§8.22 Why Do We Need the Trust When We Have the Corporation and the Third-Party Beneficiary Contract?

The slogan of modern comparative law—compare function rather than form—does not work for the trust. One cannot identify the function of the trust because there is no such function. The trust is functionally protean. Trusts are quasi-entails, quasi-usufructs, quasi-wills, quasi-corporations, quasi-securities over assets, schemes for collective investment, vehicles for the administration of bankruptcy, vehicles for bond issues, and so on and so forth. In software terminology, trusts are emulators.¹

The corporation.² While a trust, in theory, can be designed to do what a corporation can do and more,³ the corporation has for some time been an important instrument of commerce. This is, in part, because of the efficiencies attendant to a standardized form of doing business that can vary in format only within narrow limits. There are a number of advantages to standardization: “These include: reducing the burden of drafting; reducing information costs of various actors—lawyers, judges, and businesspeople—by inducing them to use the same form; making it easier for actors to bond themselves credibly to certain structures or forms of conduct; and facilitating an accretion of clarifying legal precedent.”⁴

In the eighteenth and first half of the nineteenth centuries things were different. Incorporation was conferred either by the Crown issuing a charter or Letters Patent, or by private Act of Parliament, each a cumbersome, time-consuming, and sometimes even futile process.¹ Thus the unincorporated joint stock company operating under deed of trust was the preferred instrument of commerce, and it remained so until 1844 when Parliament authorized incorporation by registration.² While one era in the commercial life of the Anglo-American trust had come to an end, another was just beginning on the other side of the Atlantic, namely, that of the great American industrial trust. It too would fall victim to legislation, but not until 1890 when Congress passed and the President signed the Sherman Antitrust Act.

Notwithstanding the many modern-day advantages of the corporation,⁵ there are still

²C. Bishop & D. Kleinberger, Limited Liability Companies ¶1.01[1] (1998). For a discussion of the advantages of the LLC for a wide variety of business ventures, see ¶1.02[1].
¹See Kevin Lindgren QC, The Birth of the Trading Trust, 9(2) Tr. Q. Rev. 5 (2011) [a STEP publication].
²See Kevin Lindgren QC, The Birth of the Trading Trust, 9(2) Tr. Q. Rev. 5 (2011) [a STEP publication] (referring to the Joint Stock Companies Act 1844 [7 & 8 Vict c 110]).
⁵See Tamar Frankel, The Delaware Business Trust Act Failure as the New Corporate Law, 23 Cardozo L. Rev. 325, 327, 330 (2001) (suggesting that while the trust is an ideal vehicle for
commercial tasks that only a trust, a child of equity and creature of the common law, can perform—or perform well. The reason: its flexibility. By way of example, the nominee trust will continue to prove a useful instrument of commerce and estate planning in situations where minimal property management is called for. In the investment management industry, the trust has become a popular form of doing business in part because of the common law principle that a trustee need not be controlled by the beneficiary. In fact, roughly 40 percent of U.S. equities and 30 percent of corporate and foreign bonds are now held in pension funds and mutual funds, most of which are trusts or trusts in substance if not in form. In Section 9.31 of this handbook, we discuss how the trust is particularly suited for managing property that has been segregated to secure the contractual rights of a class of bondholders. These trusts are known in the trade as “corporate trusts” and their trustees as “indenture trustees.”

Let us take the nominee trust. Both trustees and corporations can hold title to real estate. However, in cases where active management of that real estate is not called for, it is generally more practical and cost-effective for a trustee to hold the bare legal title than it is for a corporation. This is because the typical incorporation statute calls for an internal governance structure and a paper trail that is ill suited to a mission that is fundamentally passive. If all one is looking for is divisibility and transferability, and perhaps an element of privacy, the simple device of the nominee trust may well be the way to go.

As mentioned, there are also advantages to operating pension and mutual funds through trustees. To be sure, both trustees and corporations can hold title to portfolios of securities. But when the beneficial ownership of a portfolio is lodged with a fluid and potentially expanding class of anonymous investors, as is the case with most mutual funds, the trust model offers an important advantage over the corporate model: the trustee need not be subject to beneficiary direction. A corporate board of directors, on the other hand, must answer to shareholders in matters of internal governance. The corporate model, while appropriate perhaps for a manufacturing concern, is generally not appropriate for the mutual fund, provided the underlying assets, as well as the fund participations themselves, are reasonably liquid. If the investor does not like how the fund is being managed, he can easily cash out and invest his property elsewhere.

“managing other people's money and real estate,” it is “inconvenient” as a vehicle for operating commercial and manufacturing enterprises).

"Next to contract, the universal tool, and incorporation, the standard instrument of organization,…[the trust]…takes its place wherever the relations to be established are too delicate or too novel for these courser devices.” Isaacs, Trusteeship in Modern Business, 42 Harv. L. Rev. 1048, 1060 (1929).


See generally§9.6 of this handbook (discussing the nominee trust).

See, e.g., Aaron Lucchetti, Vanguard Moves to Alter Indexes, Wall St. J., Aug. 27, 2002, at D7, col. 2 (reporting that Vanguard Group, the nation's No. 2 mutual-fund firm, plans to make it easier for some of its large index funds to change the indexes the fund portfolios are designed to mimic: “The proposal, announced in a preliminary proxy statement filed by the Malvern, Pa., company yesterday, would allow trustees for eight large Vanguard index funds to authorize changes in their target indexes without having to call for shareholder votes.”).
The administrative “efficiencies” attendant to employing the trust model in the investment context is generally perceived to be worth the loss of investor control over the inner workings of the enterprise. It is no coincidence that most mutual funds in the United States operate as trusts even when their trappings are corporate.  

The trust, however, takes center stage in the personal (noncommercial) context. The trust makes an excellent will substitute. It is also about the only practical way to provide for the administration of interests in property that are contingent and/or subject to shifting. Moreover, it can “create and protect future interests in property for persons who are not presently ascertainable and who may be conceived in the future.” The corporation as a practical matter can perform none of these tasks. While the trustee's role as a facilitator of wealth management over time and intrafamily wealth transfers may seem trivial as set against his ever-expanding role as a commercial facilitator, on a personal level his contribution to the well-being and peace of mind of individuals can be incalculable.


The life insurance policy, a third-party beneficiary contract, is also a will substitute. As a practical matter, however, it is difficult, if not impossible, through contractual means alone, without the participation of a trustee, to create shifting and/or contingent interests in insurance proceeds, and to do so in a way that will make adequate provision for the ongoing administration of those interests. That problem is best addressed by designating a trustee as the recipient of the proceeds. This would be the case whether the payout is lump sum or periodic. See generally§9.3 of this handbook (the self-settled “special needs”/“supplemental needs” trust); John Langbein, The Nonprobate Revolution and the Future of the Law of Succession, 97 Harv. L. Rev. 1108 (1984).


As has been noted, a trust may be used to collect ownership of various assets and continue management after the underlying owner's death, while bypassing probate and administration....In the case of ownership through other forms such as corporations, partnerships, and individual ownership, no such avoidance of probate and administration is possible.” Jeffrey A. Schoenblum, 1 Multistate and Multinational Estate Planning 42–43 (1999).

See H. Hansmann & U. Mattei, The Functions of Trust Law: A Comparative Legal and Economic Analysis, 73 N.Y.U. L. Rev. 434, 437 (1998) (“Similarly, turning from the demand side to the supply side of the securities markets, asset securitization trusts are now the issuers of a large fraction of all outstanding American debt securities—more than $2 trillion worth.”).
As noted, a trust can serve as a will substitute. Upon the death of a beneficiary, neither the legal interest nor the equitable interest need be subject to probate. The corporation, on the other hand, in and of itself, cannot serve as a vehicle for transmitting property postmortem. When a shareholder dies, under most enabling statutes, his economic interest in the corporation will pass to his estate for disposition pursuant to the terms of his will or the laws of intestate succession, unless the interest had been held jointly or had been made the subject of a trust during the decedent's lifetime. A trust is a fiduciary relationship with respect to property to which the trustee has the title. A corporation, on the other hand, is itself property. Although it may internally involve fiduciary relationships, it is not itself a fiduciary relationship with respect to property.

As also noted, the corporation is unsuited to the administration of multiple, successive, shifting, and contingent property interests. Something more is needed, be it a guardianship coupled with a will, a durable power of attorney coupled with a will, or a trust. Again, the reason is grounded in first principles: A corporation is not a fiduciary relationship with respect to property, externally it is itself property. Absent substantial legislative retrofitting, the corporate model cannot serve as a trust substitute.

The contract. The academic community is revisiting the question of whether the trust is a branch of contract law or a branch of property law. This debate—essentially a continuation of what was begun by Frederick W. Maitland, who argued the former, and Austin W. Scott, who argued the latter—presupposes only two private fundamental legal relationships: contract and property. Note, however, that while Maitland may have come down on the side of contract, he did so with some ambivalence:

For my own part if a foreign friend asked me to tell him in one word whether the right of the English Destinatär (the person for whom property is held in trust) is dinglich [a property interest] or obligatorisch

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15 See generally Chapter 1 of this handbook.
16 What about the partnership that, with certain statutory exceptions, operates on the basis of agency principles? The partnership, like the trust, involves fiduciary relationships with respect to property. However, a partnership, like the corporation, alone cannot serve as a vehicle for the postmortem transmission of property interests. The reason: An agency terminates at the death of either the principal or the agent. Upon death, the deceased partner's economic interest passes to his estate, unless a trust or trust-like will substitute is somehow involved. See generally Restatement (Second) of Agency §14A cmt. a, §14B cmt. i (1958).
17 An interest is contingent if it is subject to a condition precedent such as the exercise of someone's discretion or survivorship. See generally §8.2.1 of this handbook (the Rule against Perpetuities).
18 Although the trustee by accepting the office of trustee subjects himself to the duties of administration, his duties are not contractual in nature.” Restatement (Second) of Trusts §169 cmt. c (1959).
20 For the recent articulation of the contract argument, see J. Langbein, The Contractarian Basis of the Law of Trusts, 105 Yale L.J. 625 (1995); for the recent articulation of the property argument, see H. Hansmann & U. Mattei, The Functions of Trust Law: A Comparative Legal Economic Analysis, 73 N.Y.U. L. Rev. 434 (1998). See also 7 Scott & Ascher §46.4.2 (“In any event, the creation of a trust is not a contract but a disposition of the beneficial interest in the trust property”). Cf. 3 Scott & Ascher §13.1 (coming down on the side of those who argue that a trust beneficiary has a proprietary interest in the underlying trust property, not just a chose in action or claim against the trustee, but acknowledging that “the scholarly debate continues”).
[a personal claim], I should be inclined to say: "No, I cannot do that. If I said dinglich, that would be untrue. If I said obligatorisch, I should suggest what is false. In ultimate analysis the right may be obligatorisch; but for many practical purposes of great importance it has been treated as though it were dinglich, and indeed people habitually speak and think of it as a kind of Eigenthum [property].

The issue as framed, however, can never be resolved because the premise, it is suggested, is false. Our legal system does not have two private fundamental legal relationships of the consensual variety. It has four, notwithstanding what the scholars may say: They are the agency, the contract, the bundle of legal rights and correlative duties known as property, and the trust. There are four because four are needed. No one is sufficiently elastic to encompass another without turning into the other. The Cayman Islands STAR trust, a contract-trust hybrid discussed in Section 9.8.10 of this handbook, endeavors to walk the tightrope. How successful it will be in doing this over the long term remains to be seen. These relationships are facets, however, of the single gem we loosely call the common law.

The four private fundamental consensual legal relationships are profoundly different and profoundly interrelated. The trust exhibits agency, property, contractual, and even corporate attributes, but is sui generis. Contractual rights are themselves property rights. Contractual rights may be the subject of a trust. The equitable interest in one trust may constitute the property of another. An agency may be gratuitous or associated with contractual obligations. The corporation, internally a statutory tangle of agencies, externally is merely property (a legal interest). And in the case of an incorporated mutual fund, it may actually be a trust.

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21 Maitland, Selected Essays (1936) 146.
22 There are also nonconsensual legal duties which, when breached, can constitute torts.
23 Attempting to squeeze a trust into the third party beneficiary contract slot inevitably leaves too much hanging out, e.g., the charitable trust or the private discretionary trust that calls for the shifting of property interests between and among generations of persons who at the time the contract is struck are unborn and unascertained. To doctor a third-party beneficiary contract into something that would be a satisfactory substitute for such high maintenance arrangements would merely transmogrify it into a trust. While a trust has the attributes of a contract, of property, of agency, and even of a corporation, it is now sui generis, regardless of its evolutionary origins. As one learned commentator versed in the taxonomies of both the common law and the civil law has noted: “Trusts do, indeed, impinge deeply upon the law of obligations and the law of property, but they do not belong essentially to either.” George L. Gretton, Trusts Without Equity, 49 Int’l & Comp. L.Q. 599, 614 (July 2000).
24 For purposes of this section, the term common law encompasses the law of equity.
27 See, e.g., §9.8.7 of this handbook (the Quistclose trust).
One commentator has focused not on the profound dearth of nuance of academia’s efforts to demote the trust to a sub-set of the law of contracts but on the unsavory subserviveness of it all:

Under the influence of law and economics theory, prominent scholars and reformers are rapidly dismantling the traditional legal and moral constraints on trustees. Trusts are becoming mere “contracts,” and trust law nothing more than “default rules.” “Efficiency” is triumphing over morality. In the law and economics universe of foresighted settlors, loyal trustees, informed beneficiaries, and sophisticated family and commercial creditors, trusting trustees may make sense. In the real world, however, it does not. A trust system that exalts trustee autonomy over accountability can and increasingly does impose significant human costs on all affected by trusts.28.1

Conclusion. Neither the corporation nor the contract can replace the trust as the foundation of an estate plan because neither can administer multiple, successive, shifting, and contingent property interests. For those functions, we must still look to the trust. To be sure, in the years to come we will be seeing more and more trusts containing interests in LLCs29 and more and more LLCs containing interests in trusts.30 But it will be many years, if ever, before we see the corporation or the third party beneficiary contract transmogrified into something capable of functioning as a satisfactory substitute for the common law trust that is the subject of this handbook. While the civil law foundation nowadays can be fitted out to perform some of the functions of a common law trust, the entity still has a long way to evolve before it could be said to be as protean as the trust relationship. For the reasons why, the reader is referred to Section 8.12.1 of this handbook.

As a means of facilitating investment management services in the commercial context, the trust also is superior to the other fundamental legal relationships. Having full decision-making power over the trust property, the trustee can exclude from it anybody in the world including the beneficiary.31 “This is particularly important in the business world where quick, reliable, unimpaired decision making is per se an important asset that an agent, in principle, does not enjoy but that the trustee does.”32 On the other hand, the U.S. and U.K. trust-based mutual fund models are more investor-friendly than their civil law counterparts on the Continent, in large part due to


30 Massachusetts courts, for example, have imposed liability on the owners of the shares of beneficial interests in nominee trusts, particularly when real estate is involved. In response, the owner of shares of beneficial interest in a nominee trust that contains Massachusetts business real estate may want to transfer those shares into a LLP or LLC in exchange for legal interests in the limited liability entity of equivalent economic value.


the expansive and free-ranging nature of the common law fiduciary relationship.\textsuperscript{33}

Also important is that whereas the creditors of a contract promisor, \textit{e.g.}, the creditors of an insurance company, will have access to the economic interest which is the subject of the contract, the creditors of the trustee, \textit{e.g.}, the creditors of a mutual fund trustee, will not have access to the subject matter of the trust.\textsuperscript{34} Nothing beats the trust when it comes to \textit{securitizing} a collection of assets or \textit{securing} a collection of assets against the claims of certain classes of creditors. For more on such commercial applications of the Anglo-American trust relationship, the reader is referred to Charles E. Rounds, Jr.\textsuperscript{35}

