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SHAM AND SIMULATED TRANSACTIONS:
THEIR STRUCTURAL AND FUNCTIONAL DISTINCTIVENESS

by

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To mi wife, whose support was always by my side

To Arturo, Amanda, Juan Diego and Raimundo,

whose joy and endless energy accompanied every effort in this thesis

Declaration

I confirm: (a) That this thesis has been composed solely by myself; (b) that the work contained in this thesis is my own; and (c) that it has not been submitted for any other degree or professional qualification.

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ABSTRACT

The common law doctrine of sham transactions and civil law doctrine of simulation are both difficult to understand and justify. There is no clarity as to their precise content, what they do, and thus what their added value is, but also what their underpinning rationale is. Looking at developments in English, French, Italian, and Chilean law in the context of property transfers, this dissertation argues that these doctrines serve important functions, but that to understand this, it is important to acknowledge that a legal transaction can be found to be a sham or a simulation both in a narrow and a broad sense.

A transaction found to be a sham or a simulation in a narrow sense features two distinctive structural elements. First, the parties recite in the documentary form certain rights and obligations that are different from the rights and obligations they intend to govern their legal relationship. Second, the parties share a common understanding of the divergence they create between the documentary form and the rights and obligations governing their legal relationship. While sham and simulated transactions in this narrow sense can be fraudulent, for instance where they avoid certain mandatory rules or defraud third parties, they do not have to be. In other words, fraud is not an essential requirement. For the same reason, and contrary to conventional understandings, the most distinctive function of the doctrines of sham and simulation transactions in this narrow sense is not to prevent fraud.

This dissertation aims to show that while the narrow understanding of the two doctrines protects the interests of third parties, it also enables the interests and purposes of the parties to the transaction to be implemented more effectively. In other words, so long as there is no prejudice caused to third parties, these doctrines permit the parties to split the operation of their legal transaction into their external legal effects vis-à-vis third parties and their internal binding legal effects between the parties. This function, I argue, is both useful and justified for it allows the parties to devise efficient and equitable legal structures which give better and more precise effect to the aims of their transaction when the law fails to provide them. This can occur both by filling gaps in

the law and by facilitating subtle legal changes outside the conventional framework of the legal system.

This dissertation also shows that, alongside the narrow sense of sham and simulation, courts sometimes find that a transaction can be a sham or a simulation in a broad sense. Two cases exemplifying this broad sense are analysed in detail. First, when courts determine that transactions avoiding and circumventing mandatory law are shams and simulations, and, secondly, when they determine that self-declared trusts are in fact shams. In this broad sense, sham and simulated transactions do not feature common distinctive features. Compared with the narrow sense of the terms, sham and simulated transactions in this broad sense lack precise content. Rather, they are transactions where form and substance diverge in a vague sense, and where the term 'substance' has an open texture.

Yet, finding that a transaction is a sham or a simulation in a broad sense still has its uses. By determining that a transaction is a sham or a simulation in a broad sense, courts disregard the documentary form of legal transactions to ensure that the policy of other legal rules is effectively upheld and to better protect the interests of third parties. That said, it also comes at the cost of consistency and internal coherence, and therefore, wherever possible, more specific doctrines, such as transactions in *fraudem legis* and purposive statutory interpretation, should be preferred over this broad interpretation of sham and simulation.

LAY SUMMARY

This dissertation examines and compare the common law doctrine of sham and the civil law doctrine of simulation. These doctrines address situations where the parties to a transaction use a legal document or other external evidence to conceal the legal understanding that they actually have. Although these doctrines are widely used in law, there is often confusion about what they actually mean, how they work, and why they matter.

By looking at English, French, Italian and Chilean law, this research shows that sham and simulation are distinct legal doctrines and serve important purposes but also that they are better understood acknowledging that they have both a narrow and broad interpretation in law. In a narrow sense, a sham or simulation occurs when the parties to a transaction knowingly record rights and obligations on paper that do not match their 'real' agreement. Often the parties conclude sham and simulated transactions to avoid legal obligations, but it does not need to be the case. Sham and simulated transactions do not need to involve fraud. In fact, I argue that the primary purpose of these doctrines in this narrow sense is not to prevent fraud but to enable the parties to the transaction to split the effects of their agreement: one set of effects *vis-à-vis* third parties and another just between themselves. This can help them create flexible but more effective agreements that meet their needs where the law may fall short.

However, courts sometimes interpret sham and simulation in a broader sense. In these cases, sham and simulated transactions lack precise content. They are transactions where form and substance diverge in a vague sense. Yet, finding that a transaction is a sham or a simulation in a broad sense still has its uses. It allows courts to look beyond the paperwork to make sure legal rules are respected and third parties are protected. However, this broad approach can reduce legal consistency, so the dissertation argues that, whenever possible, more precise legal doctrines should be resorted to instead.

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ABREVIATIONS

Bennion, Bailey and Norbury, *Statutory Interpretation*	Diggory Bailey and Luke Norbury, *On Statutory Interpretation* (8th edn, Lexis Nexis UK 2022)
Bl Comm	Blackstone, *Commentaries on the Law of England*
Bosquet, *Dictionnaire raisonné*	Bosquet, *Dictionnaire raisonné des domaines et droit domaniaux, Tome 1* (Paris 1775)
Bull. civ.	Bulletins des arrêts des chambres civiles de la Cour de Cassation (France)
C.	Codex Justinianus
D.	*Digesta*
Cass.	Corte Suprema di Cassazione (Italy)
Cass. Sez. Un.	Sezioni Unite della Corte Suprema di Cassazione (Italy)
civ. 1re	Première chambre civile de la Cour de cassation (France)
com	Chambre commerciale de la Cour de cassation (France)
Craies, *Legislation*	Daniel Greenberg, *Craies on Legislation* (12th edn, Sweet & Maxwell 2022).
Codice Civile Ciafardini and di Pirro	Luciano Ciafardini and Massimiliano di Pirro (eds), *Codice Civil Annotato con la Giurisprudenza* (22nd edn, Edizioni Giuridiche Simone 2020)
Codice Civile Pescatore and Ruperto	Gabriele Pescatore and Cesare Ruperto (eds), *Codice civile : annotato con la giurisprudenza della Corte costituzionale, della Corte di cassazione e delle giurisdizioni amministrative superiori* (11th edn., Giuffrè 2000)

Denisart, *Collection de décisions. Tome 3*	J. B. Denisart, *Collection de décisions nouvelles et de notions relatives a la jurisprudence actuelle. Tome 3* (Paris, 1766)
Denisart, *Collection de décisions. Tome 5*	M Denisart, *Collection de décisions nouvelles et de notions relatives a la jurisprudence. Tome* 5 (Paris 1786)
Fenet, *Recueil complet des travaux préparatoires Tome 13*	PA Fenet, *Recueil complet des travaux préparatoires du Code Civil. Tome 13* (Videcoq 1856)
Ferrière, *Dictionnaire de droit. T1*	M Claude-Joseph de Ferrière, *Dictionnaire de droit et de pratique. T1* (9 edn, Paris 1771)
Gaz. Pal.	Gazette du Palais
Giur agr it	Giurisprudenza italiana
Giur it	Giurisprudenza agraria italiana
Guyot, *Répertoire universel et raisonné. Tome 15*	M Guyot, *Répertoire universel et raisonné de jurisprudence civile, criminelle, canonique et bénéficiale.* Tome 15 (Paris, 1776)
Guyot, *Répertoire universel et raisonné. Tome 26*	M Guyot, *Répertoire universel et raisonné de jurisprudence civile, criminelle, canonique et bénéficiale.* Tome 26 (Paris, 1779)
Guyot, *Répertoire universel et raisonné. Tome 58*	M. Guyot, *Répertoire universel et raisonné de jurisprudence civile, criminelle, canonique et bénéficiale. Tome 58* (Paris, 1783)
Foro it	Il Foro Italiano
La Giurisprudenza sul Codice Civile	Cesare Ruperto, *La giurisprudenza sul Codice Civil coordinata con la dottrina. Libro IV. Delle Obbligazioni (artt. 1362-1424)* (Giuffrè 2011).
Lange, *La nouvelle pratique. Tome 1*	Mr Lange, *La nouvelle pratique civile, criminelle et beneficiale, ou Le nouveau praticien François. Tome 1* (11th edn, Paris 1712) 278

Lewin, *Trusts*	L Tucker, N Le Poidevin et al (eds), *Lewin on Trusts* (20th edn, Sweet & Maxwell 2020).
Merlin, *Repertoire universel et arasonné*	M. Le Compte Merlin, *Répertoire universel et raisonné de jurisprudence. Tome* 12 (4th edn, Paris 1815).
RDJ	Revista de Derecho y Jurisprudencia
RTD civ.	Revue trimestrielle de droit civil
Snell, *Equity*	J McGhee, S Elliott et al (eds), *Snell's Equity* (34th edn, Sweet & Maxwell 2019).
Treitel, *Contract*	Edwin Peel, *The Law of Contract* (15th edn, Sweet & Maxwell 2020)
Underhill and Hayton, *Trusts and Trustees*	David Hayton, Paul Matthew and Charles Mitchell, *Underhill and Hayton Law of Trusts and Trustees* (20th edn, Lexis Nexis 2022)

INTRODUCTION

The common law doctrine of sham transactions and the civil law doctrine of simulation are both difficult to understand and justify. As for the doctrine of sham transactions, English courts have found transactions of different types to be shams since at least the mid-19th century.[1] While in *Snook v London and West Riding Investment LTD*,[2] Lord Diplock gave the most famous definition of the legal concept involved in the use of the word sham, it is still unclear what exactly this doctrine entails. It is also uncertain whether identifying a transaction as a sham supposes a distinct legal doctrine or whether the term merely introduces ambiguity, offering little more than what other, more clearly defined legal doctrines provide.[3]

The difficulties are similar when it comes to the civilian doctrine of simulation. The doctrine of simulation has a long history that can be traced back to the medieval glossators and, through them, to Roman Law.[4] However, its precise meaning, scope, and functions remain uncertain. It is equally unclear what its underpinning rationale is. In this regard, the observation made by the Italian jurist Giuseppe Messina[5] at the outset of the 20th century, reaffirmed by Alberto Auricchio 50 years later,[6] still holds true: ‘there is nothing certain about the doctrine of simulation apart from the fact that simulated transactions do not create obligations between the parties’.

This dissertation addresses these difficulties by undertaking a comparative study of the doctrines of sham transactions and simulation. It does so by asking to what extent they are structurally and functionally distinctive, and what underlying rationale, if any, justifies their existence as legal doctrines. Looking at developments in English, French, Italian, and Chilean law in the context of property transfers, it

[1] Mike McNair, ‘Sham: Early Uses and Related and Unrelated Doctrines’ in Edwin Simpson and Miranda Stewart (eds), *Sham Transactions* (OUP 2013) 29.
[2] [1967] 2 QB 786, 802 C-E.
[3] See, for instance, Jessica Palmer, ‘Dealing with the Emerging Popularity of Sham Trusts’ (2007) NZL Review 81, 92; Simon Douglas and Ben McFarlane ‘Sham Trusts’ in Heather Conway and Robin Hickey (eds), *Modern Studies in Property Law*, *Volume 9* (Hart 2017) 237.
[4] MD Blecher, ‘Simulated Transactions in the Later Civil Law’ (1974) 91 S African LJ 358; Reinhard Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (OUP 1996) 646-650.
[5] Giuseppe Messina, ‘La simulazione assoluta’ [1907] Riv. Dir. Comm. e obbligazioni 460. Republished in Giuseppe Messina, *Scritti Giuridici V* (Giuffrè 1948) 69. I consulted the republished version.
[6] Alberto Auricchio, *La simulazione nel negozio giuridico* (Jovene 1957) 1.

argues that these doctrines have distinctive structural elements, that serve important functions, and that there is an underlying rationale for justifying what these doctrines do.

This inquiry engages in a comparison on more than one level. It compares the common law doctrine of sham transactions with the civilian doctrine of simulation, but also the doctrine of simulation across various civilian jurisdictions. These comparisons show a rich set of similarities and differences that allows us to build a framework to better understand the content and functions of these doctrines. This framework also permits us to distinguish the doctrines of sham transactions and simulation from other doctrines with which they share structural and functional similarities. In this regard, this dissertation also compares the doctrines of sham transactions and simulation with other related doctrines, such as transactions *in fraudem legis* and fiduciary and indirect transactions in civilian jurisdictions, as well as doctrines enabling a purposive statutory interpretation and rules for contractual interpretation, in common law jurisdictions.

Two fundamental ideas are elaborated upon and integrated throughout this argument. First, the words 'sham' and 'simulation' have both narrow and broad meanings in law, and therefore the doctrines of sham and simulated transactions have both narrow and broad senses. Second, the most distinctive function of the doctrines of sham and simulated transactions in the narrow sense is not to prevent and tackle fraud, and thus to protect third parties. Rather its most distinctive function is to enable the interests and purposes of the parties to the transaction to be implemented more effectively, by splitting the operation of a legal transaction into its external legal effects *vis-à-vis* third parties and its internal binding legal effects between the parties to the transaction itself. Both of these ideas introduce a novel understanding of these doctrines. Courts and legal scholars often explain the doctrines of sham transactions and simulation as if they held a single meaning in law, and they commonly assume that their function is to prevent fraud. This dissertation demonstrates that this perspective is mistaken. It thus offers a new reading which provides a stronger foundation for understanding the doctrines of sham transactions and simulation.

To introduce this dissertation, it is helpful to begin by providing some context to the doctrines of sham and simulated transactions, as well as the difficulties in giving a coherent account of what they are and do. Following this, an overview of the dissertation's main arguments will be presented. Additionally, addressing some key methodological choices will further clarify the approach taken in this research.

I.
Sham and simulated transactions: Basics and difficulties

1. The basics of the doctrines of sham transactions and simulation

In loose terms, the doctrines of sham transactions, in the common law tradition, and simulation, in the civilian tradition, are legal doctrines that determine the legal effects of transactions that have a *documentary form* that deliberately differs from their *internal substance*.[7] In a sham and simulated transaction, the parties deliberately decide to use an outward transactional form that conceals a different inward understanding. They may decide, for instance, to use the form of a sale covering a secured loan;[8] or the form of a trust concealing that, despite the external declaration of trust, there is no actual disposition of beneficial rights in property.[9]

Given that in sham and simulated transactions outward form and inward substance diverge, it is necessary to determine, as a matter of law, which of the two prevails. This question does not have an obvious answer. The two examples provided in the paragraph above may illustrate this point. It is not evident whether for all purposes the deed of sale concealing a secured loan is to be characterised as a

[7] This language seems to have appeared first in Roman sources, in particular in the C. 4.22.2, which was the rescript that was the basis for Glossators and Commentators to develop an incipient doctrine of simulation. See Blecher (n 4) 358, 358-372. For modern examples of this language in the doctrine of simulation, see Francesco Ferrara, *Della simulazione dei negozi giuridici* (Athenaeum 1922) 28, who suggested that in simulated transactions 'there is a remarkable contrast between the extrinsic form and the inner substance'. For examples of formulations of the doctrine of sham transactions using this language, see *Miles v Bull* [1969] 1 QB 258, 264 D-E per Megarry J; and *Isle Investment LTD v. Leeds City Council* [2021] EWHC 345 (Admin) [8] per Fordham J.
[8] *Re Watson* (1890) 25 QBD 27, 31; *Madell v Thomas & Co* [1891] 1 QB 230. See also *Taylor v Savik & Anor* [2024] EWCC 7 [95] for a different but still analogous language.
[9] *Midland Bank plc v Wyatt* [1997] 1 BCLC 242.

secured loan (substance prevailing) or a sale (form prevailing). Similarly, it is not evident whether for all purposes the sham declaration of trust is to be considered a void declaration with no effect (substance prevailing) or a trust having some effect in changing the beneficial entitlement to property (form prevailing). The doctrines of sham and simulated transactions attempt to provide an answer to this question.

However, the answer that emerges is not unequivocal. It is complex and subject to a number of distinctions. It also changes depending on the context and jurisdictions under analysis. This complexity makes it impossible to formulate an invariable rule or set of rules describing the content of these doctrines. The most that can be done is to outline the fundamental principles that together determine the answer(s) as to the extent to which either substance or form prevail. With that limitation in mind, an attempt to articulate what the doctrines of sham and simulated transactions consist of could be summarised in the following proposition:

> If in concluding a transaction the parties use an outward documentary form that deliberately diverges from the inward substance of their understanding, form and substance would determine the legal consequences of the transaction according to the following principles: (1) substance usually prevails over form as to the legal effects of the transaction between the parties; (2) either form or substance prevails as to third parties depending on which outcome safeguards third parties' rights in that particular context; (3) substance usually prevails over form as to the mandatory legislation that governs the transaction.

Exemplifying this:

- As to principle 1, if A and B simulate that A sells property *p* to B in consideration of price *p'* concealing from third parties that A transfers property *p* gratuitously, then A cannot enforce against B the simulated obligation of paying price *p'*. As to the parties to the transaction, there is a gratuitous transfer and not an onerous transfer resulting from a sale.

- As to principle 2, if S makes a sham declaration of trust where T holds property *p* in trust, and where T shares S's shamming intention, then S's creditors can make the allegation that the declaration of trust is a sham and therefore seize property *p* and be paid out of its proceeds. That said, the sham allegation may not be effective against *bona fide* third parties that have relied on the sham declaration of trust. This is the case of the third party who did not know that the trust was a sham and acquired property *p* from T. In this second case, form prevails over substance so as to protect the rights of *bona fide* third parties.

- As to principle 3, if a sale is a sham or a simulation covering a secured loan in fraud of usury laws, then the transaction would be considered to be a secured loan and not a sale for the purpose of those laws.

These paragraphs summarise the basics of the doctrines of sham transactions and simulation. However, when these doctrines are subjected to closer analysis, a number of difficulties arise.

2. Difficulties in explaining the content, function and justification of these doctrines

The first difficulty is that there is no clarity as to what exactly makes a transaction a sham or a simulation. Additionally, it is unclear what these doctrines actually do and to what extent they differ from other legal doctrines with which they share some structural and functional similarities. Finally, the underpinning rationale explaining these legal doctrines remains uncertain.

2.1. Difficulties in explaining what sham and simulated transactions are

Explaining what the doctrine of sham transactions and simulation consist of is difficult since formulating what makes a transaction a sham and simulated is in itself elusive. That in sham and simulated transactions the external form and internal substance deliberately diverge is useful as a first approximation to the matter. However, the meaning of 'substance', 'form', and 'deliberate divergence' between these two is

neither evident nor invariable across the different contexts and legal traditions in which these doctrines are used.

As to the meaning of 'substance', 'form', and the 'divergence' between the two, there are some interpretations of these doctrines that consider 'substance' to be restricted to the rights and obligations of the parties resulting from a legal transaction.[10] From this it would follow that form and substance diverge when the rights and obligations the parties recite in the documentary form are different from the ones they intend to govern their legal relationship. However, in some contexts, substance also includes the economic result the parties achieve or even their ultimate purposes.[11] Moreover, within some transactions, and in particular trusts, the documentary form is opaque as to the rights and obligations it creates, and the rights and obligations resulting from the trust are composed of different layers, where one complements the other, and where some layers are more transparent than others. As a consequence, trusts often consist in complex structures in which there seems to be no place for a clear distinction between form and substance.

In turn, as to the meaning of 'deliberate divergence', in most contexts for there to be a sham and a simulation, it is necessary to have a common understanding between two or more persons that form and substance should diverge.[12] However,

[10] For English law, *Snook* (n 2); *Hitch v Stone (Inspector of Taxes)* [2001] EWCA Civ 63 [63]. In civilian jurisdictions this statement results from the distinction legal scholar draw between the doctrine of simulation, on the one hand, and the doctrine of *fraus legis* and indirect transactions, on the other. For Italy, see Ferrara (n 7) 45 and 56; and Massimo Bianca, *Diritto Civile. III. Il Contratto* (3rd edn, Giuffrè 2019) 670; For France, see José Vidal, *Essai d'une théorie générale de la fraude en droit français, le principe 'fraus omnia corrumpit'* (Dalloz 1957) 183; Florence Deboissy, *La Simulation en Droit Fiscal* (1997 LGDJ) 65. For Chile, Raúl Díez Duarte, *La Simulación de Contrato en el Código Civil Chileno. Teoría jurídica y práctica forense* (3th edn, Editorial Metropolitana 2014) 301-306; Hugo Rosende Álvarez, 'La simulación y los actos fiduciarios', in Pablo Rodríguez Grez (ed), *Teorías del derecho civil moderno* (Ed. Universidad del Desarrollo 2005) 9.

[11] For English law, *Re Watson* (n 8); *Madell* (n 8); *Bankway Property Ltd v Pensfold-Dusford* [2001] 1 WLR 1369. For Italian law, Massimo Bianca, *Il divieto del patto commissorio* (Giuffre 1957) 273-285 when referring to the role of the doctrine of simulation in the interpretation of the prohibition of the 'patto commissorio'. For French law, Francois Terré and Yves Lequette, Droit civil, *Les successions, les libéralités* (3 edn, Dalloz, 1997) 386-392; F Deboissy (n 10) 44; Philippe Malaurie and Claude Brenner, *Les Successions, les libéralités* (LGDJ 6 edn, 2014) 231-232, all of them referring cases where French courts widen the content of the notion of simulation in the context of disguised donations.

[12] For English law, *Yorkshire Railway Wagon v Maclure* (1882) 21 ChD 309 (CA), 314; *Stoneleigh Finance Ltd v Phillips* [1965] 2 QB 537, 572-573; Snook (n 10). For Italian law, Ferrara (n 7) 29; Bianca (n 10) 655-657; For French law, Jean Denis Bredin 'Remarques sur la conception jurisprudentielle de l'acte simulé' (1956) 54 RTD civ 261, 265-266. For Chilean law, Avelino León Hurtado*, La Voluntad y*

authorities sometimes suggest this agreement is unnecessary or at least that it takes different forms. This is the case of the doctrine of sham transactions and simulation used for anti-avoidance purposes;[13] and the doctrine of sham transactions in self-declared trusts,[14] both discussed in more detail later.

This makes finding a more precise and clearer formulation of what makes a transaction a sham or simulated far from easy. In legal scholarship, but particularly in court decisions, different formulations of these doctrines coexist, some of them broader than others. The resulting picture is that most attempts to explain these doctrines are either not comprehensive enough to capture all cases of sham and simulation or are too vague to have any specific and defined meaning.

2.2. The doctrines of sham transactions and simulation overlap with other legal doctrines.

The second difficulty is that these two doctrines conflate both in structural and functional terms with other doctrines, so that what makes them distinctive and useful is left obscure. For instance, among other doctrines, and to different degrees depending on the jurisdiction, they easily overlap with the rules of contractual interpretation;[15] the doctrine of *fraus legis* and rules for purposive statutory interpretation;[16] and, at least in France, the mandate without representation, usually named 'doctrine of indirect representation'.[17]

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la Capacidad de los Actos Jurídicos (Ed. Jurídica de Chile 1963) 175; Duarte (n 10) 75; Enrique Paillás Peña, *La Simulación en Derecho Privado. Doctrina y Jurisprudencia* (Ed. Jurídica de Chile 2003) 11.

[13] *Bankway Property* (n 11).

[14] *Painter v Hutchinson* [2007] EWHC 758 (Ch) [114]-[116]; *Re Mohammed Munir (a bankrupt) Murphy and another v Munir and others* [2021] EWHC 278 (Ch) [47]; *Re Raymond James Gallagher* [2021] EWHC 2479.

[15] For English law, Edwin Simpson and Ben McFarlane, 'Tackling avoidance' in Joshua Getzler (ed), *Rationalising Property, Equity and Trusts: Essays in Honour of Edward Burn* (LexisNexis 2003) 135, 139-40. Susan Bright had made a similar argument but submitting that the doctrine of sham transactions makes the doctrine of rectification operative. See Susan Bright, 'Beyond Sham and into Pretence' (1991) 11 OJLS 136, 140. For Italian law, Mario Casella, 'Simulazione' in Francesco Santoro-Passarelli (ed), *Enciclopedia del Diritto XLII. Sepolcro-Sorvolo* (Giuffrè Editore 1990) 602.

[16] See references in note 11 above.

[17] Jacques Ghestin, Christophe Jamin and Marc Billiau,, *Traité de Droit Civil. Les effets du contrat* (3nd edn, LGDJ 2001) 931-933, para [871]-[872]; Agnès Dubois – de Luzy, *L'interposition de personne* (LGDJ 2010) 42-43 paras [64]-[66].

Explaining this difficulty in any detail here would lead the reader into specialised points that are postponed to later chapters. It suffices to advance here the following main points:

1) The doctrines of sham transactions and simulation are often considered to be concerned with ascertaining the true intention of the parties in executing a transactional document. This is exactly what courts do when they apply ordinary rules of construction and interpretation to transactional documents. Sham transactions and simulation, then, seem not to be doctrines distinct from the ordinary rules for construction and interpretation of transactional documents.

2) Courts and legal scholars sometimes see sham and simulated transactions as transactions where the parties use a documentary form to achieve the economic result of a different type of transaction. This would be the case, for instance, of a simulated and sham sale structured to serve as a loan secured over moveables. However, in the legal systems of the civilian tradition sales concluded for security purposes have been often analysed as fiduciary and indirect transactions; not necessarily as simulated transactions.[18] Similarly, in English law mortgages, depending on the estate held by the debtor, were created by transfer or assignment to the mortgagee.[19] If there are other doctrines that characterise and determine the effects of transactions that are found to be shams and simulations, the doctrines of sham and simulation themselves would be useless.

3) The doctrines of sham transactions and simulation also tackle transactions where the parties use a transactional form for the sole purpose of achieving an economic result that thwarts the purpose of mandatory legislation. That said, the doctrine of *fraudem legis*, in civil law tradition, and the rules of purposive statutory construction, such as the *Ramsay*[20] rule, in English law, take into account the purpose of statutory provisions to determine when a legal transaction falls within

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[18] See, for instance, Alessio Reali, 'La fiducia a scopo di garanzia, la vendita con patto di riscatto e il divieto del patto commissorio' in A. Gambaro and U. Morello (eds.) *Trattato dei diritti reali. V. Diritti reali di garanzia* (Giuffrè 2014).
[19] Lionel Smith, 'Security' in Andrew Burrows (ed), *Principles of English Commercial Law* (OUP 2015) 282 [8.06].
[20] *WT Ramsay Ltd v IRC* [1982] AC 300.

their scope. These doctrines, then, seem to add nothing different to the doctrines of *fraudem legis* and the rules of purposive statutory construction.

2.3. Difficulties in justifying how the law regulates sham and simulated transactions

A third difficulty is that the justification for the rules determining the legal consequences of sham and simulated transactions is not evident. To appreciate this difficulty, it is important to anticipate that in the civilian tradition, including in the jurisdictions considered in this dissertation, simulated transactions can be both lawful and unlawful. Moreover, the parties to the simulation can bring an action of simulation -that is, bring to court an action to enforce their secret and concealed understanding- against each other for their own benefit.[21] In England, in turn, the deliberate intention of concluding a sham document to conceal the true understanding from third parties is not itself penalised. On the contrary, the concealed understanding may be effective, and in some instances,[22] courts have granted relief to one of the parties to the sham who has alleged that the documentary form they had previously executed was a sham and, consequently, ineffective.

The justification for these rules, if any exists, is not immediately apparent. If simulated and sham transactions often facilitate various types of fraud, and involve a degree of concealment, it is not obvious why the law permits the parties to engage in sham and simulated transactions and benefit from the deceptive appearances they create. It is unclear why the law allows parties to a sham or simulated transaction to be so 'untruthful', and why it does not adopt a more repressive stance toward such transactions. Why does the law not render all forms of sham and simulation entirely void and prevent the parties from enforcing their secret agreements against each other?

2.4. These difficulties and the increasing recognition of the doctrines of sham transactions and simulation

[21] For Italy, see Raffaele Lenzi, *Simulazione. Art. 1414-1417* (Giuffrè 2017) 167-168. For France, see Claude Ophèle, 'Simulation' in Éric Savaux (ed), *Répertoire de Droit Civil, Tome X* (Dalloz 2012) 13; For Chile, see Díez Duarte (n 10) 182-184 and 191-192; León Hurtado (n 12) 186.
[22] *Bhopal v Walia* (2000) 32 HLR 302; Painter (n 14).

These difficulties present an unpromising picture for these two doctrines. Since formulating when the doctrines of sham transactions and simulation apply is elusive, they overlap with other doctrines, and there is no compelling justification for how the law regulates them, there are reasons to argue that the doctrines are useless and even pernicious. Courts and legislatures, according to this view, should refrain from using the confusing language of sham and simulation, and instead apply well-known legal doctrines that seem to have a clearer meaning.

However tempting this objection might be, the legislative and judicial developments of the last decades have gone in the opposite direction. Litigants have increasingly relied on the doctrine of sham transactions when bringing their cases to court,[23] and the doctrine of simulation currently has a considerably greater recognition in Civil Codes than it has had in the past.[24] To argue that these doctrines are useless, then, one would have to reread a large amount of authoritative law and explain why litigants, courts and legislatures resort to them despite their lack of obvious utility.

II.
The argument that this dissertation makes

Looking at developments in English, French, Italian, and Chilean law, the argument advanced throughout this dissertation is that sham and simulated transactions have defined structural elements, and that the doctrines of sham transactions and of simulation perform distinctive and important legal functions that have an underlying

[23] For court decisions using the doctrine of sham transactions in different context, see Derwen Coshott, 'The sham doctrine and intention: addressing the bilateral nature of sham trusts' (2022) 138 LQR 114, 114 fn 6.
[24] Civil Codes from the 19th century did not regulate the doctrine of simulation. Not as such at least. This was, among many other examples, the case of the French Code of 1804, the Chilean Code of 1855, and the Italian Code of 1865. The German BGB regulated simulated transactions (*Scheingeschäft*) in §117. Then, the Italian Civil Code of 1942 introduced a more comprehensive regulation of these doctrines from arts 1414 to 1417. In France, the Ordonnance n° 2016-131 of 10 February 2016 revised then by Loi 2018-287 of 20 April 2018 introduced to the Code new articles 1200 and 1201 regulating the doctrine of simulation. We can find the same trend in Latin America. Most modern Civil Codes of Latin American jurisdictions, regulate the doctrine of simulation. See, for instance, the Brazilian Civil Code (2002), art. 167 and the Argentinian Código Civil y Comercial de la Nación (2014) arts. 955-960. Finally, some of the European Harmonisation projects consider the doctrine of simulation. The Principles of European Contract Law (2001) contain a provision on simulation in art. 6:103. Similarly, the Draft Common Frame of Reference (2009) does the same in an article II.-9:201.

rationale. It further argues that contrary to the common wisdom, the most distinctive function of the doctrines of sham and simulated transactions is not to prevent and tackle fraud. It rather consists in enabling the interests and purposes of the parties to the transaction to be implemented more effectively, by splitting the operation of a legal transaction into its external legal effects *vis-à-vis* third parties and its internal binding legal effects between the parties to the transaction itself.

In making this argument this dissertation contends that sham and simulation have two meanings in law: one narrow and one broad. The narrow meaning has the distinctive character just mentioned, and it is easier to separate as a distinctive legal doctrine. The broad meaning, in turn, is very vague and overlaps with other legal doctrines, but it is still of use for the legal systems here considered. This dissertation further argues that distinguishing the narrow and broad interpretations of the doctrines of sham and simulated transactions allows us to identify when characterising a transaction as a sham and a simulation corresponds to a distinctive legal doctrine from cases in which it does not. This argument is summarised in the sections that follow.

1. The narrow explanation of the doctrines of sham and simulated transactions

As Part 1 of this dissertation contends, in the different jurisdictions considered here, there is a narrow sense in which a transaction may be found to be a sham and simulation. Starting from the loose definition that sham and simulated transactions are those where form and substance deliberately diverge, Chapter 1 and 2 argue that a transaction found to be a sham or a simulation in a narrow sense features two distinctive structural elements.

As Chapter 1 shows, the first structural element is that the parties recite in the documentary form certain rights and obligations that are different from the rights and obligations they intend to govern their legal relationship. In other words, the divergence between form and substance that characterises sham and simulated transactions in the narrow sense consists in a divergence between the rights and obligations that the parties recite in the documentary form versus those that they intend to be binding. The

second structural element, which Chapter 2 explores in some length, is that the parties intend and share a common understanding of the divergence they create between the documentary form and the rights and obligations governing their legal relationship. That is, in sham and simulated transactions the parties share a common intent concerning the divergence between form and substance, for they *intend* to give third parties the impression of having intended certain rights and obligations where they also *intend* different rights and obligations to govern their internal relationship. Chapter 3 concludes the analysis of the structural elements of the narrow interpretation of these doctrines arguing that fraud is not an inherent element of sham and simulated transactions in the narrow sense. It submits that even though sham and simulated transactions increase the risks of fraud, and they are often fraudulent – for instance where they avoid certain mandatory rules or defraud third parties – they do not have to be. These structural elements provide the necessary background to discuss the functions these doctrines perform.

The dissertation further argues that, contrary to some conventional understandings, the most distinctive function of the doctrines of sham and simulated transactions in this narrow sense is not to prevent or tackle fraud. Chapter 4 contends that the functions of the doctrines of sham and simulated transactions in a narrow sense are better understood from the point of view of enabling the interests and purposes of the parties to the transaction to be implemented more effectively, so long as there is no prejudice caused to third parties. Here is where the need of a common understanding discussed in Chapter 2 acquires all its significance. This is referred to as the 'dual operation' function of the doctrines of sham and simulation, according to which a transaction can have one legal operation, that is certain rights and obligations between the parties, and a different legal operation, that is to give the appearance of other rights and obligations *vis-à-vis* third parties, precisely because this dual operation was intended by the parties. Thus, instead of penalising all forms of sham and simulation, the law strikes a balance between the interests of the parties involved and the interests of third parties, while ensuring the enforcement of mandatory legislation.

Chapter 5 further explores the rationale behind the dual operation function here described. It argues that legal systems do not penalise all forms of sham and simulated transactions because they allow the parties to create efficient and equitable legal structures to meet their needs, these needs either consisting in their commercial needs or the needs of their families, when existing laws fail to provide them. Despite the risks of fraud associated with sham and simulated transactions, the dual operation function enables parties to address the legal shortcomings of the law. This may occur in two ways: by addressing gaps within the law and by enabling legal changes through means other than those considered by the framework of the legal system. Here I further make some comparative remarks between the supplementary role of equity in English law and the civilian doctrine of simulation. I argue that the dualism of common law and equity in English law operates in some respects in a manner analogous to the dual operation function of lawful forms of simulation.

2. The broad meaning of sham and simulation

This dissertation, however, also shows that, alongside the narrow sense of sham and simulation, courts and legal scholars sometimes find that a transaction can be a sham or a simulation in a broad sense. As Part 2 contends, throughout history and up to the present day, jurists and courts have identified transactions as shams or simulations, although they differ from sham and simulated transactions in the narrow sense just described. Two contexts in which this broad sense of sham and simulation are used are analysed in detail. Chapter 6 examines the use of sham and simulation in the broad sense when courts find that transactions are designed to avoid and circumvent mandatory law. Chapter 7, in turn, analyses the use of the broad sense of the word sham in trust law.

As these chapters show, sham and simulation in a broad sense do not correspond to any technical meaning of these words but rather the meaning they have in common language. That is ‘something that is intended to be mistaken for something else, or that is not really what it purports to be; a spurious imitation, a counterfeit’, and therefore to produce a sham and a simulation in this broad sense consists in ‘giving

the appearance of something, to resemble it'[25] and 'to pretend, to imitate something that is not what it is'. [26] In the same way that a simulated and sham medicine are not what they seem to be (that is they are not a 'real' medicine), sham and simulated transactions are, in this broad sense, nothing else than something that somehow pretends to be transaction *n,* but that in some sense is not transaction *n,* but something else, if anything.

Courts may consider that a transaction is a 'sham' or a 'simulation' in this broad sense because the parties have used an external transactional form for the sole purpose of contracting out of mandatory legislation. Courts may also consider that a transaction is simulated and a sham because the parties called their agreement a 'licence', when according to the terms of their agreement their real intention was to conclude a lease. They may even say, as French courts indeed do,[27] that when A and B conclude transaction *n*, and B acts in their own name but for the benefit of C, that such transaction is simulated because B is party only to the external form of transaction whereas C is the party to its real substance. In all of these cases, something in the outward and documentary form of the transaction somehow conceals a different substance, whatever substance means, and in this loose sense, they are 'shams' and 'simulations'.

As this description makes clear, simply saying that a transaction is a sham or simulation in this broad sense says very little about the structure and effects of the relevant transaction. Sham and simulated transactions in a broad sense lack precise content, and the structural elements discussed of the narrow sense of sham and simulation are not necessarily present. By finding that a transaction is a sham or simulation in this broad sense one is only saying that in some sense form and

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[25] The second meaning of sham listed in the Oxford English Dictionary defines sham as 'something that is intended to be mistaken for something else, or that is not really what it purports to be; a spurious imitation, a counterfeit'. See 'sham', The Oxford English Dictionary https://doi.org/10.1093/OED/6841728628 accessed 30 July 2024.

[26] The second meaning of to simulate ('simuler'*)* listed in the French Dictionary 'Larousse' define to simulate as 'offrir l'apparence de quelque chose, lui ressembler' https://www.larousse.fr/dictionnaires/francais/simuler/72825 accessed 30 July 2024. In turn the Spanish Dictionary of the 'Real Academia de la Lengua Española' defines to simulate ('simular') as 'representar algo, fingiendo o imitando lo que no es' < https://dle.rae.es/simular> accessed 30 July 2024.

[27] Civ. 1re, 11 Feb. 1976: Bull. civ. I, nº64; Civ. 1re, 28 Nov. 2000, n° 98-14.618*;* RTD civ. 2001. 134, obs. Mestre et Fages.

substance diverge, with the term 'substance' having an open texture. However, identifying a transaction as a sham or simulation in this broad sense still has practical applications. By classifying a transaction in this way, courts disregard its documentary form to ensure that the policies underlying other legal rules are effectively upheld. In doing so, courts may use the broad sense of sham and simulated transactions for a variety of purposes that depend on the context in which it is applied. However, this approach sacrifices consistency and internal coherence. Consequently, more specific doctrines should be favoured over this broad interpretation of sham and simulation whenever possible.

3. Divergences and the overall aim of this argument

Before moving onto some methodological observations, there is one remark to make. This brief introduction may make the reader object that this dissertation overlooks the dissimilarities between the doctrines of sham transactions and simulation in the different jurisdictions it considers. The reader may observe that the difficulties in understanding the doctrine of sham transactions in England cannot be exactly the same as the distinctive difficulties in understanding for instance, the doctrine of simulation in Chile. They may also object that the distinctiveness of these doctrines is not exactly the same across England, France, Italy and France.

The reader is partially correct in making these objections. The body of this dissertation will show that there are some important differences among these doctrines in the legal systems here compared. That said, these differences do not prevent the possibility of elaborating one single framework that captures these different doctrines. In fact, despite different ways of understanding these doctrines in different jurisdictions, some of their distinctiveness remains the same. More importantly, the aim of this dissertation is not to provide a description of these doctrines as the textbooks of the different jurisdictions already do. Nor it is a sort of synthesis or compilation of the content of these doctrines in the jurisdictions here analysed. Rather its aim is to compare the doctrine of sham transactions and simulation so as to provide a conceptual and common framework capable of showing both their similarities and differences, and of understanding the content and functions of these doctrines in

different jurisdictions. This framework, enables further comparison. It enables an analysis of the extent to which in different jurisdictions the doctrines of sham transactions and simulation feature a distinctive character and perform the dual operation function described throughout this dissertation.

III.
Scope and methodology

Before concluding this introduction, there are a few observations to make on the scope of this dissertation and some methodological choices that will clarify the approach taken in this research.

1. Property transfers

This research is restricted to the doctrines of sham transactions and simulation in property transfers. In other words, its aim is to explain what these doctrines are and do, and what about them is distinctive in transactions where one person transfers (or give the appearance of transferring) property or property rights to another person. Therefore, it does not consider these doctrines in other areas of law in which they have had some significant development, such as family[28] and employment law.[29] The reason for choosing property transfers as a basis for studying these doctrines is that it enables us to look at what they do from different angles, which in turn provides a richer conceptual basis for their explanation. Property transfers lie at the intersection of different areas of private law, including property and contract law, but also torts or non-contractual liability.[30] In addition, property transfers in their very nature affect third parties to the sham and simulation, and the tensions and frictions that sham and

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[28] Fabrice Boulanger 'Fraude, simulation ou détournement d'institutions en droit de la famille' [1993] JCP I 3665; Alexis Mondaca Miranda 'Statu quo de la simulación del matrimonio. Antes y después de la Nueva Ley de matrimonio civil' (2017) 39 Revista de estudios histórico-jurídicos 351.
[29] ACL Davies, 'Sensible Thinking About Sham Transactions: Protectacoat Firthglow Ltd v Szilagyi [2009] EWCA Civ 98; [2009] IRLR 365' (2009) 38 Industrial Law Journal 318; ACL Davies, 'Employment law' in Edwin Simpson and Miranda Steward (eds), *Sham Transactions* (OUP 2013) 176; M Ford and A Bogg 'Between Statute and Contract: Who is a Worker?' (2019) 135 LQR 347; Pedro Irureta Uriarte, 'Simulación y apariencia en el ámbito laboral: la especial situación del sujeto contratante' (2013) 40 Revista de derecho Valparaíso 213.
[30] Eveline Ramaekers, 'What is property law' (2017) 37 OJLS 588, 607-610.

simulated transactions generate between the parties and third parties is a fundamental aspect of these doctrines.

2. Legal transactions

This dissertation resorts to the concept of 'legal transaction'. This decision is easy to justify in civilian jurisdictions. The concept of legal transaction ('negozio giuridico' in Italian law,[31] 'acte juridique' in French law[32] and 'acto jurídico' o 'negocio jurídico' in Chilean law[33]) is a term of art in all of these jurisdictions. Legal transactions are manifestations of will, either unilateral or based on agreement, intended to produce legal effects. Under this definition, contracts, wills, and trusts are legal transactions. All of them are manifestations of will intended to produce legal effects. Moreover, in France, Italy and Chile, the rules governing contracts are often applicable to other legal transactions.[34] '[As] far as is appropriate'[35], says the French Civil Code, and 'as far as they are compatible'[36] observes the Italian Code. Consequently, there is an important overlap concerning legal transactions in general and contract law in particular. This is precisely the case in the doctrine of simulation, which concerns both legal transactions in general and contract law specifically. All of this makes it appropriate to resort to the concept of legal transactions and to refer to simulated transactions as a comprehensive way of referring to the doctrine of simulation in contracts and in other types of legal transactions.

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[31] See, for instance, Emilio Betti, *Teoria general del negocio jurídico* (A. Martin Pérez tr, Ediciones Olejnik 2018); Giuseppe Stolfi, *Teoriá del negozio giuridico* (CEDAM 1961).
[32] See arts. 1100 and 1100-1 of the French Code. Also Jacques Flour, Jean-Luc Aubert and Eric Savaux, *Droit civil. Les Obligations. 1. L'acte juridique* (16th edn, Dalloz 2014).
[33] Ramón Domínguez Águila, *Teoría General del Negocio Jurídico* (3th edn, Prolibros 2020); José Joaquín Ugarte Godoy, *Curso de Derecho Civil. El acto jurídico: elementos esenciales* (Thomson Reuters 2024).
[34] For Chile, see Chilean Civil Code, arts. 1445 to 1469. See also Javier Rodríguez Diez and Adolfo Wegmann Stockebrand, 'Título II. De los actos y declaraciones de voluntad' in Carlos Amunátegui Perelló (ed), *Comentario Histórico-Dogmático al libro IV del Código Civil de Chile. Tomo I* (Tirant lo blanch 2023) 125.
[35] Art. 1100-1, second paragraph. Unless otherwise indicated, English translations of the French Civil Code quoted in this dissertation are taken from John H. Crabb, *The French Civil Code. Revised Edition (as amended to 1 July 1994)* (Fred B. Rothman & Co 1995), except when the provisions from the Book of Obligations in which case the translations are taken from the official translation of the Ordonnance n° 2016-131 of 10 February 2016 revised then by Loi 2018-287 of 20 April 2018 by John Cartwright, Bénédicte Fauvarque-Cosson and Simon Whittaker.
[36] Art. 1324. Unless otherwise indicated, English translation from the Italian Civil Code quoted in this dissertation are taken from Mario Beltramo, Giovani E. Longo and John Henry Merryman, *The Italian Civil Code* (Oceana Publications 1969).

The justification is less evident in English law. Strictly speaking, in English law, there are contracts, trusts, wills, and gifts but not legal transactions as a general category.[37] The reason for not using this more general category of legal transaction may be connected to the reluctance towards abstractions that is often said to characterise English law. However, resorting to the concept of 'legal transaction' for the purpose of referring to the English doctrine of sham transactions is, in my view, also justified. The doctrine of sham transactions cuts across contracts, trusts, and gifts. This is why sham contracts and sham trusts are often considered as subcategories of the more general doctrine of 'sham transactions'.[38] Moreover, while the most common and repeated formulations[39] of this doctrine refer to sham contracts, these formulations have been applied to trusts and gifts. In addition, and as happens in civilian jurisdictions, while contract and trust law are clearly two different fields of private law, some of the rules and principles governing contracts are applied to other transactions as well, and in particular to trusts, as are the rules for contractual interpretation and evidence.[40] In this regard, Maitland observed that while keeping trust law apart from contract law seemed to be desirable as a matter of convenience, 'as a matter of principle it is necessary to see, as we shall see hereafter, that there are important analogies between the two'.[41] This may explain why some European harmonisation projects use the general category of 'juridical act'[42] (following the French terminology of legal transaction) observing 'all legal systems know the idea of an act (or statement) intended to have legal effect'.[43]

3. A comparative approach

[37] For an attempt to systematise different areas of private law within a coherent taxonomy following the Gaius' threefold division of law in persons, things and actions, see Andrew Burrows (ed), *English Private Law* (3rd edn, OUP 2013) ix–xii.
[38] See, for instance, Matthew Conaglen, 'Sham trusts' (2008) 67 CLJ 176, who offers some conceptual considerations of the doctrine of sham transactions in general to then discuss how it applies to trusts.
[39] *Snook* (n 2); *Hitch* (n 10).
[40] See, generally Lewin, *Trusts,* Chapter 7.
[41] FW Maitland, *Lectures on Equity* (CUP 1929) 116 (Lecture IX).
[42] DCRF II. – 1:101(2).
[43] Cristian von Bar and Eric Clive (eds), *Principles, Definitions and Models Rules of European Private law. Draft Common Frame of Reference* (OUP 2010) 128.

This research takes a comparative approach. As already anticipated, it engages in different levels of comparison. It compares the English doctrine of sham transactions with the civilian doctrine of simulation. In addition, it compares the civilian doctrine of simulation across the three civilian jurisdictions here analysed, that is Italy, France and Chile. But it also compares and distinguishes the doctrines of sham transactions and simulation from other doctrinal developments with whom they share some structural and functional similarities.

Given that there is a great variety of methods for approaching comparative law there are some remarks to be made as to how this comparative approach is undertaken.

3.1. Selection of jurisdictions for the comparison

This dissertation considers developments in Italian, French, Chilean and English law. France and Italy are in the pool because they have exerted a great influence within the civilian tradition and beyond. At the same time, in each of these jurisdictions the understanding of the doctrine of simulation varies significantly. Chile, in turn, expands the comparison beyond Europe and brings into the comparison a doctrine of simulation that features some interesting peculiarities. While the doctrine of simulation is nowhere mentioned in the Chilean Civil Code, it still has a very wide application and undisputed legal recognition in legal practice. England, in turn, enriches the comparison by introducing the doctrine of sham transactions as the common law counterpart.

Comparing these four jurisdictions permits a fruitful analysis. Their respective intellectual constructions of the doctrines of sham transactions and simulation enrich one another. The English doctrine of sham transactions provides a more analytical and concrete language to specify and clarify some elements of the content of these doctrines, particularly the sense in which external form and internal substance diverge. In turn, the civilian jurisdictions considered in this project allow us to see how wide and diverse the functions and scope of these doctrines could be. They provide new angles to understand why a common understanding between the parties is so fundamental when finding that a transaction is a sham and a simulation. Furthermore, they offer

compelling reasons to distinguish fraud from simulated transactions, an approach that, as I argue, also supports the separation of fraud from sham transactions.

3.2. Materials for the comparison

The materials for the comparison differ slightly when examining the English doctrine of sham transactions and the doctrine of simulation in the three civilian jurisdictions considered here. For the analysis of the English doctrine of sham transactions, this dissertation naturally draws on English case law but also on cases from other common law jurisdictions that have historically been closely connected to English law, such as Jersey, New Zealand, and, to a lesser extent, Australia. It also incorporates the commentary and interpretations of legal scholarship on these cases.

As for the doctrine of simulation, this dissertation relies primarily, though not exclusively, on the explanations and definitions provided by legal scholarship. There are several reasons for this. Firstly, neither the Italian,[44] nor the French,[45] nor the Chilean[46] Civil Codes offer a comprehensive definition of what constitutes a simulated transaction or the elements that make a transaction simulated. Therefore, codal provisions provide limited assistance in analysing the doctrine of simulation. In turn, while court decisions are considered where possible, the number of such decisions in the civilian jurisdictions under study far exceeds what can be meaningfully analysed. [47] As such, court decisions are included in the comparison either to confirm or, where

[44] Arts. 1414 to 1418 of the Italian Civil Code provide a comprehensive regulation of the effects and proof of simulated transactions, but it is very modest in defining their structural elements. See Auricchio (n 6) 23; Franco Anelli, *Simulazione e interposizioni,* in V. Roppo (dir.). *Trattato del Contratto. III. Effetti* (2a edn, Giuffrè Editore 2023) 594.

[45] Art. 1201 of the French Civil Code characterises simulated contracts as contracts where an apparent contract conceals a secret contract. This description does not clarify whether the parties conceal the legal rights they create or the economic result they achieve through the contract. For a general overview of this provision, see Gaël Chantepie and Mathias Latina, *Le nouveau droit des obligations. Commentaire théorique et pratique dans l'ordre du Code civil* (2nd edn, Dalloz 2018) 503-510.

[46] The Chilean Civil Code does not contain any provision explicitly regulating the doctrine of simulation. However the doctrine is an elaboration of legal scholarship and courts' decisions based, among others, on arts. 966, 1445, 1560 and 1707 of the Civil Code. See Daniel Peñailillo Arévalo, 'Cuestiones teórico-prácticas de la simulación' (1992) 191 Rev. de Derecho U. de Concepción 7, 8. In more recent times, the doctrine of simulation has been legislated for tax purposes. See Cristián Boetsch Gillet*, La norma general anti elusión: análisis desde la perspectiva del Derecho Privado* (Ediciones UC 2016).

[47] A few statistical indicators may illustrate this fact very neatly. In France, Courts of Appeal issue around 180.000 decisions per year, while the *Cour de Cassation* issues another 20.000. See Cour de cassation, *Rapport Annuel 2020* (Paris 2021). In Italy, the civil section of the *Corte Suprema di Cassazione* alone

possible, to contrast with the explanations provided by legal scholarship. However, references to court decisions are intended to be illustrative and to enrich the comparison, rather than exhaustive.

3.3. The functional method

The comparison this dissertation makes takes a functional approach in some respects, although not in its more traditional formulation.[48] The functions of the doctrines of sham and simulated transactions are not the *tertium comparationis* of this dissertation. It does not select one specific function as a benchmark for choosing the institutions, doctrines, and rules to compare. Nor does this dissertation assess or evaluate these doctrines by reference to a specific function,[49] as would be the case, for instance, if it compared the extent to which these two doctrines protected third parties.

The first reason for not using the functional method in its traditional formulation is that this is unnecessary. These two doctrines are structurally and functionally similar enough to be successfully compared without needing to select a function a priori to guide the comparison. Additionally, a purely functional method does not suit the aim of this dissertation, which is to argue for the distinctiveness, usefulness, and justification of these doctrines. In answering this question, it is more useful to analyse both what makes a transaction sham and simulated (referred to here as the structural analysis), and what these doctrines do (referred to here as the functional analysis).

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delivers around 30.000 decisions per year. See Corte Suprema di Cassazione, *Cassazione Civile. Anuario Statistico 2021*, www.cortedicassazione.it/resources/cms/documents/AG2022_ANNUARIO_civile-2021.pdf accessed 5 July 2024. In Chile, the Corte Suprema issues between 50.000 to more than 100.000 decisions per year. See information in <https://numeros.pjud.cl/> accessed 17 January 2023. These numbers are dramatically higher than the numbers of the Supreme Court and Judicial Committee of the Privy Council of the United Kingdom, which together do not give more than 150 decisions per year. See The Supreme Court, *The Supreme Court and Judicial Committee of the Privy Council Annual Report and Accounts 2021–2022* (HC 499, 2022) < https://www.supremecourt.uk/docs/annual-report-2021-2022.pdf>, accessed 5 July 2024.

[48] Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law* (Tony Weir tr, 3rd edn, OUP 1998) 32-47. See also Michele Graziadei 'The functionalist heritage' in Pierre Legrand and Roderick Munday (eds), *Comparative Legal Studies: Traditions and Transitions* (CUP 2003) 100; A. Esin Örücü 'Methodology of comparative law' in Jan M. Smits (ed), *Elgar Encyclopaedia of Comparative Law* (2nd edn, Elgar 2012) 560.

[49] For the different functions of the functional method, see Ralf Michaels, 'The Functional Method of Comparative Law', in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (2nd edn, OUP 2019) 345.

This comparative inquiry, however, does take a functional approach in that it does not ignore but seeks to see beyond the legal categories and conceptual frameworks developed in a particular legal system, to reformulate the compared material in system-neutral concepts. Recasting the legal concepts developed in each legal system into system-neutral concepts permits a better appreciation of the similarities but also the better identification of the significant differences that arise in understanding and applying these doctrines. It also makes it possible to speak to a wider audience, including scholars trained in both the civil and common law legal traditions. This dissertation also takes a functional approach in the sense that it regards that an illuminating, and for some purposes, indispensable way of understanding and explaining rules and legal principles is considering their functions. On this point, it is worth observing that while the meaning of 'function' in the functional method, and more broadly in law, is far from clear,[50] this dissertation takes 'function' to mean *the legal need that a certain community satisfies by making use of a legal rule or a given set of legal rules*. It therefore does not consider broader meanings of function such as the economic, social and cultural function of legal rules.

3.4. Complementary comparative approaches

In addition to these elements of the functional method, this dissertation draws on some historical approaches to unravel some difficulties in understanding these doctrines.[51] Examples of difficulties in which an historical approach has been useful are the relationship between simulation and fraud, and how the broad and narrow meanings of the doctrines of sham and simulated transactions relate. This dissertation also acknowledges that the legal ideas of sham and simulation developed in each of these

[50] María Ignacia Besomi, 'El funcionalismo como método en el derecho comparado' in María Paz Gatica and others (eds), *Estudios de derecho comparado* (Tirant lo blanch 2024) 27.

[51] For the connections between comparative and historical approaches, see James Gordley, Comparative Law and Legal History', in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (2nd edn, OUP 2019) 754; Jean-Luis Halpérin, 'Historical-Jurisprudential Methods', in Mathias Siems (ed), *The Cambridge Handbook of Comparative Law* (CUP 2024) 32; Adolfo Wegmann, 'Comparativismo Histórico' in María Paz Gatica and others (eds), *Estudios de derecho comparado* (Tirant lo blanch 2024) 27. See also Olivier Moréteau, Aniceto Masferrer, and Kjell A. Modéer (eds), *Comparative Legal History* (Elgar 2019).

jurisdictions have circulated and have influenced each other.[52] In that regard, the French doctrine of simulation is better understood by considering some Italian influences. Likewise, the Chilean doctrine of simulation makes much more sense when we see that it combines French and Italian influences.

A final point regarding the comparative exercise undertaken here is that it does not consider each legal system separately before making the comparison. Instead, it provides an account of these doctrines by integrating from the outset the different understandings that one may find in the four jurisdictions subject of this study. Considering all these jurisdictions in parallel facilitates a deeper comparison and allows us to illuminate each jurisdiction in relation to one another. Often, the analysis and comparison of the different aspects of these doctrines starts with the doctrine of sham transactions and continues with the civilian explanations of the doctrine of simulation. However, this is not always the case. The order is always determined by the aim of providing a clearer picture for the argument that the relevant section, chapter, and the overall dissertation makes.

After this brief introduction, it is time to initiate the comparison and analysis.

[52] Alexandra Braun, 'The Value of Communication Practices for Comparative Law: Exploring the Relationship Between Scotland and England' (2019) 72 CLP 315.

PART 1:
SHAM AND SIMULATED TRANSACTIONS
IN THE NARROW SENSE

As outlined in the Introduction, this dissertation argues that a legal transaction can be found to be a sham or a simulation both in a narrow and a broad sense. This Part 1 analyses sham and simulated transactions in the narrow sense. It argues that sham and simulated transactions in the narrow sense have two fundamental structural elements. The first element, as Chapter 1 contends, is the divergence between (1) the external evidence the parties create *vis-à-vis* third parties as to the rights and obligations that are supposed to govern their legal relationship (form); and (2) the rights and obligations that govern their legal relationship (substance). The second element, as Chapter 2 goes on to explain, is that this divergence is always the result of a common understanding of two or more parties, even in unilateral acts. Chapter 3, in turn, discusses the extent to which fraud is an inherent element of sham and simulated transactions. It concludes that it is not.

As these chapters will show, specifying and clarifying the structural elements of sham and simulated transactions is important for the question that drives this dissertation. An accurate understanding of the divergence between form and substance that characterise sham and simulated transactions allows us to differentiate these doctrines from other doctrines, such as the doctrines of indirect and fiduciary transactions, and transactions that may feature some element of artificiality but that do not satisfy the specific divergence between form and substance discussed here. Similarly, a clear account of the common understanding that characterises sham and simulated transactions enables us to rule out the application of these doctrines to transactions that may have some misleading appearance but that do not result from a common understanding of two or more parties.

Likewise, these structural elements of sham and simulated transactions permit a better understanding of the functions the two doctrines perform. In first place, they permit us to discard fraud as their distinctive function. Given that sham and simulated

transactions do not need to be fraudulent, tackling fraud cannot be their most distinctive function. Moreover, once the specific divergence between form and substance characterising sham and simulated transactions is clearly outlined, it becomes apparent that the effectiveness of the doctrines of sham and simulation in combating different types of fraud is limited. Many frauds, including legal avoidance schemes and fraud on creditors, consist in the economic results the parties achieve rather than the rights and obligations they acquire.

Part 1, therefore, also discusses the functions that sham and simulated transactions in the narrow sense perform. To that end, Chapter 4 analyses the functions that the doctrines of sham and simulated transactions in the narrow sense perform, arguing that while in their narrow sense the two doctrines may protect the interests of third parties, they also enable the interests and purposes of the parties to the transaction to be implemented more effectively. So long as no prejudice is caused to third parties, these doctrines, then, permit the parties to split the operation of their legal transaction into their external legal effects *vis-à-vis* third parties and their internal binding legal effects between the parties. Chapter 5, in turn, argues that this function is justified since it allows the parties to devise efficient and equitable legal structures that better serve the parties' commercial needs or their interest in providing for the specific needs of their families.

CHAPTER 1:
THE DIVERGENCE BETWEEN FORM AND SUBSTANCE

Judges and legal scholars usually say that in sham and simulated transactions the 'external form' or the 'external appearance' of the transaction conceals the 'internal substance'[1] (sometimes called the 'true nature', [2] 'true intention'[3] or other similar expressions). Because of this divergence between form and substance, they sometimes add that simulated transactions are 'not real',[4] but instead a mere appearance. That said, what the meaning of 'form' and 'substance' is, and how they diverge is hardly ever discussed. This chapter aims to fill this gap.

This exploration of the divergence between form and substance is significant for this dissertation. A clear understanding of this divergence positions us better to distinguish the doctrines of sham transactions and simulation from other doctrinal developments. Additionally, it offers insights into the function of these doctrines. Depending on precisely what makes a transaction a sham or simulation, we can more accurately determine the functions of these doctrines.

The argument then of this chapter is that in England, Italy, France, and Chile, the form and substance of sham and simulated transactions diverge in that the parties produce evidence of the terms of their understanding (form) that conceals the rights and obligations, if any, that actually bind them (substance). In this respect, the two doctrines share substantial similarities. However, this chapter also shows that there are differences in how these doctrines conceptualise the divergence between form

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[1] Sham transactions, said Megarry J in *Miles v Bull* [1969] 1 QB 258, 264 D-E, are transactions where 'the outward and visible form does not coincide with the inward and substantial truth'. Similarly, the Italian jurist Francesco Ferrara suggested that in simulated transactions, 'there is a remarkable contrast between the extrinsic form and the inner substance'. See Francesco Ferrara, *Della simulazione nei negozi giuridici* (2nd edn, Soc. Editrice Libraria 1905) 28.
[2] In *Isle Investment LTD v. Leeds City Council* [2021] EWHC 345 (Admin) [8], Fordham J observed that in sham transactions there is a mismatch between 'the apparent nature of the relationship' and 'the true nature of the relationship'.
[3] To the French jurist Henri Capitant, for instance, in a simulation the external declaration of intent 'does not correspond to the real intention' of the person concluding the juridical act. See Henri Capitant, *Introduction a l'étude du Droit Civil* (5th edn, A. Pedode Editeur 1929) 286.
[4] In *Madell v. Thomas & Co*, [1891] 1 QB 230, Lord Esher, MR argued that 'though such might be the form of the agreement, the Court should go into the question whether the agreement was not in reality given by way of security for money lent'.

and substance. Specifically, in the civilian jurisdictions analysed here, courts and legal scholars often use more abstract and, therefore, more malleable language than English courts typically use to explain the legal meaning of sham. Consequently, the divergence between form and substance in simulated transactions is not immediately apparent and only becomes clear when discussing the differences between simulated transactions and indirect transactions. As will be elaborated in Chapter 6, the abstract language used by courts and legal scholars may facilitate the use of the term 'simulation' and the finding that transactions are simulated not only in the narrow sense discussed in Part 1, but also in the broader sense discussed in Part 2.

The structure of this chapter is as follows. Section one addresses the notion of 'form' in sham and simulated transactions. Section two explores the different legal meanings that the substance of a transaction may have. Sections three and four unpack the meaning of 'substance' in sham and simulated transactions, respectively, and how it diverges from 'form'. Section five makes a few concluding remarks.

I. Form

1. The meaning of form

If sham and simulated transactions consist in transactions where form and substance diverge, it may be useful to start clarifying the meaning of 'form' in this context.

The meaning of form in sham and simulated transactions is simple and can be addressed briefly. While different jurisdictions use different categories when characterising the form of sham and simulated transactions, they all refer to some outward evidence created by the parties as the purported terms governing their legal relationship.

In France, the form of the transaction is the 'lettre', also sometimes called the 'acte apparent', as opposed to the 'contre-lettre' that contradicts the 'lettre', either

annulling or modifying its terms.[5] In Italy, the form corresponds to the 'dicharazione ostensibile'[6] or the 'contratto apparente',[7] whose terms amend or qualify the 'accordo simulatorio', that is the secret agreement to simulate. In Chile, the form corresponds either to the 'escritura',[8] that is the deed, or to the 'declacración de voluntad que no se desea',[9] meaning the apparent declaration of intent. In English law, in turn, the form is simply the sham document[10] that gives to third parties and the court the appearance of creating rights and obligations different from the rights and obligations, if any, that the parties actually intend to create.[11]

In practice, the form of a sham or simulated transaction is often the document or set of documents executed by the parties with the intention to give a misleading appearance as to their rights and obligations governing their legal understanding. In a sham trust, for instance, the form usually consists in the written declaration of trust.[12] Likewise, in the case of a sham licence concealing a lease, the form is the written contract subscribed by the parties.[13] In that sense, the English characterisation of this element, namely that form consists in the document executed by the parties, provides a concrete description of what the form is in practice. For that reason, this dissertation uses the terms 'form' and 'documentary form' interchangeably, both referring to the same thing.

Strictly speaking, however, the form of a sham or simulated transaction does not need to be a written document. Depending on the transaction, it may also consist of acts that are different from a document. This would be, for instance, the case of a spoken declaration made by the parties before witnesses or a public officer and whose

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[5] Jacques Ghestin, Christophe Jamin and Marc Billiau, *Traité de Droit Civil. Les effets du contrat* (3nd edn, LGDJ 2001) 928-931, paras [865]-[870].
[6] Ferrara (n 1) 28-38; Rodolfo Sacco and Giorgio De Nova, *Il Contratto* (4th edn, UTET Giuridica 2016) 638-642.
[7] C. Massimo Bianca, *Diritto Civile. III. Il Contratto* (3rd edn, Giuffrè 2019) 652-657.
[8] Luis Claro Solar, *Explicaciones de Derecho Civil Chileno y Comparado. De las obligaciones III. Tomo Duodécimo* (Ed Jurídica de Chile 2013) 609-611.
[9] Avelino León Hurtado, *La voluntad y la capacidad en los Actos Jurídicos* (4th edn, Ed Jurídica de Chile 1963) 103-116
[10] *JSC Mezhdunarodniy Promyshlenniy Bank and another v Pugachev and others* [2017] EWHC 2426 (Ch) [145].
[11] *Snook v London and West Riding Investments Ltd,* [1967] 2 QB 786, 802 C-E.
[12] *Pugachev* (n 10).
[13] *Antoniades v Villiers* [1990] 1 AC 417.

effects are recorded in a public registry.[14] In this regard, when in the famous English case *Snook v London and West Riding Investments Ltd* Lord Diplock observed that shams are 'acts done or documents executed by the parties',[15] his words may be understood in this way.

In other words, while the 'form' of a sham or simulated transaction often consists in the document executed by the parties that contains the apparent terms of their legal relationship, it may also consist in another outward 'act' intended to give a certain appearance *vis-à-vis* third parties as to the content of those terms. From a conceptual perspective, then, the form of the transaction ultimately is *the evidence that the parties create vis-à-vis third parties as to the terms of their apparent understanding*.[16] In practice, this external evidence is usually a document or set of documents.

2. The relevance of form

It might be easy to think that the form of a transaction is of little significance compared to its substance. However, this would be a mistake. In transactions that are not sham or simulations, the documentary form is the main source where the content of the terms governing the legal relationship between the parties is to be found. This is true for contracts,[17] trusts,[18] and unilateral acts[19] in the different legal systems here considered. The terms mutually agreed and declared by the parties to a transaction, usually written down in a document, are key evidence in determining the content of

[14] This may be the case of sham and simulated marriages.
[15] *Snook* (n 11) 802 C.
[16] Against this understanding Pedro Saghy-Cadenas, 'La Simulation de contrat. Étude Comparée en droit civil français et vénézuélien' (Thèse de doctorat en droit, Université Panthéon-Assas 2012) para 135-137. His argument, however, is more that a simulated contract requires some outward evidence rather than consists in a written document. As explained here, that outward evidence does not necessarily need to be a written document.
[17] In English law, see generally Treitel, *Contract* [6-040]-[6-042]. In civilian jurisdictions, this becomes apparent when looking the rules of contractual interpretation, where many of them seek to determine the intention of the parties in the words they have used, but also one the rules on proof of obligations, which give to documentary evidence a very high weight on proving the content of the obligations created by the parties. For Italy, Bianca (n 7) 374-407, and in particular 387-403. Also Sacco and De Nova (n 6) 1352-1354. For France, see François Terré and others, *Droit Civil. Les obligations* (12th edn, Dalloz 2019) 684-695. For Chile, Jorge López Santa María, *Los Contratos. Parte General* (5th edn, Ed Jurídica de Chile) 444-449 and Carlos Ducci Claro, *Derecho Civil. Parte General* (4th edn, Ed. Jurídica de Chile 2005) 402-424.
[18] *Lewin*, Trust [7-004] to [7-018].
[19] Stefan Vogenauer 'Interpretation' in Nils Jansen and Reinhard Zimmermann (eds), *Commentaries on European Contract Laws* (OUP 2018) 740, 747-749.

such transaction. This is true even where a strict subjective approach to the formation of contracts and other legal transactions is followed. Even a strong enthusiast of the theory will admit that ultimately the internal will of the parties becomes relevant for the law as manifested outwardly in a declaration.[20] As the Italian legal scholar Cesare Massimo Bianca observed, subjective approaches to contractual interpretation still consider the documentary form relevant because it is 'the means by which the real intention of the parties is externalised'.[21] In other words, the documentary form is ultimately the place where the 'substance' is often found.

The documentary form of a transaction is relevant both to the parties to the transaction and to third parties. When the parties to a transaction discuss their rights and obligations, the documentary form they have executed is the starting point (and sometimes the ending point) for finding out what these rights and obligations are. Likewise, when third parties interact with the parties to a transaction, their rights depend on the content of that form. If, for instance, the documentary form of a transaction provides that according to a contract of sale A transferred beneficial ownership of property *p* to B, this documentary form impacts C's rights *vis-a-vis* A's assets. Unless C can prove that this documentary form does not contain the transaction between A and B, C cannot claim that A still beneficially owns property *p*.

The significance of the documentary form for determining the substance of a legal transaction explains the legal questions that sham and simulated transactions give rise to. In sham and simulated transactions, the parties execute a documentary form not to provide some outward evidence of the substance of their binding understanding, but to conceal such understanding and to create a different appearance. The doctrines of sham and simulated transactions provide rules for this *sui generis* situation: they define when and why either form or substance prevail in cases where the parties have used documentary forms in order to conceal a different understanding.

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[20] François Geny, *Science et technique en droit privé positif. Vol III. Élaboration technique du droit potistif* (Libraire de la Société du Recueil Sirey 1921) 104-106.
[21] Bianca (n 7) 244.

That said, an important difficulty is that it is not self-evident what the 'substance' of a transaction is. On the contrary, as the following section shows, the substance of a transaction can mean many different things.

II.
Substance

1. The substance of a transaction in law

The meaning of the 'substance' of a transaction is more complex than that of form. As discussed in this section, the substance of a transaction may mean two things in law: one that is limited to the rights and obligations created by the parties that govern their legal relationship, and a second that also includes the parties' purposes and the economic result they achieve through a legal transaction. Clarifying from the outset these two meanings of substance is important because, as argued in this chapter and elaborated in more detail in Chapter 6, the sense in which the form and substance of sham and simulated transactions diverge has not had always a consistent answer, with substance taking different meanings.

1.1. The meanings of substance

The substance of a transaction is not a fact immediately discoverable in the physical world nor in the empirical dimension of the transaction. It is rather a concept for the law to define. Borrowing terminology employed by legal theorists, the substance of a transaction is an institutional fact,[22] which lacks a defined meaning until a norm confers on certain external facts the legal meaning of being its substance.[23] The problem is that this normative decision in not always clear, and there are different facts competing in the definition of what counts as the 'substance' of a transaction.

An example may illustrate this. Imagine that A needs financial resources and B is willing to advance them if A provides a security. To avoid the rules establishing the

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[22] Neil MacCormick, *Institutions of Law* (OUP 2007) 11-14.
[23] Hans Kelsen, *Pure Theory of Law* (Max Knight tr, University of California Press 1967) 3-4.

equal treatment of creditors (*par condictio creditorum*) and other insolvency rules in the event A goes into insolvency, B proposes to A that instead of concluding a straightforward secured loan, they instead execute a deed of sale in which A sells and transfers B goods *g* for a price *p*. Subsequently, B continues explaining to A, they can execute a hire and purchase agreement in which A will hire from B the same goods *g* for a rent equal to price *p* plus a premium, and that once the rent is fully paid, B will sell back to A goods *g* for a nominal price.

Imagine further that B objects to A that he or she does not to want to sell nor to hire goods *g* but only to raise fresh resources, to which B replies that these documents are good for that purpose. Provided A fulfils his or her obligations, he or she will ultimately keep goods *g*. In light of these assurances, A and B sign the documents they label as a sale agreement and a hire and purchase agreement. Subsequently, A and B fulfil the obligations these documents describe. That is, B pays price *p* to A, A pays the rent to B, and B sells back goods *g* to A for a nominal price.

It is not obvious in this example what the 'substance' of the transaction is. It is not self-evident whether the parties in 'substance' concluded a sale and a hire and purchase agreement or used these as transactional documentary forms to conceal a different transaction that in 'substance' consists in a secured loan. Moreover, it seems that there are at least two sets of facts competing in determining what the substance of this transaction is. On the one hand, the *rights and obligations the parties have created* suggest that the parties have concluded a sale and a hire and purchase agreement. A and B executed documents where they declared they were creating certain rights and obligations. They subsequently satisfied these rights and obligations. And these rights and obligations are the rights and obligations that result from what the law characterises as a contract of sale and hire agreement. Consequently, if the only set of facts the law takes as the substance of a transaction are these rights and obligations, then there seems to be no reason to argue that the external form of this transaction conceals a different substance. Even admitting that from an economic perspective their understanding was concluded by way of a security for money lent, there is nothing in the legal operation of the transaction that diverges

from its tenor.[24] As eloquently synthetised by the English judge Megarry J, 'if what is done is genuinely done, it does not remain undone merely because there was an ulterior purpose in doing it'.[25]

However, *the purposes of the parties and the economic result they achieve* are a second set of facts that suggests that, in substance, the transaction consists of a secured loan. Despite the legal form of the transaction, its result is a security for money lent. In Italy,[26] and France,[27] some legal scholars may say that security for money lent is the *typical cause* of the grant of a security. In other words, they would consider the economic result of the transaction in its characterisation. Another fact pointing to the substance of the transaction consisting of a secured loan is the purpose of evading insolvency law. The documents A and B executed in the example, one could argue, were nothing else than an artifice, a 'dressing up',[28] a 'façade',[29] or a 'cloak'[30] to achieve this economic result and at the same time evade insolvency rules. Therefore, if what counts in law as substance are not only the rights and obligations the parties create, but also the economic result they achieve as well as the purpose they pursued, then arguably in the transaction in this example a misleading form conceals a different substance.

1.2. Two types of divergence between form and substance

The 'substance' of a transaction, then, can consist either of *the rights and obligations the parties create* or, alongside these rights and obligations, include *the purpose of the parties and the economic result they achieve*. As will become apparent, these two meanings are of key relevance in understanding sham and simulated transactions and, in particular, how their documentary form and substance diverge.

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[24] *Yorkshire Railway Wagon Co v Maclure* (1882) 21 ChD 309, 317 per Lindley LJ.
[25] *Miles* (n 1) 264 B.
[26] Emilio Betti, *Teoria general del negocio jurídico* (A. Martin Pérez tr, Ediciones Olejnik 2018).
[27] Jacques Ghestin, *Cause de l'engagement et validité du contrat* (LGDJ 2006) 505-506 ; Judith Rochfeld, 'A future for la cause? Observation of a French Jurist' in John Cartwright and others (eds), *Reforming the French Law of Obligations: Comparative Reflections on the Avant-Projet de Réforme du Droit des Obligations et de la Prescription ('the Avant-projet Catala')* (Bloomsbury Publishing 2009) 75.
[28] *Antoniades* (n 13), 475F, per Lord Jauncey; *Re Yates (A Bankrupt)* [2004] EWC 3448 (Ch) [219], per Mr Justice Charles.
[29] *Re a Company* (1985) 1 B.C.C. 99421, 99424 per Cumming-Bruce LJ.
[30] *Smith v Hancock* [1894] 2 Ch. 377, 386 per Lindley LJ.

If the substance of the transaction is limited to the rights and obligations of the parties to the transaction, then the divergence between form and substance consists in the execution of a documentary form that gives to third parties the appearance that the parties have created certain rights and obligations, when in reality they intended to be bound by other rights and obligations (if any at all).

In turn, if the substance of a transaction includes the purpose of the parties as well as the economic result they achieve, then the divergence between form and substance does not necessarily consist in the concealment of the rights and obligations binding the parties through the documentary form. The divergence may also consist in the circumstance that the rights and obligations created by the parties permit them to achieve an economic result somehow alien to the form concluded by the parties. This will be the case, for instance, when other rights and obligations achieve this result more directly and easily, or when such rights and obligations are instrumental to a result that in other circumstance statutory law prohibits or penalises.

The transaction in the example above does not satisfy this first type of divergence between form and substance. The rights and obligations the parties recite are not different from the rights and obligations that govern their legal relationship. The documents executed by the parties do not conceal other rights and obligations. It does satisfy, however, the second type of divergence. The sale and hire and purchase agreement operated as a functional security but in a circuitous way, and not using the legal form of a security.

With this background in mind, this chapter will now move on to show that in sham and simulated transactions in the narrow sense, the substance of a transaction is restricted to the rights and obligations the parties create, and does not include the economic result they achieve. Therefore, for the narrow understanding these doctrines only the first divergence here mentioned is relevant. However, as Part II will explore, this account coexists with broader understanding of sham and simulated transactions for which the meaning of substance is wider, and where the second type of divergence becomes relevant as well.

2. Substance in sham transactions in the narrow sense

2.1. Substance as the parties' rights and obligations

In English law, the prevailing understanding is that a transaction is a sham when the documents concluded by the parties create the appearance of certain rights and obligations, whereas in reality, the parties intend others, if any. This was made clear by Lord Diplock in the seminal case of *Snook*[31] concerning a refinance agreement on a car.

Mr. Snook bought a new car for £936, paying the majority of the price upfront and leaving an outstanding balance of £200. This balance was financed through a hire purchase agreement with Totley Investment Co Ltd. After defaulting on this agreement, Mr. Snook sought further finance from Auto Finance Ltd. who requested him to sign a new hire purchase agreement that stated the car was owned by London and West Riding Investments Ltd. The agreement also stated that the purchase price was £800, with an initial payment of £500, leaving Mr. Snook with a remaining balance of £355. When Mr. Snook defaulted once again, the case was brought to court and the central issue was whether the transaction consisted of a sale and hire purchase agreement or a sham concealing a loan secured over moveables. This question was crucial because the Bills of Sale Act imposed strict formalities on loans secured against moveables.[32]

The majority of the court found that the agreement was not a sham. In delivering his opinion, Lord Diplock provided a definition of sham, which over time became the standard definition in English law, sometimes referred to as 'canonical'[33]. For what matters here, Lord Diplock observed that there is a sham when the parties to the sham execute acts or documents that give to third parties or the court the appearance of

[31] *Snook* (n 11).
[32] Bills of Sale Acts 1882, which imposed strict conditions of writing, registration, and public notice on loans secured over moveables. See RM Goode, *Hire Purchase Law and Practice* (2nd edn, Butterworths 1970); and Michael Bridge, *Atiyah and Adam's Sale of Goods* (13th edn, Pearson 2010) 8-9.
[33] *A v A* [2007] EWHC 99 [32], per Munby J.

creating 'legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create'.[34]

In *Hitch v Stone (Inspector of Taxes),* Arden LJ (as she then was) emphasised this statement explaining that

> 'It is of the essence of this type of sham transaction that the parties to a transaction intend to create one set of rights and obligations but do acts or enter into documents which they intend should give third parties, in this case the Revenue, or the court, the appearance of creating different rights and obligations.'[35]

Consistently with this understanding, courts have also observed that the fact that the parties have concluded an artificial transaction, does not necessarily render it a sham.[36] Arden LJ explained this when observing that there are two situations to be distinguished.[37] In a first situation, the parties make an unfavourable or artificial agreement that they intend to take effect according to its terms. This in her view is not a sham. In a second situation, she adds, the parties intend some other agreement to bind them, and the executed agreement is not to govern their relationship. In this second situation, there is a sham.

For the same reason, English courts normally will not declare a transaction to be a sham when the parties use the documentary form of a certain transaction with the purpose of achieving the economic result of another.[38] Lord Scarman commented that: '[i]f the method employed constitutes a sale, the mere fact that its purpose is an advance of money will not convert the transaction into a loan'.[39] Again, what matters is whether the parties intended to create the rights described in the document or

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[34] *Snook* (n 11) 802.
[35] *Hitch v Stone (Inspector of Taxes)* [2001] EWCA Civ 63, 2001 WL 14954 [63].
[36] *National Westminster Bank Plc v Jones,* [2001] 1 BCLC 98 [37]; *Belvedere Court Management Limited v Frogmore Developments Limited* [1997] QB 858, 876D; *Isle Investment* (n 2) [7], by Fordham J.
[37] *Hitch v Stone* (n 35) [67].
[38] *Chase Manhattan Equities Ltd v Goodman and others* [1991] BCLC 897, 921-923 per Knox J; *Pankhani v Chanderga* [2012] EWCA Civ 1438.
[39] *Lloyds & Scottish Finance Ltd v Cyril Lord Carpets Sales Ltd and others* [1992] BCLC 609, 619H.

documents they executed and not any ulterior purposes that they may or may not have intended, or the economic result they may or not have achieved.

2.2. Sham transactions and legal avoidance

According to the doctrine of sham transactions in the narrow sense, the fact that the transaction was designed by the parties with the sole purpose of avoiding mandatory law is not a ground to find a sham. Whether or not a transaction concluded for the sole purposes of avoiding a statute is illegal depends on the circumstances of the transaction and on the construction of the statute.[40] By contrast, for the doctrine of sham transactions, what matters is not the purposes of the parties but whether they intended the rights and obligations they appear to have intended. If they conclude a transaction in which the rights and obligations that they say they have intended are actually intended, there is no reason to consider it to be a sham even if the sole purpose of the parties was to evade mandatory legislation. Such a transaction may be challenged on grounds of illegality, but not for being a sham.[41]

The extent to which legal avoidance and finding that a transaction is a sham is connected is of significance for this dissertation. That a transaction objectively designed to avoid mandatory legislation is not by itself a ground to find a sham separates the doctrine of sham transactions from other doctrines that that tackle legal avoidance,[42] such as is the case of the *Ramsay* rule.[43] Even more, because the divergence between form and substance is restricted to the rights and obligations the parties recite, on the one hand, and the rights and obligations that govern their legal relationship, on the other, the usefulness of the doctrine of sham transactions tackling legal avoidance is very limited. The doctrine of sham transaction in the narrow sense is not the best doctrine to strike down transactions where form and substance do not diverge in the sense discussed here even though, in terms of their economic results, they circumvent a legal rule.

[40] *R. (Quintavalle) v Secretary of State for Health* [2003] 2 WLR. 692, HL.
[41] *Maclure* (n 24) 318 per Lindley LJ.
[42] See generally, Bennion, Bailey and Norbury, *Statutory Interpretation* [12.2]-[12.9].
[43] *WT Ramsay Ltd v Inland Revenue Comrs* [1982] AC 300. For a useful summary of the scope of the Ramsay rule, see *Berry v Commissioners for HM Revenue and Customs* [2011] UKUT 81 per Lewison J.

That said, the questions of whether a transaction is a sham, on the one hand, and whether it is intended to evade mandatory legislation, on the other, are not so easy to separate in practice. This separation assumes that the decision whether a transaction is a sham is independent of the decision of whether the transaction is in breach of certain statutory law.[44] It further assumes that judges, first, construe the terms of the documentary form and determine the rights and obligations of the parties not taking into account what impacts that may have for the application of statutory law. Thus, the assumption is that only after having construed the terms of the documentary form would courts analyse and decide whether the statute applies or not to the transaction. In the case of the example of the sale and hire and purchase agreement given earlier in this chapter,[45] judges would first determine the rights of A and B, to then construe the meaning of the insolvency statue. Based on these two independent conclusions, they would decide whether the meaning of the statute matches the content of the transaction.

In practice, however, and as I will explain in Chapter 6,[46] sometimes these two decisions get intermingled. In some contexts, judges tend to construe the rights and obligations of the parties in light of the meaning of the statute.[47] When this is the case, they may, for instance, conclude that the documentary form executed by the parties is a sham concealing a different substance, which in turn falls within the scope of the statue. In determining this substance of the transaction, however, the statute itself plays a significant role. More of this will be elaborated in Part II. For now, it is sufficient to say that the prevailing understanding separates the determination of whether a transaction is a sham from whether it circumvents mandatory law, and this separation limits the applicability of the doctrine of sham transactions in a narrow sense when addressing legal avoidance.

2.3. Two types of shams

[44] Susan Bright, 'Avoiding Tenancy Legislation: Sham and Contracting Out Revisited' (2002) 61 Cambridge LJ 146, 149-150.
[45] See this Chapter 1, section I.
[46] See Chapter 6, section IV.2.
[47] See, for instance, *Re Watson* (1890) 25 QBD 27; *Madell* (n 4), and *Bankway Property Ltd v Pensfold-Dusford* [2001] 1 WLR 1369.

Before concluding it should be mentioned that sham transactions in the narrow sense can be of two types. As observed extra judicially by Lord Neuberger of Abbotsbury:

> 'The first use of the word [sham] is to describe a document which is, on analysis, to be treated in law as having no effect. The second use of the word is to describe a document which purports to have one effect, but, as a matter of law, has a different effect'.[48]

In the civilian tradition, these two different meanings of sham find the equivalents of two types of simulation, namely that of the *total* and *partial* simulations.[49] Borrowing this language, one may observe that in a 'total' sham the parties execute a sham document concealing that they did not intend to create any rights and obligations and that the document is only for sake of appearance. This is usually the case of sham trusts, where the settlor uses a sham declaration of trust whilst retaining beneficial ownership.[50] If the court concludes that the declaration of trust is a sham the inquiry ends there. There is no underlying transaction to uncover. In turn, in a 'partial' sham the parties intended to create binding rights and obligations, only that those intended are different to the rights and obligations contained in the documentary form. This is the case, for instance, of a sham licence concealing a lease,[51] or a purported fixed charged concealing a floating charge.[52] Once the sham is discovered it is necessary to discover what is hidden behind the form.

This distinction between 'total' and 'partial' shams is relevant, for the effects of total and partial shams are not precisely the same. As discussed in more detail in Chapter 4, in the case of a 'total' sham, once the sham is discovered, the substance is a vacuum. By contrast, in the case of 'partial' sham, once the sham is discovered there is a substance to deal with.

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[48] Lord Neuberger of Abbotsbury, 'Company charges' in Edwin Simpson and Miranda Stewart (eds), *Sham Transactions* (OUP 2013) 158, 158.
[49] Bianca (n 7) 653; René Demogue, *Traité des obligations en général. I. Sources des obligations. Tome I.* (Rousseau & Cie 1923) 259; León Hurtado (n 9) 104-105.
[50] *Bank plc v Wyatt* [1997] 1 BCLC 242.
[51] *Antoniades* (n 13).
[52] *Orion Finance Ltd v Crown Financial Management Ltd* [1996] BCC 621.

2.4. Summary

In summary, for the doctrine of sham transaction in the narrow sense, the substance of sham transactions and the divergence between form and substance concerns the rights and obligations the parties create and not the economic result they intend or achieve. Consequently, the example of the transaction between A and B referred in the opening of this Chapter is not a sham in a narrow sense. It might be an artificial transaction concluded to avoid insolvency law, where the ultimate economic purpose of the parties was to grant a security in exchange for fresh resources. However, the parties intended the rights created by the sale followed by the hire and purchase agreement, and these agreements did not conceal the substance of their understanding. The transaction may be challenged on different grounds but not on the basis of being a sham. As argued before, restricting the substance of the transaction to the rights and obligations applying to the parties to the transaction, and excluding the parties' purposes and the economic result they achieve, limits the applicability of this doctrine for tackling legal avoidance.

3. Substance in simulated transactions in the narrow sense

Similar to the English doctrine of sham transactions in the narrow sense, in Italy, France and Chile, simulated transactions in the narrow sense are transactions where the external form conceals and gives a misleading appearance of the parties' rights and obligations and not about economic results. However, in Italian, French, and Chilean legal systems this assertion is not as straightforward as it is in English law. One can reach this conclusion only after dealing with some significant degree of ambiguity.

One reason for this ambiguity is the limited legislative recognition of the doctrine of simulation in civilian jurisdictions. Neither the Italian,[53] nor the French,[54] nor the Chilean codes,[55] provide a comprehensive definition of what a simulated transaction is, nor what makes a transaction simulated. As a result, the structural elements of simulated transactions, including what the substance of a simulated transaction is, depend to a large extent on the opinions of legal scholars and on courts' decisions. Compounding this difficulty is the fact that there is some tension between the opinions of legal scholars and courts' decisions. Albeit using an abstract and sometimes ambiguous language, very often legal scholars and courts, but particularly the former, argue that the sense in which the form and substance of simulated transactions diverge consists in the fact that the rights and obligations the parties recite are not the rights and obligations that bind them. However, on other occasions, legal scholars but more often courts, argue that the form and substance of simulated transactions may also diverge in the sense that the documentary form of the transaction is alien to the purpose of the parties and the economic result they achieve.

In light of these difficulties, this dissertation takes the explanations and the definitions as they are presented in legal scholarship to provide an account of simulated transactions in the narrow sense. This approach is preferred over relying primarily on courts' decisions for, as will become apparent, it better explains the distinctive character of simulated transactions and also the function they perform. In

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[53] Arts. 1414 to 1418 of the Italian Civil Code provide a comprehensive regulation of the effects and proof of simulated transactions, but it is very modest in defining their structural elements. See Alberto Auricchio, *La simulazione nel negozio giuridico* (Jovene 1957) 23; Franco Anelli, *Simulazione e interposizioni,* in V. Roppo (ed). Trattato del Contratto. III. Effetti (2a edn, Giuffrè Editore 2023) 594.

[54] Art. 1201 of the French Civil Code characterises simulated contracts as contracts where an apparent contract conceals a secret contract. This description does not clarify whether the parties conceal the legal rights they create or the economic result they achieve through the contract. For a general overview of this provision, see Gaël Chantepie and Mathias Latina, *Le nouveau droit des obligations. Commentaire théorique et pratique dans l'ordre du Code civil* (2nd edn, Dalloz 2018) 503-510.

[55] The Chilean Civil Code does not contain any provision explicitly regulating the doctrine of simulation, but it is an elaboration of legal scholarship and courts' decisions based, among others, on arts. 966, 1445, 1560 and 1707 of the Civil Code. See Daniel Peñailillo Arévalo, 'Cuestiones teórico-prácticas de la simulación' (1992) 191 Rev. de Derecho U. de Concepción 7, 8. In more recent times, the doctrine of simulation has been legislated for tax purposes. See Cristián Boetsch Gillet*, La norma general anti elusión: análisis desde la perspectiva del Derecho Privado* (Ediciones UC 2016).

addition, in civilian jurisdictions, and particularly in Italy,[56] France[57] and Chile[58], legal scholarship ('la dottrina' in Italy, 'la doctrine' in France, and 'la doctrina' in Chile) has historically played a crucial role in the law-making process and in shaping legal interpretation.[59] Finally, in all of these jurisdictions the number of court decisions far exceeds any number that can be meaningfully analysed.[60] This is not to say the courts' decisions are completely ignored in this account of the doctrine of simulation in the narrow sense. They are considered when they are consistent with the teachings of legal scholars.

3.1. Substance in the definitions and characterisations of simulated transactions by legal scholars

Civil law legal scholars have often conceptualised simulated transactions and the divergence between form and substance using ambiguous language. Particularly in

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[56] Alexandra Braun, 'Professors and Judges in Italy: It Takes Two to Tango' (2006) 26 OJLS 665.

[57] Philippe Jestaz and Christophe Jamin, *La doctrine* (Dalloz 2004); Philippe Jestaz and Christophe Jamin, 'The Entity of French Doctrine: Some Thoughts on the Community of French Legal Writers' (1998) 18 Legal Studies 415.

[58] Arturo Alessandri R., Manuel Somarriva U. y Antonio Vodanovic H., *Tratado de Derecho Civil. Partes preliminar y general, Tomo I* (7th edn, Ed. Jurídica de Chile 2005) 183; Ducci Claro (n 17) 83-85, and José Joaquín Ugarte Godoy, *Curso de derecho civil. El derecho civil y teoría de la ley* (Thomson Reuters 2021).

[59] This said, in Germany, and arguably elsewhere in civilian jurisdictions, the influence of legal scholarship is nowadays counterbalanced by the increasing influence of courts decisions. See Stefan Vogenauer, 'An Empire of Light? II: Learning and Lawmaking in Germany Today' (2006) OJLS 627. See also Nils Jansen, 'Hermann Kantorowicz' Concept of Legal Science and the Social Role of Legal Scholarship Today' (2022) 26 ELR 321, who argues that the role of legal scholarship is no longer taking part in the lawmaking process but making the law accessible and understandable. For the relationship between judges and legal scholarship in England, see Alexandra Braun, 'Judges and Academics: Features of a Partnership' in J Lee (ed), *From House of Lords to Supreme Court. Judges, Jurists and the Process of Judging* (Hart Publishing 2010) 227.

[60] A few statistical indicators may illustrate this fact very neatly. In France, Courts of Appeals issue around 180.000 decisions per year, while the *Cour de Cassation* issues another 20.000. See Court de cassation, *Rapport Annuel 2020* (Paris 2021). In Italy, the civil section of *Corte Suprema di Cassazione* alone gives around 30.000 decisions per year. See Corte Suprema di Cassazione, *Cassazione Civile. Anuario Statistico 2021*, www.cortedicassazione.it/resources/cms/documents/AG2022_ANNUARIO_civile-2021.pdf accessed 5 July 2024. In Chile, the Corte Suprema issues between 50.000 to more than 100.000 decisions per year. See information in <https://numeros.pjud.cl/> accessed 17 January 2023. These numbers are dramatically higher than the numbers of the Supreme Court and Judicial Committee of the Privy Council of the United Kingdom, which together do not give more than 150 decisions per year. See The Supreme Court, *The Supreme Court and Judicial Committee of the Privy Council Annual Report and Accounts 2021–2022* (HC 499, 2022) < https://www.supremecourt.uk/docs/annual-report-2021-2022.pdf>, accessed 5 July 2024.

Italy, during the 20th century, jurists and legal scholars engaged in vigorous debates[61] concerning the conceptualisation and definition of simulated transactions. In these debates, they tended to characterise simulated transactions using terminology rooted in theoretical frameworks.[62] However, they frequently failed to clearly define, in more concrete terms, the sense in which the form and substance of simulated transactions diverge.[63] As a consequence, these conceptualisations leave some ambiguity about the exact nature of the divergence between form and substance in simulated transactions.

In what follows, I will discuss four different conceptualisations of simulated transactions and particularly of the divergence between form and substance both in Italy and France. I will begin with the conceptualisations that are more ambiguous in the answer they provide to this question. I finish with the one that, although not free of every ambiguity, I believe gives the clearest answer.

i. <u>Ferraras' account of simulated transactions and the recourse to the real intention</u>

At the beginning of the 20th century, and under the influence of the German Pandectists,[64] the Italian legal scholar Francesco Ferrara published a monograph on

[61] For a more comprehensive overview of this debate in Italy, see Aurelio Gentili, *Il contratto simulato. Teorie della simulazione e analisi del linguaggio* (Jovene 1982) 7-83. See also Raffaele Lenzi, *Simulazione. Art. 1414-1417* (Giuffrè 2017) 10-23.

[62] As to the general trend in Italian scholars for debating about theoretical questions, see Mauro Cappelleti and others, *The Italian Legal System. An Introduction* (2nd edn, Sandford University Press 2015) 142-176. Good examples of characterisation of simulation using terminology rooted in theoretical frameworks are Ferrara (n 1), who characterised simulation resorting to the doctrine of 'declaration of intent', and Betti (n 26), who characterised simulation on the basis of the doctrine of the cause.

[63] This is particularly the case in Italy. It should be observed that during the first half of the 20th century, at least, the academic discussion concerning the doctrine of simulation was very much understood as part of the broader discussion of the legal nature of the 'negozio giuridico', namely the concept of 'legal transaction'. See F Anelli (n 53) 600. This contributed to framing the discussion of the doctrine of simulation within the borders of the theoretical and abstract concepts developed to explain the 'negozio giuridico'. Iconic examples of this trend are Ferrara (n 1), and Betti (n 26). Legal literature later observed that Italian legal scholarship seems to have ignored the difficulty of the meaning of the divergence between form and substance, or have referred to its meaning only superficially. See Massimo Bianca, *Il divieto del patto commissorio* (Giuffrè 1957) 268.

[64] As from the late 19th century, but specially during the first half of the 20th century, Italian jurists started to be influenced not only by the law developed in France, but also in Germany, where the Pandectists had elaborated a complex legal system based on Roman Sources. Even though this system introduced a set of legal categories that were not found in the Italian Code of 1865, Italian jurists felt attracted by this new system and started to use it to understand their own legal system. Core and distinctive categories of this system are the legal concepts of 'Rechtsgeschäft' and 'Willenserklärung', regularly

simulated transactions that has had a tremendous impact both on courts' decisions[65] and legal scholarship[66] in Italy and beyond. In simple terms, for the Italian jurist, simulated transactions consist in transactions where there is a deliberate divergence between what the parties declare, on the one hand, and *what they actually intend*, on the other.[67] Accordingly, in a simulated transaction the parties make an external declaration of intent devoid of their *real intention*.[68] This 'real' intention remains concealed, meaning that the parties create a misleading appearance disguised from third parties.[69] For instance, while they may declare to conclude a sale, their real intention is to conclude a donation. The divergence between external declaration and internal 'intention' then, is the key concept for this understanding of simulated transactions.[70] The form would be the external declaration and the substance the internal intention.

An important difficulty with this conceptualisation is that the notion of 'intention' is not conclusive as to what the object is at which the parties' intentions are directed. The parties to a transaction may intend rights and obligations but, as we saw earlier, possibly also an economic result. For instance, when A sells a certain moveable to B, their intention consists in acquiring the correlative rights and obligations of transferring the moveable and paying the price. However, their intention may also include that A

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translated as 'legal transaction' and 'declaration of intent', where 'Rechtsgeschäft' comprises any declaration of intent (that is any 'Willenserklärung') intended to produce legal effects, including a contract, a will, the act of getting married, or any other voluntary undertaking producing the legal consequences intended by its author(s). See Filippo Ranieri, 'Hacia los orígenes del derecho civil europeo. Algunas observaciones sobre las relaciones entre pandectística alemena y doctrina civilista italiana en materia de negocio jurídico' (2015) 28 Rev. Derecho Privado 14.

[65] In Italy, see for instance, Cass. 17 july 1962 n. 1905; 15 sept. 1986 n. 5599, cited in *La Giurisprudenza sul Codice Civile,* art. 1414.2, 491. In Chile, in a decision dated on December 7 1995, the Court of Appeal of Temuco cited Francesco Ferrara. See Corte de Apelaciones Temuco, 7 Dec. 1955, RDJ T. 52, Part 2, sec. II, 60. Since then and until nowadays, Chilean Courts, and particularly the Chilean Supreme Court has constantly cited Ferrara.

[66] In Italy, and among others, Luigi Cariota-Ferrara, *I negozi fiduciari* (CEDAM 1933); Giuseppe Stolfi, *Teoria del negozio giuridico* (Not identified tr, Olejnik 2018). Anelli (n 53) 600, fn 34 also refers to its impact in court decisions. In Chile, among many others, León Hurtado (n 9) 103-116; Raúl Díez Duarte, *La Simulación de Contrato en el Código Civil Chileno. Teoría jurídica y práctica forense* (3th edn, Editorial Metropolitana 2014); López Santa María (n 17) 326-336; René Ramos Pazos, *De los contratos. Teoría General* (Thomson Reuters 2023) 117-130; In France, Demogue (n 49) 259-278; José Vidal, *Essai d'une théorie générale de la fraude en droit français, le principe 'fraus omnia corrumpit'* (Dalloz 1957); Michel Dagot, *La simulation en droit privé* (LGDJ 1967).

[67] Ferrara (n 1) 38.

[68] See the parallels of this understanding with M. F. C De Savigy, *Sistema del Derecho Romano Actual. Tomo Segundo* (Jacinto Mesía y Manuel Poley tr, Centro Editorial Góngora nn) 301-304.

[69] Ferrara (n 1) 38.

[70] Ferrara (n 1) 29.

invests the price paid in a particular business; that A then spends those funds to repurchase the same moveable from B; or even that B transfers the sold moveable to C to avoid a personal incapacity that prohibits a direct transfer from A to C. Thus, explaining simulated transactions by reference to the internal 'intention' of the parties, without specifying the object of this intention, does not clarify to what extent the substance of a simulated transaction consists only in the rights and obligations that bind on the parties and to what extent it comprehends also the economic result they achieve.[71]

These difficulties seem to be one of the reasons why most Italian scholars today consider Ferrara's explanation of the doctrine of simulation an influential one but prefer different alternative explanations.[72] That said, this is by far the prevailing explanation in Chile to this day, both among legal scholars[73] and court decisions.[74]

ii. Substance and the 'typical cause' of the transaction

One of these alternative explanations to Ferrara's view was the one by the Italian jurist Emilio Betti[75] in the mid-20th century. Betti advanced a theory of legal transactions based on the doctrine of the 'cause', which he characterises as the socio-economic function that legal transactions perform. Betti's theory is that legal transactions produce legal effects not because they result from a declaration of intent but because of the socio-economic function they perform.[76] Only because legal transactions perform these economic and social function are they binding. For instance, contracts of sale create binding obligations not because of the consent of the parties but

[71] This is not to say that Francesco Ferrara did not have a defined understanding of simulated transaction. On the contrary, he made very interesting points and distinctions when separating simulated transactions from fiduciary and from transactions in *fraudem legis*. See in this regard Ferrara (n 1) 45-66. However, the very formulation of what a simulated transaction is and the categories he uses are ambiguous as to what exactly is that the external form of a simulated transaction conceals.
[72] Anelli (n 53) 600 fn 34; Lenzi (n 61) 12; Bianca (n 7) 654-655.
[73] See references in n 66.
[74] Among many others, and just to mention recent decisions, see Corte Suprema, 12 Mar. 2021, Rol Nº 6.711 – 2019; Corte Suprema, 24 May. 2021, Rol Nº 12.620-2019; Corte Suprema, 31 May. 2021, Rol Nº 12.462-2018; Corte Suprema2 Jul. 2021, Rol No. 3205-2019; Corte Suprema, 15 Sep. 2021, Rol No. 9793-2019; Corte Suprema, 4 Nov. 2021, Rol Nº 12.987-2019.
[75] Betti (n 26). For an alternative explanation of the doctrine of simulation but also based on the doctrine of the cause, see Salvatore Romano, 'Contributo esegetico allo studio della simulazione (L'art. 1414 c.c.)' (1954) 8 Rivista Trimestrale di Diritto e Procedura Civile 15.
[76] Betti (n 26) 139-142.

because they facilitate the exchange of goods for money, a function that the legal system recognises and protects. This socio-economic function is, according to Betti, the 'typical cause' of legal transactions.[77]

While the typical cause of legal transaction is supposed to match with the practical purpose of the parties,[78] Betti recognised that this is not always the case. And this is where simulated transactions arise. According to Betti simulated transactions consist of transactions where the parties have a practical purpose that is *incompatible* with the socio-economic function of the chosen transaction.[79] For example, the parties aim to circulate goods gratuitously, but they use a contract of sale whose typical function is to exchange goods for money. Betti observes that a mere incongruence between the typical cause and the practical purpose of the parties does not suffice to constitute a simulated transaction.[80] A simulated transaction means an actual incompatibility between the two; an impossibility to achieve the practical purpose of the parties and to fulfil the socio-economic function of the legal transaction.

Betti's theory encounters two fundamental difficulties in showing how form and substance diverge simulated transactions. The first is that the doctrine of the 'cause' is itself problematic, and there has been a significant debate on whether the economic function of a contract is or is not for legal purposes the cause that matters.[81] The second difficulty is the doubts arising from the assertion that there is a specific socio-economic function for each type of legal transaction. Legal transactions may serve more than one socio-economic function, and they may not even be 'typical' but are the result of the particular needs of the parties in a given case.[82] Thus, it is not always possible to take the typical cause of every legal transaction for granted and then contrast this typical cause with the practical purposes of the parties.

[77] Betti (n 26) 151-159.
[78] Betti (n 26) 162-164.
[79] Betti (n 26) 291-298.
[80] Betti (n 26) 292.
[81] For a general overview of the different meanings and understanding of the doctrine of the cause in Italian contract law see Bianca (n 7) 409-451.
[82] Bianca (n 7) 412-414.

Betti's theory, then, like Ferrara's, has been generally rejected in Italy.[83] That said, it is important to keep Betti's theory in mind for a variety of reasons. First, as will be shown later in this chapter, requiring an 'incompatibility' between the typical cause and the practical purpose of the parties is one way of distinguishing simulated transactions from other types of transactions with which they share some similarities. This distinction is useful in specifying the sense in which form and substance diverge in simulated transactions. Likewise, Betti's theory has been of influence in Italian courts[84] and to some degree in Chile as well.[85] Finally, Betti's explanation of simulated transactions shows that in that in civilian jurisdictions there is a conjunction between the legal content of legal transactions and the economic result the parties achieve. This conjunction, in turn, is also present in France and the following section shows, brings some ambiguities to the understanding of simulated transactions.

iii. Substance as the 'contre-lettre'

The next explanation of simulated transactions to examine here is the one that prevails in France. Based on art. 1201 of the French Civil Code currently in force, and art. 1321 of the French Civil Code (in the version prior to the 2016 Ordonnance for the Reform of the law of Contract),[86] French legal scholars[87] usually conceptualise simulated transactions as two divergent contracts. In order to understand this conceptualisation, it may be instructive to take a look at the two codal provisions.

Art, 1201 of the Code provides as follows:

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[83] Lenzi (n 61) 11-12; Bianca (n 7) 655.

[84] Lenzi (n 61) 11, fn 33.

[85] At least to the extent that simulated transactions are sometimes explained as transactions that lack of a cause. See, for instance, Peñailillo (n 55); José Rivera Restrepo, 'Una mirada a la doctrina de la causa y sus distintas versiones en el Código Civil chileno' (2010) 18 Revista De Derecho (Coquimbo) 305, 321-322.

[86] Ordonnance n° 2016-131 of 10 February 2016 revised then by Loi 2018-287 of 20 April 2018.

[87] Among many others, Marcel Planiol et Georges Ripert, *Traité Pratique de Droit Civil Français, Tome VI Obligations* (2 edn, LGDJ 1952) 425; George Ripert and Jean Boulanger, *Droit civil. D'Après le traité de Planiol. Tome II. Obligations* (Libraire Générale de Droit et de Jurisprudence, 1957) 222, para 586; J Flour, J Aubert and E Savaux, *Droit civil. Les Obligations. 1. L'acte juridique* (16th edn Dalloz, 2014) 407 ; Christian Larroument, and Sarah Bros, *Traité de droit civil. 3. Les obligations, le contrat* (7th edn Economica, 2014) 964; P Malaurie, L Aynès, P Stoffel-Munck, *Droit des obligations.* (10th edn LGDJ, 2018), 413 ; M Fabre-Magnan, *Droit des obligations,* vol 1 (4th edn thémis, 2016); Terré and others (n 17) 792-793.

‘Art. 1201.- Where the parties have concluded an apparent contract which conceals a secret contract, the latter (also called a ‘counter-letter’) takes effect between the parties. It cannot be set up against third parties, though the latter may rely on it’.

In turn, former art 1321 established (in a much shorter form) the following:

‘Art, 1321.- Counter-letters take effect only between the contracting parties; they cannot be set up against third parties’.

Based on these provisions, French legal scholars submit that in a simulation two ‘lettres’ or two contracts coexist.[88] In an apparent contract (the ‘lettre’), the parties create the appearance of a certain contract, and in a secret contract (the ‘contre-lettre’), they specify the extent to which the apparent contract is ‘real’. Under this conceptualisation, then, the ‘lettre’ contains the form and the ‘contre-lettre’ contains the substance.

On occasions, French scholars make remarks that seem to restrict the ‘substance’ of simulated transactions to the rights and obligations the parties create, and not to include the ulterior economic result they achieve. They, for instance, have remarked that to have a simulated contract, the counter-letter needs ‘to contradict’ or ‘to neutralize’ the apparent contract, because otherwise the parties will have accepted all the legal consequences of the apparent contract, and therefore would have simulated nothing.[89] In a similar vein, Planiol and Ripert have observed that in the

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[88] It should be observed that while in the 19th century it was controversial whether the notions of ‘lettre’ and ‘contre-lettre’ were to be understood in their literal documentary meaning, modern scholarship consistently observed that the ‘contre-lettre’ consists in a secret agreement and not necessarily in a secret document. See Claude Ophèle, ‘Simulation’ in Éric Savaux (ed), *Répertoire de Droit Civil, Tome X* (Dalloz 2012) 8. This swift is reflected in current art. 1201 of the Code which uses the words ‘secret contract’ and keep the mention to the ‘*contre-lettre*’ probably because it is the language that French legal scholars have used throughout the past centuries.

[89] To explain this distinction about when a counter-letter involves a simulation and when it does not, Bredin gives the following example. A contract of adoption where the prospective parents and prospective son use the adoption for the sole purpose of reducing inheritance tax is not simulated, he argues, even if they understand that their only interest in the contract is to reduce inheritance tax. This is still a real and not a simulated contract because its legal content remains unchanged. Both parties, he argues, accept its legal consequences, namely, to consider themselves as father and son. Such contract, he concludes, may be voidable on the grounds of *fraudem legis* but not simulated. See Jean-

‘contre-lettre’ the parties rule out at least some of the legal effects of the apparent contract,[90] and, as art. 1101 provides, the legal effects of a contract essentially are the rights and obligations arising from it.

That said, under French contract law, neither the purpose of the parties nor the economic result they achieve can be totally separated from the legal content of the contract they conclude. Naturally, this conjunction leads to ambiguities. Some French legal scholars,[91] for instance, define a contract as an agreement that creates a legal rule governing the interests of the parties, and these interests include the economic result that the parties intend. Likewise, the doctrine of the ‘cause’, very characteristic of French contract law for centuries, is linked both to the economic function of the contract and the purposes and motives of the parties. Among the different theories about the meaning of the cause of contract, there are those that propose that the cause of a contract consists in the economic function it serves[92] and those that see the cause of the contract in the motives of the parties, particularly relevant controlling the legality of the contract.[93] Although the Ordonnance of 2016 no longer uses the term ‘cause’ in specifying the requirements for the validity of contracts, the ‘but’ or purpose of the parties, as defined in article 1162, remains a relevant factor in determining the effectiveness of a contract.[94]

Moreover, in French law some types of contracts, including the contracts of partnership and donations, require that the parties have a specific intention toward an economic purpose for the contracts to come into existence. In a contract of partnership, the partners must share an *affectio societatis*, meaning the purpose to

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Denis Bredin, ‘Remarques sur la conception jurisprudentielle de l’acte simulé’ (1956) 54 RTD civ 261, 266-267.

[90] Planiol and Ripert (n 87) 428-429. Similarly, Josserand argues that in a simulation the parties conclude a transaction to then in a different transaction that is intended to remain concealed they ‘remove, modify or displace its effects’. See Luis Josserand, *Les mobiles dans les actes juridiques du droit privé* (Dalloz, 1928) 407.

[91] Terré and others (n 17) 88-92.

[92] Judith Rochfeld, *Cause et type de contrat* (LGDJ 1999), who distinguishes the cause in ‘typical contracts’ from the cause in ‘non typical contracts’.

[93] See Ghestin (n 27) 90-92. See also Josserand (n 90) 212-213.

[94] Laurent Aynès, ‘The Content of Contracts: Prestation, Objet, but No Longer la Cause?’ in John Cartwright and Simon Whittaker (eds), *The Code Napoléon Rewritten. French Contract Law after the 2016 Reforms* (Hart 2020) 137.

participate together in a shared enterprise.[95] In turn, in a donation, the transferee needs to have an 'intention libérale' or 'animus donandi', meaning the intention of suffering some impoverishment as a consequence of benefitting the beneficiary of the gift.[96] If there is no *affectio societatis*, there is no partnership. Similarly, if there is no 'intention libérale', there is no donation. The precise meaning of this subjective intention is, unsurprisingly, a matter of debate. However, it is widely accepted that as a specific requirement it is something other than the rights and obligations that the parties create, and very often is connected to the idea of an economic result the parties intend.[97]

In other words, in French contract law, the purpose of the parties and the economic result they intend is, at least to some extent, an element of the contract itself. Accordingly, arguing that in a simulation two contracts contradict each other does not necessarily exclude that the contradiction concerns their economic purposes. It is not very surprising, then, that French courts have used the doctrine of simulation to make ineffective and void contracts of partnership on the ground that the 'affectio societatis' of the parties was proven not to be real, even though it is highly doubtful that in these cases the apparent rights and obligations of the parties were different to the rights and obligation actually binding on them.[98] Likewise, it is of little surprise that to French courts the existence of an 'intention libérale' plays an important role in concluding that an apparently onerous transaction is, in substance, a disguised donation,[99] that is a simulated onerous transaction concealing a gratuitous one.

In summary, then, the way that French scholars usually characterise and define simulated transactions gives rise to some ambiguities as to the meaning of the substance of simulated transaction and as to its divergence to its form.

[95] See Ivan Tchotourian, *Verus une définition de l'affectio societatis lors de la constitution d'une société* (LGDJ 2011) 605-611. See also Paul Le Cannu and Bruno Dondero, *Droit des sociétés* (6th end, LGDL 2015) 74-80.
[96] For the meaning of this this element, see Michel Grimaldi, *L'intention libérale* (Thémis 2004); Philippe Malaurie et Claude Brenner, *Les Successions, les libéralités* (6 edn, LGDJ 2014) 189-190.
[97] Huguette Méau-Lautour, *La donation déguisée en droit civil français. Contribution a la théorie générale de la donation* (Dalloz 1985) 55-59; Ibrahim Najjar, 'Donation' in Éric Savaux (ed), *Répertoire de Droit Civil* (Dalloz 2008) 7-12.
[98] Ghestin, Jamin and Billiau (n 5) 929, para [867].
[99] Najjar (n 97) 42-53.

iv. Substance and the ‘accordo simulatorio’

Nowadays for most Italian scholars the key category to understand the doctrine of simulation is the agreement to simulate or the ‘accordo simulatorio’.[100] The ‘accordo simulatorio’, some Italian legal scholars observe, is the ‘essence of the phenomenon of simulation’.[101] The doctrine of simulation is ‘essentially distinguished by the agreement to simulate.[102]

The basic idea behind this conceptualisation is that in simulated transactions the parties conclude the apparent transaction, that is the form, but they also secretly agree in an ‘accordo simulatario’ the extent to which the apparent transaction is binding between them. While the apparent transaction contains the terms that the parties intend *vis-à-vis* third parties, the agreement to simulate contains the complete understanding of the parties, specifying which effects of the apparent transactions, if any, they intend to be binding as between them. For Italian jurists the agreement to simulate and the apparent transaction are *not* two different and separated transactions. They compose a complex but single transaction, with different effects *vis-à-vis* third parties and themselves.[103]

This understanding of simulated transactions differs from that of Ferrara, who argued that in simulated transactions, there is a lack of real intention. Now it is admitted that the parties *intend* the apparent transaction. This apparent transaction, then, is not deprived of true intention.[104] It is only that the agreement to simulate specifies that this intention is for limited purposes, namely for creating a normative content *vis-à-vis* third parties that is different from the normative content intended to govern the relationship between the parties. Likewise, the view built upon the ‘accordo simulario’ is different from the theory advanced by Betti since it does not link simulated transactions to the ‘cause’ of legal transactions. Moreover, it does not explain

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[100] Tiziana Montecchiari, *La Simulazione del Contratto* (Giuffrè 1999) 89; Anelli (n 53) 604-625; Sacco and De Nova (n 6) 655-656; Bianca (n 7) 655-657, para 373.
[101] Anelli (n 53) 609.
[102] Bianca (n 7) 655.
[103] Anelli (n 53) 600-615.
[104] Auricchio (n 53) 15; Lenzi (n 61) 9; Bianca (n 7) 652-657.

simulated transactions by reference to any of the defects of the structural elements required for the validity of legal transactions.

Even though in this conceptualisation of simulation the Italian style of using abstract and theoretical concepts to explain their law persists,[105] and legal scholars have debated about how to characterise the 'accordo simulatorio',[106] it nonetheless defines better what simulated transactions are and what it means to say that form and substance diverge. The 'accordo simulatorio' determines the actual legal relationship existing between the parties, and legal relationships are essentially composed of correlative rights and obligations rather than economic results. Thus, even if not explicitly, this way of understanding simulated transaction suggests that the divergence between form and substance that characterises simulated transactions is a divergence between the rights and obligations the parties declare in the documentary form and those that they make binding in their 'accordo simulatorio'. Finally, and as will be discussed in Chapter 4, the 'accordo simulatorio' proves to be fruitful for explaining the effects and functions of simulated transactions. This understanding should therefore be welcomed when explaining simulated transactions.

Before moving on to the next section, there is one final remark to make. None of these conceptualisations are accepted without qualification in the understanding of the doctrine of simulation in any of the jurisdictions considered in this dissertation. It is true that in France the conceptualisation based on the existence of a 'lettre' and 'contre-lettre' has a legislative recognition and prevails among legal scholars. However, the influence of Ferrara in France is undeniable; it often complements the traditional French account.[107] Similarly, while in Italy the understanding based on the notion of an 'accordo simulatorio' seems to prevail among legal scholars, the French understanding based on the coexistence a 'lettre' and a 'contre-lettre' has influenced

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[105] Cappelletti (n 62)
[106] Some Italian legal scholars argue that the 'accordo simulatorio' has a transactional nature, which means that it directly creates or modifies the rights and obligations of the parties. Other, argues that it is an 'atto di scienza', which means that it does not directly modify the rights and obligations of the parties, but only attests that those rights are different to the rights that the simulated transaction appears to create. See Bianca (n 7) 656-657; Francesco Galgano, *Il negozio giuridico* (Giuffè 2002) 367; Sacco and De Nova (n 6) 645; Anelli (n 53) 616-620.
[107] See Demogue (n 49) 259-278; Vidal (n 66); Dagot (n 66).

Italian legal scholarship both before[108] and after[109] the Code of 1942. Moreover, the formulations based on a defect in the intention of the parties and the typical cause of the transaction have been influential among Italian courts' decisions.[110] In Chile, while Ferrara's conceptualisation prevails,[111] the French understanding of the 'contre-lettres'[112] and Emilio Betti's explanations based on the typical cause are also influential.[113]

In other words, in all these jurisdictions, this diversity of conceptualisations of simulated transactions in legal literature is in different degrees mixed in how legal scholars and courts understand the doctrine of simulation in these different jurisdictions. This variety of conceptualisations enhances the malleability of the doctrine of simulation as applied by the courts, but also comes with the cost of losing consistency and coherence. Depending on the context, different conceptualisations may be of more or less usefulness, a variety that, as Part 2 will show, gives courts more discretion in defining the boundaries and scope of this doctrine.

The picture that surfaces, then, is the following: while legal scholars in Italy, France and Chile have undertaken various efforts to formulate what a simulated transaction is, they have usually failed to outline with clarity what the difference between form and substance is. As a consequence, these formulations can be read in different ways, at one time substance meaning only the rights and obligations of the parties and at others, extending to their purposes and the economic results they achieve. For this reason, in order to better understand the sense in which form and substance in simulated transactions diverge one needs to look elsewhere. As I argue in the next section, the distinction between simulated transactions and 'indirect transactions' brings more light to this point.

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108 See Giuseppe Messina, 'La simulazione assoluta' (1907) Riv. Dir. Comm. E obbligazioni, 460. Republished in Giuseppe Messina, *Scritti Giuridici V* (Giuffrè 1948). I consulted the republished version.
109 Sacco and De Nova (n 6) 638-642.
110 See, for instance, Cass. 23 Jun. 1972, n. 2102, rv. 359323, cited in *Codice Civile Pescatore and Ruperto,* art. 1414.1, 2409 and *Codice Civile Ciafardini and di Pirro* art. 1414.1, 1353; and Cass., 18 Ago. 1997, n. 7682, in Giur. It., 1998, 1342, cited by Lenzi (n 61) 11, fn 33.
111 See, for instance, León Hurtado (n 9) 103-116; López Santa María (n 17) 382-394; Ramos Pazos (n 66)
112 See, for instance, Diéz Duarte (n 66).
113 See, for instance, Peñailillo (n 55) and Rivera (n 85) 321-322, who explain simulated transactions as transactions that lack a cause.

3.2. Substance in the distinction between simulated and indirect transactions

In Italy, France and Chile, legal scholars have argued that simulated and indirect transactions are different, or in other words, that simulated transactions are not indirect transactions. Looking at this negative description of this doctrine, the meaning of this divergence between form and substance in simulated transactions becomes clearer.

i. Indirect transactions

The concept of indirect transactions, as developed by civilian legal scholars and adopted by courts, is not found in codes but in legal scholarship. Unsurprisingly, therefore, different legal scholars will disagree on some technical aspects of this legal category. Here we need merely observe that indirect transactions consist in transactions where the parties create certain rights and obligations that are only instrumental to achieve an ulterior economic result that the parties might have achieved more directly using a different transactional form.[114] Using a contract of sale for security purposes, for example, may be characterised as an indirect transaction. Likewise, a contract of partnership to benefit one partner at expense of the other may be seen as an indirect donation.

The terminology and specific classifications vary depending on the legal scholar and the jurisdiction in question.[115] Generally speaking, however, indirect transactions may include fraudulent transactions (transactions *in fraudem legis*), which are transactions where the economic result the parties achieve thwarts the purpose of

[114] In Italy, Ferrara (n 1), 71-76, L Cariota-Ferrara (n 66) 39; Betti (n 26) 294; Bianca (n 63) 273-284; Sacco and De Nova (n 6) 691. In France, Dagot (n 66) 33-47; Florence Deboissy, *La Simulation en Droit Fiscal* (1997 LGDJ, Lextenso éditions) 44-46; In Chile, Fernando Fueyo Laneri 'Algunos aspectos del negocio fiduciario' (1959) RDJ t 56, Primera Parte, 49; Adolfo Wegmann Stockebrand 'Fiducia cum creditore y simulación. La validez de la venta en garantía' in Alejandro Guzmán Brito (ed), Estudios de Derecho Civil III (Legal Publishing 2008) 599; Hernán Corral Talciani, *Curso de Derecho Civil. Parte General* (Legal Publishing 2018) 736-739.

[115] To some legal scholars, indirect transactions consist in a generic concept where fiduciary transactions and transactions in *fraudem legis* are specific cases. Other scholars consider that the three are related but distinct and independent concepts. See Ferrara (n 1) 71-76; Sacco and De Nova (n 6) 691.

mandatory legislation.[116] They may also refer to different forms of *fiducia*, including the *fiducia cum amico* and *fiducia cum creditore*, where by using the form of a will or a sale, for instance, some property passes or is transferred to someone but for the benefit of someone else.[117] Finally, they may also include indirect donations, which consist in transfers that do not take the legal form of an act of donation (eg usually a notarial deed) but that produce the economic effect of enriching the transferee at expense of the transferor.[118] These different categories of indirect transactions may, and often do, overlap. A *fiducia cum amico,* for instance, may be a fraudulent transaction if it is a device used to defeat legislation that prohibits a direct transfer from the transferor to the final beneficiary. Similarly, an indirect donation may consist in a transaction *in fraudem legis* if used to evade restrictions on testamentary freedom or to avoid tax consequences triggered by direct donations.

The importance of all this for the purposes of this Chapter is that that if indirect transactions are to be explained in terms of a divergence between form and substance, 'substance' would not be limited to the parties' rights and obligations. 'Substance' would include the economic result the parties achieve. That is what ultimately defines an indirect transaction: the unusual or non-typical economic result. Coming back to the example given earlier in this chapter,[119] the second meaning of substance is the one that characterises indirect transactions. The substance of the transaction of the example consists not only in the rights A and B recited, but also the economic result of a secured financial transaction.

For this reason, the extent to which simulated and indirect transactions can be distinguished and separated is crucial for the purpose of better understanding what simulated transactions are. If indirect transactions and simulated transactions overlap, then the substance of simulated transactions and the divergence between form and substance in simulated transactions would at least sometimes comprehend and

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[116] Reinhard Zimmermann R, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (OUP 1996) 702; Sacco and De Nova (n 114) 1044; Planiol and Ripert (n 87) 445.
[117] Luis Caritota-Ferrara (n 114); Bianca (n 7) 668-671. For the historical development of the *fiducia* in Italy and France in testamentary context, see M Graziadei, 'The Development of Fiducia in Italian and French Law fom the 14th Century to the End of the *Ancien Régime*' in R Helmholz and R Zimmermann (eds), *Itinera fiduciae – Trust and Treuhand in Historical Perspective* (Duncker and Humblot 2013) 327.
[118] P Malaurie et C Brenner (n 96) 230.
[119] See this Chapter, section II.1.

include the economic result the parties achieve. By contrast, if it is possible to draw a clear distinction between these two types of transactions, there will be no reason to include in the substance of simulated transactions anything in addition to the rights and obligations that the parties intend to create. The economic result the parties achieve would not be included in simulated transactions. The economic result of the parties would belong to the domain of indirect transactions only. As discussed above, these two types of transactions do not overlap.

ii. <u>Indirect transactions are not simulated transactions</u>

Although throughout history in the civil law tradition there has been a vacillation between distinguishing and entangling simulated and indirect transactions,[120] at least from the beginning of the 20th century civilian legal scholars have defended more consistently the view that indirect and simulated transactions are *not* the same thing. The Italian jurist Francesco Ferrara, for instance, distinguished simulated from indirect transactions disapproving of views that muddled the two.[121] He argued that although it is true that, for instance, in a fiduciary transaction the parties pursue an economic result different from the one expressed by the documentary form to which they resort, 'this does not prevent the transaction from being serious and real in its legal form'.[122] Ferrara indeed explained that in indirect transactions there is a disproportion between the economic and the legal dimensions of the transactions, but that in contrast to simulated transactions, the legal aspect of the transaction is real and not a mere *façade.*[123] Since then, Italian jurists have consistently distinguished the two categories of transactions.[124]

[120] For this vacillation in history see MD Blecher, 'Simulated Transactions in the Later Civil Law' (1974) 91 S African LJ 358, 361 concerning simulation and *fraudem legis*; M Graziadei (n 117) 353 and 356, for the use of the doctrine of simulation to explain the *fiducia* in France and Italy during the *ius commune*.
[121] Ferrara (n 1) 45, for the difference between simulated and fiduciary transactions; and Ferrara (n 1) 56, for the difference between simulated transactions and transactions in *fraudem legis*.
[122] Ferrara (n 1) 48.
[123] Ferrara (n 1) 71-76.
[124] L Caritota-Ferrara (n 114) 43; Auricchio (n 53) 219; Bianca (n 7) 670; Sacco and De Nova (n 6) 621. This does not mean that legal scholars do not sometimes admit some difficulties and ambiguities in the distinction. See, in particular, Betti (n 26) 295.

In France, in turn, the influential monograph on fraudulent transactions written by José Vidal[125] followed Ferrara's arguments. Vidal emphasised that while in a fraudulent transaction the parties use a real transaction to commit fraud, the doctrine of simulation concerns unreal transactions.[126] Other French legal scholars, both before and after José Vidal, have drawn a similar distinction.[127] Likewise, and consistently with this distinction, French scholars distinguish disguised and indirect donations, where only the former is a case of simulation.[128] While in both types of donations the parties do not use the legal form of an act of donation but achieve its economic result, namely enriching the transferee at expense of the transferor, only in a disguised donation do the parties conclude a simulated transaction to conceal a real donation. By contrast, in the case of an indirect donation, the parties conclude a real transfer that enriches the transferee but by using other forms than an act of donation.

In Chile, while fiduciary and indirect transactions have not been extensively explored, when Chilean legal scholars have discussed these types of transactions, they have concluded that indirect and fiduciary transactions are different from simulated transactions, giving similar reasons to the ones found in Italian and French scholars.[129] Likewise, Chilean scholars often distinguish simulated from fraudulent transactions. The former consist of transactions that do not contain the real understanding of the parties, and the other of real transactions that from an economic and practical perspective thwart the purpose of mandatory legislation.[130]

Simulated and indirect transactions, then, are different things. And this distinction clarifies the meaning of the divergence between form and substance that

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[125] Vidal (n 66).

[126] Vidal (n 66) 183.

[127] Ripert and Boulanger (n 87) 259; Dagot (n 66) 50-57; Deboissy (n 114) 65; Ghestin (n 5) 927 para [865].

[128] Ghestin, Jamin and Billiau (n 5) 929-930, para [869]; F Deboissy (n 114) 45 ; Francois Terré et Yves Lequette, Droit civil, *Les successions, les libéralités* (3 edn, Dalloz, 1997) 391 ; P Malaurie et C Brenner (n 96) 230 ; Geneviève Thomas-Debenest, 'Art. 931 - Fasc. 20 : Donations et testaments. – Donations entre vifs. – Forme. Absence d'acte authentique' JurisClasseur Civil Code <https://www.lexis360.fr> accessed on 07/01/2021.

[129] See Díez Duarte (n 66) 301-306; Fueyo (n 114); Hugo Rosende Alvárez, 'La simulación y los actos fiduciarios', in Pablo Rodríguez Grez (ed), Teorias del derecho civil moderno (Ed. Universidad del Desarrollo 2005) 9; Wegmann Stockebrand (n 114) 599; Corral (n 114) 736-739; Luis Claro Solar, *Explicaciones de Derecho Civil Chileno y Comparado. De las obligaciones III. Tomo Undécimo* (Ed Jurídica 2013) 113; Ramos Pazos (n 66) 129-130.

[130] Corral (n 114) 739-740.

characterises simulated transactions: form and substance diverge in the sense that the rights and obligations the parties declare in the documentary form are different from the rights and obligations they intend to be binding on them. The divergence does not concern an ulterior economic result nor an ulterior purpose that the parties may intend nor the purpose of evading mandatory law.

3.3. Summary

In summary, in understanding the sense in which form and substance diverge in simulated transactions Codes are, perhaps surprisingly, mostly unhelpful. In turn, in Italy, France and Chile legal scholars have often defined and conceptualised simulated transactions using terminology and categories that fail to clarify the meaning of the substance of simulated transactions. While this may make the doctrine of simulation capable of adapting to different types of transactions and context, it comes with the cost of lack of clarity and consistency.

To understand the meaning of simulated transactions and their substance one must look at what these scholars say about their difference with indirect transactions. Indirect transactions are transactions where the form refers to rights and obligations the parties intend to create but that are instrumental to achieve an ulterior economic result. In turn, to Italian, French, and Chilean legal scholars, simulated and indirect transactions are different and do not overlap. Whereas indirect transactions are still 'real' transactions, simulated transactions are not. This distinction shows that they also agree that simulated transactions are transactions where the external form conceals the rights and obligations they create. They would probably also agree that artificial transactions intended only for an ulterior economic result, including the avoidance of mandatory law, are not simulated transactions.

Based on this account of the doctrine of simulation, the example used to introduce the meaning of substance in this chapter should not be regarded as a case of simulation. The sale and hire purchase agreement is not simulated to the extent that the parties intended the rights and obligations they recited. Those rights and obligations are binding on them, despite the economic result they achieve. Moreover,

based on this account of the doctrine of simulation, sham and simulated transactions seem to converge. Both are transactions where the external form used by the parties conceals the rights and obligations binding on them.

III
Concluding remarks

Sham and simulated transactions are similar in that in both of them form and substance diverge. The parties to a sham and a simulated transaction produce outward evidence, and very often a transactional document, in which they give third parties the appearance that they have intended to create certain rights and obligations. This outward evidence is usually referred as the 'form' of the transaction. However, this outward evidence conceals that they have intended to be bound by other rights and obligations, or that they have not intended to create any binding rights and obligations between them. These concealed rights and obligations are usually referred to as 'substance'.

These findings are significant for the aims of this dissertation. Firstly, clarifying the way in which form and substance diverge in sham and simulated transactions allows for a better understanding of what distinguishes these doctrines. It helps to differentiate sham and simulated transactions from other legal doctrines, such as indirect and fiduciary transactions. Additionally, clarifying this divergence casts some light on the functions of these doctrines. It reveals the limited effectiveness of the doctrines of sham and simulation in addressing fraud. Many frauds, including legal avoidance schemes and fraud upon creditors, focus on the economic results achieved by the parties, rather than the rights and obligations they acquire. Thus, if sham and simulated transactions do not concern the economic result the parties achieve, the doctrines of sham and simulated transactions may not be the most effective doctrinal tools for tackling legal avoidance.

That said, there is an important difference in the divergence between form and substance in the doctrines of sham and simulated transaction. The language that civilian legal scholars use to define and characterise simulated transaction is often

vague and ambiguous. At least it is more ambiguous than the language that English courts use to describe the doctrine of sham transactions as to the meaning of the divergence between form and substance. French, Chilean and Italian jurists often use terminology whereby the divergence between form and substance can refer as much to the rights and obligations of the parties as to the economic result they seek to achieve. While this brings more flexibility, it comes with the cost of precision and consistency. In this regard, the comparison undertook in this Chapter has been helpful. The more concrete language used in English law to conceptualise sham transactions may be of use in clarifying the meaning of simulated transactions in civilian jurisdictions.

CHAPTER 2:
COMMON UNDERSTANDING
AND THE BILATERAL CHARACTER OF SHAMS AND SIMULATIONS

In the introductory chapter of this dissertation, it was proposed that, in very loose terms, sham and simulated transactions are transactions where external form deliberately diverges from internal substance. After having discussed in Chapter 1 the sense in which form and substance diverge in sham and simulated transactions in the narrow sense, this Chapter focuses on the deliberate character of this divergence. Similarly to the discussion undertaken in Chapter 1, this Chapter deals with the doctrines of sham and simulated transactions in the narrow sense.

When speaking of the 'deliberate' character of the divergence between form and substance I mean that sham and simulated transactions do not result from a mistake, nor from the intention of one party alone. Instead, they result because the parties share *a common understanding* of giving to third parties the appearance that they are intending certain rights and obligations when they actually intend others, if any, for governing their legal relationship. Thus, let us suppose that A and B execute a document where A sells and transfers property *p* to B in consideration of price *p*' both *sharing a common understanding* that price *p*' is never intended to be paid. Let us also suppose that they share the common understanding of making third parties believe that B has the obligation toward A of paying price *p*'. Such document would be a sham, English law would say, and a simulated transaction in the analysis of civilian jurisdictions. In contrast, if this common understanding fails, and only one party (B but not A, for instance) has the understanding of not intending for price *p* to be paid, but only to give third parties the appearance of this obligation, the transaction will not be a sham nor a simulated transaction.

As well as outlining what the requirement of a common understanding means, this chapter explores why requiring a common understanding for finding a sham and a simulation is relevant and how it impacts on the operation of the doctrines of sham transactions and simulation. I argue that a common understanding is necessary because the concealed intention of the parties to a sham and simulation is binding on

them, and because it is a fundamental principle of private law that in voluntary undertakings one party cannot impose rights and obligations on the other against their will. Finally, this chapter also proposes that while the doctrines of sham transactions and simulation are fundamentally similar in requiring a common understanding, the significance of this requirement is more evident and arguably more developed in the civilian doctrine of simulation than in the English doctrine of sham transactions. Therefore, the civilian doctrine of simulation may on this point be of use for a better understanding of the English doctrine of sham transactions.

This chapter is organised as follows. The first section discusses some basic ideas about the requirement of a common understanding in sham and simulated transactions. Section two, in turn, explores what this common understanding means and why the law requires it in sham and simulated transactions. Section 3, in turn, addresses who needs to be party to this common understanding, focusing on cases where this question leads to some difficulties, notably trusts, multilateral contracts and unilateral acts. Finally, section 4 discusses in more practical terms what needs to be satisfied in order to find that the parties have reached a common understanding of concluding a sham and a simulated transaction. The chapter ends with some concluding remarks.

I.
The basics

1. Commonality of intention in sham transactions

As discussed in Chapter 1, a first structural element of sham transactions in the narrow sense is that the document or set of documents executed by the parties (which here represents their form) gives the appearance that the parties have created certain rights and obligations that differ from the rights and obligations that govern their legal relationship (which here represents their substance).[1]

[1] *Snook v London and West Riding Investments Ltd,* [1967] 2 QB 786, 802 C-E; *Hitch v Stone (Inspector of Taxes)* [2001] EWCA Civ 63, 2001 WL 14954 [63].

That said, sham transactions require a second structural element. This is that the divergence between form and substance discussed in Chapter 1 is the result of a common intention of the parties to the sham. In other words, shams are neither accidental nor the result of the intention of one party alone. In order to find a sham, the parties to the sham need to have *a common intention* of giving to third parties the appearance that they are creating rights and obligations different to the rights and obligations governing their legal relationship.

Thus, for instance, suppose that A and B execute a sale and hire and purchase agreement both *sharing a common understanding* that their correlative rights and obligations are of a secured loan and that they are different to the rights and obligations as expressed in the documents they have signed, but still intend to make third parties to believe that these documents contain their legal understanding. These documents would be a sham.[2] By contrast, if only one of the parties has a shamming intention while the other intends to be governed by the document they have executed, such document will not be a sham. Similarly, if in a declaration of trust, settlor S makes a declaration of trust and transfers property *p* to trustee T, who in turn declares to accept the office, but between them there is *a common understanding* that the declaration of trust conceals that S retains beneficial ownership of *p*, such declaration would be a sham.[3] By contrast, if it is only S who intends to retain beneficial ownership, but T accepts the office on the footing that the declaration of trust is genuine, then such declaration of trust will not be a sham, and there will be a valid trust.[4]

English courts originally formulated the requirement of a commonality of intentions in cases concerning sales and hire and purchase agreements concluded for financial purposes.[5] The facts in each of these cases naturally diverge, but in all of them there was in place some statutory provision[6] restricting borrowing and taking

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[2] *Yorkshire Railway Wagon Co v Maclure* (1882) 21 ChD 309; *Stoneleigh Finance Ltd. v Phillips* [1965] 2 QB 537; *Snook* (n 1) 802 D-F.

[3] *Re Esteem Settlement* [2003 JLR 188]; *Shalson v Russo*, [2003] EWHC 1637 (Ch); *A v A* [2007] EWHC 99; *JSC Mezhdunarodniy Promyshlenniy Bank and another v Pugachev and others* [2017] EWHC 2426 (Ch).

[4] *Administrators of the State of Hanson v O'Leary* [2021] JRC319.

[5] *Maclure* (n 2); *Stoneleigh Finance* (n 2); and *Snook* (n 1).

[6] In most cases these restrictions where the ones specified in Bills of Sale Acts 1854, 1878, and 1882, which imposed strict conditions of writing, registration, and public notice on loans secured over

securities over moveables. In order to circumvent such restriction, the parties had concluded a sale and hire and purchase agreement instead of a secured loan. Then, when the rent was not paid, and the case was brought to court, one important question was whether the sale and hire and purchase agreement executed by the parties was a genuine arrangement or a sham concealing a secured loan.

Maclure,[7] for instance, was a case where a Railway Company needed funds. It therefore decided to sell some of its rolling stock to a wagon company, and on the same date to hire them for a rent equal to the price plus a premium. The Railway Company also reserved the right to repurchase the rolling stock for a nominal price at the end of the hire agreement. The Railway Company devised this structure instead of a straight secured loan because its capacity to borrow, as authorised by statutory provisions,[8] was exhausted. However, when the rent became unpaid, and the company was taken to court, one of the questions that the court needed to decide was whether the documents concluded by the parties on their face consisting in a sale and hire agreements where 'real' or a sham concealing a secured loan. Jessel MR did not find that the arrangement in question was a sham or that it concealed a loan, observing that:[9]

> '[…] even if the Wagon Company understood it as a loan, in order to set aside the deed, that is to treat it as a nullity, you must shew that the Railway Company were parties to the understanding. You cannot have a bargain on one side, and if the Railway Company only sealed this document because it carried out their intention, you cannot say it is not the real contract between the parties.'

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moveables. See RM Goode, *Hire Purchase Law and Practice* (2nd edn, Butterworths 1970); and Michael Bridge, *Atiyah and Adam's Sale of Goods* (13th edn, Pearson 2010) 8-9. In *Maclure* (n 2), however, the restrictions consisted in limitations to the power to borrow on Railways Companies imposed by sectorial statutory regulation. The report cites 7 & 8 Vict. c. 85, s. 19, and 30 & 31 Vict. c. 127, s. 4.

[7] *Maclure* (n 2).

[8] See (n 6) for details.

[9] *Maclure* (n 2), 314 per Jessel MR.

While *Maclure* is often cited as the earliest case requiring a common intention,[10] the most famous formulation of this requirement is found in *Snook v. London and West Riding Investment Ltd,*[11] where Lord Diplock provided the commonly-cited definition of sham transactions. As to the requirement of a common intention, his Lordship concluded that[12]

> 'But one thing, I think, is clear in legal principle, morality and the authorities (see *Yorkshire Railway Wagon Co v Maclure* and *Stoneleigh Finance Ltd v Phillips*), that for acts or documents to be a 'sham,' with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed intentions of a 'shammer' affect the rights of a party whom he deceived. There is an express finding in this case that the defendants were not parties to the alleged 'sham.' So this contention fails.'

Since *Snook* the requirement of a common intention has been applied and followed on many occasions, different contexts,[13] and in different areas of law, and it is considered uncontroversial that, at least as a general rule,[14] it is a condition for a transaction to be declared a sham.

2. The agreement to simulate in the doctrine of simulation

[10] It is worth mentioning that *Maclure* is very obscure on the point of requiring a common intention. On the one hand, the lower court had held in first instance that both parties were perfectly conscious that they were entering into a secured loan albeit under the form of a sale and hire and purchase agreement (See *Yorkshire Railway Wagon Company v Maclure* (1881) 19 Ch. D. 478, 483). It is not clear how on the same facts Jessel MR concluded otherwise. In addition, if there was only one party with the intention of concluding a sham, that party was the Railway Company. The Railway Company was the party that devised the alleged sham arrangement to attempt to contract out of the statutory provisions that prevented them borrowing. Jessel MR, however, seems to find a shamming intention in the Wagon Company and not in the Railway Company.

[11] *Snook* (n 1) 802 C-D.

[12] *Snook* (n 1) 802 D-F.

[13] Among many other examples, *BCCI (Overseas) Ltd v Akindele* (CA) [2001] Ch. 437, 443-444; *Hitch* (n 1) [69], [85]; *Shalson* (n 3); *A v A* (n 3); *R v Quillan* [2015] EWCA Crim 538; [2015] 1 W.L.R. 4673 [89].

[14] As this Chapter, section III.3 anticipates, and Chapter 7 discusses in more depth, sham self-declared trusts merit a separate analysis.

Just like sham transactions, simulated transactions in the narrow sense also require some sort of common understanding. This has been the case since early times[15] and it is still the case today in the jurisdictions examined in this dissertation. This bilateral element of simulations is presented differently in different civilian jurisdictions but all of them involve some sort of agreement between the parties to the simulation about giving the appearance of some transactional terms to conceal others.

As already discussed in Chapter 1, in Italy, the 'accordo simulatorio', that is an agreement to simulate, is the key legal category for explaining the Italian doctrine of simulation.[16] In an agreement to simulate, the parties to the simulation secretly agree the extent to which the apparent transaction is not binding on them. In France, in turn, the doctrine of simulation is characterised as two coexistent contracts, an apparent contract, also called 'lettre', and a secret contract or 'contre-lettre', where one contradicts the other.[17] As to the point that matters here, both French scholars and courts have observed 'that there must be full agreement between the parties as to what they intend',[18] adding that some form of consent or agreement between the parties is needed for finding a simulation.[19] Finally, in Chile, legal scholars[20] consistently observe that an agreement or common understanding between the parties is required to have a simulation.

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[15] MD Blecher, 'Simulated Transactions in the Later Civil Law' (1974) 91 S African LJ 358, 368 who refers to the Glossators and in particularly to Baldus. See also Friedrich Karl von Savigny, *Sistema de Derecho Romano Actual,* Tomo II (Jacinto Mesía and Manuel Poley trd, 2nd edn, Centro Editorial Góngora YEAR NOT SPECIFIED) 303-304.

[16] See Chapter 1, section II.3.1.iv.

[17] Chapter 1, section II.3.1.iii.

[18] Jean Denis Bredin, 'Remarques sur la conception jurisprudentielle de l'acte simulé' (1956) 54 RTD civ 261, 266. See also René Demogue, *Traité des obligations en général. I. Sources des obligations. Tome I.* (Rousseau & Cie 1923) 260; Ambroise Colin and Henri Capitant, *Traité de Droit Civil, Tome II* (Dalloz 1959) 448.

[19] Claude Ophèle, 'Simulation' in Éric Savaux (ed), *Répertoire de Droit Civil, Tome X* (Dalloz 2012) 4; Jacques Ghestin, Christophe Jamin and Marc Billiau, *Traité de Droit Civil. Les effets du contrat* (3nd edn, LGDJ 2001) 965-967, para [908].

[20] Avelino León Hurtado, *La voluntad y la capacidad en los Actos Jurídicos* (4th edn, Ed Jurídica de Chile 1963)103; Arturo Alessandri R, Manuel Somarriva U and Antonio Vodanovic H, *Tratado de Derecho Civil, Parte Preliminar y General, Tomo II* (7th edn, Ed. Jurídica de Chile 2005) 360; Carlos Ducci Claro, *Derecho Civil. Parte General* (4th edn, Ed. Jurídica de Chile 2005) 362; Raúl Díez Duarte, *La Simulación de Contrato en el Código Civil Chileno. Teoría jurídica y práctica forense* (3th edn, Editorial Metropolitana 2014) 75-76; Enrique Paillas Peña, *La simulación: doctrina y jurisprudencia* (Ed. Jurídica de Chile, 1984); Daniel Peñailillo Arévalo, 'Cuestiones teórico-prácticas de la simulación' (1992) 191 Rev. de Derecho U. de Concepción 7.

Even though as we said in Chapter 1, none of the Civil codes of in the three jurisdictions regulates the doctrine of simulation in a comprehensive manner, the requirement of an agreement between the persons to have a simulation has some support in legislative texts.[21] Art. 1414 of the Italian Civil Code of 1942 provides that the legislative provisions of simulated contracts apply to simulated unilateral acts, when there is an agreement to simulate between the author of the unilateral act and the person to whom such act is addressed.[22] Relying on this legislative provision, Italian scholars have elaborated that the requirement of an agreement to simulate is the *'essence of the phenomenon of simulation'*[23] and that it is required for any simulated transaction.

In turn, art. 1201 of the French Civil Code regulates the doctrine of simulation upon the existence of an *apparent contract* that conceals another *secret contract,*[24] implicitly requiring that the parties of the two contracts agree on simulating one and dissimulating the other. Finally, art. 1707 of the Chilean Civil Code regulates the effects of private deeds that amend the content of public deeds, distinguishing the effects between the parties to the deed and the effect *vis-à-vis* third parties.[25] Even though this provision does not explicitly regulate the doctrine of simulation, it is one of the legal provisions which Chilean legal scholars and courts rely upon to justify its normative recognition.[26] In turn, this provision assumes that between the parties to the public and private deeds there is some common understanding. If the parties want

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[21] In addition to civil codes of the jurisdiction here considered, see §117 of the German Civil Code, and art. 6:103 of the PECL and DCFR II 9-201.

[22] Section 3 of art. 1414 of the Italian Civil Code makes the doctrine of simulation applicable to unilateral acts in the following terms: 'The preceding provisions [on simulated contracts] also apply to unilateral acts directed toward a specific person, when such acts have been simulated by agreement between the author and the person to whom they are directed'.

[23] Franco Anelli, 'Simulazione e interposizioni', in V. Roppo (ed), *Trattato del Contratto. III. Effetti* (2a edn, Giuffrè Editore 2023) 577.

[24] Art. 1201 of the French Civil Code provides that '[w]here the parties have concluded an apparent contract which conceals a secret contract, the latter (also called a 'counter-letter') takes effect between the parties. It cannot be set up against third parties, though the latter may themselves rely on it'.

[25] Art. 1707 of the Chilean Civil Code provides in its section 1 that '[p]rivate deeds made by the contracting parties to amend what has been agreed in a public deed shall not be effective against third parties'.

[26] JI Contardo González and J. Carrasco Poblete, 'Título XXI. De la prueba de las obligaciones' in C Amunátegui Perelló (ed), *Comentario Histórico-Dogmático al libro IV del Código Civil de Chile. Tomo I* (Tirant lo blanch 2023) 792.

to alter or deviate from the terms of a public deed through a private deed, they must have a common understanding to do so. [27]

In summary, then, the existence of a bilateral element or some sort of agreement is an essential condition for finding that a transaction is a sham or is simulated. For the sake of clarity, hereinafter the expression ‘common intention’ is reserved to this element in the doctrine of sham transactions, while ‘agreement to simulate’ is restricted to the doctrine of simulation only. ‘Common understanding’, in turn, is used for referring to this requirement without making any specific distinction between these doctrines.

II.
Common understanding:
meaning and rationale

While requiring a commonality of intention in sham transactions and an agreement to simulate in simulated transactions is not controversial, it is not easy to explain why the law specifies this as a requirement. Exploring and unpacking a justification for this requirement, however, is essential for a better understanding of the doctrines of sham transactions and simulation. I argue that this requirement explains the legal effects of sham and simulated transactions as well as the functions they perform.

Accordingly, this section examines why the law requires a common understanding for sham and simulated transactions. In doing so, it starts off by analysing in some detail the elements of this common understanding and why it is important.

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[27] It is not surprising, then, that this is also the case is the harmonisation projects in Europe. They also require, implicitly at least, some agreement or understanding between the parties for finding that a transaction is simulated. For art. 6:103 of the PECL the simulated contract is an apparent contract not intended by the parties to reflect *their true agreement*. In turn, for art. 9:201 of the DCFR the simulated contract results from the *deliberately decision of the parties* to conclude a contract having an apparent effect different from the effect they really intend. For a commentary on these provisions, see Helge Dedek ‘Contents and Effects’ in Nils Jansen and Reinhard Zimmermann (eds), *Commentaries on European Contract Laws* 786, 814-819 and Alberto Maria Benedetti, ‘La simulazione del draft CFR’ in Guido Alpa and others (eds), *Il Draft Common Frame of Reference del Diritto Privato Europeo* (CEDAM, 2009) 37.

1. A common understanding about two intentions

A first point to clarify when discussing the meaning of the 'common understanding' as a requirement of sham and simulated transactions, is that the parties to this type of transactions have a 'dual' intention. One might even say that it is an intention composed of two intentions. On the one hand, they *intend* to give to third parties the appearance that they have created certain rights and obligations, and on the other hand, they *intend* other rights and obligations, if any at all, to be binding on them. In the language used in this dissertation, they intend both the form and substance of their transaction, only for different purposes. And the common intention in sham transactions and the agreement to simulate in simulated transactions, is about intending these two purposes.

There is authority supporting this approach. In *Hitch* Arden LJ (as she then was), made this point clear:[28]

> 'The parties must have intended to create different rights and obligations from those appearing from (say) the relevant document, and in addition they must have intended to give a false impression of those rights and obligations to third parties.'

Neuberger J (as he then was) made a similar point in *National Westminster Bank Plc v Jones*:[29]

> '[T]he whole point of a sham provision or agreement is that the parties intend to give the impression that they are agreeing that which is stated in the provision or agreement, while in fact they have no intention of honouring with the respective obligations, or enjoying their respective rights, under the provision or agreement.'

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[28] *Hitch* (n 1) [66].

[29] [2001] 1 BCLC 98 [45]. See also *Mackinnon v Regent Trust Company Ltd* [2005] JCA066) [23] where Southwell J.A. distinguished two particulars in the intention to mislead.

When it comes to the doctrine of simulation, civilian legal scholars also share this view. Modern Italian scholars have objected to Ferrara's conceptualisation of simulated transactions,[30] observing that such transactions are not devoid of a real intention. In simulated transactions, they argue, the parties *intend* some terms to be effective *vis-à-vis* third parties which are different from those that they *intend* to regulate the rights and obligations that bind on them,[31] and these two intentions are ultimately what the agreement to simulate governs. They also add[32] that this intention explains why simulated transactions are ineffective between the parties but not void. Here it is important to bear in mind that art. 1414 of the Italian code specifies that simulated transactions are *ineffective* between the parties. In contrast, arts. 1418 and 1325 of the same code specify that transactions where consent fails are not merely ineffective, but *void*.[33]

In France, in turn, it is widely admitted that simulated transactions are intended by the parties for the purpose of creating a misleading appearance,[34] and the view is sometimes proposed that a simulation ultimately consists in 'a colluded lie', 'un mensonge concerté' in French,[35] where the 'lie' of creating a misleading appearance is a deliberated and intentional act. In Chile, Ferrara's conceptualisation of simulated transactions has endured. Therefore, legal scholars still adopt the view that simulated transactions are not intended by the parties, and that they are therefore void for lack of consent.[36] However, they also admit that in simulated transactions the parties create the appearance intentionally,[37] ultimately suggesting that what is lacking is the intention of making the simulated transaction binding between the parties, rather than any sort of intention.

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[30] For Ferrara's conceptualisation of simulated transactions see Chapter 1, section II.3.1.i.
[31] Alberto Auricchio, *La simulazione nel negozio giuridico* (Jovene 1957) 15; Raffaele Lenzi, *Simulazione. Art. 1414-1417* (Giuffrè 2017) 9; C. Massimo Bianca, *Diritto Civile. III. Il Contratto* (3rd edn, Giuffrè 2019) 652-657.
[32] Francesco Galgano, 'Della simulazione' in Francesco Galgano (ed), *Commentario del Codice Civile Scialoja-Branca* (Zanichelli Editore and Soc. Ed. del Foro Italiano 1998) 6, 11-12.
[33] Second paragraph of art. 1418 of the Italian Civil Code provides that 'the failure of any of the requirement indicated in art. 1325 makes the contract void'. In turn, art. 1325 adds that 'the requirement of contracts are: (1) the consent of the parties […]'.
[34] Michel Dagot, *La simulation en droit privé* (LGDJ 1967) 9; Philippe Malaurie, Laurent Aynès, Philippe Stoffel-Munck, *Droit des obligations* (10th edn LGDJ, 2018) 414.
[35] Ophèle (n 19) 4; Malaurie, Aynès, and Stoffel-Munck (n 34) 414.
[36] Díez Duarte (n 20) 74-75.
[37] Díez Duarte (n 20) 75.

These observations show that it is not entirely correct to say, as it is sometimes said,[38] that the parties to a sham or a simulated transaction do not 'intend' the sham and simulated transaction.[39] Sham and simulated transactions result because of a common intention and an agreement to simulate, meaning that some intention is necessarily an inherent element to shams and simulations. Simulated and sham transactions, then, cannot be assimilated to transactions where intention and consent are missing. As will become apparent in Chapters 4 and 5, this is important because it explains the effects and function of sham and simulated transactions. It is more accurate to say that the parties to the sham and simulation do not intend *to be bound* by the terms of the document they have executed, but they *do intend* such terms for the purpose of giving third parties the appearance which they want to be effective against third parties.

2. Is intention in sham and simulated transactions subjective or objective?

Having clarified that in sham and simulated transactions the parties share a 'dual' intention, one internal and one external, it is worth asking what the character of these intentions is and how they are discerned. It should be remembered that courts and legal scholarship often distinguish two basic approaches to discerning the intention of the parties to a legal transaction: the subjective and the objective approaches.[40] The ultimate object of the subjective approach is to discover the actual (and subjective) intention of the parties. By contrast, the objective method takes the objective and external standpoint of a rational observer. It is also often said that civilian legal systems follow a subjective approach, while English law and systems influenced by it follow the objective one. While 'on the surface' this seems to be true,[41] comparative literature

[38] León Hurtado (n 20) 103.

[39] For a negative critic of this understanding and its negative effects in Italian court's decisions, see Rodolfo Sacco and Giorgio De Nova, *Il Contratto* (4th edn, UTET Giuridica 2016) 643-644, and fn 18.

[40] For English law, see *Treitel*, [1-002], [2-002] and [6-009]. For Italian law, see Bianca (n 31) 377-382. For French law, see François Terré and others, *Droit Civil. Les obligations* (12th edn, Dalloz 2019) 684-685. For Chile, see Jorge López Santa María, *Los Contratos. Parte General* (5th edn, Ed Jurídica de Chile) 419-513. For a comparative account of objective and subjective approaches to contractual interpretation in Europe, see Stefan Vogenauer 'Interpretation' in Nils Jansen and Reinhard Zimmermann (eds), *Commentaries on European Contract Laws* (OUP 2018) 740, 755-761. See also Hugh Bale and others, *Cases, Materials and Text on Contract Law* (3th edn. Hart 2019) 722-727.

[41] See Scottish Law Commission, Report on Interpretation in Private Law (Scot Law Com No 160, 1997) [1.15].

has also shown that today subjective and objective methods of interpretation 'are mere programmatic points of departure'[42] both complementing each other,[43] and that ultimately most modern legal systems 'hover between 'objective' and 'subjective interpretation.'[44]

Some English cases[45] and certain English legal scholars[46] suggest that in finding a sham the external intention towards third parties is ascertained taking an objective approach, while the internal intention is subjective. This understanding rests on the undeniable fact that the external intention towards third parties is contained in a transactional document from which an external observer can draw an objective meaning, while the internal intention concerning the relationship between the parties seems to be concealed from an objective external observer. Concluding a sham ultimately consists in concealing the internal intention from third parties, and in achieving this goal the parties often keep their intention to themselves. The duality of objective and subjective seems to fit to the duality of the intention to give to third parties the appearance that they have created certain rights and obligations and the intention to create other rights and obligations, if any at all, to be binding on them.

However, upon closer inspection this understanding proves inacurate. If 'subjective' here means an intention that has not been expressed in an outward form and that it is only found in the inner minds of the parties to the sham, then the commonality of intention and the agreement to simulate cannot be subjective. The mere fact that these two intentions need to be common, and that the parties must have

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[42] Vogenauer (n 40) 758.
[43] French, Italian and Chilean legal scholars admit the necessity of this complement. This is also why current art. 1188 of the French Civil Code adopts in the first paragraph a subjective point of departure for contractual interpretation but in the second paragraph introduces the objective rule of a reasonable person placed in the position of the parties. English courts, in turn, have moved from a 'literalist' to a 'contextual' approach, the latter still being and objective but, as Lord Hoffmann expressed in *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912, where the intention of the parties is ascertained by 'a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract' and where a few exceptions apart the backgrounds includes 'absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man'.
[44] Hugh Bale and others (n 40) 722.
[45] *Hitch* (n 1) [66].
[46] *Underhill and Hayton*, [8.10]; Matthew Conaglen, 'Sham trusts' (2008) 67 CLJ 176, 186; Matthew Conaglen 'Trusts and Intention' in Edwin Simpson and Miranda Steward (eds), *Sham Transactions* (OUP 2013) 122, 125.

a common understanding, makes it difficult to accept that the internal intention governing the legal relationship between the parties is subjective in an absolute sense. This is the fundamental point made by Lord Diplock in *Snook*, when he said that '[n]o unexpressed intentions of "shammer" affect the rights of a party whom he deceived',[47] and, after him, Rimer J observing that a gift received by the donee on the footing that it is genuine does not become a sham by 'some unspoken intention'[48] of the donor.

Moreover, if the internal intention is characterised as subjective in an absolute sense, all the objections that can be made against taking a subjective approach to contractual interpretation would be applicable to the internal intention governing the relationship between the parties to a sham and simulation.[49] It would, first, 'open the door to fraud'[50] jeopardizing the stability of legal transactions, since parties to a contract would be in the position of challenging its content solely based on their 'unspoken' intention. In addition, and this is particularly the case when third parties challenge a transaction for being a sham or simulated, to be successful, an allegation of a sham or simulation would require meeting the difficult burden of proving the impenetrable realm of unexpressed intentions.

A more accurate way of understanding these two intentions is to require that both have an objective meaning, or at least not a subjective meaning in an absolute sense, albeit ascertained from different standpoints.[51] In this regard, as Lord Hoffmann famously expressed, the objective intention of the parties is not ascertained by a 'disembodied reasonable observer',[52] but by 'a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract'.[53] Applying an analogous understanding to sham and simulated transactions, one might say that the internal intention governing the legal relationship between the parties is determined by a

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[47] *Snook* (n 1) 802 E.
[48] *Shalson* (n 3) [190].
[49] For these objections, see Vogenauer (n 40).
[50] *Tampling v James* (1880) 15 Ch D 215, 211.
[51] For a similar point, see Ying Khai Liew 'Sham trusts, ascertaining intention to create a trust' (2018) 12 Journal of Equity 236.
[52] Vogenauer (n 40) 758.
[53] *Investors Compensations Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896 (HL) 912.

reasonable person placed in *the same situation as the parties*. In turn, the external intention is determined by a reasonable person placed in *the same position as third parties*. Again, they are better understood as two intentions whose meaning is determined from different standpoints.

3. Why does the law require a common understanding?

Having clarified these points, it is now time to address why this bilateral element is required in order to find a sham. Lord Diplock observed that requiring a common intention for finding a sham was clear in the authorities,[54] citing *Maclure*[55] and *Stoneleigh Finance.*[56] In turn, after *Snook* there are numerous authorities[57] confirming this point of law. Similarly, and as already mentioned,[58] there are codal provisions in Italy, France and Chile suggesting that in simulated transactions there is an agreement to simulate or a common understanding between the parties, and legal scholars confirm this view. But why is this common understanding so important? Does it make any difference whether or not we require a common understanding between the parties to the sham or simulation? The truth is that, as argued here, it is important, and it does make a fundamental difference.

First, Lord Diplock observed in *Snook* that the need of a commonality of intention was not only a matter of authority but also of morality and legal principles. Other English judges have given a glimpse of these principled reasons, observing that '[n]o unexpressed intentions of "shammer" affect the rights of a party whom he deceived'.[59] Lord Diplock was right. It is a fundamental principle of private law that in a bilateral legal transaction it is impossible for one of the parties to unilaterally determine its content.[60] The protection of private autonomy prevents this result in all bilateral legal

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[54] *Snook* (n 1) 802 D.
[55] *Maclure* (n 2).
[56] *Stoneleigh* (n 2).
[57] See cases in n 13.
[58] See this Chapter, section I.2.
[59] *Snook* (n 1) 802 E.
[60] This is irrespective of which theory is adopted to explain voluntary undertakings. This is the case of theories that explain binding agreements as promises (see particularly Charles Fried, *Contract as promise* (2nd edn, 2015 OUP) 40-56) or that understand that voluntary undertakings are consent (see Randy E. Barnett, 'A Consent Theory of Contract' (1986) Colum. L. Rev 269). On freedom to contract more generally see Patrick S. Atiyah, *The rise and fall of freedom of contract* (OUP 1985). Also, *Treitel*, [1-005]-[1-008].

transactions,[61] which is why shams and simulations require a common understanding between the parties to them.[62]

A simple example may illustrate this point more clearly. If A makes a promise to B that objectively means *x*, B can rely on that objective meaning and make promise *x* effective against A. And if B understood the promise to be *y* rather than *x*, that circumstance does not change that the promise between A and B is *x* and not *y*. Therefore, if B wanted to make effective against A promise *y* and not promise *x*, he or she needs to prove that all things considered (i.e. some extrinsic evidence, other communications between A and B, etc.) the objective meaning of the promise was *y* and not *x*.[63] In other words, B needs to prove that there was a common intention between A and B that the promise was *y* and not *x.* Otherwise, B would be in the position of imposing on A rights and obligations against his or her consent, which is a result the law does not accept.

Despite the complexities that the coexistence of two intentions, one external towards third parties and one internal binding the parties, brings in sham and simulated transactions, this principle does not fundamentally change. As will be discussed in detail in Chapter 4, in sham and simulated transactions, the internal intention of the parties to the sham governs their relationship, imposing rights and obligations to them. Therefore, they need to have a common understanding about the content of this internal intention. Otherwise, the parties to the sham or simulation could impose on the other rights and obligations against their consent, harming their respective private autonomy.

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[61] The category of bilateral legal transaction refers here to both contracts and express trusts created by transfer. While in English law trusts are not contracts and contract theories cannot explain all the aspects of trust law, it is still true that trusts have a contractarian basis in the sense that creating a trust entails some sort of understanding between the settlor declaring the trust and the trustee acquiring the trust property. That is why 'we cannot define either agreement or contract without including the great majority of trusts' (FW Maitland, *Lectures on Equity* (CUP 1929) 54, Lecture IV). This contractarian basis permits to consider contracts and trusts together as voluntary undertakings. See JH Langbein, 'The Contractarian Basis of the Law of Trusts' (1995) 105 Yale LJ 627.

[62] For a slightly different justification, See Susan Bright, 'Avoiding Tenancy Legislation: Sham and Contracting Out Revisited' (2002) 61 Cambridge LJ 146, 155-157.

[63] This, obviously, is despite the doctrine of rectification when applicable. See generally *Treitel* [8-059]-[8-078].

The effects of sham and simulated transactions cannot be reduced and simplified to say that they are void. While the documentary form is not binding between the parties, that is because the parties intended to make the rights and obligations recited in that form non-binding. If they had not reached an agreement that the documentary form should not be binding, the rights and obligations recited in the documentary form would indeed be binding. In turn, if they intended other rights and obligations between them, these must be binding and effective. These effects, in turn, require from the parties a common understanding. Only if the parties have agreed to the content of the internal intention can its normative content be binding as between them. If they have not reached this agreement, there will be no reason to make this understanding binding. In other words, if sham and simulation did not require a common understanding between the parties, then, this doctrine would permit a party of a bilateral legal transaction to unilaterally determine its content, and as mentioned earlier, this is a result that the law does not tolerate.

4. A note on Professor Conaglen's justification of a commonality of intention

Before moving onto the next section there is one marginal observation to make. The explanation submitted above differs from the argument made by Professor Conaglen.[64] He argues that the rationale for requiring a commonality of intention in sham transactions rests upon the necessity of upholding certainty of bilateral transactions.[65] In protecting the stability of bilateral transactions, he says, the law would place great weight on the objective meaning of documents and other transactions, and only in very extraordinary circumstances and provided that high threshold are met, courts have the power to look into subjective intentions. One of these extraordinary cases, he continues, would be the sham doctrine and the threshold for allowing this extraordinary power of intervening in the objective meaning of legal transaction, would be that all parties to the sham must share the intention to mislead.

[64] Conaglen, 'Sham trusts' (n 46) 188-190 and Conaglen, 'Trusts and Intention' (n 46) 125.
[65] Conaglen, 'Sham trusts' (n 46) 188.

However, for the reasons already examined,[66] characterising the intention of the parties to a sham as a subjective intention in an absolute sense leads to a number of inconveniences. Also, because the intention is common it cannot be subjective in an absolute sense. In addition, Professor Conaglen's argument focusses mainly on the perspective of the third party who brings a claim that a transaction is a sham. However, as contended here and will be explored in more depth in Chapter 4,[67] sham and simulated transactions have an internal operation between the parties to them to which a common understanding is equally, if not even more, important than their operation *vis-à-vis* third parties. Finally, the rationale submitted by Prof Conaglen does not explain the operation of sham and simulated transactions in unilateral acts. For the reasons that will become apparent later,[68] the justifications that are provided here attempt to overcome this limitation as well.

III.
Parties to the common understanding

Having discussed the meaning of the common understanding in sham and simulated transactions, and the reasons why it is essential for these doctrines, the following two sections explore some more specific questions: that is, who needs to be party to this common understanding and how does the common understanding have to be reached.

Let me begin with a discussion of who needs to be a party to the common intention. This might seem so straightforward as to be trivial. If the transaction is a single bilateral contract, finding the answer does not cause major difficulties. The parties to the contract will be also the parties to the sham and simulation, and they are the parties that need to share a common understanding. However, shams and simulations are found also in other transactions, including multilateral contracts, unilateral acts, and trusts. Here it is less obvious who needs to be party to a common understanding. This section argues that the parties that need to be party to a common understanding are those whose rights and obligations are affected by the internal

[66] See this Chapter, section [II.2].
[67] See Chapter 4, section I.1 and section II.
[68] See this Chapter, section III.3.

understanding the sham and simulation conceals. While in most cases they will be the same parties that conclude the transaction that is found to be as sham, this is not necessarily always the case.

1. Commonality of intention in trusts created by transfer

The first type of transaction that is worth looking at are trusts created by transfers. Nowadays it is settled law that in trusts where settlor and trustee are different persons, both the settlor and the trustee must share a common intention to create a misleading appearance in order to conclude that the declaration of trusts is a sham.[69] Failure to find this common intention is often one of the reasons why courts reject claims of sham trusts.[70] However, not all shams are simple bilateral contracts and it is not evident how to justify the commonality of intention in sham trusts.

1.1. The argument that the settlor's intention alone suffices

Some legal scholars, notably Jessica Palmer, have submitted the opposite view.[71] Her argument is essentially that requiring a common intention was appropriate and sound in the context of *Snook*, which concerned a contract of hire and purchase agreements. Since commonality of intention is essential in concluding a contract, the commonality of intention must also be essential to create a sham contract. However, when it comes to trusts, things are different, she argues. It is the intention of the settlor alone that matters to the existence of a valid trust. The identification, and therefore the intention of the trustee, is irrelevant. Thus, she concludes, 'if no mutuality of intention is required to create a valid trust, it is conceptually incoherent to require mutuality to create a sham trust'.[72]

There are two objections to Palmer's argument. The first is that it is incorrect to say that the settlor's intention alone matters to the existence of a valid trust. It is more

[69] *Re Esteem* (n 3) [53]; *Shalson* (n 3); *A v A* (n 3) [34], per Munby J; *Heinrichs & Ors v Pantrusts International SA & Ors* [2018]; *Hanson* (n 3) [103].
[70] This was the case, for instance, in *Re Esteem* (n 3); *A v A* (n 3); *Hanson* (n 3).
[71] Jessica Palmer, 'Dealing with the Emerging Popularity of Sham Trusts' (2007) 2007 NZ L Rev 81.
[72] Palmer (n 71) 94.

accurate to say that trusts created by transfer result from two conceptually different acts: the trust declaration and the transfer of the trust property, neither of them being fully unilateral in nature. While the declaration of trust, as a legal act, results from the sole intention of the settlor, it becomes effective and it creates rights and obligations only once the trustee has accepted office.[73] Before such acceptance, the trust has not been created and the trustee has not assumed any obligations. Then, the obligational effects of the declaration of trust depend on the intentions of both the settlor and the trustee. In its own way, the transfer of property is bilateral too.[74] Both the settlor's and the trustee's intentions are needed for the transfer to take place, and the trustee cannot acquire property against his or her own will.[75] The sham doctrine, finally, challenges both of these acts, in the sense of being a mere appearance and concealing that the trust has not taken place. Therefore, for finding that a trust is a sham, both the settlors' and trustees' intention are relevant.[76]

A second ground for rejecting Palmer's position is that, as Conaglen argues,[77] accepting that a trust can be recognised as a sham based solely on the settlor's intention, would undermine the certainty of the rights and obligations arising from it. It would allow the settlor to rely on his or her subjective intention, bringing undesirable practical results.[78]

Palmer's argument has been never followed by courts. Rather, in the course of the past fifteen years common law courts have emphasised the need of a common intention between the settlor and the trustee for finding that a declaration of trust is a sham.[79] The most explicit rejection of Palmer's argument was the reference made in the New Zealand case of *Re Reynolds Official Assignee v Wilson and another*,[80] in which the New Zealand's Court of Appeal expressly disapproved of her argument.

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[73] *Lewin*, Trust [13-007]-[13-022].
[74] *Lewin*, Trust [3-021]-[3-033].
[75] *Thowson v Tickell* (1819) 2 B. & Ald. 31, 36-37.
[76] A similar point but arguing that only the transfer is bilateral in nature in D Coshott, 'The sham doctrine and intention: addressing the bilateral nature of sham trusts' (2022) 138 LQR 114-130.
[77] Conaglen 'Trusts and Intention' (n 46) 133.
[78] One can remark here that in this case the intention would indeed be subjective since it would not be common to someone else.
[79] *Re Esteem* (n 3) [53]; *Shalson* (n 3) [190]; *A v A* (n 3) [34]; *Pugachev* (n 3) [150].
[80] [2007] NZCA 122 [48].

1.2. Both the intentions of the settlor and the trustee are needed for finding that a declaration of trust is a sham

Ultimately, and recalling here the rationale explored earlier,[81] the settlor's intention alone cannot be sufficient for finding a sham. The trustee's intention is also needed for otherwise the settlor would in the position of creating rights and obligations to the trustee without the consent of the latter, which is a result the law cannot tolerate. This point was explained by Rimer J in *Shalson* when referring to the need of a common intention in both sham trusts and sham gifts:[82]

> '[o]nce the assets are vested in the trustee, they will be held on the declared trusts, and he is entitled to regard them as so held and to ignore any demands from the settlor as to how to deal with them. I cannot understand on what basis a third party could claim, merely by reference to the unilateral intentions of the settlor, that the settlement was a sham and that the assets in fact remained the settlor's property. One might as well say that an apparently outright gift made by a donor can subsequently be held to be a sham on the basis of some unspoken intention by the donor not to part with the property in it. But if the donee accepted the gift on the footing that it was a genuine gift, the donor's undeclared intentions cannot turn an ostensibly valid disposition of his property into no disposition at all. To set that sort of case up the donee must also be shown to be a party to the alleged sham.'

In summary, even though trusts are not contracts,[83] and even if it is accepted that the bilateralism of contracts cannot be applied to trusts, in the relationship between settlor and trustee there are sufficient bilateral elements so as to find a common intention. In turn, this commonality of intention is needed just as it is needed in contracts because otherwise the settlor would be in the position of being able to impose rights and obligations to the trustees against their will.[84]

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[81] See this Chapter, section II.3.
[82] *Shalson* (n 3) [190].
[83] For the contractarian elements in express truss, see n 61 and references there.
[84] As will be anticipated in this Chapter, section III.3, and developed in more length in Chapter 7, the requirement of common intention in self-declared trust that are found to be sham merits a separate analysis.

2. Common understanding in multilateral contracts

This same rationale explains how the requirement of a common understanding operates in multilateral contracts. In many multilateral contracts the question as to who needs to be part to the common understanding does not raise substantial difficulties. Similar to the case of a bilateral contract, all the parties to the contract need to share a common understanding in order to find a sham or a simulation. If, for instance, there is a written contract where A and B sell property *p* to C and D in consideration of price *p*', all the parties executing this document would need to have the shamming intention or be party to the agreement to simulate in order to find that there is no obligation of paying price *p*'.

An important characteristic of the multilateral contract described in the example above is that it creates obligations that fall on all the parties to the contract (A, B, C and D), either as creditors or debtors. Therefore, if any of these obligations are found to be a sham, all the parties of the contract will have their obligations affected and, consequently, all of them need to have a shamming intention and be party to the agreement to simulate. But there are multilateral contracts where some of the obligations do not bind all the parties to the contract but only some of them. In other words, the contract can be separated into different sets of obligations binding different parties. When the sham or simulation concerns only one set of obligations, then the intention of the parties that are not bound by the set of obligations may not be material. They are party to the contract but not to the set of obligations subject to the sham.

An example of this type of multilateral contract would be the following. Let us suppose that real estate company A, construction company B and investor C conclude a contract whereby: (1) A acquires the obligations to sell and transfer land *l* to C; (2) B acquires an obligation toward A and C to build a certain infrastructure on the land *l* before A transfers the land to C; and (3) C acquires the obligation to pay price p^1 to A and price p^2 to B. Clearly, the obligation of paying price p^1 does not fall on B, and the obligation of paying price p^2 does not fall on A. These obligations are

fragments or 'parts'[85] of the contract to which A, in the first case, and B, in the second one, are not parties.

Therefore, if A and C secretly agree that the sale concluded between them conceals a gift, and that price p^1 is never intended to be paid, a sham and a simulation may arise in the legal relationship between A and C, even if B is not party to that sham and simulation. This is possible because the obligation of paying price p^1 does not fall on B, and therefore B's rights and obligations would not be affected by the sham and simulation between A and C. As a result, two of the three legal relationships contained in the document concluded by the parties would neither be a sham nor a simulation (the relationships between A and B, and between B and C), but one would be a sham and a simulation (the relationship between A and C).

In *Hitch* Lady Arden illustrates this point eloquently:[86]

> 'I have already noted that it is an established requirement of a sham transaction that the parties should have the common intention that it should not take effect according to its tenor and in addition that a false impression should be given to third parties. But this point raises one of the issues of law that has arisen in this case: common to whom? […]. In my judgment, the law does not require that in every situation every party to the act or document should be a party to the sham. I accordingly reject Mr Price's submission save that I accept that the case where a document is properly held to be only in part a sham will be the exception rather than the rule, and will occur only where the document reflects a transaction divisible into separate parts.'

This rationale also explains why in *Stoneleigh Finance*,[87] dealing with an alleged sham financial transaction, the court required that to find a sham the plaintiff must have had an intention to create a misleading appearance. David L.J. held that it was necessary to distinguish the contract between Kane Products Ltd and Trade Service

[85] Conaglen, 'Sham trusts' (n 46) 190-191.
[86] (n 1) [85].
[87] *Stoneleigh Finance* (n 2).

Ltd, on the one hand, and the contract between the plaintiff and Kane Products, on the other. Even if the former contract were a sham, the court observed, the plaintiffs did not have an intention to mislead. They never were party to the sham. Therefore, 'the contract between them and Kane Products Ltd. was the real enforceable contract'.[88]

This view is also shared by civilian legal scholars writing about the doctrine of simulation, especially in Italy,[89] where it is accepted that some of the parties to the multilateral contract may not be parties to the agreement to simulate if this agreement does *not* concern the legal relationship of those who are party to this secret understanding. Thus, in this aspect of sham and simulated transactions there is no substantial difference.

3. Common understanding in unilateral acts

Finally let us consider the operation of the requirement of a common understanding in unilateral acts. Given that this topic has been discussed in more depth in the doctrine of simulation than in the doctrine of sham transactions I will start with the former.

3.1. Simulation in unilateral acts

At first glance, it is easy to see why many civilian legal scholars have found it difficult to contemplate that a unilateral act can be simulated. The predominant position among French[90] and Chilean[91] scholars (and among important Italian[92] scholars prior to the enactment of the Code of 1942) is that the doctrine of simulation 'should be ruled out

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[88] *Stoneleigh Finance* (n 2) 573.
[89] Bianca (n 31) 658.
[90] This applies for the narrow understanding of the doctrine of simulation. See Bredin (n 18). Some legal scholars, as Dagot (n 34), defend that simulation should be understood in a broad sense, which would include unilateral acts.
[91] Díez Duarte (n 20) 75; Peñailillo (n 20).
[92] Francesco Ferrara, *Della simulazione nei negozi giuridici* (2nd edn, Soc. Editrice Libraria 1905) 96-98.

from the domain of unilateral acts',[93] to use the words of Ferrara.[94] They argue that given that the doctrine of simulation requires an agreement to simulate, it cannot apply to unilateral acts. Some French scholars have also added that the codal provisions on the doctrine of simulation are shaped by a common understanding between two or more persons. Thus, if the doctrine were to apply to unilateral acts, then it would be a different doctrine.[95]

As mentioned before, in Italy, however, the Civil Code of 1942 makes the doctrine of simulation applicable to unilateral acts. Interestingly, however, it states that the doctrine of simulation requires an agreement to simulate even when it applies to unilateral acts. Article 1414(3) of the Italian Code provides that:

> 'The preceding provisions [on simulated contracts] also apply to unilateral acts directed toward a specific person, when such acts have been simulated by agreement between the author and the person to whom they are directed.'

Thus, in order to find that the unilateral act is simulated, an agreement is required between the author of the unilateral act and the person to whom the act is directed. When interpreting this provision, and because of the need of this agreement, Italian scholars have discussed what categories of unilateral acts could be simulated.[96] They agree that 'atti recettizi' (that is, unilateral acts that become effective only once the person to whom they are directed takes notice of their existence) can be simulated.[97] As for 'atti non recettizi' (that is, unilateral acts that do not need the notice of any addressee or beneficiary to become effective) the prevalent position today is that they too could be simulated provided they are addressed to one or more concrete

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[93] In Italy, Ferrara submitted that 'a simulation always results from an agreement between the contracting parties. Therefore, it should be ruled out from the domain of unilateral acts'. Ferrara (n 92) 32.

[94] For an interesting exception among French legal scholars see Demogue (n 18) 260. For an exception among Chilean scholars, see León Hurtado (n 20) 103.

[95] Michel Storck, 'Art. 1201 et 1202 - Fasc. unique : CONTRAT. – Effets du contrat à l'égard des tiers. – Théorie des contre-lettres. Simulation' in *JurisClasseur Civil Code,* 8. <https://www.lexis360.fr> accessed on 29/12/2020.

[96] The seminar work on this matter was produced by Salvatore Pugliatti, *Saggi Diritto civile. Metodo - Teoria – Pratica, La simulazione dei negozi unilaterali* (Giuffrè 1959) 539.

[97] See Andrea Torrente and Piero Schlesinger, *Manuale di Diritto Privato* (16th edn, Giuffrè 1999) 152.

beneficiaries.[98] This would be the case, for instance, in the renunciation of the right of usufruct made by the usufructuary. The person entitled to the usufruct may simulate to renounce to his or her right with the agreement of the bare owner.[99] Finally, Italian scholars seem to agree that the doctrine of simulation does not apply to unilateral acts that produce legal effects for the community as a whole, or for an undetermined group of people, because reaching an agreement concerning the legal effects of this kind of act is impracticable.[100]

The point to highlight here is that Italian law shows that the doctrine of simulation can apply to unilateral acts yet still require the bilateral element of a common understanding. The justification for this is, as mentioned earlier, is that the parties to the common understanding are not necessarily the same as the parties to the simulated transaction. The persons that need to be party to the simulation are those who hold rights and obligations that the common understanding regulates. The agreement of these persons is needed to have a simulation in a unilateral act because otherwise the law would accept that the author of the unilateral act would have the power to impose and modify rights and obligations on the beneficiary or the person to whom the act is addressed. And this approach is useful for comparative purposes. As anticipated in the next section and explored in greater depth in Chapter 7, it offers a new perspective for examining self-declarations of trust that have been found to be shams under English law.

3.2. Sham and self-declared trusts

[98] Bianca (n 31) 657, fn 22; Anelli (n 23) 657-658; Sacco and De Nova (n 39) 652-653.
[99] This example is from Sacco and De Nova (n 39) 653. The renunciation is an 'atto non recettizio' since it does not need to be known by the owner of the property to be effective. However, the owner of the property is still the concrete identifiable addressee of the renunciation, which makes possible an agreement between him and the usufructuary to simulate the renunciation.
[100] Some Italian scholars have taken these ideas further, submitting that there are no reasons to restrict the application of the doctrine of simulation to simulated transactions, arguing that it should be extended to any factual situation with legal consequences, provided it could be simulated as a result of an agreement or understanding between the individuals concerning the legal situation. This would be the case, for instance, when a certain property is actually transferred from A to B but they agree to simulate that the property has not been transferred nor any other transaction has been concluded. To this view the key element that triggers the application of the doctrine of simulation, is the existence of an agreement creating a divergence between the external appearance and the internal dimension of a given legal situation. What the apparent situation consists of, matters little as long as it can be simulated. See Nicola Cippriani, 'La simulazione di effetti giuridici. Appunti sulla fattispecie' in R. Di Raimo, M. Francesca, A.C. Nazzaro (eds), *Percorsi di diritto civile. Studi 2009/2011* (Edizione Scientifiche Italiane) 99.

Simulated unilateral acts mirror the common law doctrine of sham transactions as applied to self-declared trusts. In English law, however, the predominant understanding differs from the solution found in Italy. This point will be discussed in more depth in Chapter 7,[101] which is devoted exclusively to sham trusts, but for the sake of clarity and for completion of the comparison here, it is useful to anticipate the gist of what it is discussed there.

Self-declared trusts are trusts created by a declaration of trust that is not accompanied by a transfer to a trustee, and where settlor and trustee are one and the same person.[102] The settlor declares to hold on trust property that he or she already owns. Given that self-declared trusts have this unilateral structure, English court's decisions have taken the view that in this peculiar form of transaction, commonality of intention does not play a role in finding a sham.[103] The most cited authority is *Painter,*[104] where Lewison J (as he then was) observed that when considering whether a self-declared trust is a sham, the settlor's intention suffices because 'even if it is necessary to consider the intention of both the settlor and the trustee, in practice that amounts to the same thing as considering the intention of the settlor alone'.[105] This view is also shared by certain scholars.[106]

There are, however, good reasons for making some nuances and clarifications to this understanding. As Chapter 7 argues, 'sham' self-declared trusts very often are shams only in a vague sense, different to the narrow legal meaning of sham found in *Snook* and in *Hitch* discussed in Part 1 of this dissertation. Accordingly, these trusts can be characterised as 'shams' in the broad sense of consisting in a declaration of trust that on the surface appears valid but ultimately fails to create a trust for some underlying reason. Yet that reason is of a different kind and not enough to make it a

[101] See Chapter 7, section I.
[102] *Paul v Constance* [1977] 1 WLR 527; Lewin, *Trust* [3-004]. See also Sinéad Agnew and Simon Douglas, 'Self-Declarations of Trust' (2019) 135 LQR 67.
[103] *Painter v Hutchison* [2007] EWCH 758 (Ch); *Re Mohammed Munir (a bankrupt)* [2021] EWHC 278 (Ch); *Raymond James Gallagher* (A bankrupt) [2021] EWHC 2479.
[104] *Painter* (n 103).
[105] *Painter* (n 103) [115].
[106] *Underhill and Hayton*, [4.6]; Conaglen, 'Sham trusts' (n 46) 189 and Conaglen, 'Trusts and Intention' (n 46) 130.

sham in the narrow sense. Finally, there are some authorities[107] suggesting that under certain circumstances, and particularly when the beneficiary has accepted the trust, a common intention between the settlor and the beneficiary is necessary for finding that a self-declared trust is a sham. Here the solution resembles very much the Italian approach to simulated unilateral acts. More details will be provided in Chapter 7.

IV.
How the common understanding is reached

Before concluding this chapter, there is a final point to address about the common understanding in the doctrines of sham transactions and simulation. We have already discussed that the common understanding is composed of two intentions, one external and one internal, and that the rationale for requiring this bilateral element is the protection of the parties' autonomy. We have also examined who needs to be party to this common understanding, especially in trusts, multilateral contracts and unilateral acts. What we have not yet explored is how this common understanding is reached and, in particular, whether an express agreement is required or whether other forms of manifesting an intention suffice as well. This question, which is addressed in this section, is important because it permits us to understand in more concrete terms what is needed for having a common understanding, and therefore a sham and simulated transaction.

I argue that for both, the doctrine of simulation and the doctrine of sham transactions, the common understanding does not need to be reached in express terms. It can be implied from the conduct of the parties. That said, and for different reasons, this general principle is subject to exceptions and qualifications that differ in the two doctrines.

1. Agreement to simulate: tacit consent and written evidence

1.1. The general rule

[107] *Painter* (n 103) [115]; *Shalson* (n 3) [190].

Some exceptions aside, in Italy,[108] France[109] and Chile,[110] people can give their consent to any agreement either by express or tacit consent.[111] The consent is express when it is given either by words or unequivocal gestures of acceptance. In turn, the consent is tacit when implied from acts that, objectively considered, mean the acceptance to a certain transaction. Finally, under some exceptional circumstances, the silence can be taken as a form of acceptance.[112] These general rules on the formation of legal agreements, *prima facie* apply to the formation of the agreement to simulate. Italian scholars stress that even passive cooperation or passive acceptance from one party to the other is enough to conclude an agreement to simulate.[113]

In line with this view, in these jurisdictions the agreement to simulate does not need to be written either. It suffices that the parties mutually agree in any manner to produce a misleading appearance.[114] In this regard, some authors distinguish, on the one hand, the agreement to simulate and, on the other hand, the counter-letter (in France)[115] and private deed (in Chile),[116] which is the document where this agreement may be evidenced. While the agreement to simulate is essential for the doctrine of simulation, the parties may decide whether or not to put this secret agreement in writing in a counter-letter or private deed.[117] If the decision to simulate a transaction is motivated by unlawful purposes, those who simulate usually ensure they leave no traces of their conduct, thus avoiding to put their understanding to simulate in writing.[118]

1.2. Written evidence and written formalities

[108] Torrente and Schlesinger (n 97) 159-160. Conducting a critical analysis, Sacco and De Nova (n 39) 699-702.

[109] Henri Mazeaud and others, *Leçons de Droit Civil. Obligations : théorie générale*, Tome II. Vol I (Montchrestien 1991) 54-55 and 59-60.

[110] Jorge López Santa María, *Los Contratos. Parte General*, *Tomo I* (4th edn, Ed Jurídica de Chile 2005) 251.

[111] Torrente and Schlesinger (n 97) 158; Sacco and De Nova (n 39) 269-71; H Mazeaud and others (n 109) 125.

[112] H Mazeaud and others (n 109) 125-128.

[113] Lenzi (n 31) 25.

[114] Dagot (n 34); Gaël Chantepie and Mathias Latina, *Le nouveau droit des obligations. Commentaire théorique et pratique dans l'ordre du Code civil* (2nd edn, Dalloz 2018) 506.

[115] Lenzi (n 31) 33-35; Ghestin, Jamin and Billiau (n 19) 966, para [908].

[116] Díez Duarte (n 20) 103.

[117] Torrente and Schlesinger (n 97) 171.

[118] Peñailillo (n 20) 26.

This claim, however, is subject to two qualifications. The first one is that in Italy[119] and France,[120] but not in Chile,[121] for probative purposes, the agreement to simulate needs to be written to be enforced by one party against the other. Here it is important to remember that the agreement to simulate contains the internal intention of the parties which regulates their legal relationship. This agreement is legally binding on the parties if the simulated transaction does not conceal any unlawful or illegal transaction, nor prejudice third parties.[122] Because of this binding effect, if one of the parties decides to enforce this secret agreement, very often asking to disregard the document containing the simulated transaction, the agreement to simulate must be written as well. Otherwise, the allegation of simulation will be dismissed.[123] By contrast, when the person making the allegation of simulation is a third party or there is fraud involved in the simulation, all evidence is admissible,[124] and normally both witnesses and indirect conjectures will be vital evidence to prove the existence of an agreement to simulate.[125] Thus, what the law does here is to protect third parties who may be defrauded by the simulation and normally are not in the position of providing direct evidence of it.

The second qualification is that when the simulated transaction conceals a secret transaction, for the latter to be binding it must comply with the requirements of form and substance specified by the general law.[126] In other words, if for the validity and effectiveness of a transaction the law requires specific formalities, and the parties of the simulation intend in the agreement to simulate to conclude a transaction of this type, the agreement to simulate needs to satisfy such formalities at least in respect of the provisions containing said transaction. As French scholars argue,[127] while

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[119] Galgano (n 32) 58-59; Bianca (n 31) 666.
[120] Ophèle (n 19) 13; Ghestin, Jamin and Billiau (n 19) 977-980, para [919].
[121] Rodrigo Alcaíno Torres 'Prueba de la simulación de los actos jurídicos' [2003] Temas de Derecho 63, 66-69.
[122] See n 16 above.
[123] Chantepie and Latina (n 114) 506.
[124] Malaurie, Aynès, and Stoffel-Munck (n 34) 416-417.
[125] Peñailillo (n 20) 26; Ferrara (n 92) 307-308.
[126] For Italy, Bianca (n 31) 660-661. For France, Ophèle (n 19) 9-10; For Chile, Peñailillo (n 20) 18-20.
[127] George Ripert and Jean Boulanger, *Droit civil. D'Après le traité de Planiol. Tome II. Obligations* (Libraire Générale de Droit et de Jurisprudence, 1957) 225; Ophèle (n 19) 9; Jean-Luc Flour, Jacques Aubert and Eric Savaux, *Droit civil. Les Obligations. 1. L'acte juridique* (16th edn Dalloz, 2014) 409-410.

simulating does not make a transaction void, neither does it make valid an otherwise void transaction.[128]

Before moving on to the next section, it is important to make some remarks about the rationale of these rules. Requiring written evidence to enforce the common understanding by one party against the other, confirms that this common understanding has a transactional nature and that it is binding between the parties. Even more, because this understanding contradicts other outward evidence (the form of the transaction), it seems reasonable to require written evidence when alleged by the parties. Otherwise, legal agreements would be too easily challengeable by the parties and therefore essentially unstable. At the same time, however, relaxing the requirement of written evidence when the allegation of simulation is made by a third party, shows that the doctrine of simulation balances the interest of the parties to the simulation against the interest of third parties, who very rarely would be in the position to provide written evidence. As the next section shows, particular rules introducing nuances on how the common intention must be reached are not found in the English doctrine of sham transactions. As will be shown, this may be due to the fact that, in English law, the importance and impact of the common understanding between the parties, particularly its binding effects, have been explored in less depth than in the civilian jurisdictions discussed here.

2. Common intention: intention and reckless indifference

2.1. General approach

The common intention of concluding a sham can also be reached either by express terms or be implied from the conduct of the parties. Ultimately when finding whether a transaction is a sham, courts are not looking for an express agreement, but they rather ascertain whether the circumstances of the transaction as a whole prove that the parties understood that they were party to a sham and that they were concealing a different understanding to the one contained in the document they have executed.

[128] As discussed in Chapter 4, section III.5, in Italy and to some extent France this is subject to an important debate among scholars and courts.

This is also the general principle in contract law.[129] Thus, the basic principle is not dissimilar to the one discussed in the doctrine of simulation. For both doctrines, the common understanding can in principle be reached by any means and does not need any formality.

This is reflected in the way shams are normally proved. It is true that under English law 'the allegation of sham is a serious matter'.[130] However, any evidence to prove the intention of the parties to mislead is admissible as indirect evidence,[131] including private communications, the subsequent conduct of the parties,[132] and the economic results[133] the transaction produces. Moreover, in *Broxfield Limited v Sheffield City Council*[134] Mostyn J observed that ultimately the question is whether the evidence submitted by the parties, whatever that evidence is, makes it 'more likely than not [that] the agreement was a sham'.[135] Finally, given that the parties to the sham will often make efforts to leave no traces of the sham, it is accepted that 'a party alleging sham is unlikely to find a 'smoking gun' and must rely on collating sufficient inferences to make out its case'.[136]

2.2. Reckless indifference may amount to intending

English courts have not discussed whether the common intention ever needs to be in writing. They have rather focused their attention on the extent to which reckless indifference in going along with the intention of one of the parties to the transaction may amount to a common understanding. This issue has attracted particular attention in the context of sham trusts, where the shamming intention is often easier to find in the settlor than in the trustee.

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[129] Stephen A. Smith, *Atiyah's Introduction to the Law of Contract* (6th edn, 2005 OUP) 94.
[130] *A v A* (n 3) [69].
[131] *AG Securities v Vaughan; Antoniades v Villiers* [1990] 1 AC 417, 475-476.
[132] *AG Securities v Vaughan; Antoniades v Villiers* [1990] 1 AC 417, 475; *Re Yates (A Bankrupt)* [2004] EWC 3448 (Ch) [219], per Mr Justice Charles.
[133] *Jones* (n 29).
[134] [2019] EWHC 1946 (Admin).
[135] *Broxfield* (n 134) [25].
[136] S Gadhia, K Rodgers, and J Ho 'Sham Trusts' (2016) 22 Trusts and Trustees 468.

In particular, there are a number of authorities, starting with *Midland Bank plc v Wyatt,*[137] establishing that reckless indifference on the part of the trustee in going along with the shamming intention of the settlor amounts to an intention to mislead. For instance, in *Re Esteem*,[138] Mr Birt QC sitting as a Deputy High Court judge stated that 'a party who goes along with a sham neither knowing or caring what he is signing (i.e., who is reckless) is to be taken as having the necessary intention'. A similar point was made by Mr Justice Munby in *A v A*, establishing that 'what is required is a common intention, but reckless indifference will be taken to constitute the necessary intention'.[139] More recently, in *Pugachev*, and after considering the relevant authorities, Mr Justice Birss submitted that 'reckless indifference will be taken to constitute a common intention. That is the way to interpret the point made in *Midland Bank'.*[140]

There are good reasons to justify this position. As already mentioned,[141] a common understanding is needed in order to find a sham or a simulation because the internal intention of the parties is binding on them, and one party cannot impose on others rights and obligations against their will. That said, if someone enters into a transaction not caring about its content, willing to go alone with whatever the other parties to the transaction decides, he or she has accepted (or tolerated at least) the content of the transaction whatever that may be. In the case of trusts, if the trustee does not care what assets he or she will hold on trust, if any, then there is no need to protect his or her will. He or she has accepted the transaction irrespective of whether it is a trust or not, or a sham or not. In other words, reckless indifference in going along with the shamming intentions of the settlor is a form of acceptance, and therefore sufficient for finding a common intention.

It is important to mention that this understanding permits to read *Wyatt* not departing from *Snook*. The apparent conflict between these two authorities emerges when considering that in *Snook,* Lord Diplock had remarked that requiring a common

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[137] [1997] 1 BCLC 242.
[138] *Re Esteem* (n 3) [58].
[139] *A v A* (n 3) [52].
[140] *Pugachev* (n 3) [150]. Similar observations in *Minwalla v Minwalla* [2004] EWCH 2823 (Fam), [2005] 1 FLR 771; [53]; *ND v SD and others* [2017] EWHC 1507 (Fam) [190]; *Re Munir* (n 103) [48].
[141] See section II.1 above.

intention for having a sham was 'clear in legal principle, morality and the authorities'.[142] In contrast, in *Wyatt*, Young J said that he did not understand the requirement that all the parties to the sham must have a common intention in respect of all sham transactions, adding that reckless indifference would suffice.[143] Once understood that reckless indifference may be characterised as a type of acceptance, and therefore one way of having a shamming intention and of being party to the sham, then the discrepancy between *Snook* and *Wyatt* dissipates.

2.3. Recent development in Jersey

Until recently, this point of law did not provoke much controversy. It was settled law that the shamming intentions of the settlor and the trustee are needed for a sham to be found, and that reckless indifference by the trustee in going along with the shammer (the settlor) suffices to satisfy such intention. However, the recent decision of the Royal Court of Jersey in *Hanson*[144] has provoked much debate on the nature of the intention needed for a sham trust.[145] The case dealt with the estate of the deceased Mr. Hanson, who had set up a Jersey trust that was purported to be charitable but was found to be aimed at evading taxes on his assets. One allegation to strike down the trust was that it was a sham. The court rejected this allegation observing that a positive intention from both the settlor and the trustee is needed for finding a sham trust, holding that reckless indifference is not enough for satisfying the intention to mislead.[146]

Deputy Bailiff MacRae held that the intention to mislead in a sham trust is composed of two particulars. First, of an intention that the assets would be held upon terms otherwise than as set out in the trust and, second, of an intention to give a false

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[142] *Snook* (n 1) 802 D.
[143] *Wyatt* (n 137) 245.
[144] *Hanson* (n 3) [108]-[110].
[145] It is worth observing here that while England and Jersey are, obviously, different jurisdictions, they usually follow each other very closely. Moreover, in *Hanson* (n 3) [121] the court expressly observes that it is convenient to have a uniform approach in English and Jersey laws on this matter. A similar observation in *Mackinnon* (n 29) [15].
[146] For an illustrative note on this case, see Thomas Arnull, 'Sham trusts and the requirement that a shaming intent be shared: Administrators of the Estate of Hanson v O'Leary and Ord' (2022) 28 Trusts & Trustees 405.

impression to third parties or to the court.[147] The judge admitted that reckless indifference in going along with the settlor's shamming intention suffices for satisfying the first particular. However, the second particular, the judge says, would require a positive intention, a reckless indifference not being sufficient.[148]

Discussing *Hanson* in depth would divert us from this section's objective, which is to examine the common intention necessary for identifying a sham trust, and more broadly, a sham transaction. However, it is important to say a few words about why the conclusion reached in this decision is problematic for the operation of the doctrine of sham transactions. A first contextual observation to make is that on this point, *Hanson* does not seem to have support on the authorities. In his decision Deputy Bailiff MacRae refers to *Re Esteem*[149] and *MacKinnon*.[150] However, there is little in these decisions to support *Hanson*. In *Re Esteem* Mr Birt QC expressly observed that 'a party who goes along with a sham neither knowing or caring what he is signing (i.e., who is reckless) is to be taken as having the necessary intention'.[151] In later decisions,[152] this statement has been read as meaning that reckless indifference suffices. Similarly, in *MacKinnon* Southwell J.A. distinguished two particulars in the intention to mislead,[153] but without ever discussing whether a positive intention was needed for any of the two. In turn, English authorities are consistent in accepting that reckless indifference by the trustee in going along with the shamming intentions of the settlor suffices. It is surprising, then, to read in *Hanson* that 'a uniform approach to the invalidity of a trust on the grounds of sham is a desirable one'[154] when at least in this respect, the decision departs from settled English law.

Secondly, and more importantly for the purposes of this chapter, requiring a positive intention to establish a sham significantly complicates the operation and application of the doctrine of sham transactions. In many transactions, particularly in trusts, it is both possible and frequent for one of the parties to take a passive role. For

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[147] *Hanson* (n 3) [108].
[148] *Hanson* (n 3) [109].
[149] *Re Esteem* (n 3).
[150] *Mackinnon* (n 29).
[151] *Re Esteem* (n 3) [58].
[152] *A v A* (n 3) [52]; *Pugachev*(n 3); *Minwalla* (n 140) [53]; *ND* (n 140) [190]; *Re Munir* (n 103) [48].
[153] *Mackinnon* (n 29) [23].
[154] *Hanson* (n 3) [121].

instance, consider a trust where the settlor appoints several trustees, as was precisely the case in *Hanson*. In such trusts, demanding a positive intention to mislead from all parties involved is setting an excessively high threshold that may be very difficult to meet. Given these challenges, it appears more practical to adopt the position that reckless indifference in going along with the sham suffices as a shamming intention, which in any case, and as already discussed,[155] seems to be supported by sound principled reasons.

3. Summary

As we have seen, the agreement to simulate can be reached by tacit consent and does not need to be explicit. However, when the parties to the simulation want to enforce this agreement, and 'benefit' from the simulation, they need to provide written evidence. This seems sensible. After all, finding a simulation would mean that the parties are bound by different obligations from the ones they recited in the documentary form. Likewise, if they concluded a secret transaction that, according to general law, is only valid if it meets certain formalities (which very often will mean that it needs to be evidenced in writing), then this transaction must satisfy such formalities. But it also seems right for third parties alleging the simulation not to have to provide written evidence of the simulation. They very rarely would be in the position to provide such evidence.

In the case of sham transactions, the starting point is very similar. The common intention does not need to be express and can be proved by any evidence. However, English courts have not discussed whether under certain circumstances written evidence is needed. Instead, there is a substantial number of decisions discussing to what extent reckless indifference in going along with the shamming intention of the other party may amount to a common intention. While this debate is not problematic itself, it may overlook that finding a sham transaction it is not only a matter of the extent to which protecting defrauded third parties is desirable, but also of allowing the parties to enforce their secret understanding. In this regard, the French and Italian approaches

[155] See this Chapter, section IV.2.2.

seem to be more developed than the English solution in finding a balance between the interests of the parties to the simulation and sham and third parties.

V.
Concluding remarks

Having reached the end of Chapter 2 there are two concluding remarks to make. The first is that this chapter has shown that requiring a common understanding between the parties to a sham and simulated transaction is fundamental for the operation of these doctrines. Given that the internal and secret understanding between the parties is legally effective and binding on the parties of the transaction, sham and simulated transactions require this common understanding. For this reason, and as will be argued in Part 2 of this dissertation, sham and simulated transactions that do not require this common understanding are sham and simulation only in a vague or loose sense, and not in the technical meaning of these doctrines as discussed in this part of the dissertation. In other words, the common understanding is one of the elements that defines the boundaries of these two doctrines in a narrow sense, allowing us to differentiate them both structurally and functionally from other doctrines. This will become clearer in Chapter 4, which discusses the effects and functions of sham and simulated transactions.

The second remark is that, as it appears from this chapter, while the doctrines of sham transactions and simulation are fundamentally similar in requiring a common understanding, the significance of this requirement is more evident in the doctrine of simulation than in the doctrine of sham transactions. Courts and legal scholars have been ready to accept the binding effect of the secret understanding and to develop rules and draw conclusions from this assertion. That is why civil law regulates when and for what purposes the common understanding must be written, distinguishing the position of the parties to the simulation from that of third parties. This is also why in the civilian jurisdictions examined, the doctrine of simulation either does not apply to unilateral acts or applies but only provided that the author of the unilateral act and the beneficiary have reached an agreement to simulate. By contrast, in the context of the doctrine of sham transactions the binding effects of the common understanding is

underdeveloped compared to its counterpart in the civilian tradition. Courts have often focused more on the protection of third parties than on the obligational dimension of the understanding that sham transactions concealed. It is not surprising, then, that in English law the question as to when the common understanding needs to be in written has never been addressed, and also that some courts accept that the sham doctrine may apply to self-declared trusts even when, in that case, there is nothing like a common understanding.[156]

[156] See Chapter 7, section I.

CHAPTER 3:
FRAUD IN SIMULATED AND SHAM TRANSACTIONS

In the loose definition of sham and simulated transactions provided in the introduction of this dissertation, there is no mention of fraud. Sham and simulated transactions, I have submitted, are transactions where form and substance deliberately diverge. Fraud is not an inherent element of sham and simulated transactions. That said, very often sham and simulated transactions are fraudulent, and it is undeniable that courts and legal scholars have on occasions, some of them recent, conceptualised sham and simulated transactions as a type of fraud,[1] or at least transactions that are akin to fraudulent transactions.[2] It is therefore important that this exposition of the sham and simulated transactions in the narrow sense explores their relationship with fraud.

This chapter argues that even though simulated and sham transactions often enable the commission of fraud, they are not inherently fraudulent. As will become apparent in the course of this chapter, and even clearer in Chapter 4, ruling out fraud from the structural elements of sham and simulated transactions is consistent with the effects and functions of these doctrines. Sham and simulated transactions are not particular types of fraud from which third parties merit a specific protection or that circumvent mandatory laws. Simulated and sham transactions, it is argued here, are lawful arrangements that merit legal recognition so long as the interests of the parties to the sham and simulation are balanced against, and limited by, the interests of third parties. That said, this chapter also shows that fraud has been more clearly separated from the doctrine of simulation than from the doctrine of sham transactions. For the same reason, understanding how in civil law simulation and fraud are separated may help us to obtain a deeper understanding of the doctrine of sham transactions and its relation to fraud.

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[1] In France, see Jean Carbonnier, *Droit Civil. Les biens. Les obligations* (Quadrige/PUG 2004) 2068 para [1002], and ; Philippe Malaurie, Laruent Aynés, Philippe Stoffel-Munck, *Droit des obligations* (10th edn LGDJ, 2018) 414.

[2] In S Gadhia, K Rodgers, and J Ho 'Sham Trusts' (2016) 22 Trusts and Trustees 464, 468, for instance, we read that '[a]sserting sham is always a grave accusation of dishonesty. It impugns the integrity of the Settlor (often an influential businessman) and the Trustee (invariably a reputable professional)'.

In making this argument, section one provides a brief overview of the different meanings of fraud and different ways in which sham and simulated transactions can potentially be fraudulent. Section two, in turn, examines the relationship between fraud and simulation, and section three examines the relationship with sham transactions. Section four then provides some concluding remarks.

I.
The meanings of fraud

Defining fraud is not a simple task. As the French legal scholar Josserand observed, it is one of those concepts 'whose reality and importance are recognized by all, but whose meaning and scope have remained in the dark'.[3]

Without claiming to remove all darkness from this legal concept, there are three main notions of fraud that are important when discussing the relationship between simulated and sham transactions and fraud. As will be shown, there are many ways in which sham and simulation may be fraudulent.

1. Fraud as an intention to commit a wrong

In first place, fraud means the intention to commit a wrong. Fraud in this sense allows us to distinguish between unintentional wrongs, on the one hand, and intentional wrongs, on the other.[4] The intention of prejudicing a third party, for instance, is fraudulent. Likewise, the intention of committing an act that the law prohibits is fraudulent as well. Sometimes, in the civilian tradition, this notion of fraud is formulated as a synonym for bad faith. A fraudulent act is one committed in bad faith.[5]

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[3] Luis Josserand, *Les mobiles dans les actes juridiques du droit privé* (Dalloz, 1928) 214.
[4] See, for instance, John G Fleming, *The Law of Torts* (9th edn, LBC Information Services 1998) 18; Henri Mazeaud, Léon Mazeaud and André Tunc, *Tratado Teórico y Práctico de la Responsabilidad Civil Delictual y Contractual. Tomo Primero, Volumen II* (Luis Alcalá-Zamora y Castillo, tr, 5ª edn, Ed Jurídicas Europa-América 1962) 52-88, paras [395]-[440].
[5] Guyot, *Répertoire universel et raisonné. Tome 26*, entry 'fraude'; José Vidal, *Essai d'une théorie générale de la fraude en droit français, le principe 'fraus omnia corrumpit'* (Dalloz 1957).

This meaning of fraud is linked to the doctrines of simulation and sham transactions because very often the motive or at least one of the motives of the parties in concluding a sham or a simulation is to commit a 'wrong', either consisting in defrauding mandatory law (eg. avoiding usury law, tax liabilities, etc.) or prejudicing third parties such as creditors and spouses. In cases like these, then, the fraud would consist in the intention to commit a wrong whereas the simulated and sham transaction would be the means to conceal this wrong.

2. Fraud as dishonesty

Fraud can also be understood as a synonym of dishonesty as this concept has been developed in the context of accessory liability for dishonest assistance in trust law. Lord Nicholls famously observed that, 'dishonesty' means 'not acting as an honest person would in the circumstances'.[6] His Lordship further added that while dishonesty has some subjective elements, it ultimately consists in an objective standard since dishonesty 'is not an optional scale, with higher or lower values according to the moral standards of each individual',[7] but rather depends on how an honest person would behave.

This idea of dishonesty is similar to the meaning of fraud understood as an intention to commit a wrong. The reason for this similarity is that while dishonesty is an objective standard, the standard itself involves an intention to be dishonest. In other words, the paradigmatic dishonest person is subjectively dishonest, and the concrete conduct of the actual person committing the conduct is objectively dishonest if it matches the standard of the dishonest person. Moreover, and similarly to fraud understood as the intention to commit wrong, dishonesty is a broad concept covering multiple forms of wrong. Acting dishonestly means acting 'with lack of probity, which is synonymous, which means simply not acting as an honest person would in the circumstances'.[8]

[6] *Royal Brunei Airlines Sdn Bhd v Tan* [1995] AC 378, 389.
[7] *Royal Brunei* (n 6) 389.
[8] *Royal Brunei* (n 6) 389.

Accordingly, this notion of fraud is connected to the doctrines of simulation and sham transactions for the same reasons that fraud understood as an intention to commit a wrong is connected to them. Very often the conduct of the parties to the sham and simulation satisfies this standard of dishonesty. Honest persons do not intend to prejudice third parties or infringe mandatory law, and the parties to sham and simulated transaction often intend these results. That said, dishonesty has an additional and more specific link to the doctrine of sham transactions. In *Jones*[9] Neuberger J said that a sham transaction involves a 'degree of dishonesty'. And this observation has endured.[10] As discussed later in this chapter, this is one of the reasons why in English law, the separation between sham transactions and fraud is less clear than it is in the civilian simulation.

3. Fraud as an indirect wrong

Third, fraud may also consist in an unlawful or illegal result achieved by a means that is not illegal or unlawful in itself.[11] The distinctive element of this fraud is that some aspects of the conduct do not entail any inherent illegality but other aspects make the whole conduct unlawful.

Within this type of fraud, legal scholars sometimes identify two sub-types of fraud: *fraus legis* and *fraus creditorum*. Transactions *in fraudem legis*, as mentioned in Chapter 1,[12] are transactions that comply with the words and formula of the legislature but that allow the parties to achieve a result that thwarts the purpose of mandatory legislation.[13] In turn, *transactions in fraudem creditorum* are transactions that are lawful in their terms but defraud creditors in their results,[14] mainly by shielding

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[9] *National Westminster Bank Plc v Jones,* [2001] 1 BCLC 98 [36]-[41]. See similar observations in *Vooght v Hoath* [2002] EWHC 1408 (Ch), 2002 WL 1876006, again per Neuberger J, as then he was.
[10] See, for instance, *A v A* [2007] EWHC 99 [53]; *PCP Capital Partners LLP v Barclays Bank Plc* [2021] EWHC 307 (Comm) [325]-[326].
[11] *Royal Brunei* (n 6) 389.
[12] See Chapter 1, section II.3.2.
[13] Reinhard Zimmermann, The Law of Obligations: Roman Foundations of the Civilian Tradition (OUP 1996) 702; Rodolfo Sacco and Giorgio De Nova, *Il Contratto* (4th edn, UTET Giuridica 2016) 1044; Marcel Planiol et Georges Ripert, *Traité Pratique de Droit Civil Français, Tome VI Obligations* (2 edn, LGDJ 1952) 445.
[14] For *fraus creditorum* in Roman Law see M Radin, 'Fraudulent Conveyances at Roman Law' (1931-2) 18 Virginia L Rev 109. See also, John MacLeod, *Fraud and Voidable Transfer* (Edinburgh Legal Education Trust 2020) 74-77.

assets and preventing the creditors from making their rights effective. Legal scholars have discussed whether in order to find fraud in this technical sense the only thing that matters is an objective defrauding result or whether it is further necessary that the party committing fraud has a subjective fraudulent motive.[15] However, this discussion does not always matter in practice. Even if we adopt the position that a subjective fraudulent motive is needed, such subjective motive is proven on the basis of a fraudulent objective result.

This meaning of fraud is important because very often sham and simulated transactions permit the concealment of a transaction that defeats mandatory legislation, and also prejudices creditors and other third parties. Sham and simulated transactions frequently achieve the kind of results that parties achieve by means of fraudulent transactions.

There are, then, different meanings of fraud that are somehow related to sham and simulated transactions. Sham and simulated transactions may indeed serve to achieve different forms of fraud. However, as argued in what follows, this does not mean that fraud is an inherent element of transactions of this type.

II.
Simulation and fraud

As mentioned above, simulated transactions are often fraudulent. However, simulated transactions are not necessarily fraudulent. Parties may intend a simulation that does not prejudice third parties nor defraud any mandatory law and, in that regard, is alien to fraud.

Recognising that there are simulated transactions that are not fraudulent is essential, as it broadens the scope and functions of the doctrine of simulation. If simulated transactions can be lawful and not inherently fraudulent, then this doctrine

[15] See Giovanni Giacobbe, 'Frode alla legge' in Costantino Mortati and Salvatore Pugliatti (eds), *Enciclopedia del Diritto XVIII. Foro-Giuridico* (Giuffrè Editore 1969) 73; Umberto Morello 'Frode alla legge' in *Digesto delle Discipline Privatistiche. Sezione Civile* VIII (UTET 1992). See also Alex Weill and François Terré, *Droit Civil. Introduction Générale* (4th edn, Dalloz 1979) 21-23; Vidal (n 5).

extends beyond merely invalidating simulations. Its function then is not solely to address fraud; otherwise, there would be little point in identifying a transaction as simulated but not fraudulent. This chapter will thus demonstrate that addressing fraud is not the primary function of sham and simulated transactions. Chapter 4, in turn, will argue that their primary function is to permit the parties to split the legal operation of a legal transaction into its internal binding effects between the parties and external effects vis-à-vis third parties.

To fully appreciate that simulated transactions are not inherently fraudulent, it may be instructive to consider a brief historical note, demonstrating that this perspective has been recognised for centuries. We will then be better positioned to examine this aspect of simulated transactions in modern law.

1. An historical note

The understanding that simulated transactions are not inherently fraudulent has deep historical roots. Two related but distinct doctrinal developments are worth outlining.

The first development takes us back to the *ius commune*. For medieval jurists, fraud and simulation were very often intermingled. However, at least from the 14th century onwards, some jurists started to distinguish between simulation *ex honesta causa* and simulation *ex inhonesta causa*,[16] and also between *simulatio bona* and *simulatio mala.*[17] Explaining this distinction, jurists submitted that simulating a transaction could be a means for irreproachable purposes, distinguishing fraud from simulation. The early time in which this distinction was made suggests that medieval jurists were aware that simulating a transaction to conceal another one was not enough to find fraud. Fraud was something other than the mere concealment under a misleading appearance. This distinction persisted[18] and it is later found in the writings

[16] Helmut Coing, 'Simulatio und Fraus in der Lehre des Bartolus und Baldus' in *Festschrift Koschaker*, vol. III (Bohlaus Nachfolger 1939) 412; MD Blecher, 'Simulated Transactions in the Later Civil Law' (1974) 91 S African LJ 358, 368; Zimmermann (n 13) 649.
[17] Blecher (n 16) 378.
[18] Alberico, *Dictionarium iuris tam civilis, quam canonici,* v. *Simulatio* (1573); E Erlenkamp, *De simulatis contractibus pro licentia* (1664), th. 2 and th. 8.

of Chilean[19] and occasionally French scholars[20], under the vein of the categories of *legal* and *illegal* simulations.

The second doctrinal development is that in the period that preceded the French Civil Code, French jurists very often understood simulation as a type of fraud. Simulation, they repeated, is a specific fraud, which is committed by the agreement of two or more parties.[21] In line with this understanding, when Domat and Pothier characterised a transaction as simulated, they repeatedly referred to transactions that defraud either some specific legislation or a third party. In particular, Domat referred to simulated settlement agreements *colouring* an illegal act,[22] contracts where the parties simulate the price in fraud of creditors,[23] and simulations where a counter-letter prejudices third parties.[24] Pothier, in turn, referred to simulated sales[25] and simulated partnerships[26] in fraud of the ban on usury, simulated sales concealing forbidden donations,[27] or concealing a *mortis causa* donations, and therefore defeating forced heirship provisions,[28] and simulated sales in fraud of the limitations to assignments of litigated claims.[29] In other words, prior to the introduction of the Code Civil, French jurists had not developed, or at least they had overlooked, the lawful dimension of simulated transactions.

However, alongside the category of 'simulation', and at least as early as the 13th century, French law knew of the 'contre-lettres', and 'contre-lettres' originated as distinctive doctrine.[30] The parties to a 'lettre' were allowed to amend its content in a

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[19] León Hurtado (n 43) 104; Díez Duarte (n 43) 115-128; Peñailillo (n 43) 14-16.
[20] See François Terré and others, *Droit Civil. Les obligations* (12th edn, Dalloz 2019) 795, coined as 'general regime of simulation' and 'fraudulent simulations'.
[21] Denisart, *Collection de décisions. Tome 3,* entry 'simulation'; Guyot, *Répertoire universel et raisonné. Tome 58*, entry 'simulation'. This statement endured some years after the enactment of the Code. This is the case in Merlin, *Repertoire universel et arasonné* (4th edn, Paris, 1815), entry 'simulation'.
[22] Domat, *Les loix civil dans leur ordre naturel* Liv I, XIII, 2, 6.
[23] Domat (n 22) Liv. II, X, 1, 7.
[24] Domat (n 22) Liv III, VI, 2.15.
[25] R Pothier, *Traité du contrat de vente* [38].
[26] R Pothier, *Traité Du contrat de société*, I, 5, 22.
[27] Pothier (n 25) [39].
[28] R Pothier, *Traité des propres* 1, art. 3.
[29] Pothier (n 25) [592].
[30] Jeanne-Marie Tufféry-Andrieu, 'Débat sur la Contre-lettre Dans l'ancien droit français aux origines des articles 1321, 1396 et 1397 du Code Civil' (2002) 70 (3-4) Tijdschrift voor Rechtsgeschiedenis / Revue d'histoire du droit / The Legal History Review 317.

secret ‘contre-lettre’, ‘retaining with one hand what has been given away with the other’.[31] ‘Contre-lettres’ were not reprehensible per se. While courts usually viewed them with some suspicion, for they could conceal fraud, they were ‘valid in all sorts of acts with the exception of marriage’ observed Bosquet,[32] and they were ‘not illegal’ added Guyot.[33] The main concern jurists had was that ‘contre-lettres’ could prejudice third parties and they therefore discussed which formalities the ‘contre-lettres’ needed to satisfy to be effective against third parties.[34] Interestingly, most of the times the ‘contre-lettres’ and simulation were not discussed together, but on the occasions they were, legal scholars used the language and terms of simulation to refer to fraudulent ‘contre-lettres’ that prejudiced a third party.[35] In other words, before the Civil Code of 1804, French law had for centuries recognised that a documentary form intended to be effective *vis-à-vis* third parties (a ‘lettre’), and concealing a different understanding between the parties (a ‘contre-lettre’), was not necessarily fraudulent.

Of the two doctrines, the doctrine of the ‘contre-lettres’ survived in art. 1321 of the Code of 1804,[36] which provided that ‘contre-lettres’ were effective between the parties, specifying ‘they cannot be set up against third parties’. As I now turn to show, French scholars drew on this provision to develop the modern doctrine of simulation, bringing these two ancient doctrines together.

2. Simulations alien to fraud in modern law

That simulated transactions are not necessarily fraudulent is clearly asserted in modern law in the three civilian jurisdictions here explored. In France, the modern doctrine of simulation admits that there are lawful and unlawful motives for concluding a simulated contract;[37] that a simulated contract conceals a secret contract ‘also called

[31] Ferrière, *Dictionnaire de droit. T1*, entry ‘contre-lettre’; Bosquet, *Dictionnaire raisonné des domaines et droit domaniaux, T 1* entry ‘contre-lettre’.
[32] Bosquet (n 31)
[33] Guyot, *Répertoire universel et raisonné. Tome 15*, entry ‘contre-lettre’.
[34] Domat (n 22) Liv III, VI, 2,15; Lange, *La nouvelle pratique. Tome 1* 278; Denisart, *Collection de décisions. Tome 5,* entry ‘contre-lettres’.
[35] Domat (n 22) Liv III, VI, 2,15.
[36] For an account of how this provision was introduced into the Code, and its first application, see Thomas B Lemann, ‘Some Aspects of Simulation in France and Louisiana’ (1954-1955) 29 Tul L Rev 22, 25-26. See also Fenet, *Recueil complet des travaux préparatoires Tome 13,* 112-113.
[37] Claude Ophèle, ‘Simulation’ in Éric Savaux (ed), *Répertoire de Droit Civil, Tome X* (Dalloz 2012) 9.

a “counter-letter”’ (as the current art. 1201 clarifies), but that simulating is not a ground for finding that a contract is void;[38] and that what ultimately matters for determining their effects is the precise content of the simulation and the position of third parties.[39] Thus, French scholars have suggested the ‘principle of the neutrality of simulation’.[40] Simulating a transaction, they say, does not make a transaction void, nor does it make an otherwise void transaction valid. Simulating a contract is itself neutral, and its validity would depend on what exactly it is that the parties simulate and what effects the simulation produces *vis-a-vis* third parties.

In Italy, there is a similar understanding. The effects of simulated transactions depend on the position of third parties,[41] and on whether or not the concealed transaction concluded by the parties, if any, complies with the requirements provided by the general law for the validity of legal transactions.[42] Equally, in Chile, legal scholars have consistently observed that there are legal and illegal simulations,[43] where illegal simulations are those that prejudice third parties or violate mandatory law, and legal simulations the ones that do not produce these results.

To appreciate that simulated transactions are not necessarily fraudulent and that in these civilian jurisdictions there are even lawful forms of simulation it may be illustrative to consider some examples. There are first simulated transactions in which the motive for the simulation is sensible modesty and discretion.[44] It is not uncommon for friends and family members to engage in transactions that include elements of gratuity. One family member may give, for instance, to another family property under a gratuitous bailment. However, out of modesty and discretion, they may prefer to conceal these gratuitous elements from third parties, such as other family members

[38] Jacques Ghestin, Christophe Jamin and Marc Billiau, *Traité de Droit Civil. Les effets du contrat* (3nd edn, LGDJ 2001) 934-936, paras [875]-[877].
[39] Terré *and others* (n 20) 795-806.
[40] Ghestin, Jamin and Billiau (n 38) 934-936. paras [875]-[879].
[41] See arts. 1415 and 1416 of the Civil Code.
[42] See art. 1414, sec. 2 of the Civil Code.
[43] Luis Claro Solar, *Explicaciones de Derecho Civil Chileno y Comparado. De las obligaciones III. Tomo Undécimo* (Ed Jurídica 2013) 113; Avelino León Hurtado, *La voluntad y la capacidad en los Actos Jurídicos* (4th edn, Ed. Jurídica de Chile 1963) 104; Raúl Díez Duarte, *La Simulación de Contrato en el Código Civil Chileno. Teoría jurídica y práctica forense* (3th edn, Editorial Metropolitana 2014) 115-128; Daniel Peñailillo Arévalo, ‘Cuestiones teórico-prácticas de la simulación’ (1992) 191 Rev. de Derecho U. de Concepción 7, 14-16.
[44] Ghestin, Jamin and Billiau (n 38) 928, para [865].

and friends. They might execute documents that give the appearance of a transaction entirely onerous, such as a lease agreement, masking that the rent is never to be paid. Transactions of this nature need not involve any fraud.

A second instance of simulated transactions that are not fraudulent concerns lawful forms of simulation that serve to fill a gap in the law. This the case when the simulated transaction meets the formalities required by law for its legal effectiveness, but the parties' concealed agreement fills a gap in the law in the sense that enables a kind of transaction that would not otherwise be available. 'Notarial instructions'[45] in Chilean law is a good example, which, as Chapter 5 argues, provide an efficient and equitable solution for transfers of land which can only be devised and executed resorting to a form of simulation. As explained in more detail there, Chilean authoritative law does not address the risks associated with the timing of fulfilling the obligation to pay the price of sales of land. Notarial instructions permit to address these risks. They consist in a private document that recites a form of payment of the price that contradicts what the parties recite in the public deed of sale. And in cases like this, there is no fraud; the concealed understanding does not infringe the law; rather, keeping the concealed agreement out of public registries and the notice of third parties allows the legal gap to be addressed. The reader is directed to Chapter 5 for details.[46]

Finally, there are instances in which a simulated transaction may facilitate a subtle change in the law. While the non-fraudulent character of these simulations may be more controversial, they essentially arise because the law is considered deficient not only by the parties to the simulation, but also by the courts and the legal system as a whole. Therefore, the parties simulate a transaction to appear to comply with the law but actually conclude a different arrangement. Because courts and the legal system as a whole also recognise the law's deficiencies, and ultimately support the legal change that the simulated transaction conceals, the simulation is not viewed as fraudulent but is instead upheld by the courts. In this way, the simulation enables legal

[45] Joel González Castillo, 'Las instrucciones notariales' (2016) Revista de Derecho 85; Luis Eduardo Álvarez Díaz, 'Extensión de las obligaciones emanadas de las instrucciones notariales y responsabilidad civil del notario por su incumplimiento' (2015) 25 Revista Chilena de Derecho Privado 77.

[46] See Chapter 5, section II.1.

change, albeit outside the conventional framework contemplated by the legal system. A notable example is the doctrine of disguised donations in France. Again, the reader is directed to Chapter 5 for a more in-depth explanation.[47] For the purpose of this chapter suffices to say that the French legal system tolerates to conclude donations concealed under the guise of a contract of sale or a different onerous transaction, despite the fact that these donations do not comply with the formalities that French Civil Code requires for their validity.

What all these examples have in common is that they involve simulated transactions that do not prejudice third parties and do not infringe mandatory law (though this latter point is less clear in the third example). Accordingly, there is no reason to regard simulations of this type as fraudulent.

In summary, historical sources indicate that for centuries, in the civilian legal tradition, simulated transactions have not been regarded as inherently fraudulent. This perspective is also reflected today in the three civilian jurisdictions at the core of this analysis, which, in various ways, acknowledge that simulated transactions can be unrelated to fraud. Furthermore, there are indeed various instances of simulated transactions that are not fraudulent. As discussed below, the doctrine of sham transactions presents a similar picture, though its distinction from fraud is less clearly defined.

III.
Shams and fraud

In common language 'sham' is a 'pejorative word',[48] observed Lord Diplock in *Snook*, and this negative connotation sometimes echoes in its legal meaning. Some English decisions, at first glance, seem to indicate that sham transactions are always somehow fraudulent. However, as this section shows, a closer examination of the

[47] See Chapter 5, section II.2.
[48] *Snook v London and West Riding Investments Ltd,* [1967] 2 QB 786, 802 C.

authorities reveals that the law is not so different in this point from the doctrine of simulation and that shams are not necessarily fraudulent.

1. Shams in the 19th century

In the 19th century, the doctrine of sham transactions was often found in four contexts, all of them involving some form of fraud. This was the case of 'colourable' and sham conveyances to defeat creditor's executions,[49] sham transfers of shares intended to get rid of contributions before a company went into liquidation,[50] sham attornment clauses to defeat bankruptcy law,[51] and sham sale and a hire purchase agreements intended to defeat statutory restrictions on loans and securities.[52] In all of these cases, the sham transactions were used either to defraud creditors or to defeat some mandatory legislation.[53]

Some decisions in this period go further, suggesting that sham involves some sort of deceit[54] and that for that reason the parties to the sham would be prevented from obtaining any relief.[55] In that sense, it is correct to say that in the 19th century, English courts used the doctrine of sham transactions to tackle different forms of fraud.

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[49] See *Eveleigh v Purssord* (1844) 2 Moody and Robinson 539; 174 ER 374; *Wood v Dixie, Barone* (1845) 7 Queen's Bench Reports 892; 115 ER 724; *White v Morris* (1852) 11 CB 1015; *Sutton v Bath* (1858) 1 Foster and Finlason 152; 175 ER 668; *Michael v Gay* (1858) 1 Foster and Finlason 409; 175 ER 785; and *Darvill v Terry* (1861) 6 Hurlstone and Norman 807; 158 ER 333.
[50] See *Re Mexican and South American Company* (n 102); *Great Wheal Busy Mining Co, Re,* (1870-71) LR 6 Ch. App. 196; *Re European Bank* (1871-72) LR 7 Ch. App. 292. One the general law on this topic, see N Lindley, *A Treatise on the law of Partnership* (T. & J.W. Johnson & Co 1860) 1128-30, and more generally 1078-1136.
[51] See *Re Thompson Ex p. Williams* (1877) 7 Ch D 138; *Re Stockton Iron Furnace Co* (1879) 10 Ch D 335; *Re Bowes Ex p. Jackson* (1880) 14 Ch D 725. For a clause not considered a sham but still void as contrary to the bankruptcy, law see *Re Harrison Ex p. Jay* (1879) 14 Ch D 19.
[52] *Yorkshire Railway Wagon Co v Maclure* (1882) 21 ChD 309; *Manchester Sheffield and Lincolnshire Railway Co v North Central Wagon Co* (1887) 35 Ch d. 191; *Re Watson* (1890) 25 QBD 27; *Madell v Thomas & Co*, [1891] 1 QB 230; and *Beckett v Tower Assets Company* [1891] 1 Q.B. 638.
[53] Some of these cases are discussed in Chapter 6, section I.1.
[54] See *Re Harmony and Montague Tin and Cooper Minning Co* (1872-73) LR 8 Ch. App. 407; *Re Paraguassu Steam Tramway Co* (1874) LR 18 Eq 670 (1874).
[55] In *Gray v Lewis* (1871-73) LR 8 Ch. App. 1035, for instance, Justice James held that *'no action or suit arises either at law or in equity'*. Similarly, in *Re Townsend Ex p. Hall,* (1880) 14 Ch. D. 132, again Lord Justice James found that a sale was a sham and that the plaintiff was not entitled to have the goods returned to him. He observed that there was no way the court '*could give any relief*' to him and that there was no way '*to work out any equity on behalf of a man who has chosen to act in such a way. He has got himself into the difficulty, and we cannot help him out of it*'.

2. Shams in *Snook* and after

However, as the doctrine of sham transactions started to gain a more definite meaning, its association with fraud became less obvious. Neither in the famous formulation of sham provided by Lord Diplock in the seminal decision in *Snook*,[56] nor in the five points set out by Arden LJ in *Hitch v Stone (Inspector of Taxes)*[57] when formulating the content of this doctrine, is there mention of fraud. Likewise, in *Wyatt*, it was stated that a fraudulent motive is not necessary 'to prove that the transaction was a sham […]. There may or may not be such fraudulent motive'.[58] Similary, in *Mackinnon* Southwell JA rejected the assertion that the intention to mislead involves deceit.[59] Finally, in *Taylor v Savik & Anor*[60] Matthews J observed that finding of sham does not always involve finding of dishonesty. Fraud, then, seems not to be a necessary element for finding a sham.

That said, some doubts have been cast on this interpretation. In *Jones*,[61] Neuberger J said that a sham transaction involves a 'degree of dishonesty' on the part of the parties involved,[62] and this observation has been later repeated by other judges.[63] While one may read this dictum as meaning that an honest person in the sense defined in *Royal Brunei* would never conclude a sham transaction, there are good reasons for a different interpretation. There are good reasons to submit that Neuberger J in *Jones* did not add anything new to the legal meaning of sham already formulated in *Snook* and *Hitch v Stone*. In the first place, dishonesty in the context of liability for dishonest assistance is consequential upon the principal wrong of breach of trust or other fiduciary duty.[64] Because there is this principal wrong, assisting the commission of this wrong is dishonest provided that other conditions are met. This ancillary element of dishonesty is absent in sham transactions. If dishonesty exists in

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[56] *Snook* (n 48).
[57] *Hitch v Stone (Inspector of Taxes)* [2001] EWCA Civ 63, 2001 WL 14954.
[58] *Bank plc v Wyatt* [1997] 1 BCLC 242, 244 h.
[59] *Mackinnon v Regent Trust Company Ltd* [2005] JCA066) [20].
[60] [2024] EWCC 7 [100], [108].
[61] *Jones* (n 9) [40].
[62] See also *Isle Investment LTD v Leeds City Council* [2021] EWHC 345 (Admin) [9]; *PCP Capital Partners LLP v Barclays Bank Plc* [2021] EWHC 307 (Comm), 2021 WL 00741982 [326].
[63] *A v A* (n 10) [53]; *PCP Capital Partners* (n 10) [325]-[326].
[64] Underhill and Hayton, *Trusts and Trustees* [98.47]

a sham transaction, it is neither a consequence nor an accessory to any other wrongdoing. The sham transaction itself would constitute the wrong.

Secondly, it would be odd to say that in order to find that a transaction is a sham it must consist in a transaction that honest people would not have concluded. This has never been the approach taken by English courts. While finding some element of fraud is not difficult in many decisions where there is a sham transaction involved, English courts frequently do not discuss fraud as a separate requirement of this type of transaction. They rather assess the extent to which the document concluded by the parties conceals a different legal understanding. Whether this is fraudulent conduct, and what this fraud would consist of, simply are not questions addressed in sham cases. Thirdly, understanding that sham transactions are dishonest in this sense seems difficult to reconcile with *Wyatt*, which is one core case in the field. As discussed before, Young J held that the fraudulent motive was not necessary to have a sham and more generally with the sham cases where this element simply seems to be absent.[65] Finally, if sham transactions were inherently dishonest in the sense of requiring some fraud, the application of this doctrine would be hampered for evidentiary reasons, and it would be difficult to explain the cases in which the parties to the sham may obtain relief and benefit from the sham they have created.[66]

It should further not be overlooked that when Neuberger J said that shams involve a degree of dishonesty, he also said that this was supported by two authorities. First, he referred to a passage of Sir Thomas Bingham in *Belvedere Court Management*[67] where it was said that in a sham 'the parties [would be] doing one thing and saying another'.[68] Second, he relied on the definition of sham by Lord Diplock in *Snook*, where there is no mention of either dishonesty or fraud. Lord Diplock only mentions the intention of the parties to produce a divergence between the appearance *vis-à-vis* third parties and the court, on the one hand, and their internal understanding, on the other. This seems to suggest that the 'degree of dishonesty' mentioned by

[65] As it was the case in *Painter v Hutchison* [2007] EWCH 758 (Ch). This case is discussed in more detail in section III.1.
[66] *Bhopal v Walia* (2000) 32 HLR 302; *Painter* (n 65).
[67] *Belvedere Court Management Limited v Frogmore Developments Limited* [1997] QB 858.
[68] *Belvedere Court* (n 67) 876D.

Neuberger J in *Jones* means nothing different from the intention of giving third parties the appearance of creating certain rights and obligations, and concealing other rights and obligations that are binding on them. *Re Esteem* also seems to confirm this understanding, where after observing that the need for dishonesty depends on what one means by dishonesty, Mr Birt QC concluded that what the law ultimately requires is 'an intention to mislead',[69] referring to the classic passages in both *Snook* and *Hitch v Stone.* Finally, this point is made by Mr Justice Birss in *Pugachev* when after admitting that a sham document that is never produced to a third party does not become actually dishonest, he observed that '[t]o be a sham the document must be created with an intention to mislead, but the fact that the document is never deployed to mislead does not stop it being a sham'.[70]

There is indeed no reason to view dishonesty in every sham transaction. The arguments for considering simulated transactions as not necessarily fraudulent, in my view apply equally to sham transactions. If a sham does not prejudice third parties or infringe upon mandatory law, there is nothing inherently wrong with or dishonest about it. And if we dig deeper, there are a couple of cases where the sham has been concluded for lawful or at least tolerable motives, and the parties have been able to obtain relief and benefit from the sham. This was the case in *Painter*,[71] where Mrs Painter established a sham trust not for fraudulent purposes, but because she had acquired legal title of the trust property using a form of the conveyance that did not allow her to make apparent that she was also the beneficial owner. When she later alleged that the trust was a sham, Lewison J (as he then was) agreed and held that the property beneficially belonged to Mrs Painter.[72] A second example is *Bhopal*[73] where a tenant was permitted to claim that a written tenancy agreement was a sham, concealing an oral agreement for a lower rent.

[69] *Re Esteem Settlement* [2003 JLR 188] [57].
[70] *JSC Mezhdunarodniy Promyshlenniy Bank and another v Pugachev and others* [2017] EWHC 2426 (Ch) [152].
[71] *Painter* (n 65). See also the Australian case *Commissioner of Stamp Duties (Queensland) v Jolliffe* (1920) 28 CLR 178
[72] For a discussion of this decision, see Chapter 7, section I.2.
[73] Bhopal (n 66).

Accordingly, since the language of 'dishonesty' does not introduce any substantive elements to the classic formulations of the doctrine of sham transactions—and instead adds confusion to explaining this doctrine—it, it is best to refrain from referring to it as an inherent element of the intention of the parties to the sham, just as it is best not to include fraud in the definition. It is thus preferable to keep the formulation of this doctrine as it is in *Snook* and *Hitch v Stone* where what the law requires is an intentional divergence between a transactional form created *vis-à-vis* third parties, and the rights and obligations intended to be binding on the parties.

IV.
Concluding remarks

Sham and simulated transactions are often associated with fraud and can facilitate various forms of fraudulent activity. However, they are not inherently fraudulent. Fraud is not a necessary condition for determining whether a transaction is sham or simulated. In this respect, simulated and sham transactions do not significantly diverge. That said, fraud has been more clearly separated from the doctrine of simulation than from the doctrine of sham transactions. The notion that sham transactions may be lawful is a less explored aspect of the doctrine. Therefore, the developments in the civilian doctrine of simulation, clearly recognising that there are lawful forms of simulation, may help to develop a deeper and more nuanced understanding of this aspect of the doctrine of sham transactions.

This finding is important because it helps to understand and explain the effects of sham and simulated transactions. As discussed in more detail in Chapter 4, these transactions are not simply void. The secret understanding between the parties is binding on them, and the misleading appearance presented to third parties can have some legal effects. Moreover, if there are sham and simulated transactions that are not fraudulent, then the most distinctive function of sham and simulated transactions cannot be to tackle fraud. As argued in Chapter 4 their most distinctive function in a narrow sense consists in enabling the parties to devise efficient and equitable transactional schemes by splitting the internal and external operation of legal transactions.

This chapter completes the exposition of the structural elements of sham and simulated transactions in the narrow sense as propounded by this dissertation. It argues that sham and simulated transaction are transactions where:

1) the external documentary form that the parties use gives third parties the misleading appearance that they have created certain rights and obligations, when they secretly have agreed to govern their legal relationship by other rights and obligations, if any.

2) the parties have a common understanding of creating this divergence between the external form intended *vis-à-vis* third parties, and the internal understanding governing their legal relationship.

While fraud is very often present is sham and simulated transaction, it is not as we saw, an inherent element of sham and simulated transactions.

Now it is time to discuss the legal effects of sham and simulated transactions, as well as the functions these effects serve. As the following two chapters demonstrate, the structural elements I have just examined confirm the legal effects and functions that I am about to explore.

<u>CHAPTER 4</u>:
THE DUAL OPERATION FUNCTION
OF SHAM AND SIMULATED TRANSACTIONS

Chapters 1 to 3 focused on the distinctive structure of sham and simulated transactions, aiming to identify the structural elements that define them as separate legal doctrines. This chapter continues the discussion on their distinctiveness, but shifts the focus to the legal effects and functions of sham and simulated transactions. In other words, while Chapters 1 to 3 answered the question of what sham and simulated transactions are, this chapter addresses what these doctrines do, which in turn inform us what they are.

To discuss the functions of the doctrines of sham and simulated transactions, it is first necessary to clarify their legal effects. Only after examining the legal effects of sham and simulated transactions will the reader be able to understand what these doctrines do and the function they perform. Accordingly, Chapter 4 first discusses the legal effects of sham and simulated transactions, then analyses the legal functions that these effects serve and satisfy.

As this chapter argues, the effects of sham and simulated transactions can be condensed into a common general principle that apply across the different jurisdictions considered: *Provided that bona fide third parties are not prejudiced, the rights and obligations recited in the documentary form of sham and simulated transactions are not effective between the parties. Instead, their secret understanding is given effect in a manner consistent with general law*. These legal effects, in turn, do not serve as their most distinctive function the protection of third parties or enforcing mandatory legislation. Instead, they serve what is referred to here as the dual operation function of the doctrines of sham and simulated transactions. This function recognises the parties' capacity to split the transaction's operation into internal effects that bind the parties and external effects that operate *vis-à-vis* third parties.

The chapter is structured as follows: Section I describes the common principle that summarises the effects of sham and simulated transactions across the different

jurisdictions considered. It will show that sham and simulated transactions are not entirely without legal effects. On the contrary, they produce the effects the parties intend. Section II argues that these effects can be explained by the dual operation function. Section III compares the extent to which the legal systems discussed in this dissertation recognise the dual operation function, showing that Italy is the jurisdiction where this function is most recognised, while it is least recognised in England. France and Chile, in turn, are positioned between these two.

I.
The effects of sham and simulated transactions

The effects of simulated and sham transactions can be synthesised as follows:

> ‘Provided that no prejudice is caused to bona fide third parties, the rights and obligations recited in the documentary form of sham and simulated transactions are not effective between the parties, but their secret understanding is given effect in a manner that is consistent with the general law’.

This principle summarises the effects of sham and simulated transactions in England, Italy, France, and Chile. In this sense, and notwithstanding the differences we will discuss in Section III of this Chapter, it is a common principle that cuts across different jurisdictions.

The formulation of this principle reveals that we need to draw a distinction when discussing the legal effects of simulated and sham transactions. First, the effects between the parties, and second, the effects *vis-à-vis* third parties. This section starts discussing the first group of effects.

1. The effects of simulated and sham transactions between the parties

As chapter 1 to 3 have shown, sham and simulated transactions are composed of two divergent elements. A documentary form reciting certain rights and obligations, and a

concealed common understanding of the parties to modify those rights and obligations. These two elements, then, need to be considered when discussing the legal effects of sham and simulated transactions between the parties.

1.1. The effects of the documentary form between the partes

i. *The rights and obligations recited in the documentary form are not effective between the parties*

The clearest and less controversial aspect of the effects of a simulated or sham transaction is that the rights and obligations recited in documentary form are not effective between the parties.[1] Putting that more simply, the parties are not bound by the rights and obligations they recite in the documentary form. Example 1 may illustrate this point: [2]

- Example 1: A and B simulate and conclude a sham transaction where they declare that A sells and transfers property *p* to B in consideration of price *p*', while both agree that the property is neither sold nor transferred, and that A will remain the owner.

In this example, the rights and obligations contained in the documentary form are not effective between the parties. A is not obliged to sell and transfer property *p* to B, and neither is B obliged to pay price *p*' to A.

When the simulation and sham concerns only part of the transaction, the rights and obligations that are not effective between the parties are only those that are party

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[1] In Italy, Francesco Galgano, *Della simulazione, della nullità del contratto, della nullità del contratto, dell'annullabilità del contratto. Art. 1414-1446* (Zanichelli Editore 1998) 11-14; C. Massimo Bianca, *Diritto Civile. III. Il Contratto* (3rd edn, Giuffrè 2019) 660-661, para 376. In France, François Terré and others, *Droit Civil. Les obligations* (12th edn, Dalloz 2019) 796, para 733; Claude Ophèle, 'Simulation' in Éric Savaux (ed), *Répertoire de Droit Civil, Tome X* (Dalloz 2012) 9, paras 41-42. In Chile, see Avelino León Hurtado, *La voluntad y la capacidad en los Actos Jurídicos* (4th edn, Ed. Jurídica de Chile 1963); Raúl Díez Duarte, *La Simulación de Contrato en el Código Civil Chileno. Teoría jurídica y práctica forense* (3th edn, Editorial Metropolitana 2014) 178-181. In England, *Hitch v Stone (Inspector of Taxes)* [2001] EWCA Civ 63, 2001 WL 14954 [87]. See also *Midland Bank plc v Wyatt* [1997] 1 BCLC 253b; *Minwalla v Minwalla* [2004] EWCH 2823 (Fam), [2005] 1 FLR 771 [60].

[2] Examples 1 to 3 referred here will be used throughout this entire chapter to illustrate different aspects of the effects of sham and simulated transactions.

to the simulation and sham. The rest of the documentary form will contain rights and obligations legally effective between the parties.[3] Two examples may show this:

- Example 2: L and M simulate and conclude a sham transaction where L purports to sell and transfer property *p* to M in consideration of price *p'*, while both understand that property *p* is transferred to M by way of donation or gift, price *p'* never intended to be paid.

- Example 3: X sells and transfers property *p* to Y, both simulating that the price of the sale is £100 and in that respect understanding that the price in the contract is a sham, for the price to be paid is actually £150 and not £100 as they recite.

In Example 2, M is not obliged to pay L price *p'* but that does not necessarily mean that other rights and obligations recited in the sham and simulated transaction have no legal effect between them, such as the obligation to transfer property *p*. Similarly, in Example 3, Y does not have the obligation of paying £100 but that does not necessary mean that X is under no obligation to sell and transfer property *p* to Y. As we will see later in this Chapter,[4] the extent to which these obligations are binding depends on the general law.

ii. Effects of sham and simulated transactions when the parties undertake the material acts required to perform the obligations recited in the documentary form.

The effects of the documentary form of a sham and simulated transaction in practice may however be more complex to explain. This is, for instance, the case when the parties undertake all the material acts that are required to satisfy the rights and obligations contained in the documentary form. In Example 1, for instance, A and B may not only conclude the documentary form reciting a contract of sale, they may also register the recited sale and transfer of property *p* in the relevant property register, accompanied by a transfer of price *p* from B to A.

[3] In English law, see *A.G. Securities v Vaughan* [1990] 1 A.C. 417; *Lewin*, Trust [5-028]. In Chile, France, and Italy, this follows from the distinction between total and partial simulation discussed in this Chapter, section I.1.2.

[4] See this Chapter, section I.1.2.ii.

These material acts, however, do not amount to the fulfilment of obligations arising from the recited contract of sale. The sale is only simulated and a sham, and the obligations the parties recite in the documentary form are not binding between them. Consequently, in the Example 1, the contract of sale[5] and the registration of the sale in the relevant property register[6] do not transfer ownership from A to B and the transfer of price *p* is not made pursuant to an effective legal contract.

Continuing with example 1, in Italy[7], France[8] and Chile[9] it would be correct to say that property *p* never ceases to belong to A's patrimony and that B has possession of property *p* as a simulated owner only, and therefore must still recognise A's ownership. In turn, A would acquire price *p'* but will have an obligation of restitution.[10] It would otherwise constitute an unjustified enrichment. In England, in turn, this situation would be characterised as one where B never became the beneficial owner of property *p*, but rather that B held property *p* on trust for the benefit of A.[11] A similar construction would account for the title under which A holds price *p*'. Given that there was no intention from B to transfer price *p* (B transferred possession only to give an appearance *vis-à-vis* third parties), B retained his or her legal title to the money and

[5] Here it is important to bear in mind that in France and Italy, albeit some exceptions in this second jurisdiction, when the object of a contract is to alienate property, or the assignment of other real right, sold property or good pass by force of contract alone. The delivery of the thing and the eventual register of the contract in property registries have other legal effects but they are not conditions for the transfer. For France, see Terré and others (n 1) 387-393, paras 345-352. For Italy, Bianca (n 1) 477-489, paras 254-261.

[6] In England, see Land Registration Act 2002, s.11, 29 and 30. See also Janet Bignell KC, Martin Dixon and Nicholas Hopkins, *Megarry & Wade: The Law of Real Property* (10th edn, Seweet & Maxwell 2024) ch 6. In the case of the sale of goods, section 17 of the Sale of Goods Act 1979 provides that the property is transferred to the buyer 'at such time as the parties to the contract intend it to be transferred'. See Cristian Twigg-Flesner, Rick Canavan and Hector MacQueen, *Atiyah and Adams' Sale of Goods* (13th edn, Pearson 2016) 241-250. In Chile, contracts whose object is to alienate property only create an obligation to alienate property. Property does not pass by force of contract alone. Transfers take place at the time of delivery in case of movable property and at the time of registration when the subject of the contract is immovable. See Arturo Alessandri Rodríguez, *De la Compra-venta y de la promesa de venta. Tomo I. Vol 2* (Ed Jurídica de Chile 2003) 654-663; Daniel Peñailillo Arévalo, *Los bienes, la propiedad y otros derechos reales* (5th edn, Thomson Reuters 2022) 107-110, 124-127

[7] Bianca (n 1) 660; Galgano (n 1) 15.

[8] Terré and others (n 1) 794, para 730.

[9] In Chile these are consequences from the application of the rules governing void transactions. See Ramón Domínguez Águila, *Teoría General del Negocio Jurídico* (3th edn, Prolibros 2020) 395-398.

[10] See Gabriel Bocksang Hola, 'Título XX. De la nulidad y la rescisión' in Carlos Amunátegui Perelló (ed), *Comentario Histórico-Dogmático al libro IV del Código Civil de Chile. Tomo I* (Tirant lo blanch 2023) 721, 751-754.

[11] Lewin, *Trust* [5-028]. In Underhill and Hayton, *Law of Trusts* [8.14] observing that the solution depends on the facts.

this title would be superior to A's title.[12] In equity, in turn, there would arise a resulting trust for the benefit of B.[13] The payment was made for no consideration and B never intended to pass his or her beneficial interest in the money to A.[14] That said, B would rarely need to rely on his or her legal title. B may also bring an action in restitution against A.[15]

As these observations indicate, in cases of sham and simulated transactions, the documentary form and the rights and obligations it contains are never fully effective between the parties. Since the parties do not intend for those rights and obligations to be binding, they can undo what they ostensibly appear to have done.

1.2. The effects of the common understanding: the efficacy of shams and simulations

The fact that the rights and obligations contained in the documentary form of the sham and simulated transaction are not effective between the parties does not necessarily mean that the simulated and sham transaction is entirely without legal effect. We have to remember that sham and simulated transactions result from a common understanding between the parties, consisting in the creation of a simulation and a sham. The common understanding is effective in two senses. First, in the sense that it 'causes' the sham and simulation; the transaction is a sham and simulation because that is the common intention of the parties. In addition, the common understanding is also effective in the sense that it may give effect to concealed rights and obligations that are effective between the parties as long as it complies with the requirements of the general law.

To explain the effects of the common understanding of the parties in more detail it is instructive to recall[16] that in the civilian tradition, legal scholars often distinguish

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[12] David Fox, *Property Rights in Money* (OUP 2008) [3.99]-[3.103] referring to absence of effective intention to transfer ownership.
[13] David Fox (n 12) [3.86]. For general accounts of resulting trusts, see Snell's, *Equity* [25-001]-[25-036].
[14] Note that this situation is different to a case of mistake or in which the payer paid under a void title under the belief that it was valid. Thus, Lord Browne-Wilkinson's reasons in *Westdeutsche Landesbank Girozentrale v Ilington LBC* [1996] AC 669 to reject the theory that argues that when a person paid money by mistake a resulting trust would arise.
[15] David Fox (n 12) [3.20].
[16] See Chapter 1, section II.2.3.

between total and partial simulation.[17] In a *total simulation* the documentary form conceals that there is a total lack of a rights and obligations binding the parties. For the same reason, their secret agreement is limited to the fact that the transaction they appear to be concluding is a simulation. Example 1[18] is a case of a total simulation since the parties simulate selling property *p* and they do not intend any other transaction. In a *partial simulation,* in turn, the parties use the documentary form to conceal a different transaction. In this second case, the secret agreement of the parties not only consists in the simulated character of the apparent transaction but also in that they have concluded a different transaction. This is the case of Example 2,[19] where the parties simulate a sale but internally intend a gift, and also of Example 3,[20] where the simulation only concerns the price to be paid.[21]

An analogous distinction can be made in English law.[22] As the definition of sham in *Snook v London and West Riding Investments Ltd* suggests,[23] a sham document may conceal that the parties have not intended to create any rights and obligations, in which case, one can say, the sham is total. Alternatively, they may have intended other rights and obligations, in which case the sham is partial.

This distinction is useful to explain the effects between the parties of their common understanding.

[17] The classification of different types of simulation in total and partial simulation is found mainly in Italy and in Chile. In France, it is found in René Demogue, *Traité des obligations en général. I. Sources des obligations. Tome I.* (Rousseau & Cie 1923) 259, but legal scholars more often divide different cases of partial simulation into more specific categories. See, for instance, George Ripert and Jean Boulanger, *Droit civil. D'Après le traité de Planiol. Tome II. Obligations* 223-25 paras 590-595; Christian Larroument, and Sarah Bros, *Traité de droit civil. 3. Les obligations, le contrat* (7th edn Economica, 2014) 964; Philippe Malaurie, Laruent Aynés, Philippe Stoffel-Munck, *Droit des obligations* (10th edn LGDJ, 2018) 414; Jacques Flour, Jean-Luc Aubert and Eric Savaux, *Droit civil. Les Obligations. 1. L'acte juridique* (16th edn Dalloz, 2014) 407.
[18] See example in this Chapter, section I.1.1.
[19] See example in this Chapter, section I.1.1.
[20] See example in this Chapter, section I.1.1.
[21] In France this is specific case of simulation regulated in art. 1202 of the Civil Code. Interestingly, and for reasons that will be discussed later, in Italy according to some legal scholars and some court decisions this is not a case of simulation and in any case the solution is different to the one French law offers. See section II.4 below.
[22] Lord Neuberger of Abbotsbury, 'Company charges' in Edwin Simpson and Miranda Stewart (eds), *Sham Transactions* (OUP 2013) 158.
[23] [1967] 2 QB 786, 802 C-E.

i. The effects of the common understanding of the parties in a 'total' sham and simulation

It is often said that when the sham and simulation is total, the transaction amounts to a nullity and that it has no effect.[24] The parties have not concluded any transaction other than the external documentary form, and this documentary form would be nothing but a sham and simulation. Thus, once it is discovered that a transaction is a total sham and simulation, the transaction would be of no effect between the parties. This conclusion, however, overlooks that the documentary form of the sham and simulated transaction is to some extent efficacious, and that its effects result from the common understanding of the parties. This becomes clearer when it is acknowledged that the parties to a total sham and simulation have an agreement or at least share a common understanding, which is the only reason why the documentary form is a sham and simulation.[25] In other words, the documentary form of the sham and simulation is ineffective between the parties, not because they failed to imprint their intention on it, but rather because this was their intention, and this common intention is what impedes the parties from making the document the foundation of their rights and obligations. Thus, there is an intention to negate the effects the document would otherwise have. Moreover, when the parties conclude a sham and simulation, they also intend to create an appearance *vis-à-vis* third parties and, as discussed in a subsequent paragraph of this section,[26] this external appearance is to some extent effective *vis-à-vis* third parties.

One may say, then, that the common understanding of the parties is the reason why the documentary form of the sham and simulated transaction is not binding between the parties. In addition, the common understanding prevents the parties from relying on the documentary form to discuss the terms of their legal relationship. And

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[24] In Chile, see, for instance, León Hurtado (n 1) 177; Díez Duarte (n 1) 181-184. In Italy, see Francesco Ferrara, *Della simulazione nei negozi giuridici* (2nd edn, Soc. Editrice Libraria 1905) 137. In France see Ripert and Boulanger (n 17) 223 para 590.

[25] For France, see Jacques Ghestin, Christophe Jamin and Marc Billiau, *Traité de Droit Civil. Les effets du contrat* (3nd edn, LGDJ 2001) 973, para [915]; For Italy, Bianca (n 1) 655; Galgano (n 1) 9-14. Check this in Chile. For England, *Hitch* (n 1) [66].

[26] See, this Chapter, section I.2 and section II.2.

finally, although this is clearer in some jurisdictions than others,[27] the common understanding of the parties even imposes an obligation on the parties to give to third parties the appearance that they have created the rights and obligations recited in the documentary form. In other words, the parties acquire an obligation to pretend *vis-à-vis* third parties that the simulated transaction contains their mutual understanding. Thus, the effects of a total sham and simulation are more complex than those of a mere nullity.

ii. The effects of the common understanding of the parties in a 'partial sham' and simulation

When the parties have concluded a 'partial simulation' or a 'partial sham', they not only execute a documentary form but also conceal a different transaction. Thus, the effects of the common understanding are not only that the rights and obligations recited in the documentary form are not binding between the parties. It is also that the parties may be bound by additional obligations resulting from the concealed transaction. In particular, the transaction that the parties conceal will be valid and effective so long as it complies with the requirement provided by the general law. This is why in Example 2, the sale between L and M is simulated, while the gift they intended will be valid if it complies with the general law applicable to gifts.[28]

In this respect, art. 1414 sec. 2 of the Italian Civil Code specifies that if the parties intended a different contract from the one that they simulate, 'the former is binding between them provided that the requirement of form and substance are present'.[29] Chilean scholars[30] and to some extent French scholars[31] as well, have developed a similar solution that the concealed transaction will be valid and effective if it satisfies the requirements contained in the general law. In Chile, this rule is a consequence of the understanding that the parties really intend the concealed transaction, which

[27] As it is the case in Italy. See Raffaele Lenzi, *Simulazione. Art. 1414-1417* (Giuffrè 2017) 52 and 165-166.
[28] See example in this Chapter, section I.1.1.
[29] For a discussion of the actual meaning of this provision, see this Chapter, section III.5.
[30] León Hurtado (n 1) 181; Díez Duarte (n 1) 150-151; and René Abeliuk Manasevich, *Las Obligaciones. Tomo 1* (5th edn, Ed Jurídica de Chile 2010) 165, para 143.
[31] Ophèle (n 1) 10; Terré and others (n 1) 796-797, para 735. In France, however, this rule applies only to the requirements of substantial law and not to the requirements of form. See section II.5 below.

becomes apparent once the transaction recited in the documentary form is declared simulated and void.[32] In France, the argument is similar, legal scholars adding that the effects of simulated transactions are governed by the principle of 'neutralité', according to which a transaction does not become void only because it is concealed under a simulated transaction. Art. 1201 of the French Civil Code implicitly recognises this rule establishing that the secret contract 'takes effect between the parties'. English courts, finally, determine the effects of what a sham conceals on its own merits.[33] Therefore, if a sham conceals, for instance, a transaction that breaches some statutory provision, the court will apply the legal consequences that derive from the statutory breach, either making the transaction void, imposing a fine, or simply applying the statutory law the sham attempted to circumvent.[34]

In summary, it is the common understanding that what makes the rights and obligations contained in the simulated and sham transaction not binding between the parties. It also bars the parties from relying on the documentary form to rule their legal relationship. In addition, when the parties have concealed a different transaction, this later this transaction will be valid and binding, provided it complies with the general law applicable to transactions of that kind. Thus, as these observations show, sham and simulated transactions are not simply void and of no effect. They rather produce the precise effects that parties intended to produce.

1.3. Simulations and shams in court

Before discussing the effects of sham and simulated transactions *vis-à-vis* third parties it is important to mention, even if very briefly, how the parties can enforce the effects discussed in this section before a court. Only if the parties have legal standing to enforce these effects, are they actually meaningful. As argued here, in civil law

[32] Luis Claro Solar, *Explicaciones de Derecho Civil Chileno y Comparado. De las obligaciones III. Tomo Undécimo* (Ed Jurídica 2013) 113-115; Daniel Peñailillo Arévalo, 'Cuestiones teórico-prácticas de la simulación' (1992) 191 Rev. de Derecho U. de Concepción 7, 18.

[33] *Re Yates (A Bankrupt)* [2004] EWC 3448 (Ch) [219].

[34] *AG Securities* (n 3); *Bankway Property Ltd v Pensfold-Dusford* [2001] 1 WLR 1369.

jurisdictions, the parties can bring an action of simulation. In England, the rule is less clear cut although in its results it seems to be not substantially dissimilar.[35]

i. Action of simulation

In France, Italy, and Chile the parties to a simulated transaction can bring an action of simulation asking the court to declare that a transaction to which they are party is only simulated.[36] Thus, in Example 1, A may go to court asking it to declare that the sale and transfer was simulated, that he or she has never disposed property *p*, and that B has only an appearance of ownership that is of no effect between them. Similarly, in Example 3, Y may go to court asking it to declare that the price for the sale is £150, the price of £100 being simulated.

Given that the action of simulation declares the existence of the simulation, but does not bring any direct remedy for the interests of the plaintiff,[37] the party bringing an action of simulation will often combine additional petitions in the same proceeding.[38] In Example 1, for instance, in addition to the action of simulation, A may bring an action of *rei vindicatio* to recover possession of property *p*. Similarly, in Example 2, in addition to the action of simulation, A may bring a contractual remedy to enforce Sale 2.

ii. The solution in English law

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[35] See Timothy Liau, *Standing in Private Law* (OUP 2023) 31-47, for a concept of standing in English law.

[36] For Italy, see Lenzi (n 27) 167-168. For France, see Ophèle (n 1) 13; Ghestin, Jamin and Billiau (n 25) 973, para [915]. In Chile, the action of simulation is often brought by third parties, and legal scholars sometimes neglect the possibility that one of the parties may bring an action of simulation. However, Díez Duarte (n 1) 182-184 and 191-192, discusses this possibility in some length. See also Claro Solar (n 32) 114 who mentions that one party can enforce their concealed understanding against the other. A similar argument is made by León Hurtado (n 1) 186. Likewise, Chilean courts have accepted that parties to the simulation can successfully allege that the transaction they have concluded is simulated. See, for instance, Corte de Apelaciones de La Serena, 30 Dic. 1882, en Gaceta de los Tribunales (1882) 1967-1968, No. 3571; Corte Suprema, 8 Feb. 2023, Rol Nº 4.057-2021.

[37] The action of simulation ultimately consists in a declaratory relief. In Italy, see Bianca (n 1) 665.

[38] In Italy, see Rodolfo Sacco and Giorgio De Nova, *Il Contratto* (4th edn, UTET Giuridica 2016) 638-642.

[38] Bianca (n 1) 689; Lenzi (n 27) 160-161.

When it comes to the doctrine of sham transactions in English law, it is difficult to find authorities discussing at length the extent to which the parties can allege the existence of a sham against each other. However, the law seems to be similar to the position already explored in relation to civil law jurisdictions. There is nothing preventing the parties to the sham from alleging that a transaction to which they are parties is a sham. And this can be seen in at least two groups of authorities.

In first place, when a sham document avoids statutory rights that protect one of the parties to the transaction, the latter may allege that the transaction is a sham in fraud of his or her rights.[39] This has been the case, for instance, in sham tenancy agreements. In these cases, granting the endangered party to the transaction with standing to make an allegation of a sham is consistent with the protection pursued by the statutory law.[40]

In addition, and more interestingly for the purposes discussed here, there are some decisions permitting the parties to the sham to allege that they have concluded a sham document simply when, because of new circumstances, what they had previously concealed turns out to be advantageous to them. *Painter*,[41] for instance, is a case where the settlor of a purported trust successfully asserted that the declaration of trusts was a sham and obtained from Lewison J (as he then was) a declaration that in spite of the ostensible declaration of trust, she was the beneficial owner of the property apparently held in trust. A second example is *Bhopal v Walia*,[42] where a tenant was allowed to allege that a written tenancy agreement was a sham concealing an oral agreement which provided a lower rent. Finally, in the Australian case *Commissioner of Stamp Duties (Queensland) v Jolliffe*,[43] the settlor successfully asserted that the trust was a sham against the tax authority.[44] These cases suggest

[39] *AG Securities* (n 3); *Bankway Property* (n 34).
[40] These groups of authorities are not, however, the best examples. As will become apparent in Chapter 6, section I.2, these are cases where the term sham is not always used in the narrow sense discussed in Part 1 of this dissertation.
[41] *Painter v Hutchison* [2007] EWHC 758 (Ch).
[42] (2000) 32 HLR. 302.
[43] *Commissioner of Stamp Duties (Queensland) v Jolliffe* (1920) 28 CLR.
[44] In Underhill and Hayton, *Law of Trusts* [8.10] it is observed that the settlor cannot assert the existence of a sham and use his or her internal intention 'to subvert the clear provisions of his own trust instrument'. It mentions that in the Australian case *Byrnes v Kendle* [2011] HCA 26, (2011) 243 CLR

that the parties can 'benefit' from the sham they are party to, provided there is no illegality[45] and no third party prejudiced.[46] Moreover, they show that the parties to the sham have remedies to enforce their concealed understanding for their own benefit. This is important because its shows that the doctrine of sham transactions does not always protect third parties. It may also protect the interests of the parties to the sham.

iii. 'Nemo auditor' and illegality

There is one last point to address. In France and Chile,[47] it has been discussed whether the Latin maxim *nemo auditur propriam turpitudinem allegans* should deprive the parties to the simulation of standing for bringing an action of simulation. Similarly, in England, courts have addressed whether illegality should prevent the purported settlor to contend that a declaration of trust is a sham.[48] Mentioning here very briefly these developments helps to appreciate the extent to which the parties to the sham and simulation can bring an action of simulation and allege a sham.

Translated into English, the *nemo auditur* maxim would be something along the lines that 'those who allege their own wrongdoing should not be heard'.[49] The precise scope of this maxim in French law is controversial,[50] but for long time has been used to qualify the consequences of declaring a contract void.[51] When a contract is declared void, the parties have a correlative obligation of restitution of the rights and goods given pursuant to the contract.[52] Thus, if a contract of sale, for instance, is declared void, the buyer and the seller have the correlative obligations of restitution of the price paid and the property transferred pursuant to the contract. However, if the contract is

253 the judges preferred the dissent of Isaacs J and not the majority that decided *Jolliffe* (n 43). However, the discussion in *Byrnes* had nothing to do with a sham trust. The contention was that a declaration of trusts did not create an express trust but on different grounds and not for being a sham. See para 5, fn 22 and para 52.

[45] *Painter* (n 41); *Administrators of the State of Hanson v O'Leary* [2021] JRC319 [309]-[312]. See also *Vickers v Jackson* [2011] EWCA Civ 725.

[46] *Yates* (n 33) [219], per Mr Justice Charles.

[47] For the purposes discussed here, it suffices to refer to the discussion in France and England. For the discussion in Chile, see Peñailillo (n 32) 20-22.

[48] *Painter* (n 41); *Hanson* (n 45) [309]-[312].

[49] There are some interesting similarities between this maxim and the maxim of equity which says 'he who comes into equity must come with clean hands'. See Snell's *Equity* [5-010].

[50] Terré and others (n 1) 654-656, para 580.

[51] Ripert and Boulanger (n 17) 280-281, paras 759-761.

[52] Terré and others (n 1) 650-653, paras 576-577.

declared void on the grounds of illegality, the *nemo auditur* maxim prevents the parties from obtaining these restitutionary grounds of recovery. For that reason, French scholars argue,[53] that the maxim stops the parties from benefiting from their own wrongdoing.

Interestingly, French courts[54] and French legal scholars[55] understand that this maxim does not prevent the parties from bringing an action of simulation. Among other reasons, one is that the scope of the maxim is narrow.[56] But there is also the more general reason, that simulating a contract is not necessarily an illegal act.[57] As discussed in Chapter 3, simulated transactions are not necessarily fraudulent. The parties may conclude a simulated contract for different reasons. And while they cannot benefit from a simulation that conceals an illegal act, the simulation itself cannot be characterised as an illegal act, and the concealed common understanding of the parties will be effective if it complies with the general law applicable to it.

An analogous discussion is found in English law when considering whether the parties to a transaction can allege that it is a sham. In *Painter* the defendant, who was the apparent beneficiary in the trust declared to be a sham, submitted that Mrs Painter could not be heard to say that the trust in which she appeared to be the settlor was a sham, because the purpose underlying the declaration of trust would have been to conceal assets from the Inland Revenue. The court rejected this argument[58] relying on the observations on illegality by Millett LJ in *Tribe v Tribe.*[59] In a very brief synthesis,[60] in *Tribe v Tribe* Millet LJ held that the doctrine of illegality does not necessarily prevent the parties to an illegal transaction from bringing any action of restitution. Millett LJ observed that if property has passed from the transferor to the

[53] Terré and others (n 1) 654, para 579.
[54] Civ. 25 apr. 1887, DP 1887, I. p. 397; Civ. 3 Dic. 1929, *Gaz. Pal.* 27 Dic. 1929.
[55] Agnès Dubois - de Luzy, *L'interposition de personne* (LGDL 2010) 180-183, paras [324]-[330].
[56] Dubois - de Luzy (n 55) 181, para 327.
[57] Dubois - de Luzy (n 55) 181, para 326.
[58] *Painter* (n 41) [129].
[59] [1996] Ch 107, [134].
[60] *Tribe* (n 59) should now be read alongside *Patel v Mirza* [2016] UKSC 42; [2017] A.C. 467. In this latter case the court examined the common law maxims *ex turpi causa non oritur actio* and *in pari delicto potior est conditio defendentis*, the latter the one that would be more directly applicable to a sham transaction. The scope of these maxims was, however, qualified. Lord Toulson, in paragraphs [95]-[108] and with the majority in the case, stressed the importance of looking beyond the maxims to identify underlying policy concerns.

transferee, the transferor could still bring an action for restitution under certain circumstances. These circumstances would be that the transferor can bring an action for restitution without relying on the illegal purpose, which will almost invariably be where the illegal purpose has not been carried out. Millett LJ also added that the transferor can submit evidence of the illegal purpose if that 'it is necessary for him to do so provided that he has withdrawn from the transaction before the illegal purpose has been wholly or partly carried into effect'.[61] Based on these considerations, in *Painter* Lewison J concluded that Mrs Painter was not prevented from alleging the existence of the sham and eventually issued a declaration that she was the beneficial owner of the property apparently held in trust.[62]

In Italy, France, Chile and England, then, it seems that the parties can enforce the effects of sham and simulated transactions against each other by bringing an action of simulation and alleging the existence of a sham.

1.4. Summary

To sum up, the effects of simulated and sham transactions between the parties are as follows:

- The rights and obligations recited in the documentary form are not legally effective between the parties to the sham and simulation.

- The common understanding of the parties to create a sham or simulation is effective in the sense that it is the reason why the rights and obligations contained in the documentary form are not binding between them, and why the parties cannot rely on the documentary form for governing their legal relationship. In addition, if this common understanding embodies a different concealed transaction, this latter transaction will be valid and binding provided it complies with the general law applicable to it.

[61] *Tribe* (n 59).
[62] *Painter* (n 41) [129].

- The parties can enforce these effects by bringing an action of simulation and alleging that the transaction is a sham.

As will become apparent in the following paragraphs, this is not, however, the full picture of the effects of sham and simulated transactions. The interests of third parties limit the extent of these effects.

2. The effects of simulated and sham transactions *vis-à-vis* third parties

The divergence between form and substance that characterises simulated and sham transactions creates risks to third parties. In particular, it creates frictions in the relationship between the parties to the sham and simulation and third parties, and also between different third parties placed in different positions.

To understand this is important to appreciate that third parties may be grouped into two categories. Third parties may have, first, relied on the documentary form of the sham and simulated transaction, and because of this, they may suffer harm if the parties intend to enforce their secret understanding and reveal the simulation and sham. In second place, there may be other innocent third parties whose rights are being prejudiced by the documentary form of the simulation and sham, and who may want to expose the concealed understanding of the parties. The interests of these two groups of third parties set some limits to the effects of simulated and sham transactions discussed in the section above. These limits are briefly referred in what follows.

2.1. Third parties that have relied on the documentary form

The first limit to the effects of sham and simulated transactions between the parties is that the parties cannot set up and make effective their concealed understanding against innocent third parties who have relied on the documentary form. In Example 1,[63] for instance, C may be a third party that has purchased from B property *p,* with no notice that the sale and consequent transfer between A and B was in first place

[63] See example in this Chapter, section I.1.1.

simulated and sham. If this is the case, A cannot make effective against C the simulated character of the sale and transfer with B. Similarly, in the Example 2,[64] if B gives to D a security right over *p*, then A and B cannot make effective the simulated character of Sale 1 against D. As these examples show, innocent third parties are usually people who, having no notice of the simulation and sham, have acquired a real right relying on the external appearance created by the documentary form.[65]

Civil Codes have regulated the protection of the innocent third party that have relied on the documentary form of the simulated transaction earlier than any other aspect of the doctrine of simulation. When in 1804 art 1321 of the Napoleon Code regulated the 'contre-lettres', established that even though they were valid, they were not effective against *bona fide* third parties. Art. 1319 of the Italian Code of 1865 reproduced this rule adding marginal refinements,[66] and art. 1321 of the French Code was also one of the sources of art. 1707 of the Chilean Code of 1855, which contains a similar, but more detailed, rule.[67] Then, in the course of 20th century, art. 1415 of the Italian Code of 1942 reframed this rule providing a more complete wording and structure, but not changing in this respect the normative content of the rule.[68] Finally, in recent times, new art. 1201 of the French Code has also reproduced this rule in a more elaborated form.[69]

In English law, the solution seems to be similar to the solution provided by Civil Codes. Mr Justice Charles observed in *Yates* that 'it cannot lie in the mouth of the pretenders to assert to the disadvantage of that innocent third party that the

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[64] See example in this Chapter, section I.1.1.
[65] For France, see Ophèle (n 1) 13; Ghestin, Jamin and Billiau (n 25) 957-958, para [899]. For Italy, see Bianca (n 1) 662-663. For Chile, see Enrique Alcalde Rodríguez, 'La simulación y los terceros: consideraciones civiles y penales' (2002) 27 Rev Chilena de Derecho 265.
[66] This rule provided that that 'counter-declarations made in a private deed shall have effect only between the contracting parties and their universal successors'.
[67] Section 1 of art. 1707 of the Chilean Civil Code provides that: 'private deeds made by the contracting parties to modify what has been agreed in a public deed shall not produce effect against third parties'.
[68] Section 1 of art. 1415 of the Italian Civil Code is as follows: 'Simulation cannot be used as a defence by the contracting parties, by their successors in interest, or by the creditors of the: simulating transferor, against third parties who, in good faith, have acquired rights from the apparent owner of the right, subject to the effects of transcription of a judicial petition concerning simulation'.
[69] Art. 1201 of the French Codes provides as follows 'where the parties have concluded an apparent contract which conceals a secret contract, the latter (also called a 'counter-letter') takes effect between the parties. It cannot be set up against third parties, though the latter may themselves rely on it'.

transaction is a sham'.[70] The basis for this rule seems to be the doctrine of estoppel. Lady Arden mentioned this observing that

> 'if a third party in good faith and for valuable consideration enters into a transaction to acquire rights created by the sham transaction, the question would arise whether he could acquire rights from one party only, […]. He may well be able to rely on the doctrine of estoppel or be protected by the law in some other way'[71]

This point was also incidentally discussed in *Snook*, where both Lord Diplock[72] and Lord Russell[73] observed that the plaintiff was estopped from asserting the transaction was a sham against the defendants, who had acquired title from one of the parties to the alleged sham.

2.2. Third parties to which the documentary form of the simulated and sham transaction is prejudicial

As already anticipated, there might be other third parties whose interests are exposed to the sham and simulation. This often happens when the documentary form defrauds the rights of third parties.[74] Most times the simulated and sham transactions give the appearance to third parties that some assets have been transferred from one person to another, defrauding transferor's creditors or other third parties having some right on and claims against the disposed assets. In Example 1,[75] for instance, the simulated sale between A and B may prejudice A's spouse E. If this is the case, E will want to obtain from the court a declaration that the sale was simulated and a sham to have access to property *p*.[76]

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[70] *Yates* (n 33) [219], per Mr Justice Charles.
[71] *Hitch* (n 1) [87]. A similar observation in *National Westminster Bank Plc v Jones* [2001] 1 BCLC 98 [60].
[72] *Snook* (n 23) 802.
[73] *Snook* (n 23) 803-804.
[74] For France, see Ghestin, Jamin and Billiau (n 25) 938, para [879]. For Italy, see Bianca (n 1) 661-662. For Chile, see León Hurtado (n 1) 189-194.
[75] See example in section I.1.1 above.
[76] In Italy, see for instance, Cass. 17 Sep. 1981, n. 5154, rv. 415946; Cass. 5 Feb. 1987, n. 1127, rv. 450690. In English law, see for instance, *Wyatt* (n 1); *A v A* [2007] EWHC 99.

In the civilian jurisdictions discussed here, this group of third parties have *locus standi* to bring an action of simulation, and to make effective their rights against the understanding of the parties concealed behind the simulated transaction. In Italy, this is recognised in Section 2 of art. 1415.[77] In France it is implied in new art. 1201.[78] In Chile, it is a solution developed by legal scholars[79] but they rely on art. 1707 of the Civil Code. Similarly, in England, this group of third parties have *locus standi* to allege the existence of a sham. This is often the case in sham trusts, where spouses,[80] creditors,[81] trustees in bankruptcy,[82] or other third parties allege that a declaration of trust is a sham to have access to the assets apparently held in trust.

It is important to mention that when it comes to the doctrine of simulation, only third parties that have an interest endangered by the simulation have standing to bring an action of simulation.[83] Otherwise, third parties do not have standing and the external documentary form will stand. In English law, there is little authority on this point, but a conservative approach may be that anyone with an interest can allege that a transaction is a sham.

2.3. Conflicts between third parties

Third parties placed in different positions have different interests, some preferring to make the simulated and sham transaction effective (as it would be the case of C in Example 1 who was a third party that acquired from B property *p,* with no notice that the sale and consequent transfer between A and B was in first place simulated and

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[77] Section 2 of art. 1415 of the Italian Civil Code provides that 'third persons can plead simulation against the contracting parties, when it is prejudicial to their rights'.
[78] See note 69 above.
[79] In Chile, León Hurtado (n 1) 192-193; Díez Duarte (n 1) 258-259.
[80] *Minwalla* (n 1); *A v A* (n 76).
[81] *Wyatt* (n 1).
[82] *Hanson* (n 45).
[83] For Italy, see Lenzi (n 27) 87-88 and 168. For Chile, see León Hurtado (n 1) 192; Díez Duarte (n 1) 258-261; René Ramos Pazos, *De los contratos. Teoría General* (Thomson Reuters 2023) 125. This is particular clear in the decisions of the Chilean Supreme Court who requires from the third party a patrimonial interest (see, for instance, Corte Suprema, 31 may. de 2004, Rol N° 1663-2003; Corte Suprema, 30 mar. 2015, Rol 8733-2014; Corte Suprema, 20 de jul. 2016, Rol N° 9699-2015; and Corte Suprema, 24 nov. 2016, Rol N° 2968-2016) or an endangered right (see, for instance, Corte Suprema, 23 ago. 2011, Rol N° 7793-2009; Corte Suprema, 25 jun. 2012, Rol N° 1083-2012 and Corte Suprema, 23 mar. 2016, Rol N° 2284-2015). Jean Denis Bredin, 'Remarques sur la conception jurisprudentielle de l'acte simulé' (1956) 54 RTD civ 261, 285.

sham), and others preferring to make effective the secret understanding of the parties (as it would be the case of E in Example 1 who was A's spouse and who would want to obtain from the court a declaration that the sale was simulated and a sham to have access to property *p*).[84]

In civilian jurisdictions for some time, it was a matter of controversy which of these groups of third parties should be preferred.[85] However, nowadays in the three civilian legal jurisdictions considered here, the interests of third parties that have relied on the documentary form prevail.[86] The underlying rationale is that legal certainty and the stability of the content of legal transactions prevail.

In England, this point of law is uncertain.[87] The observation by Arden LJ, as she then was, in *Hitch v Stone*[88] that the *bona fide* purchaser may benefit from the doctrine of estoppel suggests that *bona fide* third parties having proprietary rights may be preferred over those defrauded by the sham.

3. Synthesis

Before I move on to discuss the functions that sham and simulated transactions serve, it is important to summarise some of the main points of this section. In the different jurisdictions considered in this dissertation, the rights and obligations the parties recite in the documentary form of a simulated and sham transaction are not effective between them. However, they are bound to accept the simulated and sham character of the documentary form they have executed, and also the legal consequences

[84] See examples in section I.1.1.
[85] For an account of the conflicting views on France, see See Marion C. Raoux, 'Simulation. Effets a l'egard des tiers. Option de l'article 1321 Du Code Civil. Conflit entre les tiers' in Henri Capitant, François Terré, and Yves Lequette (eds), *Les grands arrêts de la jurisprudence civile* (9th edn, Dalloz 1991) 426. The question was eventually settled by the Cour de Cassation in a decision issued in 1939 (Civ. 25 apr. 1939, in D.P. 1940. 1. 12, note G.L.).
[86] For France, see Terré and others (n 1) 802, para 741. For Chile, see León Hurtado (n 1) 191-192; Abeliuk Manasevich (n 30) 165, para 144. In France, during the 19th century and until a famous case in 1949 this was a matter of debate. Arguably under French influence, in Chile, there are some legal scholars that argue that it prevails the secret understanding of the parties. See Díez Duarte (n 1) 203-204. In Italy this is the general rule. However, when it comes to conflict between creditors, the one whose credit arose first prefers. See Bianca (n 1) 664-665.
[87] *Jones* (n 71) [60].
[88] *Hitch* (n 1) [87].

triggered by any concealed transaction they may have executed behind the simulation and sham. The interests of third parties, in turn, operate as limits to these effects. The parties to the sham and simulation cannot set up their secret understanding in prejudice of innocent third parties that have relied on the documentary form. Likewise, third parties that may potentially be defrauded by the simulation and sham have standing to bring an action of simulation and to allege that the transaction is a sham to prevent them being actually prejudiced by the documentary form.

This is important to be able to understand what functions simulated and sham transactions serve, which is the subject of the next section.

II.
The dual operation function

In considering the functions of sham and simulated transactions, it is telling to appreciate that in none of the jurisdictions considered in this dissertation does the law treat shams and simulations as wrongs in themselves. As discussed in Chapter 3, sham and simulated transactions are not necessarily fraudulent. Likewise, as seen in this Chapter, the law refrains from penalising the shamming and simulating intentions of the parties. Instead, it recognises the effectiveness and validity of the concealed common understanding between the parties. The interests of third parties and the necessity of enforcing mandatory legislation limit the extent to which this understanding is valid and effective. Yet its validity and effectiveness are in themselves incontestable.

This observation, then, suggests that the protection of third parties and tackling illegal transactions cannot be the sole, nor the most distinctive, functions of the doctrine of sham and simulated transactions. This section argues that the most distinctive function that these doctrines perform is to enable the parties to satisfy their interests and purposes more efficiently by recognising their capacity to split the legal operation of a transaction into its internal binding effects and its external effects *vis-à-vis* third parties. This function is referred to here as “the dual operation” function: sham

and simulated transactions have one legal operation between the parties and a different legal operation *vis-à-vis* third parties.

It is important to mention that this argument introduces a novel understanding of these doctrines. As discussed in Chapter 3, these doctrines have sometimes been conceptualised as akin to fraud, and consequently, they are often seen as primarily serving to protect third parties and to tackle legal avoidance. Even in civil law jurisdictions, where lawful forms of simulation are widely acknowledged, there is little analysis of the function these lawful simulations serve. However, this Chapter shows that these doctrines are better understood when it is seen that they first serve the interests of the parties to the sham and simulation, and that the protection of third parties and the need of enforcing mandatory legislation are limits to the dual operation function or, at best, secondary and complementary functions.

1. The effectiveness of contracts *vis-à-vis* third parties

An illustrative way of observing the dual operation function is by examining the effects of contracts that are not shams and simulations and then compare these with those that are sham and simulated transactions. As will become apparent, in non-shamming or simulated contracts, the effects of the rights and obligations between the parties themselves and third parties are the same. By contrast, in sham and simulated transactions the parties create one set of rights and obligations binding between themselves and a different set of right and obligations intended to be effective *vis-à-vis* third parties.

Examining the effects that contracts produce may bring methodological concerns. Many kinds of legal transactions, apart from contracts, can be subject to a sham and a simulation,[89] and this dissertation compares and explains these doctrines using the category of legal transaction and not the category of contract.[90] Therefore, it may seem more suitable for the scope and purpose of this dissertation to explain the

[89] See Chapter 2, section III.3. discussing the application of these doctrines to unilateral acts. Also see Chapter 7, section I on the difficulties of applying the doctrine of sham transactions to self-declared trusts.
[90] See Introduction, section III.

dual operation function of the doctrines of sham and simulated transactions by reference to the effects legal transactions produce than by reference to the effects that *contracts* produce. However, Codes, [91] courts,[92] and legal scholars [93] generally refer to the effect of contracts rather than legal transactions in general. But there is no reason, in principle, why the study should be confined in this way. The principles most commonly discussed in relation to contracts are of general application.[94] They could apply equally to forms of transaction that are not strictly contractual in nature. The following paragraphs, therefore, discuss the effects of contracts between the parties and third parties but upon the understanding that such analysis is, at least in some respects, applicable to legal transactions more generally.

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[91] As to the effects of contracts, see French Civil Code arts. 1193 to 1209; Italian Civil Code arts 1321, 1372, 1374, 1376, 1379 and 1411; and Chilean Civil Code arts. 1545 and 1546. The first time a Civil Code in these jurisdictions regulated 'legal transactions' as a technical legal category was the French Civil Code, but only after the Ordonnance n° 2016-131 of 10 February 2016 revised then by Loi 2018-287 of 20 April 2018, which redrafted the book of the law of obligations. Since this reform entered into force, the French Code regulates *les actes juridiques* in arts 1100 and 1100-1. Before that, the Chilean Civil Code introduced in 1855 the legal categories of *act and declaration of intend*, arguably under the influence of Savigny, but without fully developing these categories. See Javier Rodríguez Diez and Adolfo Wegmann Stockebrand, 'Título II. De los actos y declaraciones de voluntad' in Carlos Amunátegui Perelló (ed), *Comentario Histórico-Dogmático al libro IV del Código Civil de Chile. Tomo I* (Tirant lo blanch 2023) 125, 125-127. For its part, the Italian Code of 1942 does not contemplate the category of legal transaction, although it may be understood that art. 1324 implicitly recognises this category when makes contract law applicable to unilateral acts with patrimonial content. See Francesco Galgano, *Il negozio giuridico* (Giuffè 2002) 24-27.

[92] In Chile, see, for instance, Corte Suprema, 19 may. 1932. RDJ. t. 29, sec. 1a, p. 446; Corte Suprema, 5 ene. 1945, RDJ. t. 42, sec. 1ª, p. 507. In Italy, and again many others, Cass. Sez. Un. 14-10-1980, n. 5496, rv. 409399; Cass. 13-11-2009, n. 24133, rv. 610729. That said, courts have been more receptive than Codes to this category than legislators. In France, the *Cour de Cassation* have used the category of *acte juridique* since at least 1939 (see Cour de Cassation, Chambre civile, du 28 février 1939, Bull N. 61, p. 106); the Chilean Supreme Court, in turn, have resorted to the category of act and declaration of intent since at least 1911 (See C. La Serena, 22 abr. 1911. G. 1918, 2 sem., N 270, p. 857 and Corte Suprema 24 ago. 1918, RDJ. t. 17, sec. 1a, p. 279) and juridical act since 1927 (See Corte Suprema, 14 ene. 1927, CL/JUR/51/1927).

[93] For Italy, see Bianca (n 1) 475-563; For France, see Terré and others (n 1) 669-791, paras [595]-[723]; For Chile, see Jorge López Santa María, *Los Contratos. Parte General* (5th edn, Ed Jurídica de Chile) 285-335. Most of the authoritative textbooks on the law of legal transactions do not discuss in detail the effects that legal transactions produce. In Italy, see for instance, Galgano (n 91); Giuseppe Stolfi, *Teoria del negozio giuridico* (Not identified tr, Olejnik 2018). In Chile, see Domínguez Águila (n 9) and Víctor Vial del Rio, *Teoría General del Acto Jurídico* (5th edn, Ed Jurídica de Chile 2007). Some authors discuss the effects of legal transactions, but in doing so they mainly refer to the effects contracts produce or refers restrict the analysis to the obligatory effects legal transactions produce. In Italy, see Emilio Betti, *Teoria general del negocio jurídico* (A. Martin Pérez tr, Ediciones Olejnik 2018) 201-209. In Chile, Rodrigo Barcia Lehmann, *Actos jurídicos, negocio jurídico y teoría general del contrato* (Tirant lo blanch 2024) 319-336. In France, Henri Mazeaud and others, *Lecons de droit civil. Tome I. Premier Volume. Introduction a l'etude du droit* (12th edn, Montchrestien 2000) 399-407, paras [269]-[277].

[94] See in this regard French Civil Code, art. 1100-1 and Italian Civil Code, art. 1324 that make contract law applicable to unilateral acts. See also Stephen A. Smith, *Atiyah's Introduction to the Law of Contract* (6th edn, 2005 OUP) 29-30.

Contracts have an obligatory force between the parties.[95] This means that once concluded, the parties are bound by their legal effects. This idea is often summed up by saying that contracts are 'law' for the parties.[96] The mutual promises of the parties to a contract do not constitute mere wishes. They do not create mutual expectations only, but mandatory rules that give rise to reciprocal enforceable rights and obligations. Exceptions apart,[97] the obligatory force of contracts operates between the parties; not *vis-à-vis* third parties. When A and B conclude a contract, their contract binds A and B with each other, and not A and B with C.

Yet, contracts can still have effects *vis-à-vis* third parties. In English law, this is noticeable when the content of doctrine of privity is clearly demarcated.[98] While the doctrine of privity prescribes that a person cannot acquire rights or be subject to obligations arising from a contract to which he or she is not party,[99] this does not mean 'that a contract between A and B cannot affect the legal rights of C indirectly'.[100] A contract 'incidentally imposes on third parties the duty not to interfere with the contracting parties in performing the contract and if they do so they may be liable for inducing the breach'.[101] In France too while contracts are binding on the parties only,[102] they are 'opposable' to third parties. This means that a contract creates a legal situation that third parties have a duty to accept.[103] Art. 1200 of the French Civil Code provides that 'third parties must respect the legal situation created by a contract', paragraph two adding that 'they may rely on it notably to provide a proof of a fact'. A similar understanding prevails in Chile, where contracts are binding between the

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[95] For Italian law, see Pietro Sirena, 'Effetti e vincolo', in V. Roppo (ed), *Trattato del Contratto. III. Effetti* (2 edn. Giuffrè 2023) 3-6; Bianca (n 1) 477-478. For French Law, see Terré and others (n 1) 671-672, para [596]. For Chilean law, see López Santa María (n 93) 223-224.

[96] This formula appeared in Domat, *Les lox civil dans le ordre naturel,* Liv I, I, 2, 8 and it was later incorporated in Napoleon Civil Code, art 1134, Italian Civil Code, art. 1372; and Chilean Civil Code, art. 1545. See also Judith Rochfeld, *Les grandes notions du droit privé* (Thémis 2011) 415-422.

[97] The paradigmatic exception are contracts for the benefit of third parties. However, the obligational effect between the parties and a third parties that result from contracts for the benefit of third parties is consolidated and stabilised only after the third party accepts these obligational effects. And because of the acceptance of the third party, he or she is a third party only in a limited sense. For Italy, see Bianca (n 1) 521-521. For France, see Terré and others (n 1) 785-786, para [714]. For Chile, see López Santa María (n 93) 303-305; and for England, see Contracts (Right of Third Parties) Act 1999 s.2(1).

[98] *Treitel,* 725, [14-049]. (15th edn)

[99] *Beswick v Beswick* [1968] A.C. 58, 72, 92-93.

[100] *Treitel,* 725, [14-049]. (15th edn).

[101] *Treitel*, 790, [14-148]. (15th edn).

[102] See, French Civil Code, art. 1199.

[103] Terré and others (n 1) 750-758, paras [675]-[681].

parties, but have an ‘expansive effect’ on third parties, meaning that they constitute a legal situation that third parties cannot ignore.[104] Finally, in Italy, contracts do not produce direct legal effects on third parties, but they affect third parties in the sense that once created, they constitute a legal fact affecting third parties.[105]

To illustrate this point, it is helpful to consider some rules and doctrines that highlight the effects of contracts on third parties.

1.1. Contracts may create some *sort of legal duty* on third parties, which may result in their being liable if they facilitate or induce a contractual breach. In England this may constitute a tort of interference.[106] In France, third parties may be prohibited from consciously impeding the execution of a contract to which they are not party.[107] In Italy[108] and in Chile,[109] courts have occasionally ruled that a third party could be liable for inducing a contractual breach, and in the latter of these jurisdictions, there is also statutory recognition of this special liability regime in competition law.[110]

1.2. Contracts may also have some proprietary effect. In France[111] and Italy,[112] for instance, contracts may create proprietary rights, which can then be enforced against third parties. In England, in common law at least, contracts alone do not

[104] Ramón Domínguez Águila, ‘Los terceros y el contrato’ (1983) 174 Rev Derecho Universidad de Concepción 151; López Santa María (n 93) 308-316; Álvaro Vidal Olivares, ‘El efecto absoluto de los contratos’ (2006) 6 Rev Chilena Derecho Privado 51.
[105] Franceso Galgano, ‘Degli effetti del contratto’ in Franceso Galgano (ed), *Commentario del Codice Civile Scialoja-Branca. Degli Effetti del contratto. Della Rappresentanza del Contrato per Persona da Nominare. Art. 1372-1405* (1993 Zanichelli Editore and Soc. Ed. Del Foro Italiano) 27-36. See also Ivan Libero Nocera, ‘Il contratto “a danno del terzo”: identificazione come categoria unitaria e necessità di una tutela effettiva’ (2021) 3 Giustizia Civile 440.
[106] *OBG Ltd v Allan* [2007] UKHL 21; [2008] 1 AC 1.
[107] Terré and others (n 1) 752-754, para [679]. See also, Civ. 1re, 26 janv. 1999, RTD civ. 1999. 405, obs. P. Jourdain.
[108] See Cass., 20 Oct. 1983, n. 6160 (Giur. it., 1984, I, i, 439). See also Galgano (n 105) 34-36.
[109] Corte Suprema, 2 oct. 2023, Rol N° 100.780-2020.
[110] Ley N° 20.169, art. 4. See José Manuel Bustamante Gubbins and Enrique Urrutia Pérez, ‘Competencia desleal: inducción al incumplimiento de contratos y ejercicio manifiestamente abusivo de acciones judiciales’ [2007] 14 Cuadernos de Extensión Jurídica U de los Andes 73. See also Óscar Contreras Blanco, *La Competencia desleal y el deber de corrección en la ley chilena* (Ed UC 2012) 126-131.
[111] Terré and others (n 1) 390-393, paras [348]-[352] and 751-752, para [677].
[112] Bianca (n 1) 527-532.

create proprietary rights,[113] but courts have discussed the circumstances in which a contract concerning property may affect a third party acquiring such property with notice of the contract.[114]

1.3. Contracts impact third parties in case of insolvency. If the debtor of a contractual obligation goes bankrupt unsecured creditors will have personal rights competing for the same pool of assets to be paid,[115] in which case enforcing one personal right has an impact on others' rights.

1.4. Contracts often work as grounds for a third party to have good title to acquire property. In particular, in some jurisdictions,[116] a person may be in a better position to acquire ownership by acquisitive prescription if he or she acquired the property from a third party who in turn had good title to possess the property. This good title is often a contract. Accordingly, a contract between A and B affecting property *p*, may benefit C if he or she then purchases property *p* from B.

All these rules and doctrines differ in many substantial ways. However, they all recognise that contracts may have some effect on third parties. Moreover, they all assume that the internal binding effects between the parties and the external effects *vis-à-vis* third parties that contracts may have concern *the same rights and obligations*. In other words, there is one single bundle of rights and obligations that binds the parties to the contract and that has secondary effects on third parties, even though those are not directly provided for in the contract itself. As discussed in what follows, in sham and simulated transactions the effects between the parties and *vis-à-vis* third parties operate differently.

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[113] An exception is section 17 of the Sale of Goods Act 1979 which provides that the property is transferred to the buyer 'at such time as the parties to the contract intend it to be transferred'. On this provision, see n 6. In addition, specifically enforceable contracts can create equitable proprietary interests.

[114] *Treitel,* [14-149].

[115] For Italy, see Civil Code, art. 2741, *Legge Fallimentare,* art. 52; For France, Civil Code, art. 2285; For Chile, Civil Code, art. 2465 and Ley 20.720, art. 241. For England See Insolvency Act (1986) s. 107(1) and generally Vanessa Finch, *Corporate Insolvency Law: Perspectives and Principle*s (CUP 2002) 421-449.

[116] For France, see French Civil Code, art. 2272; see also Civ. 15 juin 2005, no. 03-17.478 P: D. 2005. 3005, note Tchotourian. For Chile see Chilean Civil Code arts. 702, 706 and 2507. See also Daniel Peñailillo Arévalo, *Los Bienes, La Propiedad y Otros Derechos Reales* (Ed Jurídica 2013) 337-338, paras [164]-[170].

2. Splitting the operation of a transaction into its internal binding effects and its external effects *vis-à-vis* third parties

Sham and simulated transactions also produce binding effects between the parties and are of some effect *vis-à-vis* third parties. However, in sham and simulated transactions the rights and obligations binding the parties are not intended to be same as the one that are of some effect *vis-à-vis* third parties.[117]

One can think, for instance, of a transaction where A and B intend to transfer a freehold in land gratuitously but they also intend to make third parties believe that the transfer is made under an onerous contract of sale. In achieving this result, they conclude a sham or simulated sale. They use an external documentary form that refers to a deed of sale reciting the obligation to pay money in consideration of the freehold, but at the same time, they secretly agree that not all the rights and obligations that the deed of sale recites are binding on them. They secretly agree that the money consideration is not to be paid. A and B have concluded a gift between them but *vis-à-vis* third parties, they have created the appearance of a contract of sale.

Interestingly, and this is the relevant point for this section, the doctrines of sham and simulated transactions do not necessarily frustrate the intent of the parties to create this divergence. Indeed, they confer on the parties the power to create it and even to some extent benefit from it. As discussed in Section 1 of this Chapter, the common understanding of the parties to the sham and simulation is effective between them notwithstanding that they have deliberately decided to keep it concealed using a misleading documentary form. Then, the parties to a simulation and sham can enforce their concealed understanding, and bring an action of simulation or allege the existence of a sham for their own benefit, when it becomes beneficial to them to reveal what it was previously concealed. Likewise, the parties to a simulation and sham can actually make the rights and obligation they intended *vis-à-vis* third parties take on some actual force against them. Only prejudiced third parties may prevent the parties from taking any benefit from the sham and simulation.

[117] *Hitch* (n 1) [66].

In other words, the doctrines of simulation and sham transactions enable the interests and purposes of the parties to the transaction to be implemented more effectively. So long as no prejudice is caused to third parties, these doctrines permit the parties to split the operation of their legal transaction into their external legal effects *vis-à-vis* third partes and their internal binding legal effects between the parties. They provide the parties with the power to make the binding obligations that result from a legal transaction different from the one the parties project toward third parties. This is what here I call the 'dual operation' function of the doctrines of sham and simulated transactions.

3. The dual operation function and its limits

The dual operation function is naturally not limitless. The law limits the extent to which the doctrines of sham and simulated transaction perform the dual operation function: third parties' rights and interests, and the need of enforcing mandatory legislation limit this function. These limits are analysed below. As will become apparent, the limits of the dual operation function show that the doctrines of sham and simulated transactions balance the interests of the parties to the sham and simulation against the interests of third parties and also the need of enforcing mandatory legislation.[118]

3.1. Third parties' rights and interests

The first limit is that the dual operation function cannot be used in prejudice of third parties' rights and interests. This means, in first place, that third parties whose rights and obligations are being defrauded by the documentary form of the transaction may bring an action of simulation and allege the sham to uncover the concealed understanding. It also means that the parties to the sham and simulation cannot enforce and set up their concealed understanding against innocent third parties. This corresponds to the two groups of third parties discussed earlier in this Chapter.[119]

[118] Dubois - de Luzy (n 55) 274, paras [528]-[530].
[119] See this Chapter, section I.2.

To appreciate the extent to which the law balances the recognition of the dual operation function with the protection of third parties, it is important to consider that the protected third parties are those who have a *right*,[120] in some jurisdictions a *legal interest,*[121] endangered by the sham and simulation. What exactly constitutes a third party's right, and a third party's legal interest would often depend on the actual circumstances, and it may be difficult to formulate in abstract terms. Yet, as a matter of principle, it is correct to say that only when the sham and simulated transactions prejudice third parties' rights (in Italy and Chile) or third parties' legal interests (in France and England), will the dual operation function of the doctrines of sham and simulated transaction be limited by the affected third party. If this is the case, the prejudiced third party will be in the position to allege that the transaction is a sham and simulation, and so make the internal effects the parties have concealed prevail. Conversely, when the sham and simulation do not prejudice a third party's right, then the law will uphold the divergence between internal and external effects of the transaction.

An example of each situation may illustrate this point. Starting with a case in which the interest of third party limits the dual operation function, suppose that A and B conclude a sham and simulated document in which A recites an acknowledgement that A is B's debtor in £1000 pursuant to a contract of service, but in which both know that the document and the recited contract of service is a sham and a simulation. B then goes bankrupt. In B's insolvency proceeding A and C compete to be paid from the same pool of assets. According to the dual operation function here explained, A and B have the capacity to conclude a transaction in which they create the divergence between the internal binding effect and their external effects *vis-à-vis* third parties. However, C has a right against B that is being lessened by the simulation and sham between A and B. A's apparent right against B is prejudicing C's chances to be paid in B's insolvency. In other words, the interest of the parties is entering into conflict with C's right. The third party's right, however, limits the dual operation function. Accordingly, and given that C has a right, C can argue that the transaction between A

[120] In Italy, see Franco Anelli, 'Simulazione e interposizioni' in V. Roppo (ed), *Trattato del Contratto. III. Effetti* (2a edn, Giuffrè Editore 2023) 748; Lenzi (n 27) 87. In Chile, see León Hurtado (n 1) 192.
[121] Dubois - de Luzy (n 55) 264, para 521.

and B was in fact a sham and simulated, and impede them from making A's apparent right effective in the insolvency proceeding.

Now take a case of a third party that lacks the protection to limit the dual operation function. A harbours the hope of inheriting from his aunt B as beneficiary of her will, but sees with sorrow that B is selling her most valuable asset to his sister C. However, A does not realise that the sale between B and C is a sham and simulated for it conceals a gratuitous bailment under which B always retained ownership. If later A discovers that the sale was a sham and a simulation, he or she would not have standing to bring an action of simulation and allege a sham. The sham and simulation do not prejudice any of A's rights but only cause him some disappointment. Accordingly, the sham and simulation stand and prevail *vis-à-vis* A. The divergence between the binding effects between the parties and the external effects *vis-à-vis* third parties stands, and the dual operation function of the doctrines of sham and simulated transaction operates freely even at the cost of A's disappointment.

3.2. The need for enforcing mandatory law

The second limit to the dual operation function of the doctrines of sham and simulated transactions is that sham and simulated transactions cannot be used to elude mandatory law. The doctrines permit the parties to create a set of rights and obligations binding between them that differs from the rights and obligations projected *vis-à-vis* third parties. However, this is the case only so long as they comply with the general law, and so long as they do not entail any illegality. Likewise, the concealed agreement between the parties will trigger the legal consequences provided by the general law. This may mean either that they are fully effective or that they may be subject to some invalidity, sanctions, fines or any other liability imposed by the law.

That said, the way this limit works varies in its detailed operation across jurisdictions. As will be discussed later in this Chapter,[122] in Italy, and to some extent in France, the doctrine of simulation allows the parties to avoid compliance with some legal formalities that would be required if the transaction were concluded overtly and

[122] See this Chapter, section III.5.

without using a misleading documentary form. In these cases, the dual operation function of the doctrines of sham and simulated transaction is allowed a greater force than in other jurisdictions. Yet it is also the case that these are exceptions and that the need to enforce mandatory law normally works as a limit to the dual operation function of the doctrines of sham and simulated transactions.

3.3. Secondary functions of the doctrines of sham and simulated transactions

A final remark before concluding this section is that the protection of third parties and the need for enforcing mandatory legislation may be considered not only as a limit to the dual operation function but also as a function in itself. As the analysis in this chapter demonstrates, the doctrines of sham and simulated transactions balance the interests of the parties involved in the sham and simulation, the interests of third parties, and the need for enforcing mandatory legislation. In this sense, the dual operation function is balanced and limited by complementary functions, among which the prominent ones are the protection of third parties and the enforcement of mandatory legislation.

Even so, it is important to emphasise that, contrary to common belief, the most distinctive function of the doctrines of sham transactions and simulation is the dual operation function. The protection of third parties and the enforcement of mandatory legislation often result from the application of other doctrines extrinsic to the rules governing shams and simulated transactions, such as, for instance, good faith[123] and estoppel.[124] Also, these additional functions are in no case distinctive and unique of the doctrines of sham and simulated transactions. The protection of third parties, including creditors, is a fundamental principle that cuts across different areas of law,[125]

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[123] In Italy, see Francesco Galgano, 'Sul principio generale dell'apparenza del diritto' (2009) 6 Contratto e Impresa 1137, but arguing that the general principle of the protection of the external appearance does not have a distinctive substance for all the instances in which this principle is applied would consist either in cases of simulation or would be decided based on particular grounds other than the protection of the external appearance. In France, see Jacques Ghestin, Gilles Goubeaux and Mauriel Fabre-Magnan, *Traite droit civil. Introduction* Générale (4 edn, LGDJ 1994), 843 [853]. See also Frédéric Durand, *L'apparence en droit fiscal* (LGDJ 2009) 167-169. In Chile, see Daniel Peñailillo Arévalo, *Obligaciones. Teoría General y clasificaciones* (Ed. Jurídica de Chile 2003) 54-65.

[124] *Hitch* (n 1) [87]; *Snook* (n 23) 802-804.

[125] Here one can think of the famous passage of Ulpian in which he summarises the law in three fundamental principles, one of them being '*not to harm any other person*' (Digest 1.1.10).

and the enforceability of mandatory legislation is essential to the very idea of law and doctrines.[126] In other words, the protection of third parties and the enforcement of mandatory legislation would be achieved by other means even if they arose outside the context of a sham or simulation. The dual operation function, in contrast, is distinctive of these doctrines.

III.
Differences

As seen in Section I of this Chapter, the effects of sham and simulated transactions can be condensed into a common principle that cuts across the different jurisdictions subject of this comparison. Equally, as Section II discussed, in all these jurisdictions these effects implement the dual operation function. However, there are significant differences in how these effects operate in more concrete terms in each jurisdiction, and for that reason in the extent to which the doctrines of sham and simulated transactions perform the dual operation here analysed.

In particular, and as this section shows, the interests of third parties and the need of enforcing mandatory legislation limits the dual operation function in some jurisdictions more than in others. As the Italian legal scholar Betti observed, different legal systems are not 'equally tolerant'[127] toward simulated transactions but that they tolerate sham and simulated transactions differently. Interestingly, these differences are not only between civil and common law, but they cut across all the jurisdictions here analysed. Italy appears to be the jurisdiction that most recognises the dual operation function. In contrast, English law places greater emphasis on protecting third parties and enforcing mandatory legislation, often neglecting the dual operation function of sham transactions. The French and Chilean approaches seem to occupy a middle position, the former closer to Italian law and the latter to English law.

[126] Kelsen, for instance identified two characteristics common to all legal social orders, saying that they are *coercive orders of human behaviour*, and argued that a law to be valid requires a minimum degree of efficacy. See Hans Kelsen, *Pure Theory of Law* (Max Knight tr, University of California Press 1967) 11, 30-44.
[127] Emilio Betti (n 93) 292-293.

Exploring this difference is significant because they show the extent to which the doctrines of sham and simulation protect the interests of the parties, and therefore the extent to which is noticeable their distinctive character. These differences are outlined below.

1. Different rationales to explain why the documentary form does not bind the parties

A first difference to mention is that there are different rationales discussed in legal scholarship and courts' decisions to explain the legal effects sham and simulated transactions produce, and in particular why the rights and obligations recited in the documentary form are not effective between the parties.

Chilean scholars[128] argue that the documentary form of a simulated transaction consists in a transaction that is void for lack of consent or other essential requirement for the validity of legal transactions. Given that the documentary form is void, the rights and obligations contained therein cannot be binding. Similarly, English courts have said that sham transactions once discovered are void.[129] Since the rights and obligations contained in the documentary form do not reflect the true intention of the parties, they cannot be effective between them. Charles LJ qualified this statement in *Yates*[130] noting that sham transactions could not be void because they have some effectiveness on innocent third parties. That said, as for the effects between the parties to the sham, *Yates* does not bring about a different solution. It says that the parties cannot rely on the sham document 'as representing the true position as to the rights and obligations they have created'.[131] French scholars,[132] in turn, make a similar argument but not arguing that the rights and obligations recited in documentary form are void. They only say that as provided by art. 1201 of the Civil Code, they are not

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[128] León Hurtado (n 1) 186-187; Díez Duarte (n 1) 132-138. Abeliuk Manasevich (n 30) 164, para 143; Peñailillo (n 32) 17.
[129] See English cases referred in n 1.
[130] *Yates* (n 33) [219].
[131] *Yates* (n 33) [219].
[132] Ghestin, Jamin and Billiau (n 25) 934, para [876]; Muriel Fabre-Magnan, *Droit des obligations,* vol 1 (4th edn thémis, 2016) 591; Malaurie, Aynès, and Stoffel-Munck (n 17) 415; Terré and others (n 1) 796, paras 733-734; Michel Dagot, *La simulation en droit privé* (LGDJ 1967) 57-58; Huguette Méau-Lautour, *La donation déguisée en droit civil français. Contribution a la théorie générale de la donation* (Dalloz 1985) 96-97.

binding between the parties because the documentary form or the 'lettre' does not reflect their real consent. The 'lettre' is for the same reason only a fact and not a juridical act.

In Italy, in contrast, and drawing on art. 1414 of the Italian Civil Code,[133] as from the second half of the 20th century,[134] legal scholars make a different argument.[135] They submit that it is not that the parties did not consent to the simulated transaction, or that simulated transactions are void or structurally deficient, or that some other requirement is missing for their legal effectiveness. Instead, they argue that the parties do consent to the simulated transaction only that they intend to make the rights and obligation they recite not binding. In other words, in a simulated transaction nothing goes wrong. Everything takes place as intended and projected by the parties. In making this argument, the Italian scholar Auricchio[136] submitted that simulated transactions are perfect and complete titles, even though that they do not provide a binding normative content for the parties to the transaction.

This difference between the Italian position and the position found in other jurisdictions is significant for explaining the effects and functions of sham and simulated transactions as understood in this dissertation. The Italian position explains in my view better the different effects of sham and simulated transactions (i.e. that the common understanding of the parties is binding between the parties)[137] and it also provides a better basis to explain the dual operation function of these doctrines. Likewise, the interests of the parties to the sham and simulation seem to be more protected if the underlying rationale is not that they failed to conclude a valid transaction (as it is the case in Chile, England and to some extent France), but simply that they intended to organise their arrangements in a more complex and efficacious manner (as it seems to be the narrative in Italy).

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[133] Art. 1414 of the Italian Civil Code provides that a simulated contract 'does not produce effects between the parties'. The Code does not use the word '*nullità*' or '*nullo*' corresponding to a void contract.
[134] During the first half of the 20th century, the view that prevailed among Italian legal scholars was that the transactional form consisted in a void contract. See Ferrara (n 24) 137; Giuseppe Messina, 'La simulazione assoluta' (1907) Riv. Dir. Comm. E obbligazioni, 460. Republished in Giuseppe Messina, *Scritti Giuridici V* (Giuffrè 1948).
[135] Galgano (n 1) 11-14; Bianca (n 1) 655, para 372; Anelli (n 120) 600-615; Lenzi (n 27) 8-11.
[136] Alberto Auricchio, *La simulazione nel negozio giuridico* (Jovene 1957) 9-14; 17-18.
[137] See this Chapter, section I.1.

2. Different degrees of explicitness and clearness

A second difference is that in some jurisdictions the rules on the effects of sham and simulated transactions are formulated in more explicit and clearer terms than in others. As is obvious, the clearer the rules are the clearer the extent to which they protect the different interests involved. Likewise, the clearer these rules are, the easier is to examine what the doctrines of sham and simulated transactions do.

Italy takes the first place in terms of clarity. The Italian Civil Code specifically regulates the effects of simulated transactions from art. 1414 to art. 1417, including the effects of simulated transaction between the parties, their effects *vis-a-vis* third parties, including creditors, and also the proof of simulated transactions. In turn, the scope and applications of these codal provisions have been discussed extensively by legal scholars[138] and courts.[139] In France, art. 1201 of the Civil Code regulates some of the effects of simulated transactions. It provides that only the 'contre-lettre' (and not the simulated contract or 'lettre') binds the parties, and also that the 'contre-lettre' cannot be set up against third parties but that 'the latter may rely on it'. In addition, legal scholarship and court decisions have complemented these rules specifying some details and areas the Code does not cover, as it is, for example, the proof of simulated transactions.[140] In Chile, the Code is very much silent on the doctrine of simulation. But still similar to France, legal scholars and courts have discussed the effects of simulated transactions and there is a reasonable consensus as to what these effects are.[141]

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[138] Among other examples, see Galgano (n 1); Lenzi (n 27) and Andrea Orestano, 'Della simulazione' in Enrico Gabrielli, Emanuela Navarretta and Andrea Orestano (eds), *Commentario del Codice Civile* (UTET 2013) 365.

[139] See the case law sumarised in G. Pescatore and C. Ruperto, *Codice Civile annotato con la giurisprudenza della Corte Constituzionale, dela Corte di Cassazione e delle giurisdizioni amministrative superriori* (Giuffrè 2000) and Luciano di Ciafardini and Massimiliano di Pirro, *Codice Civile annotato con la giurisprudenza* (22dn edn, Ed Simone 2022).

[140] Terré and others (n 1) 797-798, para 736. See also Civ. 1st, 19 Apr. 1977, Bull Civ. I, n° 379; Civ. 3rd, 15 Sep. 2010, n° 09-68.656, JCP 2010 n°112, just to mention some examples.

[141] A good synthesis of the prevalent understanding nowadays in Chile is in Rodrigo Barcia Lehmann, *Actos jurídicos, negocio jurídico y teoría general del contrato* (Tirant lo Blanch 2024) 337-362.

In English law, in turn, while some elements or aspects of the effects of sham transactions are clear, in other aspects the rules are difficult to find and to formulate in clear terms. Court decisions have defined that sham transactions are not effective between the parties and that third parties prejudiced by the sham can expose the concealed understanding of the parties.[142] However, the extent to which the parties can use the sham for their own benefit is less clear[143] as it is also the case for third parties that have relied on the sham.[144] Here the rules become more opaque and they often result from the application of principles and doctrines beyond the doctrine of sham transactions, as, for instance, the doctrines of illegality[145] and estoppel.[146] This less clearly formulated rules naturally comes with a degree of uncertainty.

3. Third parties having standing to bring an action of simulation

A third difference concerns the criteria applied to determine which third parties have *locus standi* for bringing an action of simulation or alleging the existence of a sham. This is important, for the stricter the rules are in conferring this standing, the more lenient the law is toward simulated and sham transactions. To put it other words, if only third parties that satisfy strict conditions are in a position to challenge a simulated and sham transaction, the interests of the parties to the simulation and sham will be better safeguarded. Conversely, if there is a wide universe of third parties entitled to challenge simulated and sham transactions, the interests of the parties to the simulation are more exposed.

Italy and Chile share in this respect a similar approach. In Italy, only third parties to whom the simulated transaction causes an actual prejudice have *locus standi* to bring an action of simulation.[147] In Chile, in turn, only third parties that have a right endangered by the simulated transaction and that can prove a prejudice caused by the simulated transaction, can bring an action of simulation.[148] As a consequence of

[142] This is found in many of the cases discussing sham trusts.
[143] See note 44 above.
[144] *Jones* (n 71) [60].
[145] *Hanson* (n 45) [309]-[312]. See also *Vickers v Jackson* [2011] EWCA Civ 725, Lord
[146] *Hitch* (n 1) [87].
[147] Anelli (n 120) 748; Lenzi (n 27) 87.
[148] León Hurtado (n 1); Díez Duarte (n 1) 258-261; Ramos Pazos (n 83) 125. See also C.A. 26 dic, 1957, RDJ 55, 2a parte, 188.

this principle, Italian Courts have decided, for instance, that the 'nudo propietario' or bare owner does not have standing to bring an action of simulation to challenge a transaction concerning the right to use and benefit of the property or 'usufruttos'.[149] Similarly, future heirs entitled to the 'legittima' (that is the share in the estate that the law mandates the testator to assign to certain family members) of the transferor's estate cannot bring an action of simulation before the transferor's death. The future heir, Italian Courts observe, cannot claim an actual prejudice.[150]

French law, in turn, seems to be more generous with third parties though the rules are in some respects confusing. In theory, third parties have an 'option' to decide whether to rely on the documentary form or to make the concealed understanding of the parties effective against them.[151] However, if the third party decides to make the secret understanding of the parties effective, he or she will need to bring an action of simulation. In turn, to bring an action of simulation the third party needs to have an 'interest' in declaring the transaction simulated.[152] This, then, seems to suggest that the 'option' of third parties to choose between the documentary form or the internal understanding of the parties is more limited than it may appear to be in a first sight. The third party needs to have an interest in declaring the transaction simulated if he or she wants to make the concealed understanding of the parties effective. That said, requiring an interest is still a less strict standard than requiring an actual prejudice as Italian and Chilean law require, particularly considering that French courts have been flexible and generous in recognising an interest in third parties bringing an action of simulation.[153]

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[149] Cass., 20 January 1994, n. 464, in *Giur. it.*, 1995.
[150] Cass., 29 may 1995, n. 6031, in *Nuova giur. civ. comm.*, 1996, I, 255. As noted in Lenzi (n 27) 87, fn 9, the law may have changed on this point after the reform of 2005 which amended art. 563 of the Civil Code. Amended art. 563 provides that the future heir entitled to the *legittima* has a right to oppose donations made by the deceased. This right is exercisable before the death of the deceased, and it suspends the terms of 20 years for making claw-back claims against donations affecting the *legittima.* This right of opposition may be actually prejudiced by a simulated transaction concealing a donation even before the death of the alienator. For the protection of the *legittima* in Italy, including claw-back claims, see Alexandra Braun, 'Forced Heirship in Italy' in Kenneth G C Reid, Marius J de Waal, and Reinhard Zimmermann (eds), *Comparative Succession Law: Volume III: Mandatory Family Protection* (OUP 2020) 108.
[151] Ophèle (n 1) 12.
[152] Dubois - de Luzy (n 55) 264, para 521.
[153] Dubois - de Luzy (n 55) 264, para 521. See also Paris 1 Mar. 1965, D. 1965, somm. 105.- 9 jun. 1971, D. 1972, 232, with a note of Cabannes.

In English law, there is little authority on this point, and thus there appears to be no clear criteria. A conservative approach may be that anyone with an interest can allege that a transaction is a sham, typically someone who would suffer some detriment from the sham.

4. Specific *per se* illegal simulations

A fourth difference concerns the extent to which legal systems tolerate sham and simulated transactions and do not sanction or declare void the concealed understanding of the parties. As discussed in previous section I, in Italy, France, Chile and England, the law permits the parties to simulate or conclude a sham and it also recognises some effectiveness to the concealed understanding of the parties. In other words, the fact that the parties conceal their legal understanding under a misleading transactional form does not make that legal understanding void or ineffective. On the contrary, it is valid and effective. In France, however, there are important exceptions. French law regulates particular cases of simulated transactions where the 'lettre' or the concealed understanding of the parties is void and not binding simply because it has been concluded under a different transactional form.

Art. 1202 of the French Civil Code regulates the most significant simulation in France that is illegal per se.[154] This article makes void any 'contre-lettre' that increases the price of a contract of sale or other contract where a real right is transferred for money.[155] The consequence of this provision is that the seller is forced to accept the lower price recited in the documentary form and is barred from enforcing the price recited in the 'contre-lettre'.[156] Moreover, if the higher price recited in the 'contre-lettre' has been already paid, the purchaser can claim restitution of the amount in excess.[157] This particular statutory regulation has a long history,[158] and legal scholars argue that

[154] In addition to the case mentioned here, art. 1202 also declares void the *contre-lettres* that increase the price of the assignment of public offices ('*cession d'un office ministériel*'). Arts. 911 and 1099, in turn, declare void some donations made through an interposed person.
[155] This comparison focuses on private legal effects of the transaction, namely the obligational effects between the parties and also its effects vis-à-vis third parties. It does not discuss the tax consequences. For the tax consequences see Florence Deboissy, *La Simulation en Droit Fiscal* (1997 LGDJ) 217-223.
[156] Ghestin, Jamin and Billiau (n 25) 940-943, paras [883]-[884].
[157] Terré and others (n 1) 804, para 743. Civ. 3e, 5 Mar. 1997, No. 95-14.838.
[158] Thomas B Lemann, 'Some Aspects of Simulation in France and Louisiana' (1954-1955) 29 Tul L Rev 22.

the purpose of the legislator is to deter the evasion of transfer taxes on property rights.[159] It discourages sellers from using a 'contre-lettre', and thus from concealing part of the price of the transaction.

These specific cases of simulations that are illegal *per se* affect the consequences of sham and simulated transactions and the balance between the different interests involved. These are cases in which the interest of the parties to the sham and simulation give way to other interests. In other words, in these particular instances the French solution restricts the operation of the dual operation function, and in that sense tends to protect more the interests of third parties and the need to enforce mandatory legislation rather than the interests of the parties to the simulation.[160]

5. Simulated transactions and the power of circumventing legal formalities

A final difference in the effects of simulated and sham transactions in different jurisdictions is that in France and Italy the parties can omit the formalities required by law for the validity of certain legal transactions if such transactions are concluded under the guise of a simulated transaction. This 'bizarre'[161] development, as an external observer has named it, is significant for the purposes of this chapter. It shows that, in some circumstances, the doctrine of simulation clearly prefers the protection of the interests of the parties taking part in the simulation.

5.1. France

In France, the parties can evade the formalities that the law requires for the validity of donations if they rely on a simulation. The doctrine of disguised donations permits this result.[162] In particular, art. 931 of the French Civil Code provides that all *inter vivos*

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[159] Flour, Aubert and Savaux (n 17) 410.
[160] For an analysis of how Italian law approaches to the practice of simulating the price in contract of sales see Anelli (n 120) 648-653, Lenzi (n 27) 68-69, Sacco and De Nova (n 38) 658.
[161] John P. Dawson, *Gifts and Promises. Continental and American Law Compared* (YUP 1980) 74.
[162] For French literature, Méau-Lautour (n 132); and Michele Dagot, 'Des donations non solennelles' (2000) JCP 248. For comparative literature of this invention, see Dawson (n 161) 74-83; Hyland Richard, *Gifts: A Study in Comparative Law* (OUP 2009) 382-393.

donations must be granted before notaries in the ordinary form of contracts and a copy retained. Otherwise, they are void.[163] Thus, if the parties conclude a contract of donation that does not satisfy this formality, the donation is void. However (and this is the bizarre development), if the parties deliberately disguise a donation, using the documentary form of an onerous contract, the doctrine of disguised donations provides a quite different solution: the donation will be valid. The parties can simulate an onerous contract, typically a contract of sale, and conceal that they are concluding a donation, and this will make the donation valid. Legal scholars observe that for the disguised donation to be valid it needs to comply with the substantive legal requirements for donations, meaning capacity, donative intent and proper object.[164] However, it does not need to comply with the formalities the law prescribes for donations provided that the documentary form the parties use corresponds to an onerous transaction and successfully conceals that the parties have intended a donation. So, in other words, the law explicitly permits the parties to do covertly what they are not allowed to do overtly. The law allows parties to create a valid donation without following the usual legal formalities required for the validity of such donations as long as the donation is concluded under the guise of an onerous contract.

Legal scholars have formulated different arguments for justifying this doctrinal development,[165] and some historical reasons will be discussed in Chapter 5. The point here is only to highlight that the law deliberately permits the parties who simulate an onerous contract to conclude a valid donation circumventing legal formalities that otherwise they would need to follow.[166]

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[163] Art. 931 literally provides that 'all instruments importing an inter vivos gift are executed before notaries, in the ordinary form of contracts; and record will be kept thereof, on pain of nullity'.

[164] Geneviève Thomas-Debenest, 'Art. 931 - Fasc. 20 : Donations et testaments. – Donations entre vifs. – Forme. Absence d'acte authentique' JurisClasseur Civil Code <https://www.lexis360.fr> accessed on 07/01/2021.

[165] Méau-Lautour (n 132) 28-34, 371-379; George Ripert and Jean Boulanger, *Droit civil. D'Après le traité de Planiol. Tome IV. Régimes Matrimoniaux, Successions, Libéralités* (Libraire Générale de Droit et de Jurisprudence, 1959) 1066-1068, paras 3349-3561.

[166] Chile offers the opposite position. Many cases of simulation in Chile consist of simulated sales concealing a donation in fraud of the legitim. The well-established position of the Supreme Court and legal scholars is that once the simulation is discovered, the concealed donation is void for lack of formalities. See, for instance, Corte Suprema 17 May. 2012, Rol N° 12193-2011; CS, 13 Jan. 2014, Rol N° 9631-2014; Corte Suprema 22 Oct. 2015, Rol N° 5183-2015; CS, 24 Nov. 2016, Rol N° 2968-2016 CS, 21 Sep. 2017, Rol N° 59-2017 Corte Suprema, 15 Sep. 2021, Rol No° 9793-2019.

5.2. Italy

When it comes to Italy, there is a similar, albeit more complex, development.[167] Art. 1414 sec. 2 of the Italian Code provides that if the parties to a simulated contract 'intended to make a contract different from the simulated contract, the former is binding between them, provided the requisites of form and substance are present'. The most evident meaning, and that the historical materials for the preparation of the Code seems to confirm,[168] would be that every time the parties simulate a transaction to conceal a different transaction, the latter is valid if it complies with the requirements of *form* and substance prescribed by the general law for this type of transaction. Thus, if, for instance, the parties simulate a contract of sale and conceal a donation, the concealed donation will be valid if it complies with the *formal* and substantial requirements of a valid donation.[169]

However, the majority of court's decisions[170] and some legal scholars[171] are of a different opinion. They argue that art. 1414 sec. 2 is ambiguous[172] and that it is possible to understand that it requires that either the simulated transaction or the concealed transaction satisfy the formal requirements of both transactions. Thus, for instance, if a simulated contract of sale conceals a donation, the donation would be valid if the simulated contract of sale complies with the formalities the law requires for contracts of sale, specified in art. 1350 of the Code, but also with the formalities of donations, provided in art. 782. The donation itself, however, would not need to follow any formal requirements. An argument in support of this view[173] is that the simulated transaction and the concealed transaction constitute one single legal entity united by the agreement to simulate. Therefore, if a fragment of this single entity, namely the simulated transaction, observes the formalities that the law requires for the simulated

[167] Before the Code of 1942, the doctrine of disguised donations was followed by Italian Courts. See Ferrara (n 24) 174-193, who harshly disapproves this doctrine.
[168] See G. Pandolfelli and others, *Codice Civil. Libro delle obbligazion illustrato con i lavori preparatori e disposizioni di attuazione e transitori* (Giuffrè 1942) 223-24.
[169] This is the view of some legal scholars, as Ferrara (n 24) 174-193 (before the Code of 1942); and Bianca (n 1) 661.
[170] As referred by Sacco and De Nova (n 38) 657 fn 54 and Lenzi (n 27) 38 fn 38.
[171] Galgano (n 1) 14 under certain circumstances; Anelli (n 120) 635-646; Lenzi (n 27) 35-52.
[172] Auricchio (n 136) 177-178; Galgano (n 1) 14; Sacco and De Nova (n 38) 657.
[173] Anelli (n 120) 635-646.

transaction and the concealed transaction, the formalities observed in the simulated transaction extend to the entire legal entity, including the concealed transaction.

The point here is not to go into the details of the discussion that have occupied Italian scholars, but to show that the view of a significant portion of Italian courts, and some important legal scholars, is that the parties to a simulation can circumvent legal formalities that otherwise they would be forced to follow. Here Italy and France stand together in enlarging the possibilities of the dual operation function and talking a less repressive approach to simulated transactions.

IV.
Concluding remarks

To recapitulate, sham and simulated transactions are not entirely void and ineffective. In all the jurisdictions considered in this dissertation, the law recognises some effectiveness and validity to the concealed understanding of the parties. While the rights and obligations the parties recite in the documentary form of a simulated and sham transaction are not effective between them, they are bound to accept the simulated and sham character of the documentary form they have executed. This means that if the parties have concealed a transaction behind the documentary form, they will be bound by its effects provided it complies with the applicable general law. The interests of third parties and the need to enforce mandatory legislation operate as limits to these effects.

This means that the doctrines of sham and simulated transactions perform the function of enabling the interests and purposes of the parties to the transaction to be implemented more effectively by permitting the parties to split the legal operation of a legal transaction in its effects *vis-à-vis* third parties and its binding effects between the parties. This function in turn, is limited by additional complementary functions, including the protection of third parties' rights and interests and the need of enforcing mandatory legislation.

While the dual operation function is recognised in all the jurisdictions here considered, the extent of this recognition varies. The jurisdiction that seems to recognise this function to a greater extent is Italy. English law, in contrast, focuses more on the protection of third parties and the enforcement of mandatory legislation, often overlooking that sham transactions may also perform the dual operation function. The solution in France is complex for it offers a very repressive solution in some particular cases but it is also very permissible to the parties to the sham and simulation in others. Chile, finally, seems to be in a middle position, probably closer to the English solution than the Italian one.

CHAPTER 5

JUSTIFYING THE DUAL OPERATION FUNCTION

In the previous Chapter I examined the effects of sham and simulated transactions and the functions they serve. What I have not discussed yet, is why the parties are allowed to conclude sham and simulated transactions, and why the law does not take a more repressive approach towards these transactions. The answer is not evident. In this regard, the French legal scholar Carbonnier[1] observed that the prevalence of the public interest over particular interests demands

> 'an a priori condemnation of all forms of simulation and a radical revision of the individualistic and liberal approach [...] expressed in article 1321 of the Civil Code. [...]. The view that the law must be indifferent to simulation on the pretext that there are lawful forms of simulation is questionable in the light of the facts. In the vast majority of cases, simulation is used to commit fraud.'[2]

He then advocated as an argument of *lege ferenda* that all forms of simulations should be illegal and void. Similarly, the 19th century English courts[3] have observed that a person who is party to a sham does not have clean hands when coming to court, and therefore that the person should be barred from obtaining any equitable relief. Yet, Carbonier's view has not been shared by others, and the principles that occasionally guided some 19th century English courts' decisions did not endure. As discussed in Chapter 4, legal systems tolerate sham and simulated transactions, and ultimately recognise that the parties to them may take advantage of their distinctive dual operation function.

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[1] Jean Carbonnier, *Droit Civil. Tome 4. Les obligations* (PUF 1994) 153, para [87]. The translation is mine. A similar view is adopted by Philippe Malaurie, Laruent Aynés, Philippe Stoffel-Munck, *Droit des obligations.* (10th edn LGDJ, 2018) 414.

[2] Carbonier (n 1). The original is in French. The translation is mine.

[3] In *Gray v Lewis* (1871-73) LR 8 Ch. App. 1035, for instance, James LJ said that when there was a sham 'no action or suit arises either at law or in equity'. Similarly, in *Townsend Ex p. Hall*, *Re,* (1880) 14 Ch. D. 132, again James LJ found that a sale was a sham and that the plaintiff was not entitled to have the goods returned to him. He observed that there was no way the court 'could give any relief' to him and that there was no way 'to work out any equity on behalf of a man who has chosen to act in such a way. He has got himself into the difficulty, and we cannot help him out of it'.

Carbonnier's objection, however, resonates vividly. The reasons justifying why we should tolerate sham and simulated transactions are all but obvious. As discussed in Chapters 1 and 2, sham and simulated transactions entail some degree of concealment, for it is essential to sham and simulated transactions that the parties use a documentary form that recites rights and obligations different from those that actually bind them. Likewise, as discussed in Chapter 3, they create a risk of fraud and often facilitate the commission of various types of fraud. Why, then, does the law permit parties to conclude sham and simulated transactions and split the internal and external effects of a legal transaction? Why does the law allow parties to a sham and simulated transaction to be so 'untruthful'? Why not adopt a more repressive approach toward sham and simulated transactions making, for instance, all forms of sham and simulation void in all respects? Is there any benefit in permitting parties to conclude shams and simulations?

This chapter addresses these questions. It submits that sham and simulated transactions do not just create risks of fraud and potential harm to third parties; they are also beneficial to both the parties and more generally the law, by permitting a more flexible development and application of the law. By enabling the interests and purposes of the parties to the transaction to be implemented more effectively, sham and simulated transactions allow the parties to devise equitable and efficient legal structures to better cater for their legitimate needs when the law fails to provide them. This may occur in two ways: by filling gaps in the law and by facilitating subtle legal changes outside the conventional framework of the legal system. In this regard, sham and simulated transactions may serve as remedies to certain legal shortcomings.

The chapter begins by discussing some justifications offered by legal scholars for the effectiveness of sham and simulated transactions, arguing that these justifications are not always convincing. It then presents a different and, in my view, stronger justification. It finally offers some comparative remarks on the justification of the dual operation function and the dualism between common law and equity in English law, showing that there are some functional similarities between lawful forms

of simulation in civilian jurisdictions and the supplementary role that equity plays in English law.

I.
Commonly cited reasons for justifying the dual operation function

1. Fraud cannot be presumed

The first argument often offered for the law's permission of sham and simulations, rather than imposing a general prohibition on them, is that fraud cannot be presumed. In replying to Carbonnier's argument, some French scholars have indeed argued that the law should not prohibit all forms of simulation because fraud cannot be presumed.[4] Given that there are some lawful simulations, this argument proposes, fraud needs to be proven in each case before assuming that all simulated transactions are illegal and void.

This reply does not really answer Carbonnier's objection though, nor does it provide a justification for the approach the law takes towards sham and simulated transactions. A decision to prohibit sham and simulated transactions and to make all forms of sham and simulation void does not presume that they are all fraudulent. The point is that they *very often* are fraudulent, and therefore the null benefits that sham and simulated transactions would generate compared to the numerous frauds they would entail, would not justify the decision of tolerating them or the dual operation function here described. They would rather justify treating them as illegal nullities.

This is a common justification for decisions based on public policy. The law prohibits and nullifies various forms of conduct not necessarily because they are *always* harmful or fraudulent, but because the benefits of allowing them do not outweigh their negative effects. There are many examples of that. The law requires compliance with certain formalities for the validity of specific types of transactions. Gifts and donations are a good example, as they must comply with certain formalities

[4] Michel Dagot, *La simulation en droit privé* (LGDJ 1967) 173; Jacques Ghestin, Christophe Jamin and Marc Billiau, *Traité de Droit Civil. Les effets du contrat* (3nd edn, LGDJ 2001) 935, para [876]; Agnès Dubois - De Luzy, *L'interposition de personne* (LGDL 2010) 135-136, para [232].

to be valid. [5] However, in nullifying transactions that fail to meet these formalities, the law is not presuming fraud; rather, it is taking preventive measures to minimise the chances of fraud.[6] A second example is art. 1466 of the Chilean Civil Code, which declares that obligations arising from gambling are void. The underlying rationale for this rule is not that every gambling practice is inherently harmful, but that the activity as a whole brings more costs than benefits. Similarly, to give one more example, the law penalises the commercialisation of drugs and other illicit substances unless medically prescribed by a medical practitioner. This is not because the law presumes that the consumption of these substances is never justified, but because public policy considerations suggest that restricting these substances carries more benefits than generally permitting their commercialisation and consumption.

Therefore, that fraud cannot be presumed does not answer Carbonier's objection to the law's decision to tolerate sham and simulated transactions. The answer must therefore lie elsewhere.

2. Right to privacy

A second reason often given to explain why the law tolerates sham and simulated transactions is that parties have a right to privacy.[7] The argument is that there is no legal obligation to make every legal affair public, and that the parties to a transaction are entitled to keep their affairs secret. Therefore, as long as they do not conceal any unlawful conduct, and as long as they do not prejudice third parties, the law should tolerate the parties' decision to keep their affairs in private and allow them to enforce their secret understanding, even if that privacy comes at the cost of creating a misleading appearance *vis-à-vis* third parties.

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[5] See art. 931 of the French Civil Code, art. 782 of the Italian Civil Code, and art.1401 of the Chilean Civil Code.

[6] Standard justifications for requiring these formalities for gifts being valid include the prevention of fraud on creditors and the protection of forced heirs. For a discussion on the inherently contradictory character of French law on this point, see Henry Blaise, 'La formation au XIXe siècle de la jurisprudence sur les donations déguisées' in [No editor specified] *Mélanges offerts à René Savatier* (Dalloz 1965) 114.

[7] Dagot (n 4) 174; Dubois - de Luzy (n 4) 142-145, paras [241]-[246]. A similar argument ca be found in Jérôme Huet and others, *Traité de Droit Civil. Les principaux contrats spéciaux* (3rd edn, LGDJ 2012) 1015, para 31131. This argument is often resorted to in Chile to explain lawful simulations. See for instance, of Enrique Alcalde Rodríguez 'La simulación y los terceros: consideraciones civiles y penales' (2000) 27 Revista Chilena de Derecho 265, 266.

This argument is more compelling than the previous one. However, a closer examination shows that this alone is also unsatisfactory. The right to privacy may justify the parties to a transaction being under no obligation to make their legal affair public, unless there is a good reason. However, it does not explain why they can create a misleading appearance *vis-à-vis* third parties. It is one thing to keep a matter secret, and a different one to create a misleading appearance about what one is doing. Many types of frauds people may perpetrate through sham and simulated transactions are committed not because the parties did not make their legal affairs public, but because they created a misleading appearance. French scholars in this regard have a point when repeating that a simulation consists in a 'colluded lie'.[8] Borrowing this language, the justification of the dual operation function of the doctrines of sham and simulated transactions needs to explain not only why the parties are allowed to conceal something, but also why they are allowed to tell something different from the truth.

3. Private autonomy

Private autonomy is also often mentioned as a further argument for justifying the tolerance toward simulated transactions, and the dual operation function of these doctrines.[9] Legal systems recognise that individuals have the power to regulate their legal affairs as they deem desirable as long as they do not harm other values the law protects.[10] Since sham and simulated transactions do not necessarily harm values the law protects (because they are not inherently fraudulent), they should be recognised as a legitimate exercise of private autonomy. Another dimension to this argument is that sham and simulated transactions may be reproachable on a moral basis, to the extent that misleading third parties may be considered as not morally laudable. However, from a legal perspective, they would be blameless, for they do not necessarily harm values the law protects.

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[8] Among many others, see for instance, René Demogue, *Traité des obligations en général. I. Sources des obligations. Tome I.* (Rousseau & Cie 1923) 260; Dagot (n 4) 9; Jacques Flour, Jean-Luc Aubert and Eric Savaux, *Droit civil. Les Obligations. 1. L'acte juridique* (16th edn Dalloz, 2014) 407; Malaurie, Aynès and Stoffel-Munck (n 1) 413.
[9] In this sense, Jacques Ghestin and Bernard Desché, *Traité des contrats. La vente* (LGDJ 1990) 477; Ghestin, Jamin and Billiau (n 4) 933-934, para [873]; Claude Ophèle, 'Simulation' in Éric Savaux (ed), *Répertoire de Droit Civil, Tome X* (Dalloz 2012)8.
[10] Art. 1322 of the Italian Civil Code has codified this principle.

Where this argument fails is that sham and simulated transactions frequently harm values the law protects. As we have seen, they may be used to defraud third parties and defeat mandatory legislation. If this is the case, it is not evident why we should protect private autonomy and not instead secure the values that are harmed by the use of sham and simulated transactions. Why, as Carbonnier contended, not make public policy considerations prevail over private autonomy giving way to more repressive approaches to sham and simulated transactions? Is it worth continuing to protect private autonomy when it risks undermining other values the law protects?

It seems, then, that none of these arguments alone is sufficient to justify the dual operation function of sham and simulated transactions. A better justification is in my view found in the fact that they not only bring risks of fraud and harm to third parties, but also benefit the parties and the legal system as a whole. As argued here, they complement the law by enabling parties to devise equitable and efficient transactions that satisfy their legitimate needs when the law fails to adequately provide them.

II.
Alternative justification:
Sham and simulated transaction may remedy shortcomings contained in the law

They can benefit the legal system as a whole. In particular, sham and simulated transactions can supplement the law when it fails to provide efficient and equitable solutions to the legitimate needs of parties.

This understanding is found in the writing of the French jurist Guyot, who in the 18th century observed that simulations were everywhere in every legal system, adding that many of them indicated a defect in the legislation and revealed the 'necessity of a new regulation of the same object but in a manner more in line with the truth and sanctity of law'.[11] In other words, Guyot admitted that not needing sham and simulated transactions would be the ideal in a legal system. However, sometimes the law and

[11] Guyot, *Répertoire universel et raisonné. Tome 58*, entry 'simulation'.

the authoritative sources do not provide every solution, and this shortcoming can be eased by simulations. This understanding may also have inspired Berlier when, during the preparatory works of the French Code, he observed that making void every 'contre-lettre' 'may produce a greater evil than the one we want to avoid'.[12] This seems to be correct. The parties to a sham and simulated transaction may cope with the limitations of the law contained in the authoritative sources by complying with the law for some purposes but doing something else for others. '[*A*]*liud simulare, aliud agere',* said the Romans, and in that way achieving a result that the law alone does not provide for, but still that ultimately finds the favour of courts and the legal system as a whole.

There are several examples throughout the history of sham and simulated transactions that have contributed to fill gaps in the law, providing more efficient solutions that otherwise would not had been available. Lena Fijalkowska Lodz, for instance, refers to very ancient forms of shams in Late Bronze Age of Emar.[13] For instance, sham adoptions between creditors and debtors permitted debtors to bequeath land to creditors in payments of debts, and by that way avoid the prohibition of selling the land. Another interesting example may be found in Germanic Laws, where the 'affatomie', a sham form of adoption, was used to fill gaps in succession law.[14] But there are two more recent examples that may help to illustrate this point. The first one is the recognition of the role of 'notarial instructions' in transferring land in Chile, which as I argue here, fill a gap in the law. The second is the validity of disguised donations in France, which enabled legal change outside the conventional framework of the legal system yet are still upheld by the courts and the system as a whole.

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[12] Fenet, *Recueil complet des travaux préparatoires Tome 13,* 112.

[13] Lena Fijalkowska Lodz, 'Legal remedies against misfortune: Evasion, Legal Drewnowska- Fiction, and Sham Transactions in Late Bronze Age Emar' in Olga Drewnowska and Małgorzata Sandowicz (eds), *Fortune and misfortune in the Ancient Near East: Proceedings of the 60th Rencontre assyriologique internationale at Warsaw 21-25 July 2014* (Indiana Eisenbrauns 2017) 119, 122-124.

[14] Giving that real property was inseparable from the family, and that it did not belong to the individual, individuals were prevented from disposing of the estate *mortis causa*. The main problem arose when there was no heir. Here, the 'affomite' provided the heirs that God had failed to provide by adopting the person that later will become the heir. See Reinhard Zimmermann, 'Heres Fiduciarius? Rise and Fall of the Testamentary Executor', in Richard Helmholz and Reinhard Zimmermann (eds), *Itinera Fiduciae: Trust und Treuhand in Historical Perspective* (1998) 267, 277; Reinhard Zimmermann, 'Mandatory Family Protection in the Civilian Tradition', in Kenneth G C Reid, Marius J de Waal, and Reinhard Zimmermann (eds), *Comparative Succession Law: Volume III: Mandatory Family Protection* (Oxford, 2020) 59, 79.

1. The role of 'notarial instructions' in transferring land in Chile: filling gaps in the law

A good example of how simulated and sham transactions may supplement authoritative sources of law is the role of notarial instructions in the purchase and transfer of land.[15] In this case, the parties simulate a deed not to contravene the law but rather to fill a gap within it that would put both parties at risk. In Chilean law, the transfer of land requires the execution of a deed before a notary and the recording of the deed in the Real Estate Registry.[16] The deed is the formality required for the validity of the title creating the obligation to transfer property - usually a contract of sale .[17] However, the property passes to the purchaser only when the deed is registered in the Real Estate Registry.[18] Prior to that moment, the seller still owns the land and the purchaser has only a personal right to register the deed in his or her name to transfer property. In turn, the process of registering the deed takes some time, and it could be objected by the Registry officer if he or she observes any defect in the deed.

These rules leave the risks associated with the timing of fulfilling the obligation to pay the price unresolved. If the purchaser pays the price at the time of the deed of sale, he or she may never get the property, for ownership is still with the seller. Conversely, if the seller does not receive the price at the time of the deed, he or she may lose the property and never be paid. Fortunately, a well-established practice not regulated in any Code nor in any other authoritative source of law, allocates these risks in an efficient and equitable manner between the parties. Whereas the public deed recites that the price is paid at the time the deed is granted, and that the seller

[15] For a general overview of what 'notarial instructions' are, see Joel González Castillo, 'Las instrucciones notariales' (2016) Revista de Derecho 85; Luis Eduardo Álvarez Díaz, 'Extensión de las obligaciones emanadas de las instrucciones notariales y responsabilidad civil del notario por su incumplimiento' (2015) 25 Revista Chilena de Derecho Privado 77. See also Corte Suprema, 27 abr. 2023, Rol Nº 66723-2023.
[16] Daniel Peñaillillo Arévalo, *Los Bienes, La Propiedad y Otros Derechos Reales* (Ed Jurídica 2013) 187-194 [73], 239-240. [123].
[17] See, Arturo Alessandri Rodríguez, *De la Compra-venta y de la promesa de venta. Tomo I. Vol 1* (Ed Jurídica de Chile 2003) 32-58.
[18] See, Arturo Alessandri Rodríguez and Manuel Somarriva y Antonio Vodanovich, *Tratado de los Derechos Reales. Tomo 1* (6th edn., Ed. Jurídica 2001) 215-218, paras [365]-[370].

receives the price for his or her full satisfaction, alongside such declaration the parties conclude a private deed entitled 'notarial instructions',[19] which specifies a different form of payment of the price. In the notarial instructions the parties declare that the purchaser delivers the price to a notary, who in turn acquires the obligation to either deliver the price to the seller once the registration is completed within a defined term, or to give the price back to the purchaser if the registration does not take place within that same term. Notarial instructions often regulate also other details of the sale, such as the condition of the property at the time of delivery, expenses, and any necessary works to be undertaken on the property.[20]

It should be mentioned that the parties use the notarial instructions and not the public deed of sale to specify this mechanism for paying the price, because notaries cannot be beneficiaries of the contract for which they office as notaries,[21] and because if the deed of sale does not declare that the price has been fully paid, the unpaid balance may allow for objections to the titles of the property if in the future the purchaser decides to sell it to a third party.[22] Therefore, legal practice has devised a solution in which the parties declare one way of paying the price *vis-à-vis* third parties, and a different one to be effective between them. In other words, they resort to a 'lettre' and a 'contre-lettre' in French terminology. And this practice has nothing fraudulent about it, but simply supplements and arguably improves the rules for transferring land. This has benefits not just for the parties but generally for the security of transactions. Without it both parties run an unnecessary risk. It is an improvement and solution achievable only through simulation, one that does not infringe upon the law but in fact complements it. A simulation *ex honesta causa*, a medieval jurist might say, brings a solution that authoritative sources of law fail to provide.

2. The validity of disguised donations: enabling legal change outside the conventional framework of the legal system

[19] See González Castillo (n 15) and Álvarez Díaz (n 15).
[20] See, for instance, Corte Suprema, 23 Ago. 1993, RDJ t. 90, sec. 1ª, p. 86.
[21] See, Código Orgánico de Tribunales, art. 412.
[22] If the deed recites that the price is not fully paid and that there is balance pending to be paid, the prospective acquirer will be affected by the resolution of the contract of sale in case the former seller obtains its resolution. See Alessandri (n 17) 809-865, paras [1767]-[1808].

The second example concerns disguised donations in French law. As discussed in previous Chapters,[23] disguised donations are those concealed by the external form of an onerous contract, often a contract of sale. Their peculiarity, as explained before, is that they do not comply with the usual formalities required for their validity of donations. Art 931 of the French Civil Code requires that all *inter vivos* donations be executed before notaries in the ordinary form of contracts and a copy to be retained by the notary, otherwise they are void.[24] Disguised donations do not satisfy these formalities, yet they are still regarded as valid.

French scholars have given different reasons why disguised donations are permitted, including a variety of exegetical arguments of Codal provisions,[25] as well as some arguments concerning the purpose of the rules requiring formalities in donations,[26] in both cases to conclude that art. 931 of the French Civil Code would not apply to disguised donations. However, there are good reasons to believe that underneath these arguments the validity of disguised donations rests on the necessity to give effects to donations in ways that differ from the ones offered by authoritative sources of law.

From an historical perspective, affirming the validity of disguised donations seems to have been a reaction to the radical changes to succession law and gift giving introduced in the times of the French Revolution. As Hyland explains,[27] during the 'ancien régime' donations played an important role in the French family, particularly in the south,[28] where the father had the power to favour one of his heirs by *inter vivos* donations. This was one way of preventing the fragmentation of the estate, and of exerting parental control. But '[t]he French revolutionaries abhorred gift giving'.[29] They saw donations as a device for perpetuating the arbitrariness of fathers' authority and

[23] See Chapter 1, section Chapter 4 section III.5.
[24] Art. 931 provides that '*all instruments importing an inter vivos gift are executed before notaries, in the ordinary form of contracts; and record will be kept thereof, on pain of nullity*'.
[25] Huguette Méau-Lautour, *La donation déguisée en droit civil français. Contribution a la théorie générale de la donation* (Dalloz 1985) 28-31.
[26] George Ripert and Jean Boulanger, *Droit civil. D'Après le traité de Planiol. Tome IV. Régimes Matrimoniaux, Successions, Libéralités* (LGDJ 1959) 1068, para [3351].
[27] Richard Hyland, *Gifts: A Study in Comparative Law* (OUP 2009) 1-2.
[28] For a map of different inheritance customs in different regions in Old Regime France, see Suzanne Desan, *The Family on Trial in Revolutionary France* (University of California Press 2004) 145.
[29] Hyland (n 27) 1.

inequalities among heirs.[30] They gradually dismantled gift giving and inheritance customs in France, attacking the power to make wills to eventually prohibit parents from making all forms of donations to their children. Soon this prohibition was made retroactive to the fall of the Bastille.[31]

The revolutionary legislation caused a big gap between authoritative sources of law and social practices,[32] and disguised donations flourished as 'clandestine weapons to sabotage egalitarianism'.[33] Once the upheaval of the revolution began to subside and calmer periods emerged, and after the Directory validated donations provided they satisfied formalities and did not exceed the disposable share,[34] the 'Cour de Cassation' had to decide whether disguised donations that flourished during the revolutionary years were valid or not. For twelve years the position of the Cour de Cassation was divided, leading to a series of contradictory decisions that veered towards the nullity and validity of disguised donations. Eventually the position prevailed[35] that disguised donations are valid.

However, these decisions met unsympathetic criticism by some legal scholars. As referred by Blaise,[36] Delvincourt was of the opinion that disguised donations 'favour fraud and immorality' and that the decisions that affirmed the validity of disguised donations were a disastrous ('néfaste') development in the case-law. That said, the view that disguised donations are valid endured in the Cour de Cassation and prevails also today,[37] even though art. 931 of the Code Civil still provides that to be valid, donations must observe the formalities there detailed.

This doctrinal oddity has different explanations. One is that the technical arguments formulated for supporting the validity of disguised donations concluded in

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[30] For a related and parallel development concerning equality and testamentary freedom, see Jens Beckert, *Inherited wealth* (Thomas Dunlap tr, Princeton University Press 2008) 23-39.
[31] Hyland (n 27) 2-5.
[32] Méau-Lautour (n 25) 25.
[33] Hyland (n 27) 383.
[34] Hyland (n 27) 7.
[35] For an account of this dispute within the *Cour de Cassation* see Blaise (n 5) 89; Méau-Lautour (n 25) 25-27.
[36] Blaise (n 5) 96. See also Charles Demolombe, *Cours de Code Napoléon, Vol XX* (Paris 1868) 93-105, paras [100]-[101], who after summarising the arguments for supporting the validity of disguised donations, makes an energic point for why they should be rejected.
[37] Ibrahim Najjar, 'Donation' in Éric Savaux (ed), *Répertoire de Droit Civil* (Dalloz 2008) 7-12.

the revolutionary period still apply today, even though the factual situation motivating the disguise has changed. The extraordinary circumstances of the revolution motivated these arguments, but once formulated, they were ready to be used elsewhere. In addition, it seems that French society was reluctant to give away the freedom of gifting gained in response to the revolutionary restrictions. That is why some French scholars admit that technical legal reasons given for justifying the validity of disguised donations ultimately conceals a reluctance to formalism,[38] and the impossibility of invalidating social customs.[39] Thus, as Najjar acknowledges, despite art. 931 of the Civil Code, 'informal donations are, without any doubt, the majority of donations made in France'.[40] Najjar further observed that the technical reasons for validating such donations are

> 'in reality a retrospective confirmation of the impossibility of correcting the "deviations" and "disagreeable" tendencies of daily practice. Given a positive law that is sometimes badly adapted to individuals' psychology, the scholars and courts have created for themselves a "good conscience".'[41]

If this is correct, one can say that back in the early 19th century and up until now, simulating onerous contracts and concealing donations have been a response to the restrictions authoritative sources of law imposes on donations. While art. 931 of the Civil Code is still in force, the legal system as a whole, including courts, legal scholars and individuals, ultimately prefer to endorse the view that disguised donations need not comply with this provision. Simulating a sale to conceal donations has become a mechanism of facilitating gift giving in ways that other sources of law are incapable of offering. In other words, disguised donations have enabled a legal change by means different to the ones considered by the conventional framework of the legal system, yet this change has been welcomed by courts and the system as a whole.

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[38] Méau-Lautour (n 25) 32-33.
[39] Jean-François Montredon, *La désolennisation des libéralités* (LGTJ 1989) 41-52.
[40] Najjar (n 37).
[41] Ibrahim Najjar, note to Civ. 29 May 1980 D (1981) 273, 276-277. A similar argument in Najjar (n 37) 37-39.

Sham and simulated transactions, then, are not always entirely void, and the law does not merely penalise the parties to the sham and simulation because, despite the risks of fraud, such transactions can contribute to the flexible development of the legal system. They allow the parties to devise efficient and equitable transactions that may remedy the shortcomings of the law in two ways: either by filling the gaps in the law or by facilitating legal change welcomed by courts and the legal system as a whole. Naturally, permitting these benefits needs to be balanced against the risk of endangering third parties and the need of enforcing mandatory legislation. However, as Chapter 4 has shown, this is precisely what the law does.

III.
Simulations, shams, and the dualism of common law and equity

There is one final point to address before concluding this chapter. In his famous *Lectures on Equity*, the great English historian and jurist F.W. Maitland argued that equity is a supplementary law that does not contradict common law. Giving the example of trusts, he explained that instead of denying that the trustee is the legal owner of the property held in trust, equity acknowledges the legal ownership of the trustee but adds that 'he is bound by one of those obligations which are known as trust'.[42] Equity supplements common law. They do not contradict one another, each of them ruling within their own spheres and for their own purposes. The two systems work 'together harmoniously'.[43]

These observations about the relationship between common law and equity in English law are important for this comparative study. If equity supplements common law, it is not difficult to see that once this dualism has been incorporated within the legal system, some of the lawful forms of simulations and sham that may be needed in other legal systems are no longer needed in English law. They have been incorporated within the dualism of common law and equity. The supplementary role of equity, with its open-textured principles, provides parties with solutions that the

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[42] FW Maitland, *Lectures on Equity* (CUP 1929) 18.
[43] Maitland (n 42) 17.

common law cannot, thus appears to operate in a manner analogous to the dual operation function of the doctrine of simulation in civilian legal systems. In other words, the dualism between equity and common law in English law seems to have worked as a functional equivalent to the doctrine of simulation. This parallel is briefly discussed below.

1. The duality of common law and equity and its parallel with the civilian simulation

The historical origins of the distinction between common law and equity in English law are well known and need not be detailed here.[44] Just to provide some context, a distinct equity jurisdiction emerged in the 14th century after statutes limited the Chancellor's power to issue new writs and common law jury procedures took shape. Common law processes sometimes failed to address the true merits of a case or reveal significant facts. In such instances, the Chancellor exercised the King's residuary jurisdiction to ensure justice based on equity rather than common law, a practice confirmed by Edward III in 1349. While the Chancellor acted at first in the name of the King, as from the late 15th century he started to act on his own authority.[45] The Chancellor's jurisdiction evolved into a separate system, which for more than five centuries developed and applied various legal doctrines and remedies distinct from those applied by common law courts. While the Judicature Acts of 1873 and 1875 fused the two separate courts into one jurisdiction, this fusion was only procedural. Common law and equity remain substantively different bodies of law that shape English law to this day.[46]

This is enough context. Let us now observe the similarities between the dualism of equity and common law and the dual operation function of the civilian simulation.

[44] The most famous historical account of equity in English law is in Maitland (n 42) 1-22 (Lectures 1 and 2). For a brief history of equity but covering recent literature *Snell* Equity, [1-005]-[1-031]. See also John Baker, *Introduction to English Legal History* (5th edn OUP 2019) 105-125. These notes on the origins of equity largely rely on *Snell* Equity.

[45] Snell, *Equity* [1-07].

[46] That said, the fact that courts of equity as a separate jurisdiction no longer exist have generated some debate on whether equity and common law should be fused substantively into a single body of law. See Snell, *Equity* [1-16.], [1-029]-[1-031]. See also Irit Samet, *Equity. Conscience Goes to Market* (OUP 2018) 1-76; Irit Samet, 'Equity' in Hanoch Dagan and Benjamin C Zipursky (eds), *Research Handbook on Private Law Theory*.

As this section remarks, the dualism of common law and equity has allowed individuals to conclude transactions that separate their external effects *vis-à-vis* third parties and their internal effects on the parties in a similar way to how in civilian jurisdictions the doctrine of simulation permits this dual effects. For the same reason, equity has on occasions remedied the shortcomings of the common law in the same way the doctrine of simulation has remedied the law's shortcomings in the civil law context. Let me illustrate this parallelism between common law and equity and the doctrine of simulation by providing an example of a simulated sale in a civil law jurisdiction and of an express trust in England.

1.1. Common law and equity and the split of the external and internal operations of a legal transaction

In civil law jurisdictions, when a landowner intends to dispose of land for certain purposes but wishes to retain ownership, they might consider simulating a sale. For example, a French landowner may use a 'lettre' to transfer property and, through a 'contre-lettre', retain with one hand what they have ostensibly given away with the other.[47] Depending on the terms of the 'contre-lettre', the landowner may then recover possession by bringing an action of simulation.[48] In turn, an English landowner would likely not engage in a simulated or sham sale. Instead, the English landowner would declare a trust, transferring title to a trustee while retaining beneficial ownership. Depending on the nature of the landowner's beneficial interest, they may ask the trustee to transfer the asset collapsing the trust and recovering legal title.[49]

When it comes to third parties there are also some parallelisms. Neither the simulated sale nor the English trust can be set up to the prejudice of *bona fide* third parties. Consider, again, a French landowner who has simulated a sale. If the purchaser to the simulated sale subsequently sells and transfers the property to a third party who has no notice of the simulation, the French landowner will have a claim against the simulated purchaser, but no claim against the third party. This is prescribed

[47] Ferrière, *Dictionnaire de droit. T1*, entry 'contre-lettre'; Bosquet, *Dictionnaire raisonné des domaines et droit domaniaux, T 1*, entry 'contre-lettre'.
[48] See Chapter 4, section I.1.3.
[49] *Saunders v Vautier* [1841] EWHC J82.

by art. 1201 of the French Civil Code.[50] Similarly, if an English trustee transfers the property held on trust to a *bona fide* third-party purchaser, the English landowner will have a claim for breach of trust against the trustee[51] but no claim against the *bona fide* third-party purchaser.[52]

In other words, simulating a sale and creating a trust enables the parties to transfer property (or at least the appearance of property in the case of a simulated sale) *vis-à-vis* third parties whilst allowing the seller/settlor to 'retain' ownership in their relationship with the purchaser/trustee. The technical legal categories and grounds used to explain these effects are naturally different, and these differences have implications. In English law it would probably be said that equity intervened on the ground of conscience, and that there is nothing in the conscience of the *bona fide* third party to honour the trust that he or she had no notice of. The doctrine of simulation resorts to other categories and justifications as this dissertation has shown.[53] However, in terms of function, and in this function in particular, they tend to converge. If this is correct, then, arguably much of the effects of sham and simulated transactions discussed in Chapter 4 find some parallel in the effects of an English trust.

1.2. Equity as a remedy of the shortcoming of common law

Interestingly, the parallel between the doctrine of simulation and the dualism of common law and equity is not only that they separate the effects of a transaction *vis-à-vis* third parties and its internal effects on the parties. The parallel is also that the dualism of common law and equity seems to have supplemented common law in a similar way to how the doctrine of simulation have permitted the parties to supplement the law contained in authoritative sources of law.

A good example of how equity, and particularly trust law, has complemented and supplemented common law, concerns the rules on the assignment of choses in

[50] See Chapter 4, section I.2.
[51] Snell, *Equity*, Ch.30.
[52] Snell, *Equity*, [4-017]-[4-041]. See also David Fox, 'Purchase for Value Without Notice' in Paul S Davies, Simon Douglas and James Goudkamp (eds), *Defences in Equity* (Hart Publishing 2018) 53.
[53] See Chapter 1, section II.3.1.

action. The common law rule is that if A owes an obligation to B, it is not possible for B to transfer B's right against A to C.[54] The historical reasons for justifying this common law rule include the impossibility of transferring something intangible, and concerns that the assignment of choses in action may lead to maintenance.[55] Yet, equity has supplemented the inflexibility of this rule. An assignment not valid at common law may be valid in equity.[56] Interestingly, the historical understanding was that equitable assignments operated by way of trust.[57] The assignor retained his or her right and the chose in action was not *truly* transferred. Yet the equitable assignment involved the creation of a trust that gave the assignee a right in equity, which encumbered the assignor's right, accompanied by an agreement to permit the assignee to make use of the name of the assignor.[58] Hereby, the duality of equity and common law that separates the effects a transaction *vis-à-vis* third parties and its internal effects on the parties, provided a remedy for a rule against assignment of chose of action which was seen as inflexible and sometimes even detrimental for being 'a great encouragement to litigiousness'.[59]

When looking at this from the perspective of civilian jurisdictions, it is not difficult to imagine forms of simulations that could avoid the common law rule found in England. A power of attorney given by the creditor to a third party or contract of mandate both concealing a full transfer, are some examples.

The parallel is limited, but it is worth noting that, in France during the 'ancien régime', and following Roman law, the assignment of litigious claims by way of sale was subject to some restrictions.[60] The debtor of the assigned claim was obliged to pay the assignee only the amount of the price paid by the assignee to the assignor.[61]

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[54] Treitel, *Contract* [15-02].
[55] Snell, *Equity*, [3-02].
[56] Treitel, *Contract* [15-02]. For an historical account, see SJ Bailey, 'Assignment of Debts in England from the Twelfth to the Twentieth' (1931) 47 LQR 516.
Century
[57] James Edelman and Steven Elliott, 'Two Conceptions of Equitable Assignment' (2015) 131 LQR 228.
[58] See Bl Comm, Book 2, Ch. 30, 442.
[59] Bl Comm, Book 2, Ch. 30, 442.
[60] See Pothier, *Traité du contrat de vente* [590]-[593].
[61] This rule was later incorporated in art. 1699 of the French Civil Code and art. 1913 of the Chilean Civil Code. See Carlos Amunátegui Perelló, 'Título XXV. De la cesión de derechos' in Carlos Amunátegui Perelló (ed), *Comentario Histórico-Dogmático al libro IV del Código Civil de Chile. Tomo I* (Tirant lo blanch 2023) 1209, 1230-1232.

This rule did not apply, however, in the case of assignments by way of donations, in which case the debtor's liability for the assigned claim was for the total amount of the claim. Consequently, assignors and assignees soon started to conceal sales by simulating donations. Yet this practice, in contrast to the solution provided by equity in English law, was seen as fraudulent.[62] Perhaps this was because in France the restrictions on the assignments of litigious claims were considered beneficial for society and the legal system. Therefore, the practice of circumventing these rules was regarded fraudulent and not beneficial. Borrowing the language used by Baker,[63] in France and in contrast to England, these fictional devices seem to have been not officially tolerated for the judiciary did not approve the changes which they serve to conceal.

That there are some functional similarities between the civilian doctrine of simulation and the dualism of equity and common law in English law does not mean that the solutions each provide are the same. In most respects a simulated sale in France and an English trust are very dissimilar. Likewise, the functions that the dualism of equity and common law has performed throughout history, and performs up until now, are numerous. For the same reason, there is nothing here suggesting that the functions that equitable rules perform can be reduced to dual operation function examined in Chapter 4. However, it is still the case that some of what lawful forms of simulation accomplish in the civilian jurisdictions, in England, has been accomplished by the dualism of equity and common law.

This may be one of the reasons why in England, the doctrine of sham transactions as a discrete legal doctrine is a recent development[64] compared to historical origins of the civilian simulation to be found in Roman law and more directly in the teachings of the medieval glossators and commentators.

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[62] See Pothier, *Traité du contrat de vente* [591].

[63] John Hamilton Baker, *The Law's Two Bodies: Some Evidential Problems in English Legal History* (OUP 2001) 37.

[64] Mike McNair, 'Sham: Early Uses and Related and Unrelated Doctrines' in Edwin Simpson and Miranda Stewart (eds), *Sham Transactions* (OUP 2013) 29.

IV.
Concluding remarks

The rationale for the dual operation function of sham and simulated transactions is not evident. However, sham and simulated transactions can offer certain benefits. They facilitate a more effective realisation of the parties' needs and intentions by allowing the creation of efficient and equitable legal structures that serve their commercial needs or their interests in providing for members of their family, especially when the legal system falls short. In this way, sham and simulated transactions can complement and supplement the law and serve as remedies to fill gaps and correct deficiencies in the legal system. In this regard, there are some functional similarities between the civilian doctrine of simulation and the dualism of common law and equity, both permitting a more flexible development of the law.

PART 2:

SHAM AND SIMULATED TRANSACTIONS IN THE BROAD SENSE

Part 1 of this dissertation narrowed the doctrines of sham and simulated transactions by defining their structural essential elements and their most distinctive function. However, throughout history and up to the present day, jurists and courts have identified transactions as shams or simulations and, on that ground, deemed them ineffective or deserving of some adverse legal consequence, although they differ from sham and simulated transactions in this narrow sense. In other words, alongside the narrow sense of sham and simulation analysed in Part 1, these terms have often a broad meaning in law.

Part 2 explores this alternative interpretation of sham and simulation. The argument presented is that there is a broad sense in which a transaction may be found to be a sham or a simulation that does not necessarily exhibit the common distinctive features found in the narrow sense. Compared to the narrow sense, sham and simulated transactions in this broad sense lack precise content, and the structural elements discussed in Part 1 are not necessarily present. Instead, these transactions involve a vague divergence between form and substance, with the term 'substance' having an open texture, and the one described in Part 1 being only one possibility among others. Consistent with this lack of defined structure, the rules and legal consequences following the finding that a transaction is a sham or simulation in the broad sense do not necessarily satisfy the dual operation function described in Part 1. They perform different functions that vary depending on the context is which courts use them.

Two cases exemplifying this broad sense are analysed in detail. Chapter 6 examines the use of sham and simulation in the broad sense to characterise transactions designed to avoid and circumvent mandatory law. Courts have sometimes found transactions to be sham and simulations that, due to the economic

result the parties achieve, circumvent mandatory law and thwart its purpose. This broad sense of sham and simulation serves as a device of purposive statutory interpretation. It permits courts to widen the application of a statute without changing the literal words but by bending the conditions that make the statute apply.

Chapter 7, in turn, analyses the use of the broad sense of the sham in trust law. It first argues that in certain cases involving self-declared trusts, English courts have embraced a broader concept of sham. Finding these trusts as shams in this broader interpretation involves using ambiguous language where fundamental principles of trust law. It then contends that even when sham trusts consist in sham transactions in the narrow sense, unique aspects of trust law mark them as a distinct case and a sub-category of sham trusts in the narrow sense. Particularly, the divergence between form and substance that characterises sham trusts is very specific. It consists in the settlor's failure to dispose of beneficial ownership despite a declaration of trust that on its face seems to constitute a valid trust.

As these chapters show, identifying a transaction as a sham or simulation in this broad sense still has practical applications. By classifying a transaction as such, courts disregard its documentary form to ensure that the policies underlying other legal rules are effectively upheld. This broad sense of sham and simulation is useful for courts and can be justified when the legal system lacks specific doctrines to achieve these ends or when more specific doctrines are not applicable to a particular case. However, it comes at the cost of consistency and internal coherence. Therefore, wherever possible, more specific doctrines should be preferred over this broad interpretation of sham and simulation.

CHAPTER 6:
SHAM AND SIMULATION IN THE BROAD SENSE AND LEGAL AVOIDANCE

Courts frequently characterise as sham and simulation transactions designed to avoid mandatory law. In this way, courts resort to the concepts of sham and simulation to enforce statutory provisions that the parties to a transaction might otherwise avoid. Take, for instance, statute *s* which provides that transaction *n* is null. The parties devise a transaction *m* to circumvent statute *s*. However, the courts find that transaction *m* is a sham and a simulation concealing transaction *n* which in accordance with statute *s* is null.

As this chapter argues, in these instances sham and simulation often mean something different from the narrow sense discussed in Part 1. In particular, the structural elements of sham and simulation are interpreted differently. It is not just that their documentary form and their substance diverge in the sense that the parties intend to be governed by rights and obligations different from those recited in the documentary form. The divergence may also consist in the parties' attempts to use those rights and obligations as means to circumvent mandatory legislation or achieve some other unlawful result. Likewise, sham and simulation in this broad sense no longer requires a common understanding between the parties as sham and simulation in the narrow sense do. For the same reason, sham and simulated transactions in this broad sense do not perform the dual operation function described in Chapter 4, and the law no longer protects the interests of the parties to the transaction. Instead, sham and simulation in broad sense operate as an instrument of statutory interpretation, by facilitating an indirect purposive interpretation of the statute in question. Thus, finding that a transaction is a sham or a simulation in this broad sense no longer concerns the rights and obligations that the parties have intended as individuals, but with the extent to which they are permitted to contract out of statutory provisions driven by public policy goals.

The argument proceeds as follows. Sections one and two explore instances where courts have characterised transactions that avoid and circumvent mandatory

law as shams in a broader sense than the one discussed in Part 1. Section three offers comparative remarks on this alternative meaning of sham and simulation, arguing that English law distinguishes this broad meaning of sham from the narrow one more clearly than does the law in Italy, France and Chile. Section four, in turn, discusses the relationship between this broad meaning of sham and simulation with the narrow meaning explored in Part 1, and argues that, in the context of legal avoidance, and when properly analysed, this broad meaning of sham and simulation is better understood as an approach to statutory interpretation that enables the courts to give the best effect to the purpose of the statute in question.

I.
Sham transactions and legal avoidance

As discussed in Chapters 1 and 2, *Snook*[1] and *Hitch v Stone*[2] require two fundamental conditions for finding that a transaction is a sham. First, that the parties give to third parties the appearance that they have intended certain *rights and obligations* while they intend other rights and obligations, if any, that govern their legal relationship. Second, that the parties to the sham share a *common intention* to create this divergence between the rights and obligations recited in the documentary form and those governing their internal relationship.

That said, in an early stage of development, this doctrine was often used in the context of applying statutes, and finding a sham did not necessarily mean that the parties intended rights different from those they had recited in the documentary form, as *Snook* nowadays requires. It could also mean that the parties had structured the transaction as a means to circumvent a particular statute. In more recent times this alternative account of the doctrine of sham transactions has most times been rejected.[3] Yet it has not completely disappeared. Some divergence from the narrow sense examined in Part 1 has persisted. Occasionally, courts admitted that alongside

[1] *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786, 802 C-E.
[2] *Hitch v Stone (Inspector of Taxes)* [2001] EWCA CIV 63, 2001 WL 14954 [63]-[69].
[3] *National Westminster Bank Plc v Jones* [2001] 1 BCLC 98 [37]; *Belvedere Court Management Limited v Frogmore Developments Limited* [1997] QB 858, 876D; *Isle Investment LTD v Leeds City Council* [2021] EWHC 345 (Admin) [7].

the narrow sense of the doctrine of sham in *Snook*, there is a wider definition of sham in the context of applying statutory provisions. These historical and recent developments are outlined in the following sections.

1. Sham transactions in the 18th and 19th centuries

As Mike Macnair has shown,[4] during the 19th century a variety of different legal categories, whose legal meanings were not necessary yet fully-developed, including fraud, colourable transactions, simulation and sham, converged in what is today the doctrine of sham transactions. In this initial stage of development, finding that a transaction was a sham or 'colourable', or simulated did not necessarily have the same meaning as eventually developed in *Snook*. The divergence between form and substance did not necessarily concern the rights and obligations binding the parties, on the one hand, and those projected towards third parties, on the other. It included also the use of a documentary form to achieve an ulterior economic result that circumvented a statute. Likewise, in many cases, courts did not require that both parties had a common intention of the sham they were creating. It was enough that one of the parties, the one with greater bargaining power, had structured the transaction to contract out of a certain statutory provision.

A first example of this trend is the considerable number of decisions from the 18th century dealing with 'colourable' transactions – which were sometimes called 'sham'- that were devised to evade usury laws. In many of these decisions, the conclusion that a transaction was a colourable - or sham - arrangement concealing a loan was mainly based on the fact that the parties achieved the economic result that the law of usury aimed to ban. It did not have to be that the parties used a misleading documentary form to conceal other rights and obligations.[5] The following observation by Knight Bruce V-C in *Belcher v Vardon* illustrates this point:

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[4] Mike Macnair, 'Sham: Early uses and related and unrelated doctrines' in Edwin Simpson and Miranda Steward (eds), *Sham Transactions* (OUP 2013) 29.
[5] See, for instance, *Mason v Abdy* (1689) Carthew 67; 90 ER 643; *Earl of Chesterfield v Janssen* (1750) 1 Atk. 301; 26 ER 191; *Tate v Wellings* (1790) 3 Term Reports 531; 100 ER 716. *Floyer v Edwards* (1774) Lofft 595; 98 ER 817; *Richards v Brown* (1778) 2 Cowp 770; 98 ER 1352; *Jestons v Brooke* (1778) 2 Cowp 793; 98 ER 1365.

‘I think it consistent with principle and with the authorities—although I do not say with all the authorities—to hold that if A., his necessities requiring an advance of £1000, obtains it from B. upon a bargain between them that, in consideration of such advance, A., his executors and administrators, shall pay B., his executors and administrators, an annuity of £80 for a term of seventy years, commencing immediately—the annuity to be secured by the covenant of A. binding himself personally whilst living, and after his death, his assets generally —the transaction is usurious, and upon that ground bad […]. The term loan may or may not be a correct designation of such a transaction. […] But how, in its essence or substance, does such a dealing differ from a mere loan of money at interest, when, according to the contract, the principal shall be repaid by certain fixed annual instalments, extending over a great number of years, each instalment being accompanied with interest due on the balance for the time being? I cannot see any material difference.’[6]

In other words, the substance of a transaction was defined in terms of its economic result: advancing resources on the one side and repaying such principal plus a premium in annual instalments, on the other. Thus, a transaction was found colourable and a sham when the parties achieved an economic result that fell within the scope of the legal prohibition of usury, even if they had used a different transactional document from the one representing an ordinary loan.

During the 19th century, a similar variant account emerged in cases concerning attornment clauses inserted into mortgage deeds.[7] Some context may be needed. In the late 19th century, and pursuant to section 34 of the Bankruptcy Act 1869, the landlord to whom any rent was due by the bankrupt had the right to distrain upon the goods of the bankrupt for a year’s rent. To benefit from this right, the mortgagee sometimes inserted an attornment clause in the relevant mortgage deed by which the mortgagor attorned as tenant to the mortgagee, giving the mortgagee the right to

[6] (1845) 2 Holt Equity Reports 120; 71 ER 817.

[7] *Re Thompson Ex p Williams* (1877) 7 Ch D 138; *Re Stockton Iron Furnace Co* (1879) 10 Ch D 335; *Re Bowes Ex p Jackson* (1880) 14 Ch D 725. For a clause not considered a sham but still void as contrary to the bankruptcy *Re Harrison Ex p Jay* (1879) 14 Ch D 19.

distrain.[8] Given the prejudice that this privilege could cause to ordinary creditors, and based on the reported cases we have, it seems that it was relatively common for the liquidator of the mortgagor's creditors to allege that the attornment clauses inserted by the mortgagees were mere shams for the sole purpose of giving the mortgagee both a security not recognised in bankruptcy law and an unlawful advantage over the rest of the creditors.

In some of these cases, the liquidator was successful, and the court considered that these clauses were a sham in fraud of bankruptcy law. Interestingly, among the main reasons was the fact that even though on their face the clauses seem to satisfy the words of the statute granting this privilege, they were used by the mortgagees to widen a privilege beyond the purposes of bankruptcy law. In *Ex Parte Williams,*[9] for instance, James LJ reasoned that an attornment clause inserted into a mortgage deed was a sham because of the practical result the parties achieved. He observed that the scope and object of the deed intended by the parties was to make a different distribution of the property of the mortgagors and to defeat the operation of the bankruptcy laws.[10] Likewise, Thesiger LJ reasoned that 'No one has suggested that £20,000 was a fair rent for the property; it was clearly intended only as a sham *rent'.* Again, Thesiger LJ, in *Ex p Jackson* submitted that an attornment clause is not valid if 'from the amount of the rent fixed by the attornment clause, it can be concluded by the Court that the rent is not real but a mere sham'. Finally, in *Re Stockton Iron Furnace Co*[11] the court concluded the clause was not a sham, reasoning that it was not artificial. Jessel MR observed that 'the rent was not so excessive as to prove that there was any intention on the part of the two parties to this mortgage that it should not be a real rent but a fictitious rent'.

[8] See HP Roche, *The Bankruptcy Act, 1869: The Debtors Act, 1869; the Insolvent Debtors and Bankruptcy Repeal Act, 1869* (Stevens & Haynes 1870) 34.
[9] *Re Thompson* (n 7).
[10] Lord James observed that 'looking at the whole scope and object of this deed, at the whole intention of the parties, and taking a common-sense view of the thing, it is impossible not to see that it was intended to make a different distribution of the property of the mortgagors according as they should or should not become bankrupt. It was intended that, if they should become bankrupt, certain chattels which were not included in the deed should become an additional security to the mortgagee for his debt. It appears to me that the attornment clause was a mere sham, a mere contrivance and device to give the mortgagee an additional benefit in the event of the mortgagors' bankruptcy. That is an attempt to defeat the operation of the bankruptcy laws which cannot succeed', *Re Thompson* (n 7) 142.
[11] *Re Stockton Iron* (n 7).

The last of these early developments to mention here is a number of cases concerning sales and hire purchase agreements concluded for financing purposes.[12] The facts of each of these cases were naturally dissimilar, but in all of them the parties had concluded a transaction for security purposes using the documentary forms of a sale and a hire and purchase agreement. A key question, then, was if this documentary form was genuine or a sham to cover a secured loan in fraud of mandatory legislation, and, in particular the Bills of Sale Act 1878, which required strict formalities for creating securities over moveables.[13] As in the case of sham attornment clauses, courts sometimes found that the transactions concluded by the parties were shams mainly because the economic result achieved by the parties was to advance money in exchange for goods, and not because the legal rights and obligations that they created were different from those they recited to create.

In *Watson*, Lord Esher, MR considered that the sale and hire and purchase agreements executed by the parties were shams because the 'purpose' of the seller was not to sell the moveables but 'to borrow money on the security of the furniture in order to prevent its being sold in execution'.[14] Thus, the transaction was characterised on the basis of the economic result pursued by the parties. The same principle was applied in *Madell v Thomas & Co*, where again Lord Esher MR said that

> 'the necessary implication arises that documents, which are in the ordinary meaning of language on the face of them not bills of sale, shall, nevertheless, be bills of sale within the meaning of the Act, if certain facts which do not appear on the face of the document. […] though such might be the form of the agreement, the Court should go into the question whether the agreement was not in reality given by way of security for money lent'. [15]

In none of the cases did the parties submit evidence indicating that they had had any intention to depart from the tenor of the documents they had executed. However,

[12] *Re Watson* (1890) 25 QBD 27, 31; *Madell v Thomas & Co* [1891] 1 QB 230.
[13] Bill of Sale Act (1878) Amendment Act 1882.
[14] *Re Watson* (n 12) 31.
[15] *Madell* (n 12) 233.

because the practical and economic result intended by them was to obtain fresh funding while circumventing the Bills of Sale Act 1878, in both cases the court submitted that those documents were a sham concealing a secured loan, and accordingly void for want of registration.[16]

As all these examples show, finding a sham was closely connected to the result the parties pursued and to whether this result circumvented statutory law. It did not necessarily mean that there was a divergence between the rights and obligations the parties declared and those they intended to be bound by. In modern English law, and in particular after *Snook*, the more restricted notion of sham transactions described in Part 1 has prevailed. Yet, as the following section shows, an alternative and broad meaning of sham in the context of applying statutes has managed to persist and has occasionally emerged in recent times.

2. Sham transactions as transactions in avoidance of mandatory law in modern English law: sham occupancy agreements

That transactions in avoidance of mandatory law have been found to be shams in a sense that diverges from *Snook* and, more generally, from the narrow sense discussed in Part 1, has occurred in recent English decisions in various contexts.[17] However, given the academic discussion it generated, this section briefly discusses this development in the context of residential occupancy agreements.[18]

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[16] Today there is some clarity that a mere economic result does not convert a sale into a security but the question as to when and why a contract using the form of sale should be characterised as a security interest has been persistently controversial in English law. See generally Hugh Beale and othres, *The law of security and title-based financing* (3rd edn, OUP 2018) 97- 114; MG Bridge FBA, *The sale of goods* (3rd edn, OUP 2014) 77-78; and Aubrey L. Diamond, 'Hire-Purchase Agreements as Bills of Sale (II)' (1960) 23 LMCLQ 516.

[17] For this variant in the context of legal aid, see Edwin Simpson, 'Sham and Purposive Statutory Construction' in Edwin Simpson and Miranda Steward (eds), *Sham Transactions* (OUP 2013) 86, 88-92. For a similar development in employment law, see A.C.L. Davies 'Employment law' in Edwin Simpson and Miranda Steward (eds), *Sham Transactions* (OUP 2013) 176; M Ford and A Bogg 'Between Statute and Contract: Who is a Worker?' (2019) 135 LQR 347.

[18] Susan Bright, 'Sham into Pretence' (1991) 11 OJLS 136, 139-140; Susan Bright, 'Avoiding Tenancy Legislation: Sham and Contracting Out Revisited' (2002) 61 Cambridge LJ 146; Ben McFarlane and Edwin Simpson, 'Tackling avoidance' in Joshua Getzler (ed.), *Rationalizing Property, Equity and Trusts; Essays in Honour of Edward Burn* (LexisNexis, 2003) 135; John Vella, 'Sham transactions' (2008) LMCLQ 488; Susan Bright, Hannah Glover, and Jeremias Prassl 'Tenancy Agreements' in Edwin Simpson and Miranda Steward (eds), *Sham Transactions* (OUP 2013) 105.

As Elizabeth Cooke observed, English law relating lo leases 'is largely the tale of the law's endeavours to control the power imbalance between landlord and tenant'.[19] In pursuing this aim, the law has imposed legal controls on the landlord and conferred statutory rights on tenants. A significant milestone in these endeavours was the Rent Act 1977, which conferred substantial statutory rights on certain groups of tenants, including the security of tenure,[20] that is, a protection limiting the circumstances in which the landlord could remove the tenant.[21] Importantly for the present discussion, the Rent Act 1977 did not apply to licences but only to leases or tenancies, and only to leases not excluded by the Act.[22]

The distinction between a lease and licence, then, became crucial for the application of the Rent Act. The line between the two is difficult to draw and it has been lengthily litigated,[23] but a fundamental difference is that a lease is a grant of land granting exclusive possession for a defined length of time.[24] Because it grants exclusive possession, the tenant under a lease is said to be entitled 'to exercise the rights of an owner of land, which is in the real sense his land albeit temporarily and subject to certain restrictions'.[25] A licence, in contrast, does not grant exclusive possession, and the licensee is entitled only with a personal right against the licensor.

Here is where an alternative and broad meaning of sham transactions played a relevant role. Landlords devised different ways of structuring tenancy agreements that, from an economic perspective, might reasonably be interpreted as conferring exclusive possession. The particular instances are numerous,[26] but they often consist in written documents including a combination of the following devices: an express provision that they are creating a licence and not intended to grant a lease; being

[19] Elizabeth Cooke, *Land Law* (3rd edn, Oxford 2020) 169.
[20] Kevin Gray and Susan Francis Gray, *Elements of Land Law* (5th edn, Oxford 2009) 575-576; paras [4.7.11]-[4.7.13].
[21] Rent Act 1977, sections 1,2, 3 and 98.
[22] See exclusions at Rent Act 1977, from sections 4 to 16.
[23] See generally Gray and Gray (n 20) [4.1.67]-[4.1.120]. For a principled explanation of these case law see Bright 'Avoiding Tenancy Legislation' (n 18) and Bright, Glover, and Prassl (n 18).
[24] *Bruton v London and Quadrant Housing Trust* [2000] 1 AC 406, 413 E-F; *Street v Mountford* [1985] AC 809.
[25] Street (n 24), 816b per Lord Templeman.
[26] Examples are *Somma v Hazelhurst* [1978] 1 WLR 1014; *Antoniades v Villiers* [1990] 1 AC 417.

structured into two separate but identical agreements to (often unmarried) couples; and the landlord reserving the right to permit other licensees to use the property. The question, then, is if these agreements correspond to real licences or sham licences that sought to contract out of the Rents Acts. Yet, as seen below, the meaning of 'sham' in this context is not always the same as in *Snook*.

A good example is the famous case *Antoniades v Villiers.*[27] As a matter of context it is important to mention that, a few years earlier in the House of Lords case *Street v Mountford,* Lord Templeman had observed that the Rent Act 1977 should not alter the construction of an agreement, but that the court should 'be astute to detect and frustrate sham devices and artificial transactions whose only object is to disguise the grants of a tenancy and to evade the Rent Acts'.[28] This dictum had brought some criticism, for it referred to 'sham devices' when neither *Street* nor previous cases litigated in the context of occupancy agreements in avoidance of the Rent Act 1977 had involved a sham as defined in *Snook.*[29] A second source of criticism was that the expression 'artificial transaction' has an obscure meaning. It was not clear, then, what exactly Lord Templeman's dictum in *Street* meant.

In this context, *Antoniades* came to be decided by the House of Lords. A landlord had asked an unmarried couple that were seeking a flat 'as a quasi-matrimonial home'[30] to sign two separate but identical occupancy agreements for occupying a flat. The documents expressed that the landlord was a licensor and unwilling to grant exclusive possession and that the use of the flat was in common with such other licensees or invitees as the licensor might permit from time to time. The House of Lords found that the two agreements were to be read together as if they were a single agreement, and that the right of the landlord to grant a licence to further occupiers was a 'pretence' in avoidance of the Rent Act 1977.[31]

[27] *Antoniades* (n 26).
[28] *Street* (n 24) 825.
[29] As Susan Bright observed, '[t]here are surpassingly few cases upon sham, and virtually none in the field of real property'. Bright, 'Avoiding Tenancy Legislation' (n 18) 151. An isolated example of one sham case is *Bhopal v Walia* (2000) 32 HLR 302 concerning a sham tenancy agreement that concealed an oral agreement providing a different rent.
[30] *Antoniades* (n 26) 467 h.
[31] *Antoniades* (n 26) 462 D- 466 A

For what matters here, it is important to point out that it was common ground that the landlord intended the clause that permitted him to introduce further licensees, and that it was not used to conceal other rights and obligations. Likewise, it was also clear in the case that the occupiers did not have any intention of creating a sham but only tolerated the clause since they needed to find a housing solution. Thus, there was no doubt that this clause was not a sham in the meaning defined in *Snook*. Yet it was also clear that the clause was introduced to avoid the Rent Act 1977, and that it was highly unlikely that the landlord would ever exercise it. In other words, the clause was found challengeable for evading the Rent Act 1977 on some innominate ground, but it did not lend itself naturally to characterisation as a sham. Lord Templeman then came up with the term 'pretence' to capture this ambiguous manner of evading the Rent Act. Lord Templeman even found the opportunity to clarify his previous dictum in *Street,* observing that '[i]t would have been more accurate and less liable to give rise to misunderstandings if I had substituted the word 'pretence' for the references to "sham devices" and "artificial transactions". What exactly 'pretence' means and how it relates with the meaning of sham in *Snook*, however, was not clear. The most that could be said is that pretence is something akin to sham, but not quite.

In *Bankway Property Ltd v Pensfold-Dusford*[32] Arden LJ further elaborated on these developments stating that pretences in avoidance of the Rent Act 1977 and other statutory provisions ultimately consisted in 'a variant on the usual definition of sham'[33] transactions. The facts of the case were that a landlord had introduced in a tenancy agreement a review clause to unilaterally increase the rent from £4,690 to £25,000, an amount at which the protection of the Housing Act 1988[34] was no longer applicable.[35] Sometime after concluding the agreement, the landlord increased the rent, and as was expected the occupant failed to pay it. Consequently, the landlord claimed for possession. The Court of Appeal held that the review clause was a sham

[32] [2001] 1 WLR 1369.
[33] *Bankway* (n 32) [43].
[34] The Housing Act 1988 was a reaction to the Rent Act 1977, easing some (but not all) of the restrictions on the landlords. It was particularly relevant the 'shorthold' form of assured tenancy that was introduced to regenerate the private rented housing market. See Gray and Gray (n 20), paras [4.7.17].
[35] At the relevant time the Act provided that a tenancy under which a dwelling hose was let as a separate dwelling was an 'assured tenancy' if satisfied the conditions provided in section 1, including not to be excluded by Schedule 1. In turn, Schedule 1, paragraph 2(1) excluded tenancies granted after 1 April 1990 at an annual rent exceeding £25,000.

device to contract out of the 1988 Act. The court considered that the parties did not negotiate the clause, that the rent was not a market rent, and that there was no explanation why the landlord did not increase the rent before if he had the right to. The only explanation for this review clause, concluded the court, was that it was a sham to recover possession of the property and avoid the protection granted to tenants in the 1988 Act. Arden LJ admitted that the clause fell far outside the orthodox definition of sham in *Snook* for it was not that the clause created the appearance of granting the landlord a right that he did not have. However, it was still a sham in a different sense. Arden LJ observed that

> 'there is a variant on the usual definition of sham where a question arises whether an agreement is not intended to have the effect stated but is intended to evade the operation of a statute out of which the parties cannot contract'.[36]

Then, after referring to a considerable number of authorities in which this variant definition of sham would have been applied,[37] Arden LJ added the following:

> 'In these types of situations, as Lord Ackner put it in *Antoniades v Villiers* [1990] 1 AC 417, 466, the question is: what was the substance and reality of the transaction entered into by the parties? The court is not bound by the language which the parties have used. It may for instance conclude, when it examines the substance of the transaction, that what the parties have in their agreement called a sale and repurchase of book debts is in truth a registerable charge over them'.[38]

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[36] *Bankway* (n 32) [43].

[37] Susan Bright argues that out of the cases cited by Lady Arden only the tenancy cases would involve 'contracting out', suggesting that not many authorities would support this variant definition of sham. Bright, 'Avoiding Tenancy Legislation' (n 18)163-164. For the same opinion, see Vella (n 18) 507. Yet the cases referred by Lady Arden dealt all with transactions that achieved an economic result that merits a disapproval either for contracting out of some statute (as it is the of *Re Watson* (12) in connection with the Bill of Sale Act 1878) or for abusing of a right of a different nature (as it is the case of *Aveling Barford Ltd v Perion Ltd* [1989] BCLC 626 discussing an exercise of a company's power that permitted an unlawful distribution). Both situations are not exactly the same, but they share some substantial affinity.

[38] *Bankway* (n 32) [43].

It is not easy to draw a clear principle from these cases. In *Antoniades* a pretence was characterised as a legal transaction or a clause that creates a legal right that the parties do not intend to rely on.[39] In *Bankway* this was reformulated observing that a sham in its alternative definition consists in a device intended to evade the operation of a mandatory legal statute.[40]

Some legal scholars have made commendable efforts to give a principled explanation to these authorities. Bright, for instance, has said that the essence of a pretence is not that the transaction was 'designed for the sole purpose of avoiding protecting legislation', but rather that it 'is not genuine in the sense that the parties never intended to rely on that device'.[41] However, and as she admits, there are some decisions that do not fit with this reconstruction. In *Bankway*, for instance, the landlord clearly intended and later exercised the clause that the court found to be sham.[42] Vella, in turn has argued that this variant account of the doctrine of sham should not be followed for it would not be justified. He argues that the variant account would be supported only by a minority in *Antoniades* and 'the cases that followed it',[43] which would constitute 'scant authority for a notion that departs rather drastically from the orthodoxy'.[44] He also finds that this variant account would be contradictory from a contractarian perspective for it would allow a court to ignore a term of a contract based on the subjective intention of one party only.[45]

Vella seems to be right that the variant account of the doctrine of sham departs from many authorities. Yet in the context of occupancy agreements, and particularly in the application of statutory protections, courts have used a variant account of the doctrine of shams, occasionally referred to as a 'pretence'. It is also clear that this account of the doctrine resembles the meaning of sham in the early cases decided in the 18th and 19th centuries referred earlier in this section. This variant sense of sham

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[39] *Antoniades* (n 26) 462 D- 466 A.
[40] *Bankway* (n 32) [43].
[41] Bright, 'Avoiding Tenancy Legislation' (n 18) 153. A different argument is made in Bright, Glover, and Prassl (n 18).
[42] Another decision that seems not to fit with this conceptualisation of a pretence is *Gisborne v Burton* [1989] QB 390.
[43] Vella (n 18) 507.
[44] Vella (n 18) 508.
[45] Vella (n 18) 508.

may make the understanding of the doctrine of sham transaction more complex, but we cannot ignore it. Moreover, the coexistence of both the narrow sense of sham and the variant meaning discussed here may not be necessarily problematic if they are correctly distinguished and understood. It may be that the variant on the usual definition of sham is in no conflict with any contractarian principle. As argued in section IV of this chapter, this alternative meaning of sham does not determine the rights and obligations the parties create but ultimately consists in an instrument of purposive statutory interpretation. In doing so the court is not ignoring any contractual term based on the subjective intention of one party only. Before exploring this point further, however, it is necessary to address the broad understanding of the doctrine of simulation when tackling legal avoidance.

II.
Simulated transactions and legal avoidance

As we have seen with sham transactions, when courts have found that transactions avoiding mandatory law are simulations, the term simulation often acquires a meaning that differs from the narrow sense described in Part 1. To see this, it may be useful to recapitulate how the narrow sense of simulated transactions in Italy, France, and Chile can be drawn. Chapter 1 showed that, in the absence of Codal definitions, legal scholars often define simulated transactions in very ambiguous terms. However, I also mentioned that a narrower and better-defined meaning of simulation results when contrasting simulated and indirect transactions.[46] This second category of transactions permits the parties to achieve an economic result different from the standard economic result for that type of transaction, often allowing them to avoid some statutory regime. A contract of sale operating as a security is a standard example. While the typical result of a contract of sale is the exchange of goods for money, the parties can structure a contract of sale to operate like a security. In turn, by using a contract of sale as a security, the parties may avoid statutory regimes applicable to mortgages and pledges. Although not invariably, legal scholars have predominantly argued that simulated transactions and indirect transactions are not the same. In the case of an indirect transaction, the parties conclude a 'real' transaction that they actually intend

[46] See Chapter 1, section II.3.2.

with a view to achieving an economic result that is somehow distinct from the documentary form they have used. This distinction, in turn, permits the conclusion that simulated transactions in the narrow sense do not consist of transactions that permit the parties to achieve an economic result that is different from the typical result of the documentary form they have used. Simulated transactions, as was found in Chapter 1, do not consist of transactions where the parties achieve an unusual economic result or that circumvent mandatory law. Rather, they consist of transactions where the parties intend rights and obligations to be governed differently from the rights and obligations the documentary form recites.

As this section will show, an alternative and broad meaning of simulation that emerges in applying mandatory law rests on the ambiguity of the common definitions of simulated transactions. The ambiguous definitions of simulated transactions permit courts to intermingle the doctrine of simulation and the doctrines of indirect transactions and transactions in *fraud legis*, without apparently needing to formulate a different doctrine. The notion of simulation is formulated in sufficiently flexible terms to make them mean different things. Accordingly, courts do not explicitly contradict,[47] and sometimes they even say to endorse[48] the distinction between simulated and indirect transactions. However, relying on their ambiguity, the actual practice of the courts gives this distinction a flexible and sometimes even an inconsistent meaning. As a consequence, they sometimes consider as cases of simulation not only transactions where the parties recite rights and obligations to conceal other rights and obligations, but also transactions where the external form used by the parties and the rights and obligations that they create are used to achieve an ulterior and arguably unlawful economic result. Thus, in the example of the sale operating as a security, depending on the context, courts may say that the real 'intention' of the parties was to conclude a security and that there is a simulation, since the form of contract of sale would be

[47] This is particularly the case of some cases decided by the French *Cour de Cassation*, where the court argues that whether a transaction is simulated or indirect (and in particular whether a donation is disguised or indirect) is a matter of fact and not a point of law. Accordingly, concludes the court, deciding this issue depends on lower courts not being subject of revision by the *Cour de Cassation*. See, Civ. 1re, 5 Oct. 1960: Bull. civ. I, n. 419; Civ. 1re, 12 Oct. 1964, no. 61-11.355, Civ. 132

[48] In Italy, Cass. 8 Ago. 1946, n. 1130, *Foro it.,* 1947, I, 459; Cass. 30 Dic. 1954 n. 4638, in Giur it. 1955, I. i. c. 503; Cass. 12 Jun. 1971, n. 1970; Cass. 23 Jan. 1971, n. 146; Cass. 9 dic.1982, n. 6273.

concealing what is in substance a security; or they may simply say that a contract of sale was structured as an indirect transaction to operate as a security.[49]

To illustrate how this broad account of the doctrine of simulation operates in practice, the following section provides one example per jurisdiction.

1. France: indirect and disguised donations

In French law, indirect and disguised donations are not the same.[50] In a disguised donation the parties create the appearance of concluding an onerous transaction to conceal the gratuitous transaction governing their internal relationship.[51] Disguised donations are therefore characterised as a type of simulation. By contrast, in an indirect donation, the parties conclude one transaction that, although not in the form of an act of donation, achieves the economic result of one, namely enriching one party at expense of the other.[52] An example of a disguised donation would be when the parties execute the deed of sale concealing that, contrary to the deed, they do not expect one party to pay the price in exchange of the purchased goods but rather that the goods be transferred gratuitously. Another example of a disguised donation is the acknowledgment of a fictitious debt, which the apparent debtor and creditor both secretly understand does not bind them.[53] Examples of indirect donations, in turn, are the renunciation of the rights in a succession when made by one of the beneficiaries to benefit another beneficiary in the succession. Life insurances in certain cases and the payment of someone else's debt may also consist in indirect donations.[54]

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[49] See this Chapter, section II.3, referring to the application and construction of art. 2744 of the Italian Civil Code.
[50] Jacques Ghestin, Christophe Jamin and Marc Billiau, *Traité de Droit Civil, Les effets du contrat* (3th edn, LGDJ 2001) 930, para [869]; Florence Deboissy, *La Simulation en Droit Fiscal* (1997 LGDJ, Lextenso éditions) 45-54, paras [118]-[144]; Philippe Malaurie and Claude Brenner, *Les Successions, les libéralités* (6 edn, LGDJ 2014) 230, para [440]; Thomas-Debenest Geneviève, 'Art. 931 - Fasc. 20 : Donations et testaments. – Donations entre vifs. – Forme. Absence d'acte authentique' JurisClasseur Civil Code <https://www.lexis360.fr> accessed on 07/01/2021; François Terré, Yves Lequette and Sophie Gaudemet, *Droit civil, Les successions, les libéralités* (4th edn, Dalloz 2014) 511-512, para [570].
[51] Terré, Lequette and Gaudemet (n 50) 501, para [557].
[52] Malaurie and Brenner (n 50) 230, para [440].
[53] For these and more examples see Malaurie and Brenner (n 50) 227, para [434] and Terré, Lequette and Gaudemet (n 50) 504-507, paras [561]-[563].
[54] For these and more examples, see Malaurie and Brenner (n 50) 231-236, paras [441]-[451] and Terré, Lequette and Gaudemet (n 50) 513-517, paras [572]-[577].

The essential difference between the two, is that in a disguised donation, the documentary form used by the parties gives the appearance that the parties are creating certain rights and obligations when they intend to be bound by other rights and obligations. By contrast, in an indirect donation the documentary form used by the parties does not create a misleading appearance of the rights and obligations of the parties, only that from an economic perspective it operates as a gratuitous transaction. In other words, only disguised donations are cases of simulation.[55] Indirect donations, in contrast, may consist in indirect transactions and in some cases transactions in *fraudem legis.* In this they differ from simulations.[56]

Even though this distinction may seem clear in principle, French courts sometimes blur the line that divides the two kinds of explanation. It is not that they explicitly deny the distinction, but only that, in practice, they often characterise and apply the rules of disguised donations to transactions that correspond to indirect transactions.[57] This is the case, for instance, in sales at undervalue, where the parties conclude a sale establishing a price which is the same as the price the seller and the buyer intend to receive and pay respectively but deliberately (and considerably) below its fair market value.[58] Likewise, courts sometimes have characterised as a disguised donation the arrangements of the co-heirs where they undervalue some of the assets of the estate and then in the distribution of the estate benefit some heirs at the expense of others.[59] Finally, and to give only one more example, courts often characterise as a disguised donation sales where a third party, and not the buyer, is the one who pays the price.[60]

These are all cases where the external form used by the parties does not create the appearance of certain rights and obligations to conceal others: (1) in the sale at undervalue the price established by the parties is the price they actually intend to pay

[55] Malaurie and Brenner (n 50) para [440]; Terré, Lequette and Gaudemet (n 50) 501, para [557].
[56] Terré, Lequette and Gaudemet (n 50) 511, para [570].
[57] Terré, Lequette and Gaudemet (n 50) 505-507, 511-512 paras [562-563], [570]; Deboissy (n 50) 44, para [116].
[58] Cass. com. 7 Jul. 2021 no. 19-16.446. Considering sales at undervalue as indirect donations Cass. civ. 1re, 6 Jan. 1969 : Bull. Civ. I, no. 8; Cass. civ. 1re, 12 Oct. 1964:
[59] Malaurie and Brenner (n 50) 231-232, para [442].
[60] Terré, Lequette and Gaudemet (n 50) 506-507, para [562].

and receive; (2) in the act of liquidation and distribution of the assets of the estate, the co-heirs do not conceal their rights in the estate; (3) in the sale where a third party pays the price for the purchaser, the deed of sale attests the rights and obligations of the contracting parties but somebody else decides to fulfil all or some of those obligations. In other words, there is nothing being projected *vis-à-vis* third parties concealing the rights and obligations binding the parties. Accordingly, there is nothing really simulated. However, French courts still sometimes decide to consider these transactions as disguised and not as indirect donations.

The reasons motivating courts in taking this approach will be addressed in more length in section 4 of this chapter. For now, it suffices to note that French law is more benevolent with indirect donations than with disguised donations. While they are both valid, disguised donations are a case of simulation, while indirect donations are not. Accordingly, and pursuant to art. 1201 of the Civil Code, in the case of a disguised donation third parties having an interest in the transaction, including heirs and creditors, have the option to either accept the effectiveness of the apparent onerous transaction, or to bring an action of simulation to uncover and make effective *vis-à-vis* third parties the concealed gratuitous transaction.[61] In contrast, the rules of simulation do not apply to indirect transactions.[62] In addition, art. 911 of the French Code prohibits disguised donations but not indirect donations in favour of people lacking capacity to receive them (and until 2004 art. 1099-2 also prohibited disguised but not indirect donations between spouses).[63] Finally, but not least, for tax purposes disguised donations may constitute a case of abuse of right, triggering important tax liabilities and penalties, which is not the case of indirect donations.[64] In other words, courts can extend the application of arts. 1201 and 911 of the Civil Code and also some tax liabilities if the transaction concluded by the parties is characterised as a disguised or simulated transaction and not as an indirect one.

[61] Malaurie and Brenner (n 50) 228-130, paras [437]-[439]. See also Chapter 4, section I.2.
[62] Deboissy (n 50) 47 para [123].
[63] Malaurie and Brenner (n 50) 229-230, para [439]; Deboissy (n 50) 47 para [123].
[64] Deboissy (n 50) 47-52, paras [124]-[135].

2. Chilean courts and the use of the doctrine of simulation to protect the 'legítima'

Chilean courts are sometimes flexible about the practical meaning of a simulated transaction. They may consider a transaction to be simulated not only when it satisfies the requirements set by the narrow explanation outlined in Part I of this dissertation but also when it is found to be in fraud of some statutory right. A good example of this trend is how they sometimes use the doctrine of simulation to protect the 'legítima' from lifetime donations made by the deceased.[65]

The 'legítima' consists in the share in the estate that the law mandates the testator to assign to certain family members called 'legitimarios'.[66] Since an easy way for testators to circumvent forced heirship would be to dispose of the assets during their lifetime, the share corresponding to each 'legitimario' is calculated so that it takes into account not only the assets owned by the deceased at the time of death, but also the assets the deceased has given away by way of *inter vivos* donations.[67] Moreover, if the assets disposed of in testamentary bequests and *inter vivos* donations exceed the portion of the estate that the testator was free to dispose of, a 'legitimario' can bring an action for reduction of the testamentary bequest ('acción de reforma de

[65] A second example of this trend is found in decisions concerning lease agreements in fraud of the Law of Indigenous Land No. 19.253. Among other decisions, see Corte Suprema, 21 Mar. 2022, Rol Nº 53104–2021.

[66] It is not necessary to go into details for the purpose of the example given here, but Chilean succession law if a bit more specific. In Chile, testamentary freedom is subject to the limitations of the 'legitima' and the 'mejora'. Both the 'legitima' and the 'mejora' are a portion in the estate, proprietary in nature, and not a monetary claim. The 'legítima' corresponds to two quarters of the estate and the 'mejora' to one quarter. Although the persons entitled to these two compulsory portions are essentially the same (descendants, surviving spouse, and ascendants in the absence of descendants and surviving spouse) there are some differences. The beneficiaries of the 'legítima', called 'legitimarios', and the amount of their share are entirely defined by mandatory legal provisions. In contrast, the testator is entitled to make some decisions about the beneficiaries of the 'mejora'. The testator is free to assign and distribute the 'mejora' as per his or her will among the potential beneficiaries of the 'mejora'. In addition, while the 'legítima' cannot be assigned to grand-children if the immediate descendant is alive when the decease dies, the potential beneficiaries of the 'mejora' include remote descendants (a grandchild, for instance), even if the immediate descendant is alive when the succession is opened. See Ramón Domínguez Benavente and Ramón Domínguez Águila, *Derecho Sucesorio. Tomo II* (3th edn, Editorial Jurídica de Chile 2011) 915-977; Jan Peter Schmidt, 'Forced Heirship and Family Protection in Latin America*',* in Kenneth G C Reid, Marius J de Waal, and Reinhard Zimmermann (eds.) *Comparative Succession Law: Volume III: Mandatory Family Protection* (OUP 2020) 188.

[67] Domínguez Benavente and Domínguez Águila (n 66) 978-1053.

testamento') and, in second place if it is still necessary, an action to revoke the *inter vivos* donations ('acción de inoficiosa donación').

The 'legitima' imposes substantial constraints on testamentary freedom. It is of no surprise, then, that wealthy people in Chile usually find a way to dispose of their assets avoiding both wills and *inter vivos* donations. Therefore, and among other will substitutes,[68] they set up companies and similar legal entities, constitute life annuities, or simply sell assets at undervalue to achieve the result of transferring assets gratuitously, or at least with some components of gratuity but not in the form of wills and donations.[69] It is in challenging these sorts of transactions where the doctrine of simulation plays an important role.[70] The argument for challenging these transactions is that although they appear to be onerous in nature, in reality they conceal a donation, and accordingly that they are void for they lack the statutory formality.[71] Thus, in this context the doctrine of simulation sometimes takes a broader content. Chilean courts often conclude that a transaction is simulated based only on indirect evidence concerning the economic motives of the parties and the result they achieve. Thus, for instance, a price below fair market value,[72] the fact that the transaction is of no benefit to the transferee,[73] the relationship between the parties[74] and other similar circumstances related to the economic results of the transaction are usually considered enough proof of simulation. One can say that in Chilean judges' minds, this indirect evidence proves that the intention of the parties was to conclude a

[68] For a comparative study of will substitutes see Alexandra Braun and Anne Röthel (eds), *Passing Wealth on Death. Will-Substitutes in Comparative Perspective* (Hart 2016).
[69] Manuel Alejandro Barría Paredes, 'Las asignaciones forzosas en Chile. Su estado actual y una posible revisión' (Tesis Doctoral, Universidad Católica de Chile 2013)160-163.
[70] See, among many other cases where the doctrine of simulation has been used for this purpose, Corte Suprema, 17 May. 2012, Rol N° 12193-2011; Corte Suprema, 13 Jan. 2014, Rol N° 9631-2014; Corte Suprema, 22 Oct. 2015, Rol N° 5183-2015; Corte Suprema, 24 Nov. 2016, Rol N° 2968-2016; Corte Suprema, 21 Sep. 2017, Rol N° 59-2017; Corte Suprema, 12 Mar. 2021, Rol Nº 6.711-2019; Corte Suprema, 4 Nov. 2021, Rol Nº 12.987-2019; Corte Suprema, 15 Sep. 2021, Rol No. 9793-2019.
[71] See, for instance, 'Diaz, María contra Quijano Mario, Corte de Apelaciones de Santiago, 10 jul. 1985', in Raúl Tavolari (ed), *Jurisprudencias Esenciales, Tomo II* (Ed Jurídica de Chile 2010) 85.
[72] Corte Suprema, 24 Nov. 2016, Rol N° 2968-2016; Corte Suprema, 4 Nov. 2021, Rol Nº 12.987-2019, in the context of transactions defrauding the 'legítima'. See also Corte Suprema, 26 May. 2011, Rol N° 6537-2009; Corte Suprema 26 Dic. 2011, Rol N° 2950-2011; Corte Suprema, 30 Mar. 2017, Rol N° 76454-2016; Corte Suprema, 26 Sep. 2018, Rol N° 35311-2017, for other contexts.
[73] Corte Suprema, 23 Mar. 2016, Rol N° 2284-2015.
[74] Corte Suprema, 26 May. 2011, Rol N° 6537-2009; Corte Suprema, 23 Mar. 2016, Rol N° 2284-2015; Corte Suprema, 24 Nov. 2016, Rol N° 2968-2016; Corte Suprema 26 Dic. 2011, Rol N°. 2950-2011; Corte Suprema, 30 Mar. 2017, Rol N° 76454-2016.

donation under the form of other transactions to evade the ‘legítima’, and not the apparent onerous transaction that they are pretending to conclude.

As in the case of French donations, it is important to notice that this broader meaning of simulated transactions paves the way for Chilean courts to apply mandatory legislation to facts that otherwise might be beyond its scope. The ‘legitima’ is protected not only from *inter vivos* donations taking the form of a contract of donation, but also from other transactions that produce a similar economic result.

3. Sales for security purposes and the prohibitions of the ‘patto commissorio’

The final example of the application of the anti-avoidance variant account of the doctrine of simulation concerns the prohibition of the ‘patto commissorio’ contained in Article 2744 of the Italian Civil Code.

In Italian law, when a pledge or a mortgage is created, the secured creditor acquires a real right to force the sale of the asset given in security and to be paid from the proceeds of the sale.[75] The secured creditors do not have a direct right to acquire ownership of the property. Moreover, for various reasons relating both to the weakened position of debtors and to the equal treatment of creditors (*par condictio creditorum*),[76] article 2744[77] of the Italian Civil Code declares void the foreclosure agreement (the ‘patto commissorio’) between the debtor and the secured creditor which provides that the ownership of the property mortgaged or given in pledge shall pass to the creditor in case of default in the payment of the debt. Pursuant to art. 2744 such agreement is void and of no effect.

[75] Francesca Fiorentini, ‘Il pegno’, in A. Gambaro and U. Morello (ed.) *Trattato dei diritti reali. V. Diritti reali di garanzia* (Giuffrè 2014) 126.
[76] For a discussion concerning the different reasons justifying this provision see Alessio Reali, ‘La fiducia a scopo di garanzia, la vendita con patto di riscatto e il divieto del patto commissorio’ in A. Gambaro and U. Morello (ed.) *Trattato dei diritti reali. V. Diritti reali di garanzia* (Giuffrè 2014) 517, 522-578.
[77] Pursuant to art. 2744 ‘*any agreement establishing that, upon failure to pay the claim within the fixed time limit, ownership of property mortgaged or given in pledge passes to the creditor is void. Such agreement is void even if subsequent to the establishment of the mortgage or pledge*’.

The doctrine of simulation has played an important role in the interpretation and application of this prohibition.[78] Until the 1980's, Italian courts and some legal scholars[79] considered that Article 2744 was not applicable to a sale where the seller promised to purchase back the property that was the subject of the sale in a given date, provided that the sale was *real and not simulated* for the purpose of concealing a secured loan. In turn, Italian courts considered that the sale was real if the property was transferred to the purchaser at the time of the sale and not afterwards.[80] If the transfer of the property was made conditional upon the seller's default in purchasing back the sold property, the sale was considered to be simulated, and the real transaction was a secured loan in breach of art. 2744 of the Code.[81] As may be expected, this interpretation assumed that the instantaneous transfer of property was also 'real' and not simulated. If this were not the case, and the parties declared that the property was transferred and acquired by the purchaser at the time of the sale, but it was kept by the seller until he or she failed to fulfil the promise to pay back the price, courts considered that the transfer was simulated and concluded for the purpose of concealing a secured loan.

Putting this simply, the application of Article 2744 to contracts of sale concluded for security purposes depended on whether the sale was simulated or not, and this question, in turn, depended on whether the transfer of property that apparently took place at the time of the sale was simulated or not.

This is where courts gave the notion of simulated transactions the broad meaning described in this Chapter. They often concluded that the apparently instantaneous transfer of property was simulated based on circumstantial evidence concerning the purpose of the parties of obtaining the economic result of a secured loan, and not the rights and obligations they were creating. Thus, for instance, the disproportion between the fair market value of the property and the price declared by the parties, or the fact that the seller kept possession of the assets after the sale, or that the price

[78] For a short but illustrative account of how the decisions of Italian courts evolved in this matter, see Francesca Fiorentini, 'Garanzie reali atipiche' (2000) Rivista di diritto civile 253. See also Mauro Bussani, *Il problema del patto commissorio* (Giuffrè 2000) 203-277.
[79] Domenico Rubino, *La Compravendita* (Giuffrè 1952) 489.
[80] Cass. 31 Mar. 1955, n. 956, in *Giur agr it*, 1956, p. 29.
[81] Massimo Bianca, *Il divieto del patto commissorio* (Giuffre 1957) 282-284.

that the seller was bound to repay was considered a premium, were regarded as critical evidence to prove that the apparent immediate transfer had not taken place.[82] In other words, the fact that the parties used the sale to achieve the economic result of a security in breach of art. 2744 was considered sufficient evidence that the apparently instantaneous transfer of ownership and the apparent sale was simulated, and accordingly that the apparent sale was in reality a cover for a secured loan. As put by Francesco Realmonte:[83]

> 'In substance, and more or less consciously, the approach adopted by courts was based on the assumption of an alleged structural incompatibility between a security function in its technical meaning and an instantaneous transfer of ownership.'

In this way, and without formally contradicting the principle of when a transaction is simulated, courts reached the result where they applied the doctrine of simulation to transactions where the parties did not conceal their rights and obligations but only used a contract of sale as an indirect transaction to achieve the economic result of a secured loan.[84] Interestingly, and after some discordant decisions,[85] in the 1980s Italian courts started to construe Article 2744 in purposive terms, arguing that sale and buy-back agreements concluded for security purposes were 'real' transactions but that might be in breach of this provision.[86] Because of this purposive interpretation, courts no longer used the doctrine of simulation for the application of this provision. They held instead that sales for security purposes were not simulated but that they might be in *fraudem legis*, and therefore void for being in breach of art. 2744 of the Code.[87]

Before moving on, it is useful to summarise sections 1 and 2. Both sham transactions and simulation sometimes take a different and broader meaning than the

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[82] Francesco Realmonte 'Stipulazioni commissorie, vendita con patto di riscatto e distribuzione dei rischi' *Foro it* (1989) 1140, 1440-1441.
[83] Realmonte (n 82) 1440.
[84] Bianca (n 81) 281.
[85] This new approach started with the decision Cass., 3 Jun. 1983, n. 3000, in *Foro it.,* 1984, I, col. 212 ss.
[86] A key decision in consolidating this new understanding was Cass. Sez. Un. 3 Apr. 1989, n. 1611, in *Foro it*, 1989, I, c. 1428 ss.
[87] Reali (n 76) 519-521.

one analysed in Part 1 when they are used to apply mandatory law. Sham and simulated transactions in this broad sense no longer need to be those where the parties deliberately recite certain rights and obligations in the documentary form that differ from the rights and obligations internally governing their legal relationship. Sham and simulated transactions in this broad sense may also consist in a transaction where the parties use a documentary form for the purpose of achieving an economic result that defeats or circumvents a statutory provision. For the same reason, finding that a transaction is a sham and a simulation in this alternative sense permits courts to extend the application statutory provisions to transactions that arguably fall within the purpose of the statute although the documentary form used by the parties makes this circumstance obscure. Let us now take a closer look at this broad sense of sham and simulation to observe some relevant differences in form across different jurisdictions.

III.
Comparison

As sections 1 and 2 of this chapter have shown, in all the jurisdictions considered in this dissertation, courts have found that transactions that avoid mandatory law are shams and simulations in a sense that is broader than the narrow sense discussed in Part 1. In this regard, it is a common feature that these doctrines share in all these jurisdictions. Yet it is also noticeable that this broader explanation of sham and simulated transactions emerges differently in different jurisdictions, particularly when it comes to comparing English law, on the one hand, and Italian, French and Chilean law, on the other. In English law the broad sense of sham transactions is formulated in more explicit terms than in its civilian counterparts. This difference is unpacked below.

In English law, legal scholars and courts are conscious that in some contexts a transaction may be found to be a sham in a sense that differs from *Snook* and *Hitch v Stone*. That is why Lord Templeman in *Antoniades* preferred the terminology of 'pretence' instead of 'sham',[88] and it is also why in *Bankway* Arden LJ observed that

[88] *Antoniades* (n 26) 462 D- 466 A.

'there is a variant on the usual definition of sham'.[89] In contrast, in France, Chile and to some extent Italy, courts seem to be less conscious (or at least they are less explicit in admitting) that they are resorting to a doctrinal development different from the strict and narrow meaning of simulation. Perhaps for the same reason, when in English law courts have found a transaction to be a sham in the broad sense explored in this Chapter it has been criticised in the scholarly literature,[90] which has led to a retreat by courts to the narrow sense.[91] In the civilian jurisdictions legal scholars have sometimes reacted against this less rigorous use of the doctrine of simulation.[92] Yet courts have navigated from the narrow sense to the broader sense and then back to the narrow sense, only to move again to a broad meaning, without giving much justification for these different approaches and, it seems, without much regret.

As this section shows, there are at least three reasons that may explain why in English law the broad meaning of sham transactions has developed in more explicit terms than in the civilian jurisdictions analysed here.

1. The use of ambiguous legal categories to define simulated transactions

One reason for the difference lies in the ambiguity of the categories that legal scholars use to define simulated transactions. The more ambiguous these categories are, the more discretion courts have to broaden the interpretation of simulated transactions. As discussed in Chapter 1,[93] and reiterated in Section 2 of this Chapter, the ambiguous legal categories allow courts to determine whether the divergence between form and substance pertains solely to the rights and obligations created by the parties or also to any ulterior economic results they may achieve. As we saw in Chapter 1, the terms 'intention' and 'contracts', for instance, are vague enough to admit the two possibilities.

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[89] *Bankway* (n 32) [43].
[90] Vella (n 18) 505-511.
[91] See Simpson (n 17) who argues that English courts sometimes depart from *Snook* (n 1) towards wider formulations of the sham doctrine to then often retreat and move back to *Snook*.
[92] See, for instance, Jean-Denis Bredin, 'Remarques sur la conception jurisprudentielle de l'acte simulé' (1956) 54 RTD civ. 261, 262-269.
[93] See Chapter 1, section II.3.1.

When it comes to the doctrine of sham transactions, the picture is considerably different. The so-called canonical definition[94] of sham transactions formulated by Lord Diplock in *Snook* makes very clear that the mismatch that defines a sham is between the rights and obligations that appear in the face of the *document* executed by the parties, on the one hand, and the *real rights and obligation* they intend to create, on the other.[95] These concrete terms (documents, rights and obligations) have a more definite and clearer meaning. As a result, it is harder for courts to apply the doctrine of sham transactions to transactions where the parties did not conceal their rights and obligations. English courts are therefore forced to explain their reasoning if they depart from the narrow explanation of sham transactions.

2. The significance of the economic result of legal transactions in defining their legal nature

A second reason is that in France, Chile and Italy, the economic result of a legal transaction cannot be easily separated from its legal content. Therefore, there is a natural tendency to understand that the definition of a sale, a donation, or any other transaction, includes not only the rights and obligations the parties create but also the economic result they achieve.

There are a number of doctrines that show this proximity between the legal nature of a legal transaction and its economic result. A good example is the doctrine of the *cause*, which I have referred to before.[96] As it is well known, the *cause* as a requirement for the validity of contracts and legal transactions has acquired different meanings throughout history. Some of these meanings include the subjective purpose of the parties[97] and the economic function of the transaction.[98] Accordingly, in the civilian jurisdictions considered here legal transactions are binding not only because

[94] *A v A* [2007] EWHC 99 (Fam) [32], per Munby LJ.
[95] *Snook* (n 1); *Hitch* (n 2).
[96] See Chapter 1, section II.3.1.ii and iii.
[97] Louis Josserand, *Les mobiles dans les actes juridiques du droit privé* (Dalloz 1928).
[98] For France François Terré and others, *Droit Civil. Les obligations* (12th edn, Dalloz 2013) 439-452, paras [395]-[405]. For Italy C. Massimo Bianca, *Diritto Civile. 3. Il contratto* (3rd edn, Giuffrè 2019) 409-420, paras [220]-[225] and Francesco Galgano, *Il negozio giuridico* (Giuffrè 2002) 99-119. For Chile, José Joaquín Ugarte Godoy, *Curso de Derecho Civil. El acto jurídico: elementos esenciales* (Thomson Reuters 2024) 417-469; José Rivera Restrepo, 'Una mirada a la doctrina de la causa y sus distintas versiones en el Código Civil Chileno' (2011) 2 Rev. Derecho Universidad Católica del Norte 305.

the parties consented to create certain rights and obligations, but also because their motives and (or) the economic function of the transaction qualify as a sufficient *cause*.[99] These two meanings of *cause*, in turn, often match with the economic result the parties achieve. The doctrine of the *cause*, then, connects the nature and character of a legal transaction with the parties' motives and the economic function that the transaction performs.

The doctrine of 'indirect transactions' is a second and related example. Legal scholars observed that transactions do not always produce the economic result that they are supposed to produce.[100] And they found this problematic. They found an inconsistency in that a transaction may permit the parties to achieve a result different from the 'typical' result of that type of transaction. The example of this dichotomy that is often mentioned is of the contract of sale for security purposes. The ordinary and typical result of a contract of sale, a civilian jurist would say, is to transfer goods and services in consideration of a sum of money. How then can the parties use a contract of sale for obtaining fresh resources, on the one side of the bargain, and a right of being repaid plus a premium guaranteed by an asset, on the other? To address this inconsistency, legal scholars and courts defined indirect transactions as a term of art and occupied themselves in discussing their validity and efficacy.[101]

It is easy to see how this proximity between the constituent elements of a legal transaction and their economic result affects the understanding of the doctrine of simulation. In the minds of civil lawyers, the fact that a contract of sale is not a 'real' sale, but a simulated one, concealing a security may mean a number of different things. It may mean that the parties consciously recited rights and obligations different from the ones that they intended to govern their legal relationship. It may also mean that the economic result the parties achieved is the one of a security and not of a sale. Both things may count as to what make a transaction a 'real' security.

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[99] Emilio Betti, *Teoría General del Negocio Jurídico* (A. Martín Pérez tr., Olejnik 2018) 151-177, paras [20]-[24].

[100] Bianca (n 81) 275-284; Bianca (n 98) 441-443, para [236].

[101] Luigi Cariota-Ferrara, *I negozi fiduciari* (CEDAM 1933)121-129, Betti (n 99) 291-293, para [50], Franco Anelli, *Simulazione e interposizioni,* in V. Roppo (ed.). *Trattato del Contratto. III. Effetti* (2nd edn, Giuffrè Editore 2023) 681-686.

In English law the picture is different. The ultimate motives of the parties and the economic function of a transaction play a less significant role in defining the legal character of a transaction.[102] As Megarry J observed 'if what is done is genuinely done, it does not remain undone merely because there was an ulterior purpose in doing it'.[103] There is no such a thing as a structural element of every transaction consisting of the economic function it satisfies or the purpose of the parties. Thus, the decision of an English court on the allegation that a sale is a security, or that a licence in reality is a lease, or any other allegation of sham, depends mainly on the rights and obligations the parties create and not on the economic result of the transaction. This logically restricts the discretion of English courts to declare a transaction a sham on the basis of the economic result the parties achieve.

3. The relevance of indirect evidence in proving simulated and sham transactions

A final reason that may explain why in civilian jurisdictions the narrow and broad explanations of the doctrine of simulation are often intermingled is the extent to which indirect evidence is sufficient to prove that a transaction is simulated.

It comes as no surprise that the party asserting that a transaction is simulated bears the burden of proof.[104] However, when the allegation is made by a third party, or the party alleging the simulation also claims to be a victim of fraud by the counterparty, there is a flexible approach to the rules on admissibility and probative value of the evidence submitted to the court.[105] Thus, the restrictions on the competence of witness and the requirements of written evidence do not apply, and instead any sort of evidence is admissible, including indirect evidence.[106] Moreover, at least in some jurisdictions, such as Italy and Chile, indirect evidence is admittedly

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[102] *Chase Manhattan Equities Ltd v Goodman and others* [1991] BCLC 897, 921-923 per Knox J.
[103] *Miles v Bull* [1969] 1 QB 258, 264 B.
[104] Jacques Ghestin et Bernard Desché, *Traité des contrats. La vente* (LGDJ 1990) 471.
[105] See Chapter 2, section IV.1.
[106] In Italy, Francesco Galgano, *Della simulazione, della nullità del contratto, della nullità del contratto, dell'annullabilità del contratto. Art. 1414-1446* (Zanichelli Editore 1998) 57-59. In France, Marcel Planiol et Georges Ripert, *Traité Pratique de Droit Civil Français, Tome VI Obligations* (2 edn, LGDJ 1952) 285; Claude Ophèle, 'Simulation' in Éric Savaux (eds), *Répertoire de Droit Civil,* Tome X (Dalloz 2012); Terré and others (n 98) 801, para [740]; In Chile Daniel Peñailillo A, 'Cuestiones teórico-prácticas de la simulación' (1992) 191 R Derecho U de Concepción 7.

of particular significance, where the artificiality of the transaction and the purpose of the parties to evade legislation or defraud a third party are some of the key items of evidence proving that a transaction is simulated.[107] Thus, for instance, the facts that the price is far below the fair market value of the property sold, or that the transaction does not confer any economic benefit on the seller, or that there is a close relationship between the parties to the transaction, or finally, that simulating the transaction allows the parties to evade legislation or defraud a third party's right are all indirect evidence that may support the conclusion that a simulation exists.[108] In addition, at least in Chile, courts expressly admit that they have more discretion when simulations are alleged than in ordinary cases to decide the probative value of the evidence submitted by the parties.[109]

This flexible approach to the proof of simulation contrasts to the approach taken by English courts, or at least the one English judges say that they take. As in the case of simulation, the burden is on the party asserting the existence of a sham[110] and the parties can submit any evidence to prove this allegation, including the subsequent conduct of the parties.[111] That said, in practice, courts take a more cautious approach. The artificiality of the transaction might be an indication of a sham but in no case is that sufficient evidence.[112] '[T]he allegation of sham is a serious matter'[113] and

> 'there is obviously a strong presumption, even in the case of an artificial transaction that the parties to what appear to be perfectly proper

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[107] In Italy, See Francesco Ferrara, *Della simulazione nei negozi giuridici* (2nd edn, Soc. Editrice Libraria 1905) 307-320. In Chile, D Peñailillo A (n 106).

[108] This more flexible approach to the rules of proof in the doctrine of simulation has a long tradition in history and it traces its origins to the *ius commune*. See Emilio Bussi, *La formazione dei dogma di diritto private nel diritto commune* (Cedam 1937) 289-290; MD Blecher, 'Simulated Transactions in the Later Civil Law' (1974) 91 S African LJ 358, 370-371. It is an understandable solution to the difficulty that parties may find in submitting direct evidence of something that by definition is concealed. See in this regard Ferrara (n 107) 307 and D Peñailillo (n 106).

[109] Corte Suprema, 31 May. 2011, Rol N° 6489-2009; Corte Suprema, 25 Jun. 2012, Rol N° 1083-2012; Corte Suprema, 23 Mar. 2016, Rol N° 2284-2015; Corte Suprema, 24 Nov. 2016, Rol N° 2968-2016; Corte Suprema, 12 Dic. 2016, Rol N° 45940-2016; Corte Suprema, 30 Mar. 2017, Rol N° 76454-2016; Corte Suprema, 31 Jan. 2018, Rol N° 19126-2017; Corte Suprema, 3 Mar. 2020, Rol N° 14915-2018.

[110] *ND v SD and others (FINANCIAL REMEDIES: TRUST: BENEFICIAL OWNERSHIP)* [2017] EWHC 1507 (Fam) 184. Matthew Conaglen, 'Sham trusts' (2008) 67 CLJ 176,192.

[111] *AG Securities* [1990] 1 AC 417, 475-E; *Jones* (n 3) [42].

[112] *Jones* (n 3) [39].

[113] *A v A* (n 94) [69].

> agreements on their face, intend them to be effective, and that they intend to honour and enjoy their respective obligations and rights'.[114]

It has therefore been said that courts are slow to find a sham[115] and 'mere circumstances of suspicion do not by themselves establish a transaction as a sham'.[116] This is probably owing to two reasons. One is the primacy of objective inference of intention in legal transactions, and the importance of promoting the security of apparently legal and valid transactions. The second one is that in England sham transactions have occasionally seemed to be akin to fraud,[117] and the allegation of fraud has always been a 'serious matter'.

With these comparative remarks, the examination of the anti-avoidance explanation of the doctrines of sham transactions and simulation is completed. Now it is time to turn to a reconstruction of this explanation to explain its significance in the quest for the distinctive character of these two doctrines.

IV.
Sham and simulation as an instrument of indirect purposive statutory interpretation

The differences between sham and simulated transactions in the narrow sense and in the broad sense in the context of legal avoidance analysed in this chapter are fairly obvious. Every element that defines sham and simulated transactions in the narrow sense turns out to be either not applicable or irrelevant for sham and simulated transactions in the anti-avoidance meaning. It is intriguing, for instance, that almost none of the five points Arden LJ mentions in *Hitch*[118] to define the doctrine of sham transactions apply to the variant definition of sham she herself later formulated in

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[114] *Jones* (n 3) [46].
[115] *Jones* (n 3) [46]; *Vooght v Hoath* [2002] EWHC 1408 (Ch), 2002 WL 1876006.
[116] *Miles* (n 103) 264D-E. These statements of law have been later nuanced by Mostyn J in *Broxfield Limited v Sheffield City Council* [2019] EWHC 1946 (Admin) [25], observing that the question should be reframed as to whether 'the evidence satisfies the court that it is more likely than not that the arrangement was a sham'.
[117] See Chapter 3, section III.
[118] *Hitch* (n 2)

Bankway.[119] Likewise, all the discussion about the dual effects of the doctrines of sham transactions and simulation finds no place in sham and simulated transactions understood in this alternative sense.

The substantial difference between the two explanations leads to the question of how they relate to one another and what exactly the broad meaning of sham and simulation does in the context of legal avoidance. These questions are addressed below.

1. The broad sense of sham and simulation and its multiple functions

A brief look on the history may be a good starting point for answering these questions. Legal historians have observed that in Roman law, simulation did not have a technical meaning.[120] The verb *simulare* and the adjective *simulatus* were often used in their grammatical sense referring to a number of different situations that would be difficult to capture under a single doctrine. Likewise, the rubric of the Justinian's Code *plus valere quod agitur quam quod simulate concipitur* (C. 4, 22), which was the main source used by the medieval glossators and commentators for developing this doctrine,[121] contains five rescripts, most of them referring to situations that nowadays we would probably would not call simulation.[122] Only over time did a more defined meaning of simulation emerge, often attributed to the teachings of Baldus and Bartolus.[123] Among other important contributions, these jurists separated simulation from transactions *in fraudem legis* and in fraud of creditors.[124] Yet this more

[119] *Bankway* (n 32) [43].
[120] Blecher (n 108) 358-362. See also Reinhard Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Oxford 1996) 646-650.
[121] Zimmermann (n 120) 648.
[122] C. 4.22.1, declares that in contracts 'the truth of the matter rather than the writing ought to be looked at'. This rescript need not be restricted to cases of simulated transactions. It could apply to cases concerning contractual interpretation. C 4.22.2 provides that *acta simulata* cannot change the essential nature of the truth. The meaning of this rescript is vague enough to concern both cases of simulated transactions and other situations. Then, C. 4.22.3 runs that when a contract of pignus is disguised as a sale, not what is written but what is done is looked at. This is perhaps the rescript that seems to be more restricted to simulated transactions. C. 4.22.4 adds that if someone causes it to be written that someone else has done something which he himself has done, 'plus actum quam scripture valet'. Finally, C. 4.22.5 concerns a purported contract that is void for error *in negotio*. This last case is clearly not a case of simulation as that term has come to be understood.
[123] In Bussi (n 108) 284 we read that Baldus was 'il grande sistematico di questa materia'.
[124] Blecher (n 108) 368; Zimmermann (n 120) 649.

specialised meaning of simulation coexisted and was often intermingled with other meanings of simulation closer to the ordinary meaning these words have in common language. Thus, long after the commentators, both courts and jurists have used an ambiguous notion of simulation to refer to a number of different doctrines and institutions, including the narrow sense discussed in Part 1 of this dissertation, but also transactions *in fraudem legis*,[125] rules of contractual interpretation,[126] and mandates where there is an agent acting for an undisclosed principal,[127] just to give some examples.

In other words, alongside the technical and more precise meaning of simulation described in Part 1 as the narrow sense of simulated transactions, there is a broader, generic meaning of simulation. The ambiguity inherent in this generic meaning of simulation can encompass various doctrines and legal institutions, including the narrow sense analysed in Part, 1 and also the anti-avoidance meaning examined in this Chapter. However, it is not entirely devoid of content. It still provides courts with normative criteria. When a court finds that an act or transaction is simulated in this broad sense, it means that the legal meaning—and thus the legal consequences—of the act or transaction found to be simulated does not depend solely on its documentary form. In other words, if a court determines that a transaction is simulated in this broader sense, it is not bound to consider only the documentary form to determine its legal consequences.

While this ambiguous sense of simulation lacks precision and may not be the clearest or most certain guide, it remains relevant. It offers useful guidance to the courts in their decision-making process. In that regard, in an ideal legal system with fully developed doctrines, such an ambiguous meaning would be unnecessary, as courts would rely on more precise and well-defined doctrines. Yet, legal systems are not ideal. Law is in a constant state of development and judges may sometimes find it

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[125] See Chapter 1 n 120
[126] This was the case in early modern Scots law, where the Institutional Writer Lord Stair included the 'plus valere' rubric as one of the rules of interpretation of Writs (Stair, IV, 42, 21). The Court of Session also made use of this ambiguous notion of simulation as for construing Writs. See, for instance, *Alison and Black v Hart* (1701) Mor 14643; *Advocate v William Hamilton of Fallahall* (1711) Mor 5712; and *Ogilvie of Murthil v Lesly of Glaswell* (1715) Mor 4154.
[127] Agnès Dubois – de Luzy, *L'interposition de personne* (LGDJ 2010) paras 64-66; François Collart Dutilleul and Philippe Delebecque, *Contrats civils et commerciaux* (9th edn Dalloz 2011) para 661.

useful to rely on this ambiguous concept of simulation when more precise doctrinal tools are unavailable, or when they find themselves unable to formulate these doctrines in more precise language.

One can say then that the broad meaning of sham and simulation performs in first place a sort of residual function, providing courts with a principle broad enough to encompass many different situations that for whatever reason cannot be handled by more specific legal doctrines. In addition to this residual function, this broad meaning of sham and simulation performs a more specific function in more concrete contexts where courts and judges make use of this broad notion of sham and simulation. As this chapter has shown, one of these contexts is legal avoidance.

I turn to some observations concerning what exactly the broad meaning of sham and simulation does in the context of legal avoidance.

2. Sham and simulation as a device of purposive statutory interpretation

Here it may be helpful to contrast sham and simulated transactions in the narrow sense and sham and simulated transaction in the broad sense in the context of legal avoidance. The doctrines of sham and simulated transactions in the narrow sense are private law doctrines whose main focus rests on the rights and obligations that the parties create, on the one hand, and the protection of third parties, on the other. In this regard it is a doctrine within the field of private law in a very strict sense. Its subject matter is restricted to the interests of individuals as individuals. When it comes to the broad meaning in the context of legal avoidance discussed in this chapter, the picture is quite different. These doctrines are no longer concerned with the rights and obligations that the parties have created and intended as individuals, but with the extent to which they are permitted to contract out of statutory provisions driven by public policy goals, and the extent to which these public policy goals must be taken into account in applying these statutory provisions. For this reason, I disagree with Vella[128] when he argues that what Lord Templeman called 'pretence' would conflict with principles of the law of contract. The notion of 'pretence' is not a doctrine

[128] Vella (n 18) 508. His argument is sketched out in this Chapter, section I.2.

concerning the rights and obligations the parties create, but the meaning and scope of a statute driven by policy goals.[129]

Moving one step forward toward a more precise conceptualisation of what the broad sense of sham and simulation does in the context of legal avoidance, one may say that it ultimately serves as a veiled instrument of purposive statutory interpretation. By resorting to a broad sense of sham and simulation, courts do not need to bend the literal meaning of the words of the statutes. Instead, they bend the facts to make them satisfy the conditions required for the statute to apply.

To appreciate this point, we only need to consider the dilemma courts face when they determine the legal consequences of a transaction that achieves a result that arguably defeats the purpose of a statutory provision:

- On the one hand, they may be aware that there is a rule (or rules) contained in legislation according to which a given condition triggers a certain legal consequence. To mention some of the examples referred above: (1) English courts are aware that if A grants a lease conferring exclusive possession on B, the security of tenure introduced by the Rent Act 1977 applies; (2) French courts are aware that if C and D conceal a donation using the misleading form of a sale, a tax liability of D is triggered.

- On the other hand, courts may find that the transaction in question does not satisfy the words used by the relevant legislation to describe the condition that triggers its application, but that the transaction permits the parties to achieve an economic result that arguably is comprehended within its purpose. Thus, again following the previous examples: (1) A has reserved for him or herself some right to occupy the property and to introduce further occupants. Therefore, in a strict sense A has not granted a 'lease' as required by the Rent Act. However, given the circumstances, it is very likely that such right will never be exercised, and as a matter of economic result B will enjoy exclusive possession; (2) C and D did not conclude a fictitious

[129] For a similar argument, see McFarlane and Simpson (n 18).

sale but a sale for a low price. This transaction does not satisfy the words used by French tax legislation, but it is arguable that, if the legislation is read purposively, it should apply not only to simulated sales but also to sales at an undervalue.

When faced with these transactions, the courts have two straightforward alternatives. They can first conclude that they do not satisfy the conditions in the legislation, and therefore that they do not trigger the legal consequences that would otherwise follow. Alternatively, courts can consider that the purpose of the legislation is broader. They may conclude, that despite not falling within the exact words of the legislation, the result of the transactions nonetheless satisfies the legislative condition. They can therefore apply the legislation to the transaction.

For varied reasons, each of these options can be problematic. As to the first one, it has the disadvantage of tolerating transactions that although not fulfilling the words of the legislation can be notoriously undesirable and even pernicious for the legal system. This is particularly the case when, on the one hand, the legislation pursues a purpose that is highly valued by courts and general public, and therefore that they have a natural inclination to protect, and, on the other hand, the transaction concluded by the parties frustrates that purpose. As to the second one, the relevant legal system may not allow, or may at least restrict, purposive statutory construction.[130] In English law, for instance, while the strict formalism that prevailed until mid-20th century has been abandoned,[131] a purposive statutory interpretation still cannot allow courts to

[130] This was the case of England from the late 19th century to mid-20th century. In *R v Wimbledon Justices, ex p Derwent* [1953] 1 QB 380, 384, for instance, Lord Goddard CJ said: 'A court cannot add words to a statute or read words into it which are not there'. Then, Lord Parker CJ observed in *R v Oakes* [1959] 2 QB 350, 354 observed that where the literal reading of a statute 'produces an intelligible result, clearly there is no ground for reading in words or changing words according to what may be the supposed intention of Parliament'. Finally, to give one more example in *Jones v DPP* [1962] AC 635, 662, Lord Reid observed that '[i]t is a cardinal principle applicable to all kind of statutes that you may not for any reason attach to a statutory provision a meaning which the words of that provision cannot reasonably bear'.

[131] This was evidenced by Lord Diplock in *Carter v Bradbeer* [1975] 1 WLR 1204, 1206-1207, where he observed that looking back to the decisions of the Hose of Lords on question of statutory construction over the last 30 years 'one cannot fail to be struck by the evidence of a trend away from the purely literal towards the purposive construction of statutory provisions'.

deviate from the words of the statute.[132] Likewise, courts may be convinced that in a particular case it is correct to include the transaction within the purpose of the legislation, without being sure that this should always be the case in the future. They may not be able to formulate the true purposive understanding of the legalisation with sufficient clarity.

Here is where a broad sense of sham and simulation offers courts an alternative. By resorting to the broad sense of sham and simulation in the context of legal avoidance, the courts bend the legal nature of the transaction itself. In this way, they bring it within the triggering conditions of the relevant legislation. By admitting that in a sham and simulated transaction the divergence between form and substance can consist in using the rights and obligations the parties create as means to achieve an economic result that defeats a statutory provision, courts can attach to the transaction the legal effects provided in the legislation, without altering the literal content of the statutory rule.

The same result can be explained using the language of fictions.[133] If the court is unwilling or unable to formulate the statutory rule in purposive terms, it instead creates a sort of fiction about the transaction to make it to fulfil the condition in the relevant legislation. As fictions go, this is not too blatant, particularly in the civilian jurisdictions considered here, because courts may rely on the ambiguity of the legal categories in question, the proximity between the economic function and legal content of a transaction, and on the relevance of indirect evidence to mix the distinction between legal rights and economic result. Thus, courts create the appearance that the transaction satisfies the condition specified in the rule when, in reality, that might not be the case.

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[132] The current understanding is synthesised in Bennion, Bailey and Norbury, *Statutory Interpretation* [12.2] saying that while 'in construction an enactment the court should aim to give effect to the legislative purpose', purposive statutory interpretation still consists in interpreting the meaning of the words used by the legislator, for '[a] purposive construction of an enactment is a construction that interprets the enactment's language' in a way which best gives effects to its purpose. See generally Craies, *Legislation* [18.1.1]-[18.1.14].

[133] JH Baker, *The Law's Two Bodies: Some Evidential Problems in English Legal History* (OUP 2001) 33; Maksymilian Del Mar, *Artefacts of legal inquiry: the value of imagination in adjudication* (Hart 2020) 235-277.

For example, a broad sense of sham permits courts to argue (or *feign*) that A and B concluded a lease despite the right that A reserved to introduce further occupants, understanding that such clause was used to achieve an economic result that falls within the scope of the Rent Act 1977. Similarly, a broad meaning of simulation permits us to conclude that C and D made a donation even though they recited a contract of sale and there was a price to pay, because they achieved the economic result that they would have achieved if they had concluded a donation. Accordingly, the rule contained in French tax legislation applies to such transaction.

3. The broad sense of sham and simulation and other related legal doctrines

As seen in this section, in the context of legal avoidance sham and simulated transactions in the broad sense take on the function of an indirect purposive approach to statutory interpretation. If this is correct, one would expect that the more accepted purposive statutory interpretation is allowed in a legal system, the less prevalent the use of the broad sense of sham and simulation as a device of purposive statutory interpretation would be. If the legal system is equipped with doctrines to perform such function, there would be less need to rely on the broad sense of sham and simulation.

While a much more in-depth study is needed to corroborate this hypothesis, two examples suggest that it might be correct. One example is the application of the prohibition of the 'patto commissorio' in Italy. As already observed,[134] and after decades of using the doctrine of simulation, the courts decided to treat sales for security purposes as transactions in breach of art. 2744 of the Italian Civil Code. To make this change they substituted a purposive reading of this provision, facilitated by the doctrine of 'frode alla legge', for the doctrine of simulation. The change might have seemed more cosmetic than substantial. It did not change the fact that sales for security purposes were in breach of this provision and therefore void.[135] Yet it is arguable that this change was only possible because the doctrine of 'frode alla legge'

[134] See this Chapter, section II.3.
[135] Realmonte (n 82) 1440.

is recognised in the Italian Civil Code[136] and had been abundantly discussed in case law[137] and legal scholarship.[138]

A similar argument can be made when it comes to English law. After a period in which courts followed a strong formalist approach to statutory interpretation,[139] from the last decades of the 20th century they have increasingly favoured a purposive approach. They have even developed new doctrines allowing purposive statutory interpretation in areas of law where the traditional approach was markedly formalist.[140] This has been matched by a realisation that it may be more legitimate to rely on purposive approaches to interpretation than to resort to the anti-avoidance uses of the sham doctrine.[141] Connected to this, we might note an example from the time of Lord Esher's tenure as Master of the Rolls. In 1892 Lord Esher MR was a clear advocate of formalism in statutory interpretation, observing that '[i]f the words of an Act are clear, you must follow them, even though they lead to a manifest absurdity.[142] But in two of his other decisions at about the same time, he adopted a very flexible approach to the notion of sham, using it to achieve an anti-avoidance goal.[143] He had found the

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[136] Art. 1344 of the Italian Civil Code regulates the contract in *fraudem legis*, providing that a contract is considered to have an unlawful cause '*when it is a mean to circumvent an imperative legal rule*'.

[137] See, for instance, Cass. Sez. Un. 17 Jun 1981, n. 4414, rv. 415115; Cass. 26 Jan 2010, rv. 611488. In the latter decision, the Italian Supreme Court noted that in a contract in *fraudem legis* the means used by the parties, i.e. the contract itself, is lawful, but it is the result they obtain that is unlawful.

[138] See, Giovanni Giacobbe, 'Frode alla legge' in Francesco Calasso (ed), *Enciclopedia del Diritto XVIII. Foro-Giud* (Giuffrè Editore 1969); Umberto Morello, *Frode Alla Legge* (Giuffrè 1969) Umberto Morello 'Frode alla legge' in *Digesto delle Discipline Privatistiche. Sezione Civile VIII* (UTET 1992); Giuseppe Cricenti, *I contratti in frode alla legge* (Giuffrè 1996).

[139] See n 131 above.

[140] The most remarkable example is the so-called Ramsay Rule in the field of tax law. In the tax field courts were reluctant to accept a purposive statutory interpretation. The famous dicta of Lord Tomplin in *IRC v Duke of Westminster* [1936] AC 1, 19 incarnated this approach. However, in *WT Ramsay Ltd v Inland Revenue Comrs* [1982] AC 300 the House of Lords developed a new principle later coined as the Ramsay Rule that opened the gate for purposive statutory interpretation of tax legislation. The exact content of the Ramsay Rule has been a matter of a long litigation. A useful summary was made by Lewison J *in Berry v Commissioners for HM Revenue and Customs* [2011] UKUT 81. One should note that the Ramsay Rule has been also applied in non-tax cases as it was *Rossendale Borough Council v Hurstwood Properties* (A) Ltd [2021] UKSC 16. In this case an argument that the transaction in question was a sham was made but rejected in first instance and not raised again.

[141] McFarlane and Simpson (n 18); Edwin Simpson and Miranda Steward, 'Introduction' in Edwin Simpson and Miranda Steward (eds), *Sham Transactions* (OUP 2013) 3, 26; Shelley Griffiths and Jessica Palmer, 'Sham, Tax Avoidance, and a GAAR: A New Zealand Perspective' in Simpson and Steward (eds), *Sham Transactions* (OUP 2013) 228.

[142] In *R v City of London Court Judge and Payne* [1892] 1 QB 273, 290 he said that '[i]f the words of an Act are clear, you must follow them, even though they lead to a manifest absurdity. The court has nothing to do with the question whether the legislature has committed an absurdity',

[143] See Lord Esher MR opinions in *Re Watson* (n 12) and *Madell* (n 12) and the discussion of these decisions in this Chapter, section I.1.

way, whether deliberately or not, to do veiledly what he was prevented from doing openly.

V.
Concluding remarks

The terms sham and simulation are not only used to refer to transactions that satisfy the conditions discussed in Part 1 and perform the dual operation function. Sham and simulation are also used in a broad sense, which does not have clearly defined content nor scope or contours, but only refers to the external appearance of a transaction and the divergence between this and its substance. Substance is treated here as an open-texture term. It has also been shown that this broad sense of sham and simulation in the context of legal avoidance serves as a device for purposive statutory interpretation. It permits courts to widen the application of a statute without changing the literal words but by bending the conditions that make the statute apply. For the same reason, this broad sense of sham and simulation is expected to serve as a device of statutory interpretation more frequently when the legal system does not recognise explicit doctrines enabling this purposive interpretation.

That said, as the following chapter argues, this is not the only case and context in which courts have used the broad sense of sham and simulation.

CHAPTER 7:
SHAM TRUSTS:
ARE THEY SHAM TRANSACTIONS IN THE NARROW SENSE?

One might think that sham trusts are the central instance of the English doctrine of sham transactions. Many of the court decisions[1] and scholarly analyses[2] that have discussed this doctrine concentrate on sham trusts. Yet, as this Chapter argues, in some respects sham trusts differ from sham transactions as formulated in *Snook v London and West Riding Investments Ltd*[3] and *Hitch v Stone (Inspector of Taxes)*,[4] both cases that we have come across before, and therefore from the doctrine of sham transactions in the narrow sense.

The argument this Chapter makes is that while sham trusts typically consist of sham transactions in the narrow sense, two important clarifications must be made. Firstly, there are cases in which English courts have characterised self-declarations of trust as 'shams', where the term does not align with its common usage, nor meet the essential elements of sham transactions in the narrow sense outlined before. In these decisions, courts use the term 'sham' to be able to find that, because of the lack of one or more fundamental requirements for the constitution of a valid trust, the declaration has failed to create a trust. For that reason, it is also argued that, whenever possible, the use of this broad sense of 'sham' should be avoided in trust law.

The second refinement to make is that even in those cases in which the declaration of trust consists in a sham in the narrow sense, it is important not to overlook that it represents a particular sub-category of sham in the narrow sense. This

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[1] See, for instance, *Re Esteem Settlement* [2003 JLR 188]; *A v A* [2007] EWHC 99 (Fam); and *JSC Mezhdunarodniy Promyshlenniy Bank and another v Pugachev and others* [2017] EWHC 2426 (Ch).
[2] See, among others, Matthew Conaglen, 'Sham trusts' (2008) 67 CLJ 176; Matthew Conaglen, 'Trusts and Intention' in Edwin Simpson and Miranda Steward (eds), *Sham Transactions* (OUP 2013) 122; Simon Douglas and Ben McFarlane, 'Sham Trusts' in Heather Conway and Robin Hickey (eds), *Modern Studies in Property Law: Volume 9* (Hart 2017) 237; Dervent Coshott, 'The sham doctrine and intention: addressing the bilateral nature of sham trusts' (2022) 138 LQR 114; Graham Virgo, 'Abuse of Trust' in RC Nolan, HW Tang, and MM Yip and TH Wu (eds), *Trusts and Private Wealth Management: Developments and Directions* (CUP 2022) 285.
[3] [1967] 2 QB 786, 802 C-E.
[4] [2001] EWCA CIV 63, 2001 WL 14954 [63]-[69].

sub-category becomes apparent when considering the divergence between form and substance that characterises sham trusts. This divergence does not lie in any difference between the rights and obligations the parties declare, on the one hand, and the rights and obligations they intend to make binding, on the other. Instead, it specifically consists in a declaration of trust in favour of others that, on its face, gives the appearance of creating a valid trust (form), but in which the settlor fails to dispose of beneficial ownership (substance).

Outlining these specificities of sham trusts is important for both theoretical and practical purposes. It permits to identify when characterising a declaration of trust as a 'sham' corresponds to a distinctive legal doctrine and when it does not. Likewise, it enables us to formulate a more coherent explanation of when and why a declaration of trust is a sham.

This chapter examines the extent to which sham trusts fulfil the two essential elements that, as outlined in Part 1 of this dissertation, define sham transactions in the narrow sense. Section one investigates whether sham trusts satisfy the requirement of a common intention between the parties involved. Section two, in turn, explores the sense in which form and substance diverge in the context of sham trusts.

I.
Sham trusts and commonality of intention

Part 1 of this dissertation has argued that sham transactions result from a common intention of the parties.[5] This requirement means that the parties to the sham must share the intent of giving the impression that they are creating certain rights and obligations while they actually intend others, if any.[6] In the context of trust law, courts require a commonality of intention between the settlor and the trustee, and in this respect this structural element seems to fit well with sham trusts. As elaborated in Chapter 2,[7] courts have consistently ruled that both the settlor's and trustee's

[5] See Chapter 2, section I.1. and section II.
[6] *Yorkshire Railway Wagon Co v Maclure* (1882) 21 ChD 309; *Stoneleigh Finance Ltd. v Phillips* [1965] 2 QB 537; and *Snook* (n 3).
[7] See Chapter 2, section III.1.

intentions are relevant for finding that a declaration of trust is a sham.[8] In this respect sham trusts are not so different from, for instance, sham contracts and may be characterised as sham transactions in a narrow sense. Moreover, requiring the trustee's intention seems to be sound, as a different solution would allow the settlor to impose on trustees' rights and obligations against their will.[9]

That said, trusts may not necessarily result from a transfer. They can also result from a self-declaration of trust,[10] where settlor and trustee 'are one and the same person'.[11] The settlor declares a trust over property that he or she already owns. Since self-declared trusts lack the separation between settlor and trustee, they seem to leave no room for a common intention and thus for the application of the doctrine of sham transactions.

This solution, however, is not easy to reconcile with authoritative law. English courts have found that self-declarations of trust were in fact 'shams',[12] referring to *Snook,*[13] *Hitch,*[14] and other landmark cases on the doctrine of sham transactions. The following dictum by Lewison J in *Painter* is the most cited authority: 'in the case of a unilateral declaration of trust, where the beneficiary has not accepted the gift, I consider that it is the intention of the settlor alone that is decisive'. Thus, these decisions suggest that self-declared trust can be shams, and that in declarations of this type, the settlor's intention alone suffices. In other words, there may be sham trusts that do not satisfy the definition of sham in *Snook*. There is a general consensus of views endorsing this this interpretation.[15]

If this general consensus were correct, some disadvantages would follow. It would deprive the doctrine of sham trusts of its actual meaning and give no reason as to what

[8] *Re Esteem* (n 1) [53]; *Shalson v Russo* [2003] EWHC 1637 (Ch) [190]; *A v A* (n 1) [34]; *Pugachev* (n 1) [150].
[9] See Chapter 2, section II.3.
[10] *Paul v Constance* [1977] 1 WLR 527; Lewin, *Trust* [3-004]. See also Sinéad Agnew and Simon Douglas, 'Self-Declarations of Trust' (2019) 135 LQR 67.
[11] *Painter v Hutchison* [2007] EWHC 758 (Ch) [115].
[12] See *Painter* (n 11); *Re Munir* [2021] EWHC 278 (Ch); and *Re Gallagher* [2021] EWHC 2479.
[13] *Snook* (n 3).
[14] *Hitch* (n 4).
[15] Lewin, Trust [5-027]; Underhill and Hayton, *Trusts and Trustees* [8.12]. See also, Conaglen, *Sham trusts* (n 2) 189 and Conaglen, *Trusts and Intention* (n 2) 130. Against this common believe, Coshott (n 2) 121-123.

exactly these 'sham' trusts mean. Fortunately, a closer analysis of the authorities suggests a more satisfactory interpretation.

1. Self-declarations of trust as sham transactions in the narrow sense

In first place, in a self-declaration of trust a commonality of intention is not impossible. It is surprising, in this regard, that when judges, legal scholars, and commentators cite the dictum by Lewison J in *Painter*,[16] they often omit to consider its full length. It is true that Lewison J observed that one cannot require two intentions in the person that declares the trust and acts as trustee. However, Lewinson J further observed that the intention of the settlor alone is decisive for finding a sham 'where the beneficiary has not accepted the gift'.[17] In other words, *Painter* suggests that if the beneficiary has accepted the gift, the settlor's intention alone would not suffice, and the beneficiary's intention would be relevant as well.

And this suggestion seems to be sound from a principled perspective. There are good reasons to argue that at least under certain circumstances, once a trust has been constituted, and the beneficiary has accepted the gift, his or her intention becomes relevant in finding a sham. If the beneficiary's intention were not considered, it would mean that the settlor and trustee would have the power to dispose of the rights of the beneficiaries under a trust. Consider, for instance, that S declares a trust on property *p* for the benefit of B, who accepts the 'gift' on the foot that it is a genuine trust. Would it rest in that case solely with S to assert that the trust is a sham, even if doing so may be to B's detriment?[18] Now suppose that B accepts the gift but with a common understanding with S that the declaration of trust is a sham to disguise third parties. Would that declaration not consist of a sham in the narrow sense?

It might be instructive to recall the discussion in Chapter 2, where it was argued that the parties to the sham who must share a common understanding are those whose rights and obligations are subject of the sham. What is needed for finding a sham is the common intention of the parties whose rights and obligations are subject

[16] *Painter* (n 11).
[17] *Painter* (n 11) [115].
[18] *Shalson v Russo*, [2003] EWHC 1637 (Ch) [190].

of the sham.[19] A similar argument can be made when it comes to a beneficiary under a self-declared trust. Since the beneficiary's rights are subject to the shamming intent, and the settlor's intention affects the beneficiary's rights, the beneficiary's intention should be relevant when finding that the declaration is a sham.

Naturally, this assertion needs to be weighed against the fact that in many trusts not all the beneficiaries are ascertained, and requiring the common intention of all of them might not be practicable. This difficulty was identified by Munby J in *A v A*.[20] There were two family trusts in which the original trustees had been replaced by new trustees. Since it was accepted that the original trustees had not shared a shamming intention, an important question was whether a properly constituted trust could become a sham by a subsequent agreement between the settlor and the successor trustee. Munby J ruled out this possibility. He stated that the effect of a such agreement 'is to expose the trustee to a claim for breach of trust and, it may well be, to expose the settlor to a claim for knowing assistance in that breach of trust'.[21] Then he complemented this assertion observing that

> 'The only way, as it seems to me, in which a properly constituted trust which is not, *ab initio*, a sham could conceivably become a sham subsequently would be if all the beneficiaries were, with the requisite intention, to join together for that purpose with the trustees […]. But since that would require the participation of all the beneficiaries […], and since, as I have already pointed out, not all the beneficiaries in the present case are ascertained and sui juris, the possibility cannot here arise, and I therefore say no more about it.'

One can read *A v A* as making a point similar to *Painter*. If a trust is properly constituted and the beneficiaries have accepted their interest on the footing that it was genuine, the trust cannot become a sham trust only by reason of an unknown settlor's intention. The beneficiaries hold vested interests and can demand accountability from the trustee. However, *A v A* adds something else. It acknowledges that requiring the

[19] *Hitch* (n 4) [85]. See also Chapter 2, section III.
[20] *A v A* (n 1).
[21] *A v A* (n 1) [43].

participation of all the beneficiaries in order to find a sham could be impracticable. There is no way of making beneficiaries who are not ascertained party to a sham. There is no way of making all the beneficiaries party to the sham when, for instance, the trust is a discretionary one and some of the ascertained beneficiaries ignore the existence of the trust.

To further illuminate this topic, it may be helpful considering the approach of Italian law to the doctrine of simulation in unilateral acts. As examined in Chapter 2, Italian law recognises that unilateral acts can be simulated.[22] However, it requires an agreement to simulate between the author of the unilateral act and the person to whom the act is directed. For this reason, the doctrine of simulation applies to unilateral acts when they are addressed to one or more specific beneficiaries. In contrast, when a unilateral act is directed at the community as a whole, or to an indeterminate group of people, the doctrine of simulation cannot apply. Reaching an agreement to simulate regarding the legal effects of such acts is impracticable.[23] It seems to me that an analogous argument in English law—concerning the settlor (the author of the unilateral act) and the beneficiaries under the trust (the individuals to whom the act is directed)—is possible and sound.

The point here is not to settle to what extent and the circumstances under which the beneficiary's intention is needed to find that a declaration of trust is a sham. Rather, it is first, to demonstrate that a common understanding between the settlor and beneficiary in a self-declared trust is indeed possible. Likewise, it is also to show that if this common understanding involves that the self-declaration of trust is made solely to conceal from third parties that the settlor has not disposed of beneficial ownership, there is no reason to deny that such a declaration of trust qualifies as a sham transaction in the narrow sense. This would be a sham that meets the two essential elements of sham transactions in the narrow sense, as examined in Part 1 of this dissertation.

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[22] See Chapter 2, section III.3.

[23] C. Massimo Bianca, *Diritto Civile. III. Il Contratto* (3rd edn, Giuffrè 2019) 657; Franco Anelli, *Simulazione e interposizioni,* in V. Roppo (ed), *Trattato del Contratto. III. Effetti* (2nd edn, Giuffrè Editore 2023) 657-658; Rodolfo Sacco and Giorgio De Nova, *Il Contratto* (4th edn, UTET Giuridica 2016) 652-653

2. Self-declarations of trust as shams in the broad sense

There are, however, cases in which courts seems to have found self-declarations of trusts to be shams on the basis of the settlor's intention alone. Among these are *Painter*,[24] *Re Munir*[25] and *Re Gallagher*.[26] It is important, however, not to overstate what these cases say. In all of them, courts have used the language of 'sham', and in all of them the judges refer to the most significant cases discussing the doctrine of sham transactions in a narrow sense, including *Snook*[27] and *Hitch*.[28] Even so, they are not necessarily authority for the view that only the settlor's intention is necessary for the finding of a sham in the narrow sense. In making this point, it will be illustrative to discuss in some detail both *Painter* and *Re Gallagher*.

2.1. *Painter: the settlor never departed with the beneficiary interest.*

Mrs Painter had declared herself trustee for the benefit of a bank, who in turn was described as trustee of the Gemini Trust. She made this unilateral declaration of trust to complete the purchase and acquisition of a property with funds that were held by the Gemini Trust but that belonged beneficially to Mrs Painter's husband, and that the husband had then gifted to Mrs Painter. The intention all along therefore was that Mrs Painter would be the beneficial owner of the property, but the form of conveyance did not allow this to be made apparent.

That said, the bank and the Gemini Trust knew that declaration of trust was a device designed as a solution to a practical difficulty of having Mrs Painter appear as the beneficial owner of the property. Sometime later, however, one of the beneficiaries of the Gemini Trust contended that pursuant to the unilateral declaration of trust, Mrs Painter did not own the property beneficially. Mrs Painter reacted by

[24] *Painter* (n 11).
[25] *Re Munir* (n 12)
[26] *Re Gallagher* (n 12).
[27] *Snook* (n 3).
[28] *Hitch* (n 4).

issuing proceedings seeking a declaration from the court that she was the sole beneficial owner of the property held in trust under the self-declared trust and that this declaration was a sham. The court ruled in favour of Mrs Painter. The court discussed several grounds for holding that the declaration had failed to constitute a trust and that Mrs Painter owned the property beneficially. Lewison J put the case in the following terms:[29]

> 'Under the trust declared by Mrs Painter the Bank was a beneficiary, albeit a beneficiary who was to hold its beneficial interest on the trusts of the Gemini Trust. Where a beneficiary disclaims a beneficial interest which a lifetime settlement purports to confer upon him, there is, in general, a resulting trust in favour of the settlor [...]. In terms of the paperwork (i.e. the declaration of trust itself) Mrs Painter was the settlor. Since the Bank refused to accept (or disclaimed) the purported gift, it follows, in my judgment, that as between the Bank and Mrs Painter there was a resulting trust in favour of Mrs Painter […].'

In other words, the declaration of trust made by Mrs Painter failed, in first place, not because it was a sham, but because the beneficiary (that is, the Gemini Trust) did not accept the gift and 'the law certainly is not so absurd as to force a man to take an estate against his will'.[30]

It is true that in *Painter* the court also concluded that the declaration of trust was a sham. However, there are at least two observations that suggest that this statement should not be taken at face value. First, it is arguably an *obiter* conclusion, in the sense that the court formulated this observation as an additional reason for concluding that the declaration of trust had failed to create a beneficial interest in favour of the Gemini Trust. Second, and more importantly, even though Lewison J held that the intention of the settlor was sufficient for finding a sham, he still decided to consider 'the intentions of the others involved',[31] including the intention of the purported beneficiary, namely the bank. On the facts of the case, the court concluded that there was some common intention between Mrs Painter and the bank. The bank

[29] *Painter* (n 11) [104].
[30] *Towson v Tickell* (1819) 3 B & Ald 31; 106 ER 575, 576-577, per Abbott CJ.
[31] *Painter* (n 11) [116].

always knew that the declaration of trust was only a paperwork for completing the acquisition of the property 'until the matter is fully sorted after completion'[32] and, in the bank's eyes, the property was never held in trust under the Gemini Trust.[33] In other words, had the Gemini Trust accepted the beneficiary's right, the trust would have been a sham to the extent that the beneficiary had accepted such right on the footing that it was not genuine but a sham.

There are two ways, then, to read *Painter*. One way is that the declaration of trust was ineffective because of a common understanding between the settlor and the beneficiary, and therefore that it was a sham in the narrow sense. If one reads *Painter* this way, it is important not to overlook that the facts of the case and the argument developed by Lewison J, reveal that the declaration of trust was ineffective because of the common intention of the settlor and the other parties involved in the trust, and particularly the beneficiary's intention. In other words, the trust would consist of a sham trust in which the requirement of a commonality of intention was met, and therefore a sham trust in the narrow sense. The second way to read *Painter* is that the declaration of trust failed to create an effective trust not because it was a sham in the narrow sense, but because the settlor never parted with beneficial ownership given that the beneficiary never accepted the gift. If this is the right way of understanding *Painter*, the declaration of trust may be regarded as a 'sham', this term taken in the broad sense examined in this Part 2. The sham in this case does not consist in a specific legal doctrine. It rather seems to entail the use of ambiguous language to apply fundamental principles of trust law. I believe that the first interpretation is correct. However, which of these two interpretations is to be preferred does not matter for the point I am raising here. What matters is that in none of them does *Painter* seem to suggest that the self-declaration of trust can be considered a 'sham' in the narrow sense and on the basis of the sole settlor's intention.

2.2. <u>*Re Gallagher: no duty to account*</u>.

[32] *Painter* (n 11) [117].
[33] *Painter* (n 11) [102].

Then there is *Re Gallagher*.[34] After being declared bankrupt, Mr Gallagher approached the trustees of his estate with an unwitnessed document, handwritten and signed by himself, according to which he held some property for the benefit of his son. The trustees of Mr Gallagher's estate issued an application claiming the beneficial ownership of the property based on several grounds. One of these grounds was that the declaration of trust was not genuine, but a salvage document manufactured shortly before the start of the bankruptcy proceeding. In addition, they also claimed that even if the declaration of trust were genuine, in the sense that it was created on the date therein specified, it was a sham. The application succeeded. Deputy Judge Greenwood concluded that the declaration of trust was not genuine[35] and, if wrong in that respect, in any case a sham document.[36]

In *Re Gallagher*, Deputy Judge Greenwood also approved *Painter* when he said that in a self-declared trust, the settlor's intention suffices for finding a sham. However, the circumstances of the case, and the grounds given for concluding that the declaration was a sham suggest that the sham consisted in something quite different from the legal doctrine described in *Snook*[37] and from a sham transaction in the narrow sense. They suggest that the declaration was found ineffective because Mr Gallagher did not have any obligation to account. In other words, they suggest that the term 'sham' was taken in the broad sense, and that in this case it conceals the application of a fundamental principle of trust law, that is that trusteeship requires accountability.

To understand this point it should be remembered that trustees have the obligation to inform beneficiaries of the existence of the trust and of their interest.[38] This obligation is cognate with the very core of the trusts. If the beneficiaries are unaware of the existence of the trust, they cannot make the trustee account, and if there is no accountability there is no trust.[39] Although the way in which trustees should

[34] *Re Gallagher* (n 12).
[35] *Re Gallagher* (n 12) [65].
[36] *Re Gallagher* (n 12) [66].
[37] *Snook* (n 3).
[38] *Burrows v Walls* (1855) 5 de gm & g 233, 253; *Brittlebank Goodwin* (1868) LR 5 EQ 545, 550. *Hawkesley v May* [1956] 1 qb 304, 332; Underhill and Hayton, *Trusts and Trustees* [53.2]-[53.4]; Lewin, *Trust* [21-08].
[39] *Armitage v Nurse* [1998] Ch 241, 253, per Millett LJ.

fulfil this obligation depends on the circumstances of the trust, such as the nature of the beneficiary's right,[40] and the age of beneficiaries,[41] there are reasons to argue that this obligation becomes stricter in self-declared trusts. If the settlor decides that he or she will never inform the beneficiaries about the trust, there is no way to make him or her account,[42] and if a trustee is not accountable there is no trust.

The facts of the case show that Mr Gallagher never had this obligation to account. His position was that he had signed the trusts declaration twelve years before his bankruptcy. However, the beneficiary on such declaration, Mr Losowski-Gallagher, was not told about the declaration of trust, until after Mr Gallagher's bankruptcy.[43] Mr Gallagher even accepted that had he not been made bankrupt he still might not have revealed the existence of the trust to anyone.[44] In other words, if it was true that Mr Gallagher executed the declaration of trust twelve years before his bankruptcy, such trust would have only existed secretly in Mr Gallagher's mind. This, then, was not a trust because 'an uncontrollable power of disposition would be ownership, and not trust'.[45]

It is illustrative in this sense that the main reason why Deputy Judge Greenwood concluded that the declaration of trust was a sham was 'the essentially undisputed fact that the documents was kept entirely secret, allowing Mr Gallagher to use or not to use as might one ("rainy") day be convenient'.[46] In other words, although the Deputy Judge Greenwood said that the declaration of trust created by Mr Gallagher was a 'sham', it is still true that such declaration of trust was ineffective, first, because Mr Gallagher was never accountable. We may read, then, *Re Gallagher* as a case in which the trust failed because accountability was missing rather than because the declaration of trust was a sham. At least we could say that the declaration of trust was not a sham in the sense of the 'legal concept [that] is involved in the use of this

[40] Lewin, *Trust* [21-09]-[21-10] referring to future interests and interests in discretionary trusts.
[41] Lewin, *Trust* [21-14] referring to minors.
[42] Scots Trust law is in this aspect sensitive, requiring the intimation of the written declaration to a least one beneficiary. See *Allan's Trs v Lord Advocate* 1971 SC (HL) 45 and Scottish Law Commission, Discussion Paper on the Nature and the Constitution of Trusts (Scot *Law* Com DP No 133, 2006) para 4.16.
[43] *Re Gallagher* (n 12) [60].
[44] *Re Gallagher* (n 12) [64.6].
[45] *Morice v Bishop of Durham* (1804) 9 Ves Jun 399.
[46] *Re Gallagher* (n 12).

popular and pejorative word'.[47] Characterising the declaration of trust as a 'sham' seems to be nothing substantially different from finding that there was no trust for the trustee had no obligation to account.

2.3. Using this broad sense of sham in trust law should be avoided when possible

As the analysis of these cases has shown, courts have sometimes found that self-declared trusts are shams, and on the basis of the settlor's intention only. However, in these decisions the term sham is taken in its broad sense, and it does not consist in a distinctive legal doctrine. Correctly understood, this broad sense of sham in the context of trust law consists in an ambiguous way of applying fundamental principles of trust law, such as the requirement that the settlor must part with beneficial ownership and that the trustee has an obligation to account. The trusts fail on the grounds of these principles rather than under the doctrine of sham transactions in any defined and technical sense.

This discussion leads us to the question of whether this broad sense of sham is useful in trust law. Here one has to bear in mind that courts may encounter difficulties in applying fundamental principles of trust law directly. Litigants, for instance, may not present the necessary arguments and authorities. Additionally, the complexity of the facts may obscure the relevant legal principles. However, when a direct application of these principles is possible, this broad sense of sham should be better avoided. Otherwise, a more distinctive doctrine of sham transactions is muddled and conflated with a vague and confused notion. Likewise, the clarity of fundamental principles of trust law becomes blurred by a confusing use of the term 'sham'.

Now let us consider the extent to which sham trusts satisfy the requirement of a divergence between documentary form and internal substance.

II.
Sham trusts
and the divergence between documentary form and substance

[47] *Snook* (n 3) 802 C, per Lord Diplock.

Chapter 1 of this dissertation has argued that in sham transactions in the narrow sense there is a divergence between form and substance.[48] Sham trusts do satisfy this requirement. Accordingly, and provided that the requirement of a commonality of intention is also met, they typically consist in sham transactions in the narrow sense. However, it is important not to overlook that, as the next section will show, sham trusts represent a sub-category of sham transaction in the narrow sense. The reason for this is that the divergence between form and substance that characterises sham trusts is specific. It consists, on the one hand, in a declaration of trust that ostensibly establishes a valid trust (form), and, on the other, the settlor's failure to part with beneficial ownership (substance).

To show this, this section takes a circuitous route. It begins by considering a type of divergence between form and substance that does not make a declaration of trust a sham. Discussing this type of divergence first will place us in a better position to understand what precisely constitutes a sham declaration of trust. The section then addresses the specific divergence between form and substance that characterises sham trusts. It concludes by exploring why it is important to outline this divergence and to identify this sub-category of sham transactions.

1. Divergence between beneficiaries declared in the declaration of trust versus the person who actually benefits from the trust

Many declarations of trust are not transparent as to who benefits from the trust: one can find that the beneficiaries designated in the declaration of trust are different from the individuals who actually benefit from the trust. There is then some sort of divergence between 'form' (designated beneficiaries) and 'substance' (individuals who actually benefit from the trust).

This divergence usually results from a combination of different doctrinal resources and drafting techniques. In first place, declarations of trust can be unclear about the equitable interests they create. They may provide no reliable indication as to who

[48] See Chapter 1, section II.2.

benefits from the trust.[49] The certainty of objects of the trust is a condition for its validity, and in a fixed trust this means that the declaration will provide enough details as to enable the intended beneficiaries to be practically identified.[50] However, in a discretionary trust, the beneficiaries will be determined only by reference to a class, and the extent to which each member of the class benefits from the trust is left to the trustees' discretion.[51] Likewise, declarations of trust nowadays often include objects of discretionary powers. The settlor confers on trustees a discretionary power but not the obligation to transfer the trust property to some person.[52] Technically speaking, objects of discretionary powers are not trust beneficiaries. Yet, in practice, they may benefit from the trust more than anyone else. They are often the only ones who benefit from the trust.[53]

Then, this divergence can be reinforced by the widespread use of private letters in which settlors express their wishes to trustees.[54] They may ask trustees to consider some members of the class as primary beneficiaries, or give other advice on how to distribute the benefits, including the benefit the objects of discretionary powers are supposed to receive. Letters of wishes are not terms of the trust and trustees have 'no legal obligation'[55] to follow the settlor's wishes expressed in them nor to reveal them. However, they are bound to take a serious account of the settlor's wishes.[56] Moreover, an efficient way of ensuring that trustees consider these wishes is by conferring powers on protectors or other third parties - including themselves - whom settlors equip with powers to direct and control the trustees.[57]

In other words, a settlor may use a declaration of trust alongside a bundle of technical resources that trust law provides to give the appearance of benefiting certain beneficiaries whereas in reality he or she intends to benefit others, including him or

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[49] *Schmidt v Rosewood Trust Ltd* [2003] UKPC 26; [2003] 2 WLR 1442; [2003] 2 AC 709 [1].
[50] *Whishaw v Stephens* [1970] AC 508, HL, 523-524. See also Lewin, *Trust* [5-046].
[51] *Mettoy Pension Trustees Ltd v Evans* [1990] 1 WLR. 1587, 1614E-F.
[52] *Re Baden's Deed Trusts* [1971] AC 424, 448-449; *Schmidt* (n 49) [40].
[53] One this point, see Lionel Smith, 'Massively Discretionary Trusts' (2017) 70 Current Legal Problems 17.
[54] Lewin, *Trust* [29-045].
[55] *Re Esteem* (n 1) [215].
[56] *Pitt v Holt* [2013] UKSC 26; [2013] 2 AC 108 at [66].
[57] Lewin, *Trust* [28-036]. See also Donovan Waters, 'The Protector: New Wine in Old Bottles?' in A.J. Oakley (ed), *Trends in Contemporary Trust Law* (Clarendon 1996) 63.

herself. The declaration of trust then may be regarded as a documentary form concealing a different substance. In this respect, Lord Walker of Gestingthorpe in *Schmidt v Rosewood Trust Ltd* [58] described the lack of transparency of some declarations of trusts in the following terms:

> 'The trusts and powers contained in a settlement established in such circumstances may give no reliable indication of who will in the event benefit from the settlement. Typically it will contain very wide discretions exercisable by the trustees (sometimes only with the consent of a so-called protector) in favour of a widely-defined class of beneficiaries. The exercise of those discretions may depend on the settlor's wishes as confidentially imparted to the trustees and the protector. As a further cloak against transparency, the identity of the true settlor or settlors may be concealed behind some corporate figurehead.'[59]

This divergence, however, does not entail a sham. The authorities hold that these declarations of trust are not shams and that they are valid and effective.[60] In *Schmidt*, for instance, the petitioner argued that in most offshore trusts, as it was the case of the two trusts there being litigated, 'the persons intended to benefit are not true beneficiaries but mere objects of those discretionary powers' and that 'the only beneficiary properly so called is a charitable institution […] having no connection with the settlor and never intended to benefit'.[61] Yet Lord Walker of Gestingthorpe stated twice that it was a common ground that the two declarations of trusts there discussed were not shams.[62] In *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Co (Cayman) Ltd and others,*[63] Lord Collins observed that 'for practical purposes'[64] the beneficiaries of two declarations of trusts were the settlor and his wife, even though according to the relevant declarations of trust, the only beneficiary (called 'residual'

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[58] *Schmidt* (n 49).
[59] *Schmidt* (n 49) [1].
[60] *Schmidt* (n 49) [8], [36]; *Tasarruf* (n 63) [9]. Questioning the validity of trusts with these characteristics, see Smith (n 53). See also Hanoch Dagan and Irit Samet, 'What's Wrong with Massively Discretionary Trusts' (2022) 138 LQR 629.
[61] *Schmidt* (n 49) 711.
[62] *Schmidt* (n 49) [8], [36].
[63] [2011] UKPC 17, [2012] 1 W.L.R. 1721.
[64] *Tasarruf* (n 63) [4]

beneficiary) was a charity. These declarations of trust, however, were 'valid and duly constituted as a matter of Cayman Islands law'.[65]

It may not seem self-evident that this sort of declarations of trust are not shams. It might seem that in a trust like this, the settlor declares certain rights and obligations but intends to create others. It might seem, then, that this sort of declarations of trust should be treated as a sham in terms of the test set out in *Snook*.[66] However, the apparent problem goes away if we bear in mind the content and nature of the beneficiary's interest under a trust.

In this regard, in *Target Holdings Ltd. v Redferns (A Firm)* Lord Browne-Wilkinson remarked that the basic right of a beneficiary 'is to have the trust duly administered in accordance with the provisions of the trust instrument, if any, and the general law'.[67] This description of the content of the beneficiary's right may fail to capture the benefits that beneficiaries under a trust ordinarily expect to receive. Yet in the case of a beneficiary under a discretionary trust, the right to have the trust duly administered often is all he or she has. In a discretionary trust, a beneficiary has no right to any income but only a mere *spes* that the trustee in the future will make a distribution to him or her.[68] As formulated by Professor Nolan, the beneficiary's core proprietary rights under a trust 'consist in the beneficiary's primary, negative, right to exclude non-beneficiaries from the enjoyment of trust assets'.[69] Positive claims to benefit from trust assets 'do not—and cannot—form the generally characteristic feature of equitable proprietary right under trust'.[70] Thus, *Target Holdings* is ultimately quite accurate as to the interests the beneficiary under a trust actually has.

Seen in this way, the lack of transparency in declarations of trust described in this section is no longer a reason for finding a sham. It is true that the settlor gives no reliable indication of who benefits from the trust and that he or she may intend to

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[65] *Tasarruf* (n 63) [9].
[66] *Snook* (n 3).
[67] [1996] A.C. 421, 434A
[68] Lewin, *Trust* [1-061].
[69] RC Nolan, 'Equitable Property' (2006) 122 LQR 232, 233. Nowadays one may be tempted to say that this is a negative right to exclude non-beneficiaries from the enjoyment of trust assets *unless they are objects of a discretionary power*.
[70] Nolan (n 6969) 237.

benefit other objects than the designated beneficiaries. Yet the settlor also intends to endow the designated beneficiaries with a right to have the trust duly administered and to exclude non-beneficiaries from the enjoyment of the trust assets. The declaration of trust confers this right on the beneficiaries. Therefore, the sham as understood in terms of *Snook*[71] disappears. The divergence between form and substance results from technical devices that trust law itself enables and allows.

2. Divergence between form and substance that does make a declaration of trust a sham in the narrow sense

So, what divergence is required to render a declaration of trust a sham in the narrow sense? This requires a closer look at those trust cases where shams are actually found. Interestingly, in all these cases, it is not that the settlor intended to create rights different from those declared. Rather, these are cases where the settlor did not create a trust at all.

In *Wyatt*,[72] for instance, the declaration of trust created by a husband was found to be a sham given that 'Mr. Wyatt did not have any intention, at the moment of its execution, of endowing his children with his interest' in the trust asset.[73] The declaration of trust, consequently, was declared entirely 'void and unenforceable'.[74] Similarly, in *Minwalla v Minwalla,*[75] Singer J found that the Fountain Trust was a sham given that the settlor's intention 'always was that the resources were his and would continue to be his'.[76] A similar picture emerges if one examines the numerous cases in which the sham allegation has been rejected.[77] If they were not found to be shams, this was due to a variety of reasons. The alleged sham, however, consistently involves a declaration of trust which on its face seems to constitute a valid trust, but because the settlor does not part with beneficial ownership he did not create an valid express trust. This is precisely what characterises sham trusts in the narrow sense.

[71] *Snook* (n 3).
[72] *Bank plc v Wyatt* [1997] 1 BCLC 242.
[73] *Wyatt* (n 72) 252h.
[74] *Wyatt* (n 72) 253b.
[75] [2004] EWHC 2823.
[76] *Minwalla* (n 75) [57].
[77] See, for instance, *Re Esteem* (n 1); *A v A* (n 1); *Administrators of the State of Hanson v O'Leary* [2021] JRC319.

Again, the cases in which courts have found a declaration of trust to be sham illustrates this point. They are all cases in which the settlor retained beneficial ownership despite the existence of a declaration of trust in favour of others that, on its face, gave the appearance of creating a valid trust. What matters, then, when finding a sham trust is not simply a divergence between the declaration of trust and the 'reality' of the arrangement or the rights governing the relationship between the parties. In other words, the divergence between form and substance that characterises sham trusts is very specific. It involves the declaration of trusts in favour of others but also a failure by the settlor to dispose of beneficial ownership.

3. Importance: sham trusts and settlor's control

All this is significant both for theoretical and practical purposes. This argument provides a better explanation of what sham trusts are, but also a better understanding of the application of sham trusts in practice. To illustrate this point, it is useful to observe how sham trusts are related to the question of whether the control of the settlor over the trust is so significant to constitute a valid trust.

It is nowadays common to say that the question of whether a declaration of trust is a sham is different from the question whether the control of the settlor over the trust is so large that the settlor has failed to dispose of beneficial ownership.[78] It is also said that so long as the trust is intended to operate according to the terms of its declaration, the retention of large powers by a settlor does not make the trust a sham.[79] In other words, sham trusts and settlor's control are seen as two separate doctrinal developments.

This distinction is correct from an analytical perspective. However, it should not be overstated. Both doctrines are very much intertwined. In first place, they are intertwined from a principled perspective. Finding that a declaration of trust is a sham,

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[78] Lewin, *Trust* [5-020]. Making a less radical separation between the two question, Underhill and Hayton, *Trusts and Trustees* [8.1].
[79] Lewin, *Trust* [5-031].

and that the settlor's control frustrates the existence of a trust, ultimately involve the same underlying general principle: that for the creation of a trust the settlor needs to part with beneficial ownership.[80] Moreover, the two doctrines respond to a similar factual scenario: a declaration of trust that fails to establish a trust given that the settlor retained beneficial ownership. The means by which the settlor achieves this result vary. In one case the declaration of trust conceals this circumstance. In the other it results from the true construction of the trust deed.[81] However, the outcome is not fundamentally dissimilar. In addition, the two doctrines are also intertwined from a practical perspective. Settlors may achieve the result of declaring a trust but retaining beneficial ownership, combining different drafting techniques, and these drafting techniques may include both the retention of large powers and some elements of a sham in the declaration of trust.

A good example of the extent to which both doctrinal developments operate intertwined is *Pugachev.*[82] Mr Pugachev created five trusts, and declared himself as protector and discretionary beneficiary in each of them. As protector, Mr Pugachev was vested with substantial powers, including the rights to give approval before the trustee made distributions, to remove trustees with or without cause, and to appoint new trustees. In addition to these ostensible powers, the court noticed that the trust deed did not show on its face that Mr Pugachev had been appointed protector and beneficiary. This appeared only from external evidence. Moreover, the court was of the opinion that while the deed described the powers vested in the protector as fiduciary, in reality they were a 'pretence' to cover personal rights.[83] Finally, the court also considered that the decision to appoint Mr Pugachev's son as potential protector was only a 'pretence' to mislead third parties.[84] This led the court to conclude that the trust deed was drafted not to make what was going on 'quite so stark'.[85]

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[80] *Webb v Webb* [2020] UKPC 22; [2020] WTLR 1461 [89].
[81] *Pugachev* (n 1).
[82] *Pugachev* (n 1).
[83] *Pugachev* (n 1) [265]-[269].
[84] *Pugachev* (n 1) [424].
[85] *Pugachev* (n 1) [271].

Based on these facts, the court reached two conclusions. First, that according to the trust deed 'properly construed' Mr. Pugachev never parted with ownership.[86] In other words, that the different powers Mr. Pugachev retained, when considered all together, were equivalent to beneficial ownership. Second, that in any case, the trust deed was a 'pretence' to mislead third parties, and accordingly, if the conclusion about the meaning of the trust deed properly construed were wrong, the deed would be a sham. [87]

So, what made the declarations of trust in *Pugachev* fail? Was it the powers that the settlor retained, or was it that the declarations of trust were a sham because they contained 'pretences' that made what was going on not 'quite so stark'? Birss J concluded that the trust failed based on the terms of the declaration of trust and the settlor's reserved powers. However, Birss J was also aware that the terms of the deeds made the trusts fail partly because they were applied as pretences misleading third parties. In that regard, perhaps the best answer is that there were two reasons that led to the conclusion that Mr Pugachev retained beneficial ownership despite the declaration of trust: the reserved powers and the fact that there were some sham elements in the trust deed. Since both doctrines operate within similar factual contexts, and represent instances of a broader principle, the distinction between them appears less significant than initially apparent.

Before concluding it may be useful to recapitulate the main findings of this section. In sham trusts there is a divergence between documentary form and internal substance. In this respect, sham trusts can be characterised as sham transactions in the narrow sense. However, the divergence between form and substance that characterises sham trusts is very specific. It involves a declaration of trust in favour of others but without the settlor ever disposing of the beneficial ownership. Therefore, the language used to describe sham transactions in the narrow sense, which pertains to the declared versus intended rights and obligations governing the relationship between the parties, may not be the best way to capture what a sham trust truly entails. Sham trusts are therefore better regarded as a sub-category of sham

[86] *Pugachev* (n 1) [455].
[87] *Pugachev* (n 1) [456].

transactions in the narrow sense, marked out by the specific divergence between form and substance that this section has examined. Moreover, the fact that in sham trusts, form and substance diverge in this specific sense affects the application of this doctrine. It shows that the question as to whether a declaration of trust is a sham cannot be completely separated from the question of whether the powers reserved by the settlor are so broad as to frustrate the creation of a valid trust.

III.
Concluding remarks

In conclusion, while in most cases sham trusts may be regarded as sham transactions in the narrow sense, there are two qualifications to make. In certain cases, involving self-declared trusts, English courts have embraced a broader concept of sham. Finding these trusts as shams in this broader interpretation involves using ambiguous language where fundamental principles of trust law could have been applied: the necessity for the settlor to part with beneficial interest and for the trustees to fulfil their obligations to account. For this reason, and when a direct application of these fundamental principles is possible, this broad concept of sham should be avoided.

In addition, even when sham trusts consist in sham transactions in the narrow sense, unique aspects of trust law mark them as a distinct case and a sub-category of sham trusts in the narrow sense. Particularly, the divergence between form and substance that characterises sham trusts is not a divergence between the rights and obligations recited in the documentary form and the internal relationship between the parties. It rather consists in the settlor's failure to dispose of beneficial ownership despite a declaration of trust that on its face seems to constitute a valid trust. Outlining these particularities of sham trusts provides a better explanation of what makes a declaration of trust a sham and of the relationship between sham trusts and the question as to when settlor's reserved powers are so large so as to frustrate the constitution of a valid trust.

CONCLUSIONS

The argument developed throughout this dissertation is that the doctrines of sham and simulated transactions have a distinctive character, both in terms of their structure and functions. That said, in order to appreciate the extent of their distinctiveness, this dissertation argues that it is necessary to differentiate the narrow and broad sense of sham and simulation in law.

There is first a narrow sense in which the doctrines of sham and simulation should be understood. In this narrow sense, sham and simulated transactions have a well-defined structure based on two distinctive structural elements: (i) a documentary form that recites rights and obligations different to the rights the parties intend to govern their legal relationship; (ii) a common understanding between the parties of creating this divergence between the external form intended *vis-à-vis* third parties, and the internal understanding governing their legal relationship. In turn, while fraud is very often present is sham and simulated transaction, it does not need to be. Fraud is not an inherent element of sham and simulated transactions. This is important because we then also see that their most significant function is not to prevent fraud.

Specifying and clarifying the structural elements of sham and simulated transactions anticipates part of the answer to the question that drives this dissertation, that being the extent to which they are distinctive legal doctrines. Clarifying the way in which form and substance diverge in sham and simulated transactions, allows us to differentiate these doctrines from others, such as the doctrines of indirect and fiduciary transactions, and transactions that may feature some element of artificiality but that do not satisfy the specific divergence between form and substance here discussed. Similarly, providing a clear account of the ‘common understanding’ that characterises sham and simulated transactions permits us to rule out the application of these doctrines in cases of transactions that may have some misleading appearance but that do not result from a common understanding of two or more parties. This is the case of self-declared trusts that occasionally English courts have found to be ‘sham’ notwithstanding the want of a common understanding. Accordingly, as this dissertation

contends, these declarations of trust are not sham in the technical and narrow meaning of this word.

These structural elements of sham and simulated transactions enable a better understanding of the functions they perform. In first place, they permit us to discard addressing fraud as their distinctive function. Giving that sham and simulated transactions do not need to be fraudulent, tackling fraud cannot be their most distinctive function. Even more so, once the specific divergence between form and substance that characterises sham and simulated transactions is clearly outlined, it becomes apparent that the effectiveness of the doctrines of sham and simulation in combating different types of fraud is limited. Many types of fraud, including legal avoidance schemes and fraud on creditors, are materialised by the economic results the parties achieve rather than the rights and obligations they acquire. Thus, if the divergence that characterises sham and simulated transactions does not concern the economic result the parties achieve, the doctrines of sham and simulated transactions are not and cannot be regarded the sharpest doctrinal tools for tackling fraud. Other doctrines, such as *fraudem legis* and the purposive approach to statutory interpretation, are then more suited to this purpose.

In fact, this dissertation argues that the function that most distinguishes the doctrines of sham and simulated transactions in the narrow sense is the so-called double operation function. This function consists in enabling the interests and purposes of the parties to the transaction to be implemented more effectively by permitting the parties to split the legal operation of a transaction between its effects *vis-à-vis* third parties and the parties. This function in turn, is limited by additional complementary functions, including the need to protect third parties' rights and to enforce mandatory legislation. In other words, these doctrines seek to strike a balance between the interests of the parties to the simulation and the protection of third parties, as well as the need to ensure efficacy of mandatory legislation.

This 'dual operation function' is more easily appreciated when considering the effects that sham and simulated transactions produce. The rights and obligations the parties recite in the documentary form of a simulated and sham transaction are not

effective between them. However, the parties are bound to accept the simulated and sham character of the documentary form they have executed, and to fulfil their obligations under any concealed transaction they may have executed behind the documentary form. The interests of third parties, in turn, operate as limits to these effects. The parties to the sham and simulation cannot set up their secret understanding in prejudice of innocent third parties that have relied on the documentary form. Likewise, third parties that may potentially be defrauded by the simulation and sham have standing to bring an action of simulation or allege that the transaction is a sham to prevent being actually prejudiced by the documentary form. Finally, the efficacy of mandatory legislation operates as a second limit to these effects. Any concealed transaction the parties may have intended will be valid and effective as long as it complies with the applicable general law.

The justification for the dual operation function of sham and simulated transactions is not beyond argument. Sham and simulated transactions very often permit the commission of fraud and increase the risks of prejudice to third parties. Therefore, it is reasonable to ask whether the law should not take a more restrictive approach toward sham and simulated transaction, for instance, by making the parties' concealed intention invariably and entirely void. However, this dissertation argues that the dual operation function is justified because of the benefits it offers. The doctrines of sham and simulated transactions facilitate a more effective realisation of the parties' needs and intentions by allowing the creation of efficient and equitable legal structures that serve their commercial needs or their interests in providing for members of their family, especially when the legal system falls short. This can occur in two ways. First, by filling a gap in the law and providing a solution that, while dependent on sham and simulation for effectiveness, does not contravene legal principles. An example of this is the use of notarial instructions in Chile to facilitate land transfers. Second, by enabling a legal change my means different from the conventional instruments contemplated by the legal system to change the law, as illustrated by the doctrine of disguised donations in France.

While the narrow sense of sham and simulated transactions as described in these conclusions is found across all the jurisdictions considered in this dissertation,

it naturally varies from one jurisdiction to another. An obvious difference is that while in English law the divergence between form and substance is more clearly defined and understood than in the three civilian jurisdictions considered here. In English law, courts have defined in clear and precise terms the sense in which form and substance of sham transactions diverge. By contrast, in civilian jurisdictions this divergence is frequently explained by resorting to abstract and theoretical categories that often fall short of giving a precise meaning of this divergence. However, the opposite happens with the requirement of a common understanding. While in most cases English courts require a common understanding of the parties in order to find a sham, in some cases they have disregarded this requirement. More telling is that in English law the rationale for this requirement is often unclear.

An analogous comment applies to the extent to which the dual operation function is recognised in the jurisdictions here considered. The jurisdiction that seems to recognise this function to a greater extent is Italy. English law, in contrast, focuses more on the protection of third parties and the enforcement of mandatory legislation, often overlooking that sham transactions may also perform the dual operation function. France and Chile, in turn, seems to be in a middle position.

Sham and simulated transactions in the narrow sense do not exhaust the argument that this dissertation makes. It argues that jurists, legal scholars, and courts have sometimes identified transactions as shams and simulations in a different and broad sense. In this broad sense, sham and simulated transactions lack precise content, and the structural elements found in sham and simulations in the narrow sense are not necessarily present. Instead, they involve a less sharply defined divergence between form and substance, with the term ‘substance’ having an open texture. Consistent with this lack of defined structure, the rules and legal consequences following the finding that a transaction is a sham or simulation in the broad sense do not necessarily satisfy the dual operation function. On the contrary, the broad meaning of sham and simulated transactions may perform different functions that will vary depending on the context in which courts make use of it.

The broad sense of sham and simulated transactions often figures in cases of legal avoidance. Courts sometimes have found transactions to be sham and simulations that, due to the economic result the parties achieve, circumvent mandatory law and thwart its purpose. This broad sense of sham and simulation serves as a means of purposive statutory interpretation. It permits courts to widen the application of a statute without changing the literal words, by bending the conditions that make the statute apply. For the same reason, this broad sense of sham and simulation is expected to serve as a device of statutory interpretation more frequently when the legal system does not readily recognise purposive approaches to interpretation.

A second context in which the broad sense of sham surfaces is trust law. True, in most cases sham trusts may be regarded as sham transactions in the narrow sense. However, in certain cases involving self-declared trusts, English courts have embraced a broader and more vaguely defined concept of sham. This broader interpretation has led to some trusts being deemed shams. On closer examination, however, they are better characterised as cases where the settlor has failed to part with beneficial interest, or where the beneficiaries cannot hold the trustees accountable.

Finding that a transaction is a sham and simulation in broad sense has practical implications. It can be useful for courts when the legal system lacks specific doctrines to achieve a solution deemed correct or when more specific doctrines are not applicable to a particular case. For the same reason, references to sham and simulation in this broad sense often consist of an ambiguous way of referring to a more specific doctrine that in a particular case. By classifying a transaction as a sham and simulation in the broad sense, courts disregard its documentary form to ensure that the policies underlying other legal rules are effectively upheld. Therefore, there is some value in this broad interpretation of sham and simulation. However, because it comes at the cost of consistency and internal coherence, wherever possible, more specific doctrines should be preferred over this broad interpretation of sham and simulation.

These findings have broader implications and suggest various avenues for further research. First, the framework developed from comparing the doctrines of simulation and sham transactions—distinguishing between narrow and broad interpretations, along with their structural elements and functions—could be valuable for jurisdictions beyond those examined here. In some jurisdictions, the doctrines of simulation or sham may be understood only in a narrow sense, while in others, they may be interpreted more broadly. In certain jurisdictions, these doctrines might be absent altogether, yet other legal principles may exhibit structural and functional similarities with the narrow and broad interpretations discussed here. Thus, the comparative framework developed in this dissertation provides a valuable tool for understanding these doctrines more generally.

This leads to a broader implication concerning comparative law methodology. While this dissertation does not engage directly in the ongoing debate on comparative law methods, it suggests that a system-neutral conceptual framework can effectively synthesise and explain the differences and similarities of comparable legal doctrines and institutions. Such a framework can provide a deeper understanding of these doctrines and suggest directions for their further development. Refining and elaborating on this methodology is, therefore, one of the directions in which this dissertation points.

Finally, this dissertation raises questions across various topics and, in some cases, offers tentative answers. These questions include whether the role of parties' intentions in a contract—and more generally in a transaction—is similar in both common law and civil law jurisdictions, and what broader implications this may have. This dissertation suggests that, in civilian jurisdictions, parties' purposes can be relevant, whereas in English law, they play a less prominent role. Additionally, this work has explored the relationship between statutory interpretation and private law, revealing instances where courts, ostensibly construing a contract or legal transaction, are in effect interpreting a statute. Lastly, this dissertation raises the question of the role individuals and the legal solutions they devise in arranging their needs play in driving legal change. The findings suggest that individuals can indeed contribute to

legal change outside the formal institutional framework of the legal system. All these are questions and topics that merit further research.

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