by the fact that it was the vehicle of choice, at least on this side of the Atlantic, for securitizing packages of sub-prime mortgages. Thus, in 2008 and 2009, when U.S. real estate prices leveled off or began to decline and mortgage default rates escalated, common law trustees would become major players in the sub-prime mortgage securitization global unwind:

Like other banks, J.P. Morgan’s mortgage business services loans on the bank’s books, as well as those sold off to investors, or securitized. Securitized mortgages represent more than three-quarters of the $1.5 trillion in mortgages that J.P. Morgan services. In October [of 2008] . . . J.P. Morgan launched a plan to modify the terms of $70 billion in mortgages it owns for borrowers behind on payments or showing signs they could soon slip into delinquency. “From the moment we made our last announcement, we have been working as diligently as we can to expand it to all loans because we think it’s the right thing to do,” said Charles Scharf, who runs J.P. Morgan’s retail operations. In formulating the plan, J.P. Morgan said it held discussions with about a dozen major trustees that represent investors of securitized mortgages . . . “The trustees and investors have been extra-


\(^{86}\) HENRY ADAMS, THE EDUCATION OF HENRY ADAMS 500 (1918).

\(^{87}\) Id.
ordinarily cooperative in getting to the point where we are allowed to do these modifications," Mr. Scharf said.88

When it comes to an asset-backed security whose sponsor intends for property law purposes to be equity rather than contract debt (leaving aside what the characterization for tax purposes is to be in the hands of investors)89 the common law trust is tailor made for creating readily marketable equity, that is for converting pools of legal property interests into readily divisible and transferable vested equitable property interests. These equitable property interests are known in the industry as "pass-through certificates."90 Recall that the vested equitable property interest is a common law term of art that I dropped with little explanation into my discussion of the German Bundestag’s efforts to come to grips with the strange legal structure of the American mutual fund. In this section I will flesh out my explanation of the term by elaborating on the relevant common law doctrine.

When it comes to an asset-backed security, whose sponsor intends for property law purposes to be contract debt rather than equity, again, leaving aside what the desired tax characterization in the hands of investors is to be the common law trust is tailor made as a vehicle for securing or collateralizing the contractual rights of the investors.91 These legal interests are known in the industry as “pay-through bonds.”92


89 Sometimes it is not entirely clear whether an asset-backed security is truly an equitable beneficial interest or merely a contract right masquerading as one. “Trusts . . . [for example,] formed to hold revolving pools of receivables (most notably, credit card receivables) have issued to investors . . . [an] . . . interest . . . which takes the form of a beneficial interest in the trust (much like a pass-through certificate) but is intended to be treated for tax purposes as debt of the issuing trust based on its economic resemblance to conventional debt.” David Z. Nirenberg, Introduction to Securitization Taxation: Types of Asset-Backed Securities, in NEW DEVELOPMENTS IN SECURITIZATION 2008 829, 856 (Practising Law Institute 2008). “Traditionally, pass-through debt certificates have been cast in the form of ownership interests despite their economic similarity to debt so that the sponsor could characterize the sale of the certificates as a sale of trust assets rather than a borrowing for financial and regulatory accounting and bank regulatory capital purposes.” Id.; see generally Richard Barley, Heard on the Street: Hybrids Laid Low by Crisis at Banks, WALL ST. J., Feb. 7, 2009, at B10 (noting that “if banks keep making payments and calling bonds when expected, rating agencies and regulators may decide the instruments aren’t really equity capital, because they aren’t absorbing losses”).

90 See generally Nirenberg, supra note 89, at 829, 835.

91 Id. at 829.

92 Id. at 845-50.
case of a pool of sub-prime mortgages, the trustee takes the legal title to
the mortgaged-backed promissory notes for the purpose of securing or
collateralizing the contractual rights of the bond investors. Unlike pass-
through certificates, “which represent an ownership interest in trust as-
sets,” pay-through bonds are obligations of the trustee that are backed
by assets to which the trustee holds the legal title. The investor has a
beneficial interest in the segregated pool of notes and mortgages that is
the equitable equivalent of a legal security interest. And then there is the
“CDO squared.” This is a collateralized debt obligation that is secured
by other collateralized debt obligations, an investment vehicle with a
trust structure that is well beyond the scope of this article.

Professor Maitland had it right when he suggested that the trust
was “an ‘institute’ of great elasticity and generality; as elastic, as general
as contract.” This elasticity and generality can get confusing. Without
knowing all of common law’s facets, one could easily confuse the con-
cept of “securitizing” contractual rights with the concept of “securing” or
collateralizing contractual rights, such as contractual rights that one
might have as against a trustee. There is an irreducible core of substan-
tive legal knowledge that every good lawyer needs to have internalized:

Every good lawyer knows some law, knows something of the general
sea of substantive doctrine in which he works. In comparison with
the entire legal universe, no lawyer, of course, knows very much law
outside the single field or sub field in which he has specialized. But
every good lawyer can locate himself and his client’s position on the
general map of substantive law.

Again, the common law trust is not just the component of some rich
person’s estate plan. Because of its protean nature, it is also an instrument

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93 Id. at 845.
94 Editorial, Treasury’s Very Private Asset Fund, WALL ST. J., Apr. 1, 2009, at A22 (defining and
discussing “CDOs squared”).
95 MAITLAND, supra note 76, at 23.
96 GEE & JACKSON, supra note 23, at 6.
97 “. . . [T]he slogan of modern comparative law—‘compare function rather than form’—does not
work for the trust. One cannot identify the function of the trust because there is no such function.
The trust is functionally protean. Trusts are quasi-entails, quasi-usufructs, quasi-wills, quasi-
corporations, quasi-securities over assets, schemes for collective investment, vehicles for the
administration of bankruptcy, vehicles for bond issues, and so on and so forth. In software termi-
nology, trusts are emulators.” Gretton, supra note 15, at 599; see generally Rounds & Dehio, su-
pra note 15.
of commerce, an instrument of commerce that continues to give the statutory corporation a run for its money.\(^98\)

1. **SECURITIZATION**

I first take up the trust as a securitization vehicle, that is to say, a vehicle for converting legal property interests, such as mortgaged-backed promissory notes, into equitable property interests that are readily divisible and transferable. The share of a mutual fund is an example of such an equitable property interest. To understand the concept of a divisible and transferable vested equitable property interest incident to a trust, one needs to appreciate where legal title to the underlying trust property is located and what makes some equitable interests vested rather than contingent. This is a body of foundational common law doctrine that is generally no longer covered in any systematic way in the American law school. If the mechanics who teach the bar review courses wish to get down into Equity’s weeds, that is their business. We academics have bigger fish to fry and much larger themes to contemplate.\(^99\)

Assume the owner of some promissory notes that are secured by real estate mortgages transfers the legal title to each note, along with its mortgage, to a bank for the benefit of those who will be investing in the pool of notes. The bank is the trustee of the notes. As to the world, the bank owns the notes.\(^100\) Thus, the bank-trustee collects the interest and principal payments of the mortgagor-debtors for the benefit of the investor-beneficiaries. If a particular mortgagor-debtor defaults on his or her contractual obligations under a particular promissory note, it is the obligation of the bank-trustee to foreclose on the real estate that is securing that note.\(^101\)

Whether or not the investor-beneficiaries have property rights in the notes themselves is an academic debate that found its way into the

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\(^99\) See generally Edwards, The Growing Disjunction Between Legal Education and the Legal Profession, supra note 4; Edwards, Postscript, supra note 4 (bemoaning the fact that the American law school in straying from its principal mission of professional scholarship and training is inflicting on the law student classroom instruction that has little relevance to the actual practice of law); Cf. Rounds, supra note 4 (focusing on critical doctrinal gaps in the curriculum of the modern American law school).

\(^100\) See generally ROUDS & ROUDS, supra note 51, at § §3.5.1 (discussing the nature and extent of the trustee’s legal estate).

\(^101\) RESTATEMENT (THIRD) OF TRUSTS § 76(2)(b) (1959); 3 SCOTT & ASCHER, supra note 53, at §§ 17.8, 18.1.2.1.
tax case that was decided by the House of Lords, but which is a debate that has no relevance to this discussion. Even if the investor-beneficiaries have no direct property rights in the notes, it is certain that they have equitable property rights in the pool of notes, notwithstanding the fact that as to the world the bank-trustee is the legal owner of the notes.\footnote{See generally ROUNDS & ROUNDS, supra note 51, at § 5.3.1 (discussing the nature and extent of the trust beneficiary’s equitable property interest).} The equitable property right is sometimes referred to as a beneficial or a pass-through interest.\footnote{Michael C. McGrath, Structural and Legal Issues in Securitization Transactions, in ASSET BASED FINANCING 2008, at 525, 532-33 (Practising Law Institute 2008).} In any case, the equitable economic interests of the investor-beneficiaries trump the legal property interests of the bank-trustee, which is, however, entitled to be reasonably compensated from the pool for its administrative services.\footnote{See generally ROUNDS & ROUNDS, supra note 51, at §§ 3.5.2.3 & 3.5.2.4 (discussing the trustee’s right in equity to be indemnified for expenses reasonably incurred and to be reasonably compensated).} In any case, one who owns a share of beneficial interest in a trusteed pool of promissory notes that are not secured by sub-prime mortgages is a trust beneficiary.

Next, I need to sort out the differences between a contingent equitable property interest and a vested one if we are ever to come to grips with the legal mechanics of the pass-through certificate. A vested equitable property interest that is subject to no transfer restrictions is fully divisible and transferable. Here is a classic example of a vested equitable property interest. I have a gentleman who is currently a bachelor. His name is John Jones. The obligee of a secured promissory note, that is the owner of the contractual rights incident thereto, transfers legal title to the note to Bank of America in trust for the benefit of John Jones for life. Upon John Jones’ death, Bank of America is to transfer the note outright and free of trust to the personal representative of John Jones’ probate estate. John Jones’ equitable interest is vested because it is subject to no condition precedent, such that he must be married to receive trust income or such that for the note to become a part of his probate es-

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\footnote{Securitization is the process whereby a large number of financial contracts, receivables or, in some instances, operating assets (constituting a representative range of the originator’s, seller’s or lessor’s entire portfolio) are transferred by the originator, seller or lessor to a bankruptcy-remote entity which (directly or indirectly) issues a new financial instrument either collateralized by, or representing an ownership interest in, the financial contracts and the receivables thereunder.’’ McGrath, supra note 103, at 529.}
tate he must be married at the time of his death. The trust contains no spendthrift clause that would restrain John Jones’ right to transfer by assignment the equitable property interest. Let us assume that John Jones sold his entire equitable property interest to X, who then stepped into the shoes of John Jones. X became the sole beneficiary of the trust. X has since transferred the equitable property interest on to Y who has in turn transferred the equitable property interest on to Z, his cousin in Iceland. The cousin has vertically sliced the equitable interest into three shares, one for each of his children.

As the equitable property interest was handed on from person to person, the legal title to the note remained back with Bank of America, as trustee, where it remains to this day. If the obligor defaults on the note, it is the bank’s job to foreclose on the security for the benefit of the last person in the chain of equitable ownership, the one who is left holding the bag, as it were. That is what I mean by “unwinding” of a securitized position.

The common law trust is particularly suited as well to partitioning of property interests horizontally as well as vertically. By horizontal partitioning we mean that John Jones may assign the trust’s current equitable interest, that is to say the trust’s income stream, to one person and the trust’s equitable remainder interest, that is to say the ultimate right to principal, to another. In the realm of securitization, this is essentially what a stripped pass-through certificate is all about:

At the extreme, there is a complete separation in the ownership of rights to income and principal. In a typical transaction, debt instruments are transferred to a trust in exchange for two classes of certificates. One class represents the right to receive 100 percent of each principal payment on the debt. The other class represents the right to receive 100 percent of each interest payment. These principal only and interest only classes are often referred to as *PO Strips* and *IO Strips*, respectively.106

2. COLLATERALIZATION

I now turn to the asset-backed debt security. I set the stage for my discussion of the role the common law trust plays in the construction of an asset-back debt security, such as a pay-through bond, by asking a simple question about our law’s basic anatomy: Can the common law

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106 Nirenberg, *supra* note 89, at 842.
contract, the common law agency, and the statutory corporation either individually or collectively fulfill the same functions as the common law trust? Most law faculty members and students nowadays would find such a question challenging, this in light of the fact that the traditional common law Agency course and the traditional common law Trusts course are all but extinct in the world of the legal academic. Professors Henry Hansmann and Ugo Mattei remind us that the common law trust is unique in its ability to order with respect to those who have property interests in a “set of assets” whose creditors shall have access to those assets and whose shall not. Trust law “allows the parties to the trust to partition off a discrete set of assets for separate treatment in relationships formed with creditors.”

Here is an example of the type of “ordering” that the professors are referring to. A corporation wishes to establish a defined benefit pension plan for its retired employees, that is to say a plan where each retiree gets a fixed benefit rather than the balance in a segregated individual account, such as would be the case with a 401k or 403b plan. With the help of actuaries, accountants, and lawyers, the employer-corporation designs the plan and then appoints a bank to act as trustee of the plan’s assets. Over time, the employer-corporation transfers sufficient corporate assets to the trustee to meet the ongoing economic obligations of the plan.

By subjecting the corporation’s plan contributions to a trust, the corporation insulates those assets from the claims of the corporation’s creditors and from the claims of the bank trustee’s own creditors. The retired employees receive equitable property rights in the entrusted pool of assets to the extent of their legal contractual rights under the plan. To the extent that any creditors would have access to the segregated pool of assets, they would be the creditors of the “plan,” such as agents of the trustee who, pursuant to contract, have rendered to the trustee specialized investment management services in exchange for compensation. The creditors of a retired employee would have access to his or her equitable property interest under the plan to the extent that the equitable property interest is not protected under state or federal law by an enforceable

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107 Rounds & Rounds, supra note 51, at § 8.22.
108 Hansmann & Mattei, supra note 66, at 434.
109 Scott & Ascher, supra note 53; Rounds & Rounds, supra note 51, at § 7.4 (“Because the assets of a trust are supposed to be segregated from the personal assets of the trustee, the personal bankruptcy of the trustee should be a non-event insofar as the equitable interests of the beneficiaries are concerned”).
spendthrift provision in the trust. Here, the common law trust is a collateralization rather than a securitization vehicle. It has enabled the employer corporation “to partition off a discrete set of assets for separate treatment in relationships formed with creditors.”

Likewise, in the case of the structuring of an asset-back debt security such as a pay through bond, the function is to secure the interests of the bondholders, not to securitize the equitable interest in the entrusted assets. When the entrusted property is a pool of mortgages, we have a collateralized mortgage obligation (CMO). To create a CMO security issue, the owner of a pool of mortgages transfers the pool to a trustee, referred to in the industry somewhat inaccurately as a special purpose vehicle (SPV). I say inaccurately because a trust, unlike a corporation, is not a juristic person. The trustee then issues bonds to the public that are secured by the pool, the bonds essentially being IOUs of the trustee. Thus, the trust is tailor made for serving as a vehicle for shifting sub-prime mortgage creditor risk from the stockholders of a lender-bank to the general investing public. Sub-prime mortgages stuffed into such a special purpose trust conveniently do not appear on the lending bank’s balance sheet.

Because legal title to entrusted collateral—such as promissory notes back by subprime mortgages—is indivisibly anchored in the trustee, while the collateral itself is insulated from the trustee’s personal creditors. It is not hard to see why the common law trust has been the vehicle of choice when it comes to creating, administering, and marketing divisible and transferable collateralized tranches of debt obligations, that is to say “a number of classes of securities, each senior class entitling the holders to a certain priority as against a junior class with respect to payments of principal and interest.”

Here is an ultra-simplified version of how the typical CMO bond issue has been structured. Four tranches, A, B, C, and Z, are created, a

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111 Hansmann & Mattei, supra note 66, at 434.
112 See generally Rounds & Rounds, supra note 51, at § 3.5.1 (discussing the nature and extent of the trustee’s estate).
113 In the future, “[t]here are likely to be fewer opportunities for banks to offload risk to third parties . . .” Mollenkamp, Perry & Galloni, supra note 88, at A7.
tranche in this context being a block of bonds.\textsuperscript{115} The A tranche has the shortest maturity and the C tranche has the longest maturity, with the Z tranche being what is left over after everyone else has been paid off:

Upon receiving payments of principal and prepayments [from the obligors on the entrusted notes,] the SPV trustee [, who holds the legal title to all the underlying property and as to the world is the owner thereof,] applies [the payments] to retire Class A. After all Class A securities have been retired, all principal payments and prepayments are applied to retire Class B and then Class C. All classes except Class Z receive periodic interest payments [via the trustee] from the collateral. Class Z is an accrual security that receives no periodic interest until the other three classes are retired.\textsuperscript{116}

And now to the miracle of “credit enhancement,” which some have suggested was the principal cause of the global sub-prime mortgage debacle,\textsuperscript{117} although not the only cause.\textsuperscript{118} Regardless of the cause, there is no dispute that we entered 2009 with a global financial system “frozen in a vast lake of toxic, mispriced securities.”\textsuperscript{119} Let’s assume that with respect to a particular equity or debt asset-backed security issue, the rating agencies have given the underlying secured promissory notes a D investment rating and the securities themselves an A rating.\textsuperscript{120} We would have here something akin to what was behind the global sub-prime mortgage mispricing fiasco:

Indeed, [gaming the investment rating process by securitization] . . . is the entire \textit{raison d’etre} of the $6 trillion structured-finance busi-

\textsuperscript{115}The general definition of a tranche is “a cutting, a cut; a piece cut off, a slice.” \textit{OXFORD ENGLISH DICTIONARY} 383 (2d ed. 1989).

\textsuperscript{116}FRANKEL, supra note 114, at 362. “Slicing loans horizontally into tranches create[s] classes that have conflicting interests in a dissolution strategy of the same underlying asset.” Ramsey Su, \textit{Why Be a Nation of Mortgage Slaves?}, WALL ST. J., Jan. 31, 2009, at A9. “The holder of a senior tranche would be agreeable to modification, since his position is secured; the holder of a junior tranche would essentially be wiped out.” \textit{Id}. “The lower tranches are worthless but are still legally an encumbrance, hindering any type of sale or work-out effort.” \textit{Id}.

\textsuperscript{117}See generally McGrath, supra note 103, at 533 (“Originator and investment banker arrange for ‘external’ credit enhancement (or ‘internal’ enhancement such as subordination of one class of certificates to the senior class) and rating for the certificates.”).

\textsuperscript{118}“The current situation was created by a perfect storm of mutually reinforcing trends and major policy mistakes: loose monetary policy (years of negative real interest rates in a growing economy); socially engineered housing policy; poorly implemented regulation; the rapid growth of leverage, opaque and technically deficient derivatives, and the shadow banking system; lax investor diligence and bank supervision; poor governance and misaligned incentives; and outright fraud.” Michael Boskin, \textit{Investors Want Clarity Before They Take Risks}, WALL ST. J., Jan. 13, 2009, at A15.


\textsuperscript{120}Such toxic financing ceased in the spring of 2007. See Su, supra note 116.
ness, which serves little economic function other than as a rating-agency arbitrage. Subprime mortgages (and all manner of other risky loans) held directly by financial institutions are questionable assets with high associated capital charges. Each one alone would deserve a “junk” rating. Structured finance simply piles such risky assets into bundles and slices the bundles into tranches. The rating agencies deemed some 85% of the tranches by value as AAA, and nearly 99% as investment grade—thus turning dross into gold by a sort of ratings alchemy. 121

The securities should have had an investment rating closer to that of the assets that has been entrusted. 122 Bottom line: many investors took on a whole lot more risk than they had bargained for. They assumed that AAA meant AAA:

Much of the subprime disaster could have been avoided if only the credit raters had never agreed to slap the AAA tag on collateralized debt obligations (CDOs). Almost no one understood these instruments, which contained portions from other pools of mortgage-backed securities, but with even less transparency. Most investors around the world had never heard of a CDO before the housing boom. But they knew what AAA meant. They had been told for years by the government’s chosen credit raters that this label meant sound, conservative investing. Highly unlikely to default. 123

It was when some European or Asian bank took the American equity or debt asset-backed security for its own account or as security for its own loan to one of its customers that the virus then entered the global financial system itself. 124 The banks, however, were not the only transmission mechanism. For example, American International Group, Inc., (AIG) a global insurance conglomerate with operations in more than 130 countries and jurisdictions, took to lending its reserve of high grade long-term corporate bonds and other such securities to banks and broker-dealers, so-called counter parties, in exchange for cash collateral which it

122 George Soros sees the mispricing phenomenon as an illustration of “reflexivity.” By that he means that “markets did not reflect an objective ‘truth’... Rather, the beliefs of market participants—that house prices would always rise, that an arcane financial instrument based on a sub-prime mortgage really could merit a triple-A rating—created a new reality... Ultimately, that ‘super-bubble’ was unsustainable, hence the credit crunch of 2007 and the recession and financial crisis of 2008 and beyond.” Chrystia Freeland, The Profit of Doom, FIN. TIMES, Jan. 31, 2009, at 1.
124 “Banks were the main transmission mechanism that spread the credit crisis across borders, between asset classes and among species of investor.” Paul J. Davies, May Bankers Live in Less Interesting Times Next Year, FIN. TIMES, Dec. 31, 2008 at 17.
would then invest in the type of asset backed securities that are the subject of this article:

At one point, AIG Investments was putting about $70 billion into subprime-mortgage bonds and other higher-risk assets, said people familiar with the matter. These choices helped AIG squeeze an additional 0.2 percentage in yield, or roughly $150 million in revenue. AIG’s spokeswoman said the firm “invested counterparty cash in highly liquid, floating rate, triple-A rated” residential mortgage-backed securities. The approach backfired, exacerbating the liquidity crunch that forced the U.S. government’s initial $85 billion bailout of AIG in September [of 2008].

Any American law student aspiring to practice law in such a transnational setting would need to have some sense of the common law trust’s protean nature. A trust is not just the component of some wealthy person’s estate plan.

Again, the purpose of this article is not to deconstruct the global sub-prime mortgage debacle. Certainly the actual tax-driven legal mechanics of using a common law trust to effect the securitization or collateralization of a pool of subprime mortgages is well beyond the scope of this article. The U.S. federal tax code has been particularly perverse in the way it has obfuscated and mischaracterized the core common law legal relationships that underpin a particular asset-backed security issue.

Rather, my purpose is to endeavor to make the case that an American lawyer needs a thorough grounding in all facets of the common law as enhanced by Equity and tweaked by statute if he or she aspires to practice law in a transnational setting. The bank in Berlin which has been left in the lurch because that American asset-backed security, which it took as collateral for a loan that it made to an Icelandic customer, turned out to be riskier than what it had bargained for. The bank in Berlin wants to know what happened and what it options are, if any, for

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125 Serena Ng & Liam Pleven, An AIG Unit’s Quest to Juice Profit: Securities-Lending Business Made Risky Bets, WALL ST. J., Feb. 5, 2009, at C1.
126 “. . . [T]he slogan of modern comparative law—‘compare function rather than form’—does not work for the trust. One cannot identify the function of the trust because there is no such function. The trust is functionally protean. Trusts are quasi-entails, quasi-usufructs, quasi-wills, quasi-corporations, quasi-securities over assets, schemes for collective investment, vehicles for the administration of bankruptcy, vehicles for bond issues, and so on and so forth. In software terminology, trusts are emulators.” Gretton, supra note 15, at 599; Rounds & Dehio, supra note 15; Rounds & Rounds, supra note 51, at § 8.12.1 (Civil Law Alternatives to the Trust).
127 McGrath, supra note 103, at 525-64.
128 The REMIC tax rules, for example, “are applied to a pool of mortgages and related securities based on their functional characteristics, without regard to legal form.” See Nirenberg, supra note 89, at 854.
being made whole. It could care less if U.S. counsel has a foreign law appreciation survey course under his or her belt. The point of departure when it comes to getting at the entrusted asset is the applicable common law of the state in the U.S. that has jurisdiction over the trust’s administration. That is the foundation upon which the state and federal statutory and regulatory edifices are constructed that relate to the issuance and transfer of securities, as well as the point of departure for assessing the applicability of any treaty provisions.

In 1940, one U.S. law school had three semester hours of Agency and six semester hours of “Equity and Trusts,” a single course, on the required side of its curriculum.\textsuperscript{129} Today, only a handful of U.S. law schools even have discrete required courses in Equity and the trust relationship, the trust being one of Equity’s creatures.\textsuperscript{130} Moreover, as I have already noted, the rule against perpetuities is a bird that is all but extinct in the world of the legal academic. This is unfortunate because learning how to apply the Rule in various situations was not an end in itself. Rather, the purpose of the exercise was both practical and profound: to assist the law student in coming to grips with the critical differences between the contingent and the vested property interest, an equitable interest in a basket of toxic assets being an example of the latter. The pedagogical rationale for requiring students to wrestle with the Rule was not to test their memorization skills. It was a vehicle for internalizing common law doctrine in an era when one was expected to have learned in law school more than just a few things about the common law. In any case, my U.S. counsel for the Berlin bank would be expected to have a thorough understanding of the common law context in which asset-backed securities are structured, however that understanding has been acquired. It is not enough just to know something about the context.

E. THE MADOFF PONZI SCHEME GLOBAL UNWIND:
HIGH-LIGHTING THE FIDUCIARY ASPECTS OF THE COMMON LAW AGENCY

An agency is the fiduciary relationship that arises when one person (a “principal”) manifests assent to another person (an “agent”) that the agent shall act on the principal’s behalf and subject to the prin-

\textsuperscript{129} See Suffolk University Law School 1940 Course Catalogue (on file with author).

\textsuperscript{130} GEE & JACKSON, supra note 23.
While the global subprime mortgage securitization debacle was in many respects about securitization, that is to say it was about the property aspects of the trust relationship, the Madoff global Ponzi scheme appears to be first and foremost about the fiduciary aspects of the common law agency relationship.\textsuperscript{132}

A Ponzi scheme is a “system which operates on the principle of using investments of later contributors to pay early contributors.”\textsuperscript{133} Mr. Madoff’s “system” was the rendering of investment management agency services to an ever-expanding class of investors. Mr. Madoff appears to have been in separate one-to-one investment management agency relationships with most of his many victims, either directly or as a sub-agent through intermediaries. As to each agency relationship, the victim was the principal and Mr. Madoff was the agent. Because a victim-principal would grant agent-Madoff discretion to manage a portion of the victim-principal’s property, agent-Madoff would owe an equitable fiduciary duty of undivided loyalty to the victim-principal, that is to say a duty to act solely in the victim-principal’s interest as to matters within the scope of the investment management agency relationship.\textsuperscript{134}

I assume for purposes of this article that there was no direct or indirect securitization activity going on at his end, that he was not the constructive sponsor of any so-called “feeder” funds. Time will tell, however. If an intermediary affiliated with a pooled investment vehicle that used Mr. Madoff’s investment advisory services is discovered to have been a dual common law agent, that is to say simultaneously an agent of Mr. Madoff and an agent of the fund investors, then Mr. Madoff also may have run afoul of federal and state securities, a topic that is, in any case, well beyond the scope of this article. In any case, Mr. Madoff’s investment management agency activities would only have been lightly regulated under the federal Investment Advisor’s Act of 1940.

\textsuperscript{131} \textsc{Restatement (Third) of Agency § 1.01 (2006)}.

\textsuperscript{132} “The losses linked to Bernard Madoff may be closer to $15bn-$25bn rather than the $50 bn the New York broker allegedly told US investigators, according to Harry Markopolos, a former money manager turned fraud investigator.” Joanna Chung & Brooke Masters, \textit{SEC Staff ‘Illiteracy’ to Blame for Madoff Affair, Says Investigator}, \textsc{Fin. Times}, Feb. 5, 2009, at 1.

\textsuperscript{133} \textsc{Oxford English Dictionary, supra} note 115, at 101.

\textsuperscript{134} Rounds, \textit{supra} note 4, at 786-87.
“Among the securities acts, the Advisers Act is considered to be the statute with the fewest teeth in it.”

The brokerage arm of his business would have been subject to greater regulatory scrutiny under other federal statutes. For the most part, however, victim-principals will be looking for state-law equitable remedies against Mr. Madoff, at least to the extent their access to such remedies have not been foreclosed by the federal Bankruptcy laws.

The primary fiduciary duty that agent-Madoff allegedly violated was the duty of undivided loyalty. He did so in two respects. First, he engaged in acts of self dealing. Second, he engaged in acts that favored some principals at the expense of other principals in violation of the duty of impartiality. Those principals who managed to “cash out” likely did so at the expense of those principals who were left holding the bag. Also implicated was the agent’s duty of full disclosure, the agent’s duty to protect property that is the subject of the agency, the agent’s duty not to commingle, the agent’s duty not to exploit confidential information for the agent’s own account, the agent’s duty to account, and the agent’s duty to em...

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137 See generally Rounds, supra note 4, at 774.
138 RESTATEMENT (THIRD) OF AGENCY § 8.01 (2006).
139 Id. § 8.05(1) (“[A]n agent has a duty not to use property of the principal for the agent’s own purpose . . . ”); Id. § 8.03 cmt. b (“Likewise, an agent who acts on behalf of more than one principal in a transaction between or among the principals has breached the agent’s duty of loyalty to each principal through undertaking service to multiple principals that divides the agent’s loyalty.”).
140 Id. § 8.11(1) (“[A]n agent has a duty to use reasonable effort to provide the principal with facts that the agent knows, has reason to know, or should know when . . . the agent knows or has reason to know that the principal would wish to have the facts or the facts are material to the agent’s duties to the principal . . . ”).
141 Id. § 8.08 (“[A]n agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents in similar circumstances.”).
142 Id. § 8.12(2) (“[A]n agent has a duty . . . not to mingle the principal’s property with anyone else’s . . . ”).
143 Id. § 8.05(2) (“[A]n agent has a duty not to use or communicate confidential information of the principal for the agent’s own purposes . . . ”).
144 Id. § 8.12(3) (“[A]n agent has a duty . . . to keep and render accounts to the principal of money or other property received or paid out on the principal’s account.”).
145 Id. § 8.09 (“[A]n agent has a duty to take action only within the scope of the agent’s actual authority. An agent has a duty to comply with all lawful instructions received from the principal and persons designated by the principal concerning the agent’s actions on behalf of the principal.”); Rounds, supra note 4, at 784-99.
ploy the skills that he or she claims to have. All these state law fiduciary duties Mr. Madoff appears to have violated in spades, it being unlikely that the victim-principals gave their informed consent to being participants in his alleged Ponzi scheme.

In the unlikely event that discovery reveals that there were some principals, some “early contributors,” who got out whole with specific property that was traceable to those principals who were left holding the bag, even the common law doctrine of bona fide purchase may have to be dusted off. Some who managed innocently to cash out still may have to disgorge to the bankruptcy trustee any fictitious or notional profits that were received incident to the alleged criminal enterprise. “Bankruptcy judges are versed in the peculiar justice of ‘fraudulent conveyance’ that allows them to claw back Ponzi profits from some clients for the benefit of others.” Moreover, anyone who received back his or her capital “investment” just before the scheme collapsed may be required by federal or state statute to turn over those funds to the bankruptcy trustee, unless the “cash out” was solicited in good faith.

On the other hand, any traceable yet-to-be-committed funds of a prospective investor in the hands of Mr. Madoff at the time his Ponzi scheme collapsed might well avoid the clutches of the bankruptcy trustee. The prospective investor would want to make the argument that Mr. Madoff was a common law trustee of the segregated un-commingled funds for the benefit of the prospective investor pending their commitment to the scheme. If that were the case, then the equitable property rights of the prospective investor would trump the legal rights of the bankruptcy trustee. “[T]he personal creditors of the trustee cannot reach the trust property, because the trustee, as trustee, has no beneficial interest in either the trust or the trust property.” There are some who came late to the party who are making just such an equitable argument:

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146 See RESTATEMENT (THIRD) OF AGENCY § 8.08 (2005) (“If an agent claims to possess special skills or knowledge, the agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents with such skills or knowledge.”).
147 Id. § 8.06 (outlining the criteria for a principal’s informed consent to what would otherwise be a breach of fiduciary on the part of the agent).
148 See ROUDS & ROUDS, supra note 51, at § 8.15.63 (discussing the doctrine of bona fide purchase).
151 In re Bayou Group, LLC, 396 B.R. at 815, 844.
152 3 SCOTT & ASCHER, supra note 53, at §14.11.
As one can see, this particular corner of the common law has seen considerable amount of statutory tweaking, both at the state and federal levels. The equitable doctrine of laches applicable to breaches of fiduciary duty, for example, has in many states been partially codified by statute. In the federal Bankruptcy context it has been shunted aside altogether. The much-maligned “first in, first out” approach of the common law rule in Clayton’s Case, which might have favored innocent later Madoff investors over innocent earlier ones, also has no place in the federal Bankruptcy Code, which instead takes a pro rata approach when full reimbursement of the general creditors is not an option.

An agent-fiduciary who perpetrates acts of common law fraud against the principal is first and foremost committing an equitable breach of fiduciary duty. Thus, because the fiduciary principle is implicated, the victim-principal is entitled not only to legal remedies, which would primarily be damages, but also to select from a smorgasbord of equitable remedies, such as the injunction and the decree for specific performance. Traceable assets that have not passed into the hands of good faith purchasers for value may be traced and made the subject of a constructive trust for the benefit of the victim-principal. Property in a se-
gregated account of which Mr. Madoff is a common law trustee would certainly be beyond the reach of the bankruptcy trustee.\(^{161}\) I could go on and on. Suffice it to say that some state court will have the equitable power and authority to endeavor to make the victim-principal whole, subject, however, to the constraints of what is practical and possible, and, of course, subject to the acquiescence of the federal bankruptcy judge.

This is all well and good but Mr. Madoff is likely insolvent, and soon may be behind bars. All may not be lost, however. There may be other equitable strategies available to victims that are incident to the following principles of black letter agency law:

- A victim-principal may be entitled to obtain equitable relief from a third party who knowingly participated with agent-Madoff in a breach of fiduciary duty to the principal.\(^{162}\) If the third party were the primary agent and Mr. Madoff the sub-agent, the fiduciary principle would be directly implicated.\(^{163}\)

- If a primary common law investment agent of the victim-principal in the innocent exercise of investment discretion retained Mr. Madoff to render investment management sub-agency services to the victim-principal, then the victim-principal may have equitable recourse against the primary agent, the intermediary as it were, under common law agency principles, provided the primary agent had failed to exercise due care in the selection of Mr. Madoff as a sub-investment manager,\(^{164}\) or breached some other fiduciary duty to the victim-principal, such as having accepted from there,’ he said.” Dionne Searcey & David McLaughlin, *Madoff Took in Cash Near Arrest, Suit Says*, WALL ST. J., Jan. 3, 2009, at B1.

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\(^{161}\) SCOTT & ASCHER, supra note 53.

\(^{162}\) See RESTATEMENT (SECOND) OF TORTS § 874 cmt. c (1979) (discussing third-party participation in a breach of fiduciary duty). The common law agency principles governing the attorney-client relationship generally govern as well the relationship of investment manager and investor. Rounds, supra note 4, at 788-89.

\(^{163}\) See RESTATEMENT (THIRD) OF AGENCY § 8.01 (2005) (outlining the fiduciary principle as it applies to agents).

\(^{164}\) Id. § 8.08 (“Subject to any agreement with the principal, an agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents in similar circumstances.”). “Special skills or knowledge possessed by an agent are circumstances to be taken into account in determining whether the agent acted with due care and diligence.” Id. “If an agent claims to possess special skills or knowledge, the agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents with such skills or knowledge.” Id.
Mr. Madoff secret placement fees without the victim-principal’s informed consent.\textsuperscript{165}

Of course, one can be an agent of another fiduciary, as well as agent for a non-fiduciary. Thus, it is possible that the trustees of an American mutual fund could have innocently retained Mr. Madoff as their agent for purposes of investing fund assets. Mr. Madoff’s fiduciary duties would then have run to both the trustees, and, under the Investment Company Act of 1940, to the fund investors.\textsuperscript{166} He also could have been an investment agent for a pride of hedge fund partners that was clueless about the Ponzi scheme, a partnership itself essentially being a contract of mutual agency.\textsuperscript{167} Such partnerships are being referred to in the press as “feeder funds.”

Mr. Thierry Magon de La Villehuchet, the French aristocrat who committed suicide in his New York apartment in December of 2009, had invested in the Madoff Ponzi scheme both for his own account and as a fiduciary. His tale illustrates how Mr. Madoff had managed to globalize his agency activities. Mr. de La Villehuchet had placed $50 million of own funds in the hands of Mr. Madoff. Now Mr. de La Villehuchet’s crown jewel, his riverside chateau in the Brittany village of Plouër-sur-Rance, which has been in the family since 1695, may have to be sold.\textsuperscript{168}

Mr. de La Villehuchet was also a principal in an investment management firm that serviced a civil law Luxembourgian SICAV or Société d’investissement à capitale fixe, a type of incorporated mutual fund that has some but not all the attributes of a common law trust.\textsuperscript{169} In

\textsuperscript{165} For example, the agent’s duty of full disclosure, \textit{RESTATEMENT (THIRD) OF AGENCY} § 8.02 (2005) (“An agent has a duty not to acquire a material benefit from a third party in connection with transactions conducted or other actions taken on behalf of the principal or otherwise through the agent’s use of the agent’s position.”) and id. § 8.11, reporter’s notes b (“Information about an agent that the agent may have a duty to provide to the principal may include the fact that the agent has breached duties owed to the principal.”); \textit{Cf.} Aaron Lucchetti, \textit{Finra Wants to Know About Client Referrals}, WALL ST. J., Jan. 27, 2009, at C2 (“Regulators are zeroing in on the fees paid to intermediaries such as brokers who steered clients to the investment-advisory unit, which was run by Mr. Madoff.”). “One question being explored is whether fund managers or others who steered clients were given incentives such as additional commissions or fees.” \textit{Id.} In a case when Mr. Madoff was acting as a sub-investment agent, his loyalty first and foremost would have been to the victim-principal, not the primary agent. See \textit{RESTATEMENT (THIRD) OF AGENCY} § 8.01 cmt. c (2005).

\textsuperscript{166} Rounds & Dehio, supra note 15, at 511-14.

\textsuperscript{167} 59A AM. JUR. 2D \textit{Partnership} § 3 (2003).


\textsuperscript{169} \textit{See} Rounds & Dehio, supra note 15, at 500-02 (discussing the legal structure of the Luxembourgian SICAV).
any case, in the course of providing investment management agency services to the SICAV, some SICAV funds were placed with Mr. Madoff as an investment sub-agent. The rest is history.

Many Europeans availed themselves of Mr. Madoff’s “services” through Luxembourgian conduits, such as Mr. de La Villehuchet’s SICAV feeder:

Although the sum lost in the affair—€1.7bn, according to the [Luxembourgian] financial regulator, though some say up to €7bn—represents only a fraction of one per cent of funds based in Luxembourg, the duchy as European leader in mutual funds, has most to lose.170

The National Bank of Kuwait has voluntarily paid about $50 million to some twenty individuals who had availed themselves of Mr. Madoff’s investment management agency services through its Swiss affiliate. These lucky individuals received not only the equivalent of the principal sums they had Mr. Madoff “invest” but also their fictitious profits.171 The Financial Times has identified a dozen or so Madoff feeders based in Caribbean tax havens that were advised from London, Switzerland, and Austria.172 It is likely that hiding low in the European weeds are even funds that were in the business of feeding Madoff feeders.173

Again, the point of this exercise is not to legally deconstruct the Madoff global Ponzi scheme. It will take many years before all the applicable facts and law are sorted out, and certainly many volumes to chronicle that exercise. Rather, it is to make the case that any American law student who aspires to practice law in a transnational setting needs total cultural immersion in core U.S. common law doctrine, in all aspects of it, including the nature of the equitable property interest, the agency and trust relationships, the fiduciary principle generally, and how law and Equity interact. There is nothing wrong with taking the foreign law appreciation survey course, provided it does not intrude upon the immersion process. A course in contracts does not a domestic lawyer make, let alone a transnational one.174 The legal tort of fraud is also only a very

173 Id.
174 See Rounds, supra note 12, at 1202-03.
small corner of the common law. Likewise the federal regulations governing Mr. Madoff’s brokerage operation and the SIPIC insurance rules are only small corners of a large and complex structure of codification that sits atop and is dwarfed by a common law foundation that is infinitely vast and deep. That being the case, should the regulation of the global financial services industry be rules-based? Or should it be principles-based, with the fiduciary principle pulling the laboring oar. I know where Britain’s Prince Andrew stands:

“Madoff couldn’t happen in London. It could never get to that scale,” the Duke of York told the Financial Times at the World Economic Forum in Davos. The fact the UK had avoided the more rules-based US system meant that while fraud could still happen, “we would have bowled something like that a lot earlier.”

As to the Luxembourgian SICAV, it needs a U.S. lawyer who, at the very minimum, has a thorough cultural grounding in local agency law, the mysteries of Equity and its remedies, and how all this interfaces with the U.S. federal bankruptcy laws, the U.S. federal Investment Advisors Act of 1940, and the federal securities laws generally. Luxembourgian counsel is there to fill in the gaps in U.S. counsel’s understanding of the Luxembourgian SICAV and the culture in which it nests. The auditor of a Luxembourgian SICAV feeder, for example, was likely to have had duties that were more fiduciary-like than those that the auditor of a U.S. feeder would have had.

CONCLUSION

For an American lawyer to practice effectively in a transnational context, he or she needs to have internalized common law doctrine. In

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175 Id. at 1205.
177 See, e.g., David McLaughlin, Trustee Seeks Europe Counsel, WALL ST. J., Feb. 4, 2009, at C4 (“[T]he trustee in charge of liquidating Bernard Madoff’s investment firm wants to hire a law firm to represent him in Europe as he works to recover property for victims of the alleged Ponzi scheme. Court-appointed trustee Irving Picard wants to hire Lovells LLP, a large international law firm, to represent him in liquidation proceedings in London, where Mr. Madoff had operations.”).
178 See generally Brooke Masters, Stanley Pignal & Joanna Chung, Plaintiffs Take Aim at Madoff’s Auditors, FIN. TIMES, Feb. 6, 2009, at 18 (“‘Under [Luxembourg’s] regulations, an auditor’s role goes further than the classical task of compiling accounts,’ said Edouard Fremalt, of Deminor, a shareholder group, which is planning a broad-ranging lawsuit against E&Y for its audit of funds based in the grand ducy.”).
the last analysis, American counsel brings to the table in Berlin, London, Moscow, or anywhere else for that matter, first and foremost his or her cultural mastery of the common law as it has been enhanced by Equity. Even the American academic who holds himself or herself out as a serious legal comparatist needs a working knowledge of common law doctrine. Knowing about the common law is not sufficient.

Today, about the only common law doctrinal courses that can still be found on the required side of the typical American law school curriculum are Contracts, Torts, and a policy-focused course about some aspects of Property. More and more it is all about a few facets of the common law. The neglected facets, namely the equitable property interest, the agency and trust relationships, as well as the fiduciary principle generally, and of course Equity, have all been relegated to the elective side, or tossed out of the ivory tower altogether. This process of marginalizing the core fiduciary relationships in the American law school is now all but complete, notwithstanding the fact that “our society is evolving into one based predominantly on fiduciary relations.”

While the prospect of “globalizing” the American law school curriculum may be “exciting” to us law professors, we would not be doing the students any favors if the end result is to perversely render American legal education even more provincial, parochial, and irrelevant than it has already become. After all, the common law is not only the foundation upon which all our statutory and regulatory edifices are constructed but the very point of departure for the American lawyer practicing in a transnational setting.

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179 Frankel, supra note 3, at 798.