16. Business trusts

Peter B. Oh

1. INTRODUCTION

Virtually ignored by academics, the business trust arguably is the most prominent organizational form used today. This claim is disputable essentially only insofar that no one knows the actual composition, scale, and volume of trusts used for commercial purposes.[1] Yet no one doubts that trusts are the dominant form for massive employee pensions and mutual funds, as well as for a myriad of asset securitization and structured finance transactions.[2]

The multi-trillion dollar question is why.[3] To arrive at an answer, one first must delve into the historical origin and growth of the business trust. Grasping this in turn enables one to comprehend and evaluate the diverse modern permutations of this organizational form, which has been described as a "mystery" with a "secret life."[4] Demystifying the business trust is difficult, because it has the ability to assume many different forms, bear many labels, and perform many functions. This versatility resists the conventional approach of using a template of features (e.g., formation, limited liability, management structure, transferability) to compare the business trust to other types of organizational forms. Instead, the common functions of the business trust are delineated to evince some of its objective merits and, incidentally, its comparative advantages over other forms.

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[1] *See, e.g.*, Robert Flannigan, *Business Applications of the Express Trust*, 36 Alta. L. Rev. 630, 630 (1998) ("The extent to which the trust is employed to serve commercial purposes is unknown and probably unknowable."). Part of the problem is a lack of reliable data, as there is no registration requirement for trusts. *See, e.g.*, John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 Yale L.J. 165, 178 (1997) ("The data available on the asset values of the various forms of trust has many shortcomings, but the drift is unmistakable. . . . [T]he data leave[ ] me on solid ground asserting . . . that well above 90% of the wealth in trust in the United States is held in commercial as opposed to personal trusts."). This problem is compounded by the "considerable conceptual difficulty in distinguishing between commercial and non-commercial activities," Flannigan, *supra*, at 631, as well as between business and commercial activities, Steven L. Schwarcz, *Commercial Trusts as Business Organizations: Unraveling the Mystery*, 58 Bus. Law. 559, 562 n.18 (2003).

[2] *See, e.g.*, Robert H. Sitkoff, *Trust as "Uncorporation": A Research Agenda*, 2005 U. Ill. L. Rev. 31, 38.

[3] *See, e.g.*, Langbein, *supra* note 1, at 168–78 (estimating conservatively $11.6 trillion in commercial trusts almost two decades ago).

[4] *See supra* note 1.

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2. THE NASCENT BUSINESS TRUST

From Britain to Massachusetts

The business trust arose as a subversive alternate to the British company. In response to numerous speculative commercial ventures gone awry, Parliament enacted the Bubble Act of 1720, requiring all corporate forms with transferable stock to obtain formal permission to do business "either by act of Parliament, or by a charter from the Crown,"[5] which thereby "drastically limited the development of business corporations in Britain."[6] But these corporations were not the target of the Bubble Act; rather, the legislation's aim was to eliminate the slew of voluntary associations that had emerged as a way to circumvent the charter requirement. And after Parliament repealed the Bubble Act in 1825, these voluntary associations re-flourished. By the 1860s British investors began to flock to what became known as the investment trust, "the earliest of [which] were unincorporated, of a voluntary nature, and of a fiduciary character, and hence were called trusts in accordance with the custom of that time."[7] Although registration later was required by the Companies Acts, these voluntary associations were permitted to retain their form as a trust.[8]

Across the Atlantic business trusts already had begun to germinate in a concurrent, similar manner. Decades before the Companies Acts, various American state legislatures had enacted their own general incorporation statutes; and all of these statutes prohibited use of the corporate form for real estate, an apparent hold-over from medieval English mortmain statutes.[9] To circumvent this prohibition, real property owners formed business trusts, which also were not subject to any of the capital limits or regulatory disclosure requirements applicable to corporations.[10]

The incubator for these alternate corporate forms was Massachusetts. Although it was the first state to enact a general incorporation statute in 1809, Massachusetts was one of the last to permit incorporation without legislative sanction.[11] And, like other states, Massachusetts prohibited corporations from dealing in real estate,[12] which in turn spawned the use of business trusts. But what set Massachusetts apart was a series of early court decisions ruling that real estate business ventures would be treated as trusts, and not as corporations or partnerships, in matters of tax[13] and limited

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[5] 6 Geo. I c. 18 (1720).

[6] Ronald E. Seavoy, *The Public Service Origins of the American Business Corporation*, 52 Bus. Hist. Rev. 30, 32 (1978).

[7] Theodore J. Grayson, Investment Trusts, Their Origin, Development and Operation 1–2 (1928).

[8] *See* The Companies Acts, 25 & 26 Vict. ch. 89, § 180 (1862).

[9] *See* Sheldon A. Jones *et al*., *The Massachusetts Business Trust and Registered Investment Companies*, 13 Del. J. Corp. L. 421, 426 (1988) (citing *Report of the Massachusetts Tax Commissioner on Voluntary Associations*, Mass. House Rep. No. 1646, at 2 (1912)).

[10] *Cf*. Mass. Pub. Stat. tit. XV, ch. 106, § 14 (1882).

[11] *See, e.g*., E. Merrick Dodd, Jr., *Statutory Developments in Business Corporation Law*, 50 Harv. L. Rev. 27, 31 (1936).

[12] *Id*.

[13] *See, e.g*., Williams v. Inhabitants of Milton, 102 N.E. 355 (Mass. 1913); *see also* Wheeler A. Rosenbalm, Comment, *The Massachusetts Trust*, 31 Tenn. L. Rev. 471, 472–76 (1964).

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liability.[14] By recognizing these ventures as a distinct commercial entity, Massachusetts courts "provide[d] a hospitable environment for the business trust"[15] whose jurisdictional superiority was so manifest that these entities became known as "Massachusetts Trusts."[16]

Numerous advantages set this commercial form apart from its rivals. As with other jurisdictions, business trusts in Massachusetts were not subject to any minimum or maximum capital limits, nor were they subject to the annual financial disclosure requirements that applied to corporations.[17] But equally important, investors held only a beneficial interest within, and a not a share of, a Massachusetts Trust, and thus had "no right to manage it by themselves nor to instruct the trustees how to manage it for them";[18] to obtain, much less exercise, any control over the trustees would result in the entity being treated as a general partnership, and not a Massachusetts Trust.[19] On the other hand, though, Massachusetts business trustees were not afforded limited liability or indemnification protection that corporate directors enjoy;[20] absent an exculpatory clause, Massachusetts business trustees were allowed only an equitable right to reimburse themselves for "obligations incurred for the benefit of the trust."[21]

From Common Law to Statutory Trusts

Until the early 1900s the business trust thrived in the common law.[22] On the one hand, the business trust thus represented an attractive alternative to the myriad of statutory limitations and regulations applicable to early corporations and later also general partnerships.[23] On the other hand, a consequence of being grounded in the law of trusts was that business trusts were not a legal entity, and thus only could sue (or be sued) and transact in the name of the trustee. All of this was compounded by judicial confusion and inconsistency across jurisdictions about how to treat business trusts.[24] And in some

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[14] *See, e.g.*, Dolben v. Gleason, 198 N.E. 762 (Mass. 1935).

[15] Jones *et al.*, *supra* note 9, at 429.

[16] *See, e.g.*, Edward H. Warren, Corporate Advantages Without Incorporation 328 (1929) ("A business trust is often called a Massachusetts Trust, because such trusts have probably been used in Massachusetts more than in any other one state.").

[17] *See supra* notes 13–14.

[18] Williams, 102 N.E. at 357.

[19] *See, e.g.*, Frost v. Thompson, 106 N.E. 1009 (Mass. 1914). The right to elect trustees initially was among the disqualifying types of control, but later was held not to result in treatment as a partnership. *See* Commissioner of Corporations and Taxation v. City of Springfield, 71 N.E.2d 593 (Mass. 1947).

[20] *See, e.g.*, Dolben v. Gleason, 198 N.E. 762, 763 (Mass. 1935) ("[I]n the absence of a stipulation to the contrary a trustee is personally liable in an action on a contract made by him for the benefit of the trust estate.").

[21] Town of Hull v. Tong, 442 N.E.2d 427, 429 (Mass. 1982).

[22] *See, e.g.*, Sitkoff, *supra* note 2, at 32 ("In the late 1800s and early 1900s, before the corporate form had matured, the common-law business trust . . . was a strong competitor to corporation as a mode of business organization.").

[23] *See* Uniform Partnership Act (1914). *See also* William C. Dunn, Trusts for Business Purposes 230–68 (1922).

[24] *See, e.g.*, Tamar Frankel, *The Delaware Business Trust Act Failure as the New Corporate Law*, 23 Cardozo L. Rev. 325, 326 n.4 (2001) (citing Herbert B. Chermside, Jr.,

jurisdictions the business trust even was denounced altogether as an "impermissible evasion of local corporate law."[25]

These developments did not escape the attention of the federal government. In 1939 the Securities and Exchange Commission (SEC) undertook a massive study of business trusts, specifically those used in connection with securities investments, and released a multi-volume report.[26] Although that report did examine trusts with individual investors, as well as Massachusetts Trusts,[27] the SEC was far more interested in the use of structures such as "a pyramided system of investment companies, based upon one company holding a controlling block of stock of other investment companies and noninvestment companies."[28] In direct response to the increasing use of trusts for mutual funds and investment companies Congress implemented the Investment Company Act of 1940.[29]

Waves of state trust statutes then followed during the 1960s and 1980s, including Delaware's contribution in 1988.[30] The reason for this surge in trust regulation is not entirely clear, but one distinct possibility is an apparent consensus among jurisdictions by the late 1950s that "employment of trust in the carrying on of trade or business" was "per se imprudent unless expressly authorized by the trust instrument."[31] Accordingly, state legislatures perhaps decided to take matters into their own hands to eschew any confusion or uncertainty within the common law about whether trusts could be used for business or commercial purposes. Delaware, for instance, reportedly adopted its Act for the "principal purpose of . . . recogniz[ing] the statutory trust as an alternate form of business organization."[32]

Not surprisingly, Delaware crafted a pivotal business trust statute. Interestingly, Delaware's Statutory Trust Act appears in Title 12, "Decedents' Estates and Fiduciary Relations," and not within Title 6, "Commerce and Trade," where all other business

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Annotation, *Modern Status of the Massachusetts or Business Trust*, 88 A.L.R.3d 704 (1978 & Supp. 2001)).

[25] Sitkoff, *supra* note 2, at 36 (citing Leland S. Duxbury, *Business Trusts and Blue Sky Laws*, 8 Minn. L. Rev. 465 (1924)).

[26] *See* I Securities and Exchange Commission, Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission Pursuant to Section 30 of the Public Utility Holding Company Act of 1935 (1939) (hereinafter SEC, Investment Trusts).

[27] *See, e.g., id*. at 29–34.

[28] *Id*. at 100.

[29] *See, e.g*., IV SEC, Investment Trusts, *supra* note 26, at 383 (describing the 1940 Act as being designed "to eliminate and prevent deficiencies and abuses in these organizations"). For a more detailed examination of the 1940 Act's impact on trusts, see, for example, Thomas S. Harman, *Emerging Alternatives to Mutual Funds: Unit Investment Trusts and Other Fixed Portfolio Investment Vehicles*, 1987 Duke L.J. 1045; Jay B. Gould & Gerald T. Lins, *Unit Investment Trusts: Structure and Regulation Under the Federal Securities Laws*, 43 Bus. Law. 1177 (1988).

[30] According to one prominent commentator, there are "perhaps as many as four generations of business trust legislation," with the first being colonial acts such as the Massachusetts statute, followed by those in the 1960s, then "legislation passed in the 1980s but before the Delaware Act," and finally post 1988 enactments. Sitkoff, *supra* note 2, at 36.

[31] *Id*. at 37 (quoting Restatement (Second) of Trusts § 227 cmt. f (1959)).

[32] Wendell Fenton & Eric A. Mazie, *Delaware Statutory Trusts*, *in* The Delaware Law of Corporations & Business Organizations § 19.2 (9th ed. 2004 Supp.).

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organizations are located; nevertheless, the statute defines a "statutory trust" as "an unincorporated association" that:

> (1) Is created by a governing instrument under which property is or will be held, managed, administered, controlled, invested, reinvested and/or operated, or business or professional activities for profit are carried on or will be carried on, by a trustee or trustees . . . including but not limited to a trust of the type known at common law as a "business trust," or "Massachusetts trust," or a [Real Estate Investment Trust].[33]

And, consistent with its approach to all business organizations, Delaware treats a statutory business trust as a "separate legal entity,"[34] subject to "maximum effect to the principle of freedom of contract."[35] Accordingly, while "the laws of [Delaware] pertaining to trusts are hereby made applicable to statutory trusts,"[36] they still benefit from the same contractarian framework that contributes to the state's durable dominance as the jurisdiction of choice for all other business entities.

Delaware's statute also implemented two significant refinements. First, the statute resolved a persistent common law ambiguity about the partitioning of the business trust's assets from the personal assets of beneficiaries and owners; as the statute now makes clear, beneficial owners are "entitled to the same limitation of personal liability extended to stockholders of private corporations for profit," and no personal liability can be imposed on a trustee unless provided by contract.[37] Second, as is the case for its limited liability companies, Delaware adopted a *laissez faire* conception of trustees' fiduciary duties, in that they "may be expanded or restricted or eliminated by provisions in the governing instrument" beyond the "implied contractual covenant of good faith and fair dealing";[38] accordingly, unlike other jurisdictions, Delaware features a complete opt-out regime as to whether any kind of trust-based duties of care or loyalty exist.[39] In these regards, then, Delaware's statutory business trusts offer some of the same fundamental benefits that the state's most popular business organization forms do, leading some to conclude that, "[i]n theory, any entity that can be formed as a business corporation, an LLC, an LLP, or an LLLP could be formed instead as a statutory business trust."[40]

Currently at least 18 states have some type of business trust statute. And at least 29

[33] Del. Code Ann. tit. 12 § 3801(g)(1) (2012).

[34] *Id.* at § 3801(g)(2); *see also* I.R.S. Rev. Rul. 2004-86 (ruling that Delaware statutory trusts are a separate entity that "will be classified as a trust for federal tax purposes").

[35] Del. Code Ann. tit. 12 § 3825(b) (2012). *See also* Frankel, *supra* note 24, at 326–27 ("[T] his marvelous contract-like organizational form, [with] its liberal contractarian approach and the freedom to . . . take on such characteristics of traditional *inter vivos* trusts, business trusts, corporations, or partnerships . . . may be the greatest advantage of the business trust over alternative forms of business organizations."); Professor Frankel, however, offers some persuasive criticisms that the Delaware act actually fails to deliver fully on these promises. *See generally id.*

[36] Del. Code Ann. tit. 12, § 3809 (2012).

[37] *Id.* at § 3803; *see also id.* at § 3817 (providing for trustee indemnification). However, beneficial owners do have a right to bring a derivative action against a trustee, *id.* at § 3816.

[38] *Id.* at § 3806(c).

[39] *See, e.g.*, Sitkoff, *supra* note 2, at 38 ("[T]rust law's more rigorous duties of loyalty and care . . . appear to be incorporated by reference by the modern business trust statutes.").

[40] Henry Hansmann *et al.*, *The New Entities in Historical Perspective*, 2005 U. Ill. L. Rev. 5, 14; *see also infra* notes 68–78 and accompanying text.

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states have legislation permitting the trust for business or commercial uses,[41] while 47 states have provisions that at least recognize the existence of a statutory trust.[42] The most recent, significant contribution is the Uniform Statutory Trust Entity Act, which was introduced in 2009 and has been adopted by two jurisdictions.[43] Slowly, but surely, the statutory business trust is becoming an established part of the business organizations landscape.

3. THE MODERN BUSINESS TRUST

The business trust is a mercurial entity that resists precise definition. The most "current" definition from the Supreme Court was formulated in 1924,[44] well before states proceeded to enact multiple generations of business trust statutes. But most of these recent statutes do not displace common law trusts; on the contrary, these statutes typically "provide that the common law of trusts applies unless otherwise displaced by a specific statutory provision or the terms of the trust instrument."[45] Moreover, jurisdictions such as Delaware subscribe to an overt contractarian approach, conferring parties with tremendous flexibility in constructing and operating a business trust. All of this suggests that trying to define the business trust may not be necessary to understand it—all we have to do is see it at work.[46]

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[41] *Cf. id*. at 35–36 ("The existing literature . . . puts the count of states with general business trust legislation anywhere from seventeen to thirty-four. Based on fresh electronic searches, I put the current count at twenty-nine.") (citing sources).

[42] My electronic searches revealed that only the state codes of Indiana, New Mexico, and Vermont lack any reference to the term "statutory trust."

[43] *See* Uniform Law Commission, *Statutory Trust Entity Act*, http://uniformlaws.org/Act.aspx?title=Statutory%20Trust%20Entity%20Act (last visited August 23, 2014) (listing the District of Columbia and Kentucky as having adopted the model act).

[44] In a case concerning the applicability of the Revenue Act of 1916 to three Massachusetts trustees, the court stated:

> The "Massachusetts Trust" is a form of business organization . . . consisting essentially of an arrangement whereby property is conveyed to trustees, in accordance with the terms of an instrument of trust, to be held and managed of such persons as may from time to time be the holders of transferable certificates issued by the trustees showing the shares into which the beneficial interest in the property is divided. These certificates . . . entitle the holders to share ratably in the income of the property, and, upon termination of the trust, in the proceeds. (Hecht v. Malley, 265 U.S. 144, 146 (1924) (Sanford, J.))

This evidently remains the operative definition used by the court. *See* Navarro Sav. Ass'n v. Lee, 446 U.S. 458, 467–68 (1980) ("In *Hecht v. Malley* . . . this Court described the Massachusetts business trust in terms that have come to be accepted as the classic definition") (Blackmun, J., dissenting) (citing 16A R. Eickhoff, Fletcher Cyclopedia of the Law of Private Corporations §8228 (1979)).

[45] Sitkoff, *supra* note 2, at 38.

[46] *Cf*. Jacobellis v. State of Ohio, 378 U.S. 184, 197 ("I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed intelligibly in doing so. But I know it when I see it") (Stewart, J., concurring); The Departed (2006) ("I know what you are, and what you aren't.") (Mark Wahlberg aka Det. Sgt. Dignam).

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One useful approach is to view business trusts through a taxonomy. According to one prominent commentator,

> [c]ommercial trusts can be categorized in two ways: by the "type" of trust, where labels have been given to commercial trusts, and by the business use to which the trust has been placed. Both ways are needed because there is sometimes an imprecise correlation between labels and functions: certain entities called trusts are not trusts, and other entities may be trusts even though they do not go by that name.[47]

While not without merit, cataloging the entire universe of business trusts by label or name is a difficult, and perhaps futile, exercise. Past attempts have been helpful in identifying a broad range of business trust-like entities, but many of them can be denominated or described in multiple ways;[48] moreover, this population is potentially too numerous to yield a wieldy list.[49]

The superior approach is thus to focus just on different functions. Business trusts have at least five discrete, categorical functions: (1) property holding, (2) asset securitization, (3) risk management, (4) pooled asset management, and (5) tax advantages. Each of these applied features of the business trust is described concisely here, with reference to more detailed treatment in academic literature.

Property Holding

Trusts are a useful commercial vehicle for simply holding property. This is because trusts serve as an intermediary entity through which developers or owners can transact via a trustee, without having to reveal their own identity.[50] Trusts also can facilitate transactions involving multiple parties by having property centralized within the custody and control of a trustee.[51] Typically, the trustee performs the function of "nothing more than a nominee or 'bare' trustee . . . [who] holds the legal title, but has no power to deal independently with the property."[52] In both scenarios the operative rationale is a mitigation of collective action problems; shielding identities can avoid potential hold-out problems by third-parties, while representation by a fiduciary can reduce the number of creditors or litigants who are directly involved in decision-making.

This rationale is clearly illustrated by transactions under the Trust Indenture Act of 1939. When, for example, a corporate entity issues debt securities, a trustee is appointed to represent the interests of all securityholders. Effective representation is possible because while the indenture is by and between the issuer and trustee, the latter has no control, custody, or right of the property unless a default occurs, and instead bears fiduciary duties that inure to the benefit of securityholders.[53] By occupying this peculiar intermediary role

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47 Schwarcz, *supra* note 1, at 563–64.
48 *Compare, e.g.*, *id.* at 566–73, *with* Langbein, *supra* note 1, at 168–77.
49 *See, e.g.*, *id.* (listing at least 12 distinct types of business trusts).
50 *See, e.g.*, Flannigan, *supra* note 1, at 631.
51 *Id.* at 631 and 633.
52 *Id.* at 632.
53 *See, e.g.*, *id.* ("The trust is associated with a notorious set of default fiduciary rules and principles that . . . is a considerable convenience to settlors . . .").

between the issuer and the securityholders, the trustee serves to "overcome[ ] the coordination problem that inheres in widespread public ownership of debt securities."[54]

Asset Securitization

Business trusts also serve an integral role in structured finance deals. Although data on the size of the structured finance market are elusive, $21.7 billion in asset-backed securities were traded in 2013,[55] a large fraction of which "is financed—or somewhat more accurately, refinanced—through asset securitization trusts."[56] Undoubtedly, even after the recent global financial crisis, structured finance continues to thrive, and it does so primarily in the form of the business trust.

In this arena the trust typically serves as a special purpose entity (SPE). Although the range of potential transactions is diverse, in essence an operating company can transfer assets (e.g., receivables) or even liabilities (e.g., mortgages) to a trust, which in turn issues securities to third-party investors, whose cash largely will flow back to the company.[57] The trust thus performs a crucial function as an intermediating shield; while the company enjoys a lack of privity with investors, the SPE trust's "bankruptcy remote" status protects investors should the company become insolvent.[58]

Risk Management

Related to its role in securitization, business trusts diversify risk. Traditionally, lenders would guard against overextended liabilities by selling undivided interests to other banks;[59] under this approach, however, selling each interest to a separate bank quickly accrued substantial transaction costs to achieve a level of sufficient diversification.[60]

Instead, businesses use a variety of different types of trusts. Rather than the traditional method, a simple statutory business trust can diversify risk easily by the issuance of trust certificates, with a so-called residual class that is retained by the lender for the purposes of recouping any remaining value after all senior investors have been paid as well as providing an incentive for the lender to monitor the originating debtor's financial situation.[61] Another common diversification vehicle is a master trust, which enables a party to create multiple classes of trust certificates for a specific set of financial assets; as with

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[54] Langbein, *supra* note 1, at 174.

[55] *See* Securities Industry and Financial Markets Association, *US SF Trading Volume*, www.sifma.org/research/statistics.aspx (last visited August 29, 2014).

[56] Langbein, *supra* note 1, at 172 (reporting "'[p]atchy Federal Reserve data show[ing] nearly $1.9 trillion in mortgage pools," albeit in 1996).

[57] For an excellent diagram of this structured transaction, see, for example, Paul Halpern & Oyvind Norli, *Canadian Business Trusts: A New Organizational Structure*, 18 J. App. Corp. Fin. 66, 67 fig.1 (2006) ("Business Trust Structure"). And for excellent information and insight into the benefits of asset securitization, see Steven L. Schwarcz, *What Is Securitization? And for What Purpose?* 85 S. Cal. L. Rev. 1283 (2012).

[58] *See, e.g.*, Schwarcz, *supra* note 1, at 564; Langbein, *supra* note 1, at 173.

[59] *See, e.g.*, Schwarcz, *supra* note 1, at 565.

[60] *See, e.g., id.* at 565–66.

[61] *See, e.g., id.*

corporations, different classes can have entirely different terms, which can appeal to a broader population of potential investors and thus increase the amount of investments.[62]

Pooled Asset Management

The majority of pension and mutual funds are organized as trusts.[63] Pension funds assume this form because the Employee Retirement Income Security Act of 1974 (ERISA) "codifies the central principles of trust fiduciary law, and ERISA's legislative history makes clear that Congress meant to track the common law of trusts."[64] In contrast mutual funds have a choice to form either as an investment company or investment trust, but the majority reportedly favor the latter option.[65]

Trusts are preferred pooled investment vehicles for multiple reasons. Beyond ERISA's mandatory regulatory framework,[66] pension funds resort to the trust for its structural relationship with beneficiaries, since undistributed funds may be transferred to a pension plan owner's survivors; in this way, "the pension trust exhibits a hybrid trait: Although it is a commercial trust, it commonly gives rise to a gratuitous transfer."[67]

The trust rationale for mutual funds, however, is far more complex. As one prominent commentator has observed, "[t]here are not . . . clear answers to the fundamental question of whether trusts are a better form of business organization than corporations . . . ."[68] According to the commentator, one possibility is that the corporate form may be better suited for more unilaterally aggressive mutual funds, because the presence of strong limited liability and the Business Judgment Rule may shield managers from litigation risks, versus "where all of the fund's beneficiaries want the manager to take these risks, there would be no real conflicting interests, and the trust form is sufficient."[69] This seems somewhat dubious, given that the Investment Company Act of 1940 provides identical fiduciary standards to managers of investment companies and investment trusts.[70]

A more plausible reason is governance. The choice of entity for mutual fund managers largely is not between a trust and a generic corporation, but rather what is known as the

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[62] *See, e.g., id*. at 567.

[63] *See, e.g*., Langbein, *supra* note 1, at 168–71 and 178; Flannigan, *supra* note 1, at 633 ("Most mutual funds in Canada are in fact trusts.").

[64] Langbein, *supra* note 1, at 169 (citing sources).

[65] *Id*. at 171.

[66] Cf. *id*. at 169 ("Actually, the federal policy of promoting the trust form for pension funds is older than ERISA.").

[67] *Id*. at 170; *see also* Paul B. Miller, *The Future for Business Trusts: A Comparative Analysis of Canadian and American Uniform Legislation*, 36 Queen's L.J. 443, 449 (2011) ("The popularity of the trust for managing funds is understandable given similarities between the management of pooled assets of multiple investors and the management of trust property for multiple beneficiaries of an ordinary private donative trust.").

[68] Schwarcz, *supra* note 1, at 560 (noting also the vagaries of the trust's superiority over partnerships); *see also* Langbein, *supra* note 1, at 188 ("[W]e should in principle be able to specify why one or the other prevails in a particular setting. I am not yet able to do this.").

[69] Schwarcz, *supra* note 1, at 571.

[70] *See* 15 U.S.C. § 77b, 80a-1 to 80a-64, 80b-1 to 80b-21 (1994). *See also* Miller, *supra* note 67, at 450 ("As in corporations, [trust] management is subject to fiduciary strictures to guard against careless and disloyalty.").

Maryland corporation. According to a survey, "half of all newly organized mutual funds took the form of [Massachusetts business] trusts, but . . . a further 28% were organized as Maryland corporations."[71] During the late 1980s Maryland's legislature revamped its corporation statute "to ape the flexibility of the commercial trust in governance."[72] Specifically, Maryland investment company boards are not required to hold annual meetings merely for informational purposes,[73] thereby avoiding "attendant proxy costs, one of the distinctive advantages of trust-type mutual funds,"[74] and may modify unilaterally the aggregate number of shares.[75]

The business trust, however, features a unique structural advantage. In essence the trustee can be understood as "two distinct legal persons: a natural person contracting on behalf of himself, and an artificial person acting on behalf of the beneficiaries."[76] The distinction turns on asset partitioning, whereby the trustee represents an agent whose personal assets are shielded from any of the trust's creditors while the trust is managed by a "de facto office of the trustee" that "serves as the organizing hub for the various relations that aggregate into the trust."[77] Put differently, individual trustees can come and go, but the office of the trustee is a stable entity that actually performs the function of handling all of the trust's creditors and facing their claims. And, most crucially, "[t]his creation of two distinct persons c[an] not feasibly be reproduced with explicit contracting" due to excessive transaction costs.[78] No exact structural counterpart exists within any other kind of business organization, including the Maryland corporation.

Tax Advantages

Tax considerations also cannot be discounted from the business trust. Pursuant to the Check-the-Box regulations, American business trusts are not treated the same as so-called "ordinary," or donative, trusts, but rather as a business entity;[79] nevertheless, under this regime, business trusts can elect to be taxed on a "pass-through" basis, thereby avoiding the entity-level tax applied to all corporations.[80] And for those business trusts beyond the reach of the Check-the-Box regulations, the same effect can be obtained by utilizing internal debt to offset any profits, with cash distributed in the more favorably taxed form

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[71] Langbein, *supra* note 1, at 187 (citing Jones *et al.*, *supra* note 9, at 422).

[72] *Id.*

[73] *See* Md. Ann. Code § 2-501 (requiring an annual meeting only when there is an election of directors, approval of the investment advisory agreement, ratification of selection of independent accountants, or approval of a distribution agreement). *See also* Jones *et al.*, *supra* note 9, at 422 n.5 (describing some interpretative ambiguities within this statutory provision).

[74] Langbein, *supra* note 1, at 187.

[75] *See* Md. Ann. Code § 2-105.

[76] Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 Yale L.J. 387, 416 (2000).

[77] Robert H. Sitkoff, *An Agency Costs Theory of Trust Law*, 89 Cornell L. Rev. 621, 641 (2004).

[78] *Id.* at 632 (citing Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. Rev. 434, 466 (1998)).

[79] *See* 26 C.F.R. § 301.7701-4(a)–(c) (2014).

[80] *See id.* at § 301.7701-2.

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of interest, rather than as capital gains or dividends.[81] Moreover, unlike partnerships, business trusts functioning as pension funds or other types of retirement accounts have their tax deferred to a later period, thereby yielding further gains.[82]

Summary

Business trusts can bear many names and assume an even greater number of forms. More importantly, business trusts can perform multiple functions in a wide variety of settings, only some of which have been described here. At the risk of stating the obvious, these functions are neither mutually exclusive nor singularly dispositive in explaining why business trusts are preferred in certain industries or transactions. On the contrary the diverse array of functions and context in which business trusts thrive bespeaks to a versatility that few other organizational forms can exhibit; this advantage is only reinforced when one considers the contractual flexibility permitted in business trust instruments, particularly in *laissez faire* jurisdictions such as Delaware. Accordingly, the pertinent question is not really why business trusts exist, but rather why they are not used to an even greater extent than what the available data already suggest.[83]

4. CONCLUSIONS

Despite its venerable history, the business trust continues to be a dynamic organizational form. Over the past two centuries the business trust has evolved from an almost purely common law creature into a contractarian entity governed by modern statutory defaults that incorporate traditional trust principles. Recent academic and legislative attention only promise to further refine the business trust and unlock its true potential.

For this to occur, however, a great deal of work remains to be done. Among the most significant and pressing deficiencies with regard to the business trust is a virtual dearth of empirical evidence. Official and private regulatory bodies here and abroad currently do not compile reliable, much less textured, data on the frequency, scale, and types of business trusts in use, despite clear indications of their ubiquity. Moreover, we lack even any anecdotal evidence from users of business trusts about why they have chosen that form over any other alternatives. Finally, there are thousands of published legal decisions concerning business trusts, which would benefit from systematic treatment of the issues that tend to arise with these entities. Obtaining all of these sorts of information would go a long way to establishing a clear positive portrait about the business trust and how it enhances value in various settings and transactions.

There is also a fundamental conceptual issue that merits serious attention. The modern

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[81] *See, e.g*., Halpern & Norli, *supra* note 57, at 70.

[82] *See, e.g., id*.; Miller, *supra* note 67, at 451 ("Income trust conversions in Canada were largely driven by preferred tax status.").

[83] A plausible explanation may lie in network effects and status quo bias, whereby entrepreneurs favor more established and familiar types of organizations rather than the business trust. *See, e.g*., Sitkoff, *supra* note 2, at 46. Or perhaps the reason is simple ignorance. Regardless, the answer requires some empirical evidence.

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business trust is viewed conventionally from the robust contractarian approach, which fruitfully frames and guides our understanding of unincorporated and corporate entities; indeed, Delaware's statute explicitly embraces contract as the natural legal foundation for business trust.[84] But, at the same time, the trust is grounded in property law; this the basis for the materially distinct set of fiduciary relationships within trusts,[85] as well as the structurally peculiar relationships between the trustee, the underlying *res*, and beneficiaries.[86] The relationship between contract and property is not mutually exclusive,[87] and so perhaps the most apt characterization of the trust is as a "hybrid of contract and property, [where] . . . contractarian elements do[ ] not require disregard property components whose convenience abides."[88] But that nevertheless renders the business trust a meaningfully different kind of form than the partnership, corporation, and limited liability company.[89] To be sure, all of these forms conform to various cost-structure or feature-based analysis.[90] The challenge, however, is not confined simply to finding some kind of golden thread that runs through the entire universe of business organizations; rather, the trust's quirky nature presents a rich array of provocative questions about what is and potentially what should be the proper paradigmatic way to view business law in general.

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[84] *See supra* note 35 and accompanying text.

[85] *See, e.g.*, Gregory S. Alexander, *A Cognitive Theory of Fiduciary Relationships*, 85 Cornell L. Rev. 767, 768 (2000).

[86] *See, e.g.*, Hansmann & Mattei, *supra* note 78, at 147.

[87] *See, e.g.*, Thomas W. Merrill & Henry E. Smith, *The Property/Contract Interface*, 101 Colum. L. Rev. 773 (2001).

[88] Langbein, *supra* note 1, at 669; *see also generally* John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 Yale L.J. 625 (1995).

[89] *Cf*. Navarro Sav. Ass'n v. Lee, 446 U.S. 458, 476–77 (1980) (questioning "the Court's distinction between business trusts and . . . other enterprises . . . on the locus of title to the trust assets") (Blackmun, J., dissenting).

[90] *See generally* Sitkoff, *supra* note 2; Hansmann & Kraakman, *supra* note 76. One also could apply an information or transaction cost analysis or focus on differences within the conventional matrix of attributes derived from the Kintner Regulations.