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Trust Law: Private Ordering and the Branching of American Trust Law

John D. Morley[*]
Robert H. Sitkoff[**]

Abstract

In this chapter, we identify the principal ways in which the common law trust has been used as an instrument of private ordering in American practice. We argue that in both law and function, contemporary American trust law has divided into distinct branches. In our taxonomy, one branch involves *donative* trusts and the other *commercial* trusts. The donative branch divides further to include separate sub-branches for *revocable* and *irrevocable* donative trusts. We explain the logic of this branching in both practical function and doctrinal form.

I. Introduction

The common law trust sits at the heart of Anglo-American private law. For centuries, the trust has enabled private parties to order their affairs in an impressive variety of ways. "The purposes for which we can create trusts," says the leading treatise, "are as unlimited as our imagination."[1] In addition to facilitating gifts down the generations, the trust has also conveyed land, managed wealth, structured secured loans, resolved bankruptcies, issued bonds, securitized assets, and organized major businesses. Frederic Maitland, the great English legal historian, summed up the trust's significance in the early 20th century: "If we were asked what is the greatest and most distinctive achievement performed by Englishmen in the field of jurisprudence, I cannot

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[1] 1 Austin Wakeman Scott, William Franklin Fratcher & Mark L. Ascher, Scott and Ascher on Trusts § 1.1, at 4 (5th ed. 2006) (hereafter Scott and Ascher on Trusts).

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think that we should have any better answer to give than this, namely, the development from century to century of the trust idea."[2]

Despite the trust's immense importance, it has received little attention from social scientists. The law-and-economics movement, in particular, has only recently begun to take the trust seriously,[3] and economic scholarship on trust law remains underdeveloped in comparison to other private law fields. The thinness of economic scholarship on trust law, however, should not obscure the long and deep tradition of doctrinal, historical, and jurisprudential scholarship in the field. Since long before Maitland in the early 20th century, scholars on both sides of the Atlantic have focused on the trust as a major source of inquiry.

The law of trusts thus presents an especially fruitful field in which to employ the analytical tools of the "New Private Law."[4] Centuries of legal scholarship have given us a rich institutional understanding of trust law, but we are just now beginning to combine that understanding with the insights of social science. The field has ample room for the "inclusively pragmatic" approach to private law urged by the leaders of the New Private Law movement.[5] The law of trusts is replete with categories that we can take seriously as theoretical and doctrinal constructions, even as we pragmatically explore their functions in facilitating private ordering.

To that end, this chapter proposes a legal and functional taxonomy of contemporary American trust law.[6] Our argument is not merely that trust law serves different sets of purposes. Rather, our claim is that the law of trusts in both doctrine and practice has developed into a set of distinct categories that branch outward from the central historical core of trust law. To break down trust law in this way is to approach it pragmatically, by asking about its functions, and also inclusively, by accepting that the law's conceptual categories are interesting objects of inquiry in and of themselves.

Our taxonomy divides the law of trusts into two categories: *donative* and *commercial*. We further divide donative trusts into *revocable* and *irrevocable* trusts. We

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[2] 3 The Collected Papers of Frederic William Maitland 271-284, at 272 (H.A.L. ed., 1911).

[3] See, e.g., Henry Hansmann & Ugo Mattei, The Functions of Trust Law: A Comparative Legal and Economic Analysis, 73 N.Y.U. L. Rev. 434 (1998); Robert H. Sitkoff, An Agency Costs Theory of Trust Law, 89 Cornell L. Rev. 621 (2004); Max M. Schanzenbach & Robert H. Sitkoff, Did Reform of Prudent Trust Investment Laws Change Trust Portfolio Allocation?, 50 J. L. & Econ. 681 (2007); Robert H. Sitkoff, Trust Law as Fiduciary Governance Plus Asset Partitioning, in The Worlds of the Trust (Lionel Smith ed., Cambridge University Press 2013).

[4] See John C. P. Goldberg, Introduction: Pragmatism and Private Law, 125 Harv. L. Rev. 1640, 1650–63 (2012).

[5] Id.

[6] Our focus is on *American* trust law, which differs in meaningful respects as to the matters discussed from the law in the British Commonwealth. Within American law, our focus is on *private express trusts*. We set to the side the *constructive trust*, which in American law is a remedy to make restitution for unjust enrichment, and the *resulting trust*, which in American law is an equitable reversionary interest. See Robert H. Sitkoff & Jesse Dukeminier, Wills, Trusts, and Estates 131-32, 417-18 (10th ed. 2017). We also set to the side the *charitable trust*, as per infra note 8.

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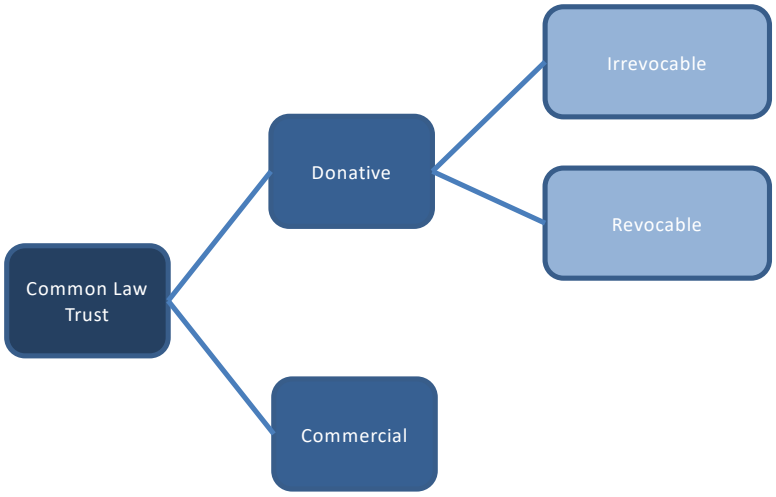
show how the law has divided among these different branches and offer some initial reflections, rooted in on-the-ground trust practice, about the reasons why it divided. We also note that the divide between donative and commercial trusts reflects the deep logic of private law and its role in facilitating private ordering. The law of donative trusts reflects the policy of *freedom of disposition*, and the law of commercial trusts reflects the policy of *freedom of contract*.[7] These two policies are overlapping and not mutually exclusive, but they are nevertheless separate, and they underpin the distinctiveness of the different branches of trust law, albeit each in service of private ordering.

II. A Taxonomy of Trust Law

We divide contemporary American trust law in both form and function along the lines of an organizing taxonomy illustrated by Figure 1. The principal distinction is between a *donative* trust and a *commercial* trust. The donative branch then subdivides into two sub-branches: *revocable* and *irrevocable*.[8]

Figure 1: Taxonomy of Trust Usage



In the donative branch, the trust paradigmatically involves familiar estate planning objectives such as avoiding probate and ensuring ongoing financial support for

[7] See id. at 591.

[8] The location of a particular trust in the scheme of Figure 1 is often easy to discern, but not always. The categories in Figure 1 are ideal types whose correspondence to real-world manifestations is imperfect. *Charitable trusts* can be especially vexing. A trust that holds wealth in anticipation of payment for a charitable purpose, such as a trust that pays investment income to a scholarship fund, might belong most appropriately on the donative side. But a trust that functions like a corporation by holdings the assets operating charitable business is more like a commercial trust. This is especially true of a commercial charity, such as a hospital, whose charitable mission involves serving charitable patrons in exchange for a fee. See Henry B. Hansmann, The Role of Nonprofit Enterprise, 89 Yale L.J. 835, 840-41 (1980) (distinguishing commercial and donative nonprofits).

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a surviving spouse or children.[9] In the commercial branch, the trust paradigmatically involves a bargained-for exchange, such as secured lending, bond issuance, or the organization of a company.[10]

These two major branches of contemporary American trust law reflect mirror-image principles that underpin the role of private law in recognizing autonomy toward private ordering.[11] In donative applications, the trust implements a settlor's *freedom of disposition*—the notion that an owner of property has broad autonomy to dispose of her property gratuitously on whatever terms and conditions she desires.[12] In commercial applications, the trust implements a settlor's *freedom of contract*—the notion that a person has broad autonomy to enter into a voluntary exchange with others on terms and conditions of the parties' choosing.[13]

These overlapping but conceptually distinct policies together point contemporary American trust law toward recognizing individual autonomy in private ordering. However, the manner by which trust law implements this purpose varies across its different branches. The core claim of this chapter is that both the formal legal rules and the norms and customs of trust practice, including especially those relating to a trustee's fiduciary duties, have developed differently along the lines of the branching depicted in Figure 1. Contemporary American trust law applies different formal rules to different branches of trust practice in a manner that reflects those branches' distinctive functional needs.

III. Donative Trusts

The more salient of the two major branches of contemporary American trust law is the *donative* branch. The essential characteristic of a trust in this branch is that it effects a gratuitous transfer of property in service of the settlor's freedom of disposition. This branch includes, for instance, a trust made by a settlor to transfer property at death outside of probate (i.e., a will substitute), a trust for the support of a surviving spouse upon the settlor's death, a trust for the education of grandchildren, or a trust for a mentally or physically incapacitated sibling. At its core, a donative trust implements a settlor's freedom of disposition by allowing the settlor to make a gift of property across time to one or more beneficiaries (or for one or more charitable purposes) subject to the terms and conditions prescribed by the settlor. Both the law governing such trusts and the norms and customs of practice applicable to them have evolved in a manner that reflects this donative rather than commercial character.

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[9] See Sitkoff & Dukeminier, supra note 6, at 391-92.

[10] See John H. Langbein, The Secret Life of the Trust: The Trust as an Instrument of Commerce, 107 Yale L.J. 165, 167 (1997) (defining a commercial trust as "a trust that implements bargained-for exchange, in contrast to a donative transfer").

[11] See, e.g., Hanoch Dagan, Autonomy and Pluralism in Private Law, **[this volume]**.

[12] See Robert H. Sitkoff, Trusts and Estates: Implementing Freedom of Disposition, 58 St. Louis U. L.J. 643 (2014).

[13] See Charles Fried, Contract as Promise: A Theory of Contractual Obligation 7-27 (2d ed. 2015).

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Within the donative trust category, we draw a line between an *irrevocable trust* and a *revocable trust*. Both kinds of donative trust implement a settlor's freedom of disposition. But they do so in such different ways that the law governing them has branched along different paths that reflect the distinctive norms and customs of practice for each. An irrevocable trust is typically used to effect a gift across time subject to management by a fiduciary. A revocable trust, by contrast, is typically used as a substitute for a will to transfer property at the settlor's death. The law governing each has evolved to reflect these distinctive uses.

A. Donative Irrevocable Trust

The first sub-branch of donative trusts is made up of *irrevocable trusts*. The paradigmatic use of an irrevocable trust in contemporary practice is for wealth management within a family and down the generations—what has been aptly dubbed a *management trust*.[14] By making a transfer in trust rather than outright, a settlor ensures that the property will be managed and distributed in accordance with the settlor's wishes as expressed in the terms of the trust rather than according to the whims of the beneficiaries. A trust thus allows a settlor to postpone important decisions about the investment and distribution of the trust property, leaving those decisions to be made by the trustee in view of changing market conditions and the beneficiaries' evolving circumstances, but within the framework established by the settlor.[15] In this application, therefore, the trust is a powerful tool for implementing a settlor's freedom of disposition.

The most distinctive evolutionary development within this branch of trust law concerns the *powers* and *duties* of a trustee.[16] Today, the law of trustees' powers and duties in an irrevocable trust provides a ready-made governance regime for a settlor who wishes to create a trust for wealth management down the generations, that is, a management trust. This evolution was necessary, because trust law was not always so conducive to this use of a trust.

In late medieval and early modern times, when wealth was primarily held in land and the trust was used mostly as a conveyancing device to circumvent primogeniture and feudal death taxes (note the parallel to revocable trusts used as will substitutes, discussed below[17]), a trustee needed few powers. The main task of the trustee was to pass the deed for the family's land to the next taker in accordance with the terms of the trust. The beneficiaries of these conveyancing trusts, who typically lived

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[14] See John H. Langbein, Rise of the Management Trust, 143 Tr. & Est. 52 (Oct. 2004).

[15] Such a trust can also be structured to reduce tax liabilities and to protect the trust property from creditor claims. See, e.g., Sitkoff & Dukeminier, supra note 6, at 696-727 (creditors), 813-15 (taxes), 929-82 (taxes).

[16] The following discussion draws on David J. Feder & Robert H. Sitkoff, Revocable Trusts and Incapacity Planning: More than Just a Will Substitute, 24 Elder L.J. 1, 7-9 (2016), which relied heavily on Langbein, Management Trust, supra note 14, and John H. Langbein, The Contractarian Basis of the Law of Trusts, 105 Yale L.J. 625, 640-44, 666 (1995).

[17] See infra Part III.B.

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on the land, were safeguarded by the rule that the trustee had no powers other than those expressly granted by the terms of the trust. Trustee disempowerment was thus the original form of beneficiary safeguard.

Over time, as the nature of wealth holding evolved from land to interests in business entities and other financial assets, trust law and practice evolved to accommodate ongoing administration of such assets down the generations. For this use of the trust, which has to do more with management than conveyancing, the trustee would need broad powers of administration—for example, powers to invest and reinvest the trust assets, to vote securities held in the trust, to take or make loans, and so on. Accordingly, trust lawyers commonly overcame the no-powers default rule of the common law by including an expansive schedule of trustee powers in their trust instruments. Eventually, as provisions for broad powers became a normal and customary drafting practice and standard boilerplate, most states enacted statutes that presumptively gave trustees an expansive statutory list of powers.[18] Even after these statutes, many drafters continue to include an expansive schedule of trustee powers in their trusts.[19]

With the broadening of a trustee's powers, a new system of beneficiary safeguard was needed. Instead of limiting a trustee's powers, trust practice today safeguards a beneficiary by constraining the trustee with an elaborate system of fiduciary duties. All of a trustee's actions (or failures to act), even if they are within the trustee's expressly granted powers, are nonetheless subject to judicial review for consistency with the trustee's fiduciary duties regarding loyalty, prudence, impartiality, disclosure, and the other aspects of trusteeship.[20] The Restatement (Third) of Trusts describes this "basic principle of trust administration" regarding powers and duties thus: "a trustee presumptively has comprehensive powers to manage the trust estate and otherwise to carry out the terms and purpose of the trust, but … all powers held in the capacity of trustee must be exercised, or not exercised, in accordance with the trustee's fiduciary obligations."[21]

This general pattern, with evolution from limited powers to expansive powers subject to fiduciary duty, is especially pronounced in the area of trust investment.[22] The

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[18] The Uniform Trust Code ("UTC") (Unif. Law Comm'n 2000), following the lead of the Uniform Trustees' Powers Act (Unif. Law Comm'n 1964) and other earlier legislation, provides a trustee by default with "all powers over the trust property which an unmarried competent owner has over individually owned property," and supplements this broad statement with a non-exhaustive illustrative list of more specific powers. UTC §§ 815(a)(2)(A), 816.

[19] See, e.g., Northern Trust, Will & Trust Form 201, at 201-31, 201-35 (2014) https://www.northerntrust.com/documents/wealth-advisor/forms/pdf/Form_201.pdf?bc=25833394.

[20] *See, e.g.*, Robert H. Sitkoff, Fiduciary Principles in Trust Law, *in* The Oxford Handbook of Fiduciary Law 41 (Evan R. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019).

[21] Restatement (Third) of Trusts § 70 cmt. a (Am. Law Inst. 2007); see also UTC § 815(b).

[22] Other specific examples of this general evolutionary trend abound, including so-called *directed trusts* and *trust decanting*. See, e.g., John D. Morley & Robert H. Sitkoff, Making Directed Trusts Work: The Uniform Directed Trust Act, 44 ACTEC L.J. 1 (2018); Robert H. Sitkoff, The Rise of Trust Decanting in the United States, 23 Tr. & Tr. 976 (2017).

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law first prescribed legal lists of permitted investments, typically government bonds and first mortgages on real property. To overcome the disempowerment of trustees by the legal lists, trust lawyers often included a provision in their trusts that empowered the trustee to make any investment even if not of a type or kind that was otherwise permitted by trust law. Eventually, the legal lists were succeeded by the prudent man rule, which was nominally more empowering, but which in application came to favor government bonds and to disfavor stocks, similar to the old legal lists. Boilerplate empowerment of the trustee to invest in any type or kind of investment thus persisted to overcome the courts' constrained application of the prudent man rule. Today, all states have replaced the prudent man rule with the prudent investor rule, which empowers a trustee to invest in any type or kind of property, subject to fiduciary risk management rules that typically require a diversified overall investment strategy with portfolio-level risk and return objectives reasonably suited to the trust.[23]

In sum, the quintessence of the donative irrevocable trust branch of contemporary American trust law—the branch that covers a management trust for wealth management down the generations in a dynastic trust—is the rise of law and practice that broadly empowers a trustee but subjects the trustee's exercise or nonexercise of those powers to fiduciary duties. Crucially, these fiduciary duties of a trustee in an irrevocable trust are owed to the trust beneficiaries, defined as anyone who is potentially eligible ever to receive a distribution from the trust.[24] The hallmark of a modern donative irrevocable trust, in other words, is broad empowerment subject to fiduciary duties enforceable by a beneficiary. Such a management trust "is essentially a gift, projected on the plane of time and so subjected to a management regime."[25]

B. Donative Revocable Trust

The second sub-branch of donative trusts includes *revocable* trusts. A revocable trust is a trust that the settlor can revoke by taking back the trust property and terminating the trust. Under traditional law, a trust was presumptively irrevocable. Today, however, this default has been reversed so that a trust is presumed to be revocable unless its terms provide otherwise.[26] Like an irrevocable trust, a revocable trust implements a settlor's freedom of disposition, but it does so in a narrower set of ways.

1. Revocable Trust as Will Substitute

A revocable trust is most commonly used as a *substitute for a will*. If a settlor conveys property to a revocable trust prior to the settlor's death, then after the settlor's death, the trust property will be distributed or held in further trust in accordance with

[23] See, e.g., Max M. Schanzenbach & Robert H. Sitkoff, The Prudent Investor Rule and Market Risk: An Empirical Analysis, 14 J. Emp. Leg. Stud. 129 (2017).

[24] See Restatement (Third) of Trusts § 94 (Am. Law Inst. 2012). For an application, see, e.g., Jo Ann Howard and Assoc., P.C. v. Cassity, 868 F.3d 637, 646-47 (8th Cir. 2017).

[25] Bernard Rudden, Book Review, 44 Mod. L. Rev. 610, 610 (1981).

[26] See Sitkoff & Dukeminier, supra note 6, at 453-54.

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the trust's terms. By funding the trust, the settlor transfers legal title to the trustee, obviating the need to change title at the settlor's death by probate administration or otherwise. In this use of the trust to avoid probate, we find a modern echo to the ancient use of the trust to convey land while avoiding primogeniture and the feudal death taxes.

A revocable trust is an especially apt will substitute precisely because it is revocable. During life, a will is freely changeable ("ambulatory" in the jargon), and the testator is free to do with her property as she wishes notwithstanding a contrary disposition in her will. A revocable trust is likewise freely changeable, so that the settlor can change beneficiaries or alter their interests, and the settlor also retains the power to revoke the trust and take back the property to do with as she wishes. For both a will and a revocable trust, the donor can arrange for a gift during lifetime that does not become final and irrevocable until the donor's death.

Just as the law of trusts has adapted to accommodate the use of an irrevocable trust for family wealth management that continues down the generations, it has also evolved to accommodate the use of a revocable trust as a will substitute. This evolution is especially pronounced in two features of modern American revocable trust law.[27]

First, under modern law, a beneficiary of a revocable trust has no legally enforceable interest so long as the trust remains revocable. As we have seen, in an irrevocable trust, the duties of the trustee run to the beneficiaries. The same was true under the traditional law of revocable trusts, in which courts supposed a beneficiary to have a present enforcement right.[28] This supposed enforcement right, reflecting a present interest in the trust, was what courts said differentiated a revocable trust from a will, allowing such a trust to pass property at death without satisfying the formalities required for a will.[29]

Today, however, American law provides that the duties of the trustee of a revocable trust run exclusively to the settlor.[30] Thus, under modern law, just as a beneficiary under a will has no cognizable legal right to the donor's property prior to the donor's death, neither does a beneficiary under a revocable trust. Extending the analogy of a revocable trust to a will, under modern law the trustee of a such a trust must "comply with a direction of the settlor even [if] the direction is contrary to the terms of the trust or the trustee's normal fiduciary duties."[31] Yet at the same time such a trust is deemed not to be testamentary, and thus is valid to pass property at death without the

[27] A third and related evolutionary development in revocable trust law is the validation by statute in all states of a *pour over* from a will to an unfunded revocable trust. Under traditional trust law, a trust is not valid without property, hence the trustee of an unfunded trust could not be a valid will beneficiary. This reform has enabled the rise of unfunded revocable trusts as a centerpiece substitute for a will in modern practice, into which a donor pours all of her probate and nonprobate transfers. See id. at 466-67.

[28] See id. at 445-47.

[29] Id.

[30] UTC § 603 (amended 2018); Restatement (Third) of Trusts § 74 (Am. Law Inst. 2003); Sitkoff & Dukeminier, supra note 6, at 447-53.

[31] Restatement (Third) of Trusts § 74(1)(a)(i) (Am. Law Inst. 2003).

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formalities of a will.[32]

Second, reflecting the power of the analogy of a revocable trust to a will, courts and legislatures increasingly apply to a revocable trust many of the rules of construction for a will, such as revocation-on-divorce of a bequest to a spouse, and many of the substantive policy limits on freedom of disposition by a will, such as the spousal forced share.[33] The logic behind most of the rules of construction—implementing a testator's probable intent—applies with the same force to a revocable trust used as a substitute for a will. Likewise, because the substantive limits on freedom of disposition by will, such as the spousal share, reflect policy judgments about the proper extent of freedom of disposition at death, they should also apply to a revocable trust.

In this doctrinal evolution, reworking the law of revocable trusts to align with the law of wills, function has come to triumph over form. Perhaps the most arresting example concerns the rights of a settlor's creditors. Under traditional law, a creditor of the settlor had no recourse against the trust property through the settlor's power of revocation—a creditor could not compel a revocation, which was treated as a personal power of the settlor.[34] Under modern law, by contrast, the settlor's power to revoke the trust and take back the trust property is regarded as equivalent to outright ownership and, hence, the trust property is subject to the claims of the settlor's creditors during life and at death.[35]

2. Revocable Trust in Planning for Incapacity

In addition to its use as a will substitute, the revocable trust is also commonly employed in contemporary practice to plan for *incapacity*. If a person becomes mentally incapacitated or otherwise unable to manage her own affairs, the person can avoid the cumbersome intervention of a court-appointed conservator if the person has funded a revocable trust while the person was still competent, at least with respect to the trust property. Even if the person had been serving as sole trustee, a successor trustee can take over without court involvement if the person becomes incapacitated and the terms of the trust prescribe a mechanism for determining the settlor's incapacity.[36] For a settlor who already plans to fund a revocable trust to avoid probate, the marginal cost of also avoiding conservatorship upon incapacity by including an appropriate further provision in the terms of the trust is trivial.

The main question for law reform around this use of a revocable trust is whether upon the settlor's incapacity the other beneficiaries of the trust should have standing to enforce the trust—that is, whether this use of the trust as a conservator substitute

[32] See id. § 25 cmt. b; see also Sitkoff & Dukeminier, supra note 6, at 447-48.

[33] Restatement (Third) of Property: Wills and Other Donative Transfers § 7.2 (Am. Law Inst. 2003).

[34] See Restatement (Second) of Trusts § 330 cmt. o (Am. Law Inst. 1959).

[35] See, e.g., UTC § 505(a)(3); Restatement (Third) of Trusts § 25 cmt. e (Am. Law Inst. 2003).

[36] A typical drafting strategy is to require agreement of the settlor's physician and identified persons (commonly spouse or children). See Feder & Sitkoff, supra note 16, at 31-32 (discussing such clauses and quoting a formbook example).

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differentiates it from a pure will substitute.[37] There is a strong argument that a "rule of presumptive standing for revocable trust beneficiaries upon the settlor's incapacity … is … more likely to implement the typical settlor's actual or probable intent."[38] The cases, the Restatement, and the Uniform Trust Code point in contradictory directions on this point, though the trend in the case and statute law is against recognizing such standing.[39]

C. The Place of Donative Trusts in American Legal Practice

In the culture of American trust practice, donative trusts are distinct from commercial trusts. In law firms, donative trusts are the province of the estate planning lawyers, not the business or corporate lawyers. Banks and other financial institutions also commonly segregate donative trusts from other activities, often placing them in "wealth management" departments under the supervision of a "fiduciary officer." In law schools, donative trusts are taught within the rubric of succession law, organized around freedom of disposition, in a course called "Trusts and Estates" or the like.[40]

IV. Commercial Trusts

Next to the donative trust stands another branch of trust law and practice, lesser known but still immensely important: the *commercial trust*. As John Langbein has observed, although the donative trust is the paradigm of a trust in American legal culture, in fact the great bulk of assets held in trust have been placed there for commercial purposes.[41] The essential characteristic of a commercial trust is that it implements an exchange of value in exercise of the parties' freedom of contract. A commercial trust carries out a bargained-for commercial exchange. The law governing a commercial trust and the customs of practice surrounding it tend to reflect this distinctive purpose.

The line between commercial and donative trusts is longstanding. In *Morrissey v. Commissioner*, decided in 1935, the United States Supreme Court pointed to "the transaction of business" as the essential characteristic of a commercial trust.[42] The Court differentiated a donative trust from a commercial trust as follows: "In what are called 'business trusts' the object is not to hold and conserve particular property, with incidental powers, as in the traditional type of trusts, but to provide a medium for the conduct of a business and sharing its gains."[43] Similarly, a 1929 article in the *Harvard Law Review* remarked that "modern business has become honey-combed with trusteeship.

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[37] See id., at 3-4 (advocating a "conservator substitute model"); *see also* Grayson M.P. McCouch, Revocable Trusts and Fiduciary Accountability, 26 Elder L.J. 1 (2018).

[38] Feder & Sitkoff, supra note 16, at 4.

[39] Id.

[40] See Sitkoff, supra note 12.

[41] See Langbein, supra note 10.

[42] 296 U.S. 344, 356-57 (1935).

[43] Id.

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Next to contract, the universal tool, and incorporation, the standard instrument of organization, it takes its place wherever the relations to be established are too delicate or too novel for these coarser devices."[44]

A. Corporation Substitute and Other Uses

Some commercial trusts resemble corporations.[45] Instead of tradable certificates of stock, a business trust can issue tradable certificates of beneficial ownership. Instead of titling property in the name of a corporation, a commercial trust may title its property in the names of its trustees in their fiduciary capacities. Instead of bylaws and articles of incorporation, a trust may have a declaration of trust. And instead of directors, a trust may have trustees.[46]

Other commercial trusts serve to structure loans, bonds, or insolvencies. In secured lending transactions, borrowers have long used trusts to provide guarantees to lenders. A borrower conveys property to a trustee with instructions to return the property to the borrower if the borrower repays the loan and to grant the property to the lender if the borrower defaults. In bankruptcy and insolvency, debtors and courts often employ a trustee to sell the debtor's property in an orderly manner and distribute the proceeds to creditors. And in corporate bond practice, a trust is often used to overcome a collective action problem among bondholders by allowing a trustee to act on behalf of all of the bondholders.

Historically, the trust offered several advantages over the corporate form. The first was freer formation. Until fairly recently, trusts have been much easier to form than corporations.[47] Before the mid-19th century, forming a corporation required special permission from the King, Parliament, or a state legislature, and this permission did not always come easily. A trust, by contrast, required only a private declaration or deed of trust, which needed no action from anyone other than the person forming the trust (and the trustee, if a third party).

Second, a trust avoided regulation. Until the mid-20th century, state corporation statutes imposed burdensome regulations on the corporate form. State corporate law commonly prohibited a corporation from growing beyond a certain size, owning real estate, or investing in the shares of other corporations. These rules did not appear in trust law, so they could be avoided by organizing a business in trust. The trust became especially popular in Massachusetts in the early 20th century partly as a way to avoid Massachusetts' famously restrictive corporate law. To this day, a trust for corporation-like purposes is commonly known throughout the country as a "Massachusetts trust."[48]

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[44] Nathan Isaacs, Note, Trusteeship in Modern Business, 42 Harv. L. Rev. 1048, 1060-61 (1929).

[45] See John Morley, The Common Law Corporation: The Power of the Trust in Anglo-American Business History, 116 Colum. L. Rev. 2145 (2016).

[46] The Court noted these analogies in *Morrissey*, 296 U.S. at 359.

[47] See Morley, supra note 38.

[48] See, e.g., Comment, Massachusetts Trusts, 37 Yale L.J. 1103 (1928).

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The trust has largely disappeared from the organization of conventional business companies. But the trust remains common among asset securitization vehicles and mutual funds, which early in their history were known as "investment trusts."[49] Mutual funds continue to be formed as trusts rather than as corporations to avoid the corporate law requirements concerning shareholder voting and related matters of governance and to take advantage of special features of business trust law, such as the ability to issue shares in different series with distinct creditor claims.[50]

B. Distinctive Law for Commercial Trusts

The popularity of the trust in commerce has pushed courts and state legislatures to develop a distinct body of law for these kinds of trusts. Many courts have held that because a business trust is distinct in function and purpose from a donative trust, rules developed for a donative trust should not reflexively be applied to a business trust.[51] In consequence, "a specialized case law has arisen applicable to a common-law trust with a business purpose."[52] This case law is especially deep in Massachusetts, where the Supreme Judicial Court has said that "[i]t is appropriate to treat business trusts on a somewhat different basis from private trusts."[53] Thus, we find in the case law differentiation between business trusts and donative trusts, at least in certain areas.[54]

By way of illustration, a line of cases in New York holds that an indenture trustee is subject only to those duties provided for by the terms of the indenture agreement, and not to any additional fiduciary duties arising under the common law as would be

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[49] See Morley, supra note 38.

[50] See John Morley & Quinn Curtis, Taking Exit Rights Seriously: Why Governance and Fee Litigation Don't Work in Mutual Funds, 120 Yale L.J. 84 (2010) (explaining why redemption rights diminish a mutual fund shareholder's interest in voting); iShares Trust, Registration Statement (Form N-1A), 2-3, Aug. 16, 2017, https://www.sec.gov/Archives/edgar/data/1100663/000119312517258768/d426583d485bpos.htm (listing 76 exchange-traded funds as series of the iShares Trust, a Delaware statutory trust).

[51] See, e.g., Bank of New Jersey v. Abbott, 503 A.2d 893, 897-98 (N.J. App. Div. 1986) (acknowledging "the differences between business and liquidation trusts and ordinary testamentary trusts" in applying nonetheless a probate code rule on fiduciary compensation to a business trust); In re Carriage House, Inc., 120 B.R. 754, 763 (Bankr. D. Vt. 1990) (stating that "each business trust, as any contract at common law, must be treated *sui generis*" and noting "features of a business trust that distinguish it from a private trust").

[52] Uniform Statutory Trust Entity Act ("USTEA") pref. note (Unif. Law Comm'n 2009, last amended 2013).

[53] Swartz v. Sher, 184 N.E.2d 51, 54 (Mass. 1962); see also First Eastern Bank, N.A. v. Jones, 602 N.E.2d 211, 212 (Mass. 1992) (holding that a statutory reform to trustee liability was applicable only to "a trust … of the donative type associated with probate practice" and not to a "business trust"); Town of Hull v. Tong, 442 N.E.2d 427 (Mass. App. 1982) (differentiating between business trusts and donative trusts in applying limitations statutes governing creditor claims); Northstar Financial Advisors, Inc. v. Schwab Investments, 807 F. Supp. 2d 871, 876-79 (N.D. Cal. 2011) (reviewing authority treating fiduciary litigation involving a mutual fund organized as a Massachusetts business trust differently from a donative trust).

[54] See In re Trust Known as Great N. Iron Ore Properties, 263 N.W.2d 610, 620 (Minn. 1978) ("But we need not finally decide the proper characterization of the trust to resolve the extent of the trustees' duties because it has been recognized that even a common-law or Massachusetts business trust, although governed by special corporate-like rules in certain respects, is subject to the underlying equitable and fiduciary duties toward trust beneficiaries imposed by the common law of trusts.").

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applicable to a trustee of a donative trust. This line of cases traces back to *Hazzard v. Chase Nat. Bank of City of New York*,[55] decided in 1936, in which the court said, "The corporate trustee has very little in common with the ordinary trustee, as we generally understand the fiduciary relationship. … The trustee under a corporate indenture … has his rights and duties defined, not by the fiduciary relationship, but exclusively by the terms of agreement. His status is more that of a stakeholder than one of a trustee."[56] In the years since, multiple courts applying New York law have followed *Hazzard*.[57]

Some of the adaptation of the law of trusts to commercial purposes occurred remarkably early on. Case reports from English and American courts in the late 18th, 19th, and early 20th centuries show extensive disputes about whether a trust used for commerce should be able to litigate without the joinder of its many commercial beneficiaries.[58] Similar disputes took place about whether a commercial trust should be able to offer those beneficiaries a form of limited liability akin to that of a modern corporation.[59] Neither of these issues arose with regard to donative trusts.

C. Recognition in Canonical Authority

Reflecting the tendency toward differentiation of a business trust from a donative trust, the canonical secondary authorities applicable to a donative trust—most prominently the Restatements of Trusts, the Uniform Trust Code, and the leading Scott treatise[60]—tend to disclaim or at least caution against application to a commercial trust. Let us begin with the Scott treatise:

> The obvious difficulty with attempting to integrate any significant coverage of trusts used commercially into a generalized study of trust law is that commercial trusts have, as their central purposes, objectives that are completely alien from those effecting gratuitous transfers. Yet it is the latter around which the law of trusts developed. Moreover, the terms of commercial trusts typically do indicate departures, and often quite substantial departures, from one or more of the familiar standards of trust fiduciary law. In addition, such trusts are often subject

[55] 287 N.Y.S. 541 (N.Y. Sup. Ct. 1936), aff'd, 257 A.D. 950 (1939).

[56] 287 N.Y.S. at 570.

[57] See AG Capital Funding Partners, L.P. v. State Street Bank and Trust Co., 896 N.E.2d 61, 66-67 (N.Y. 2008); Meckel v. Continental Resources Co., 758 F.2d 811, 816 (2d Cir. 1985). Yet another line of cases under New York law rejects *Hazzard* and holds that an indenture trustee is subject not only to those duties provided for by the terms of the indenture agreement, but also to the additional fiduciary duties arising under the common law as would be applicable to a trustee of a donative trust. This line of cases traces back to *Dabney v. Chase National Bank*, 196 F.2d 668 (2d Cir. 1952), in which the court applied the "fundamental duty" under trust law of "undivided loyalty" to an indenture trustee. Id at 670-71 (internal quotations omitted). In the years since, some courts applying New York law have opted to follow *Dabney* rather than *Hazzard*. See Beck v. Manufacturers Hanover Trust Co., 632 N.Y.S.2d 520, 526-27 (N.Y. App. Div. 1995); U.S. Trust Co. of New York v. First Na. City Bank, 394 N.Y.S.2d 653, 660-61 (N.Y. App. Div. 1977).

[58] Morley, supra note 45, at 2167-97 (describing debates over limited liability and personhood in litigation).

[59] Id.

[60] See Sitkoff & Dukeminier, supra note 6, at 387-91 (describing sources of trust law).

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> to special purpose legislation and case law. Commercial trusts thus … [are] sufficiently different, in both purpose and operation, to justify separate treatment.[61]

Accordingly, the treatise "deals primarily with the more traditional use of the trust, in which the purpose generally is to confer, gratuitously, upon one or more persons, the beneficial ownership of property."[62]

The Uniform Trust Code keeps a similar distance from the business trust. It states that it "is directed primarily at trusts that arise in an estate planning or other donative context," in contrast to "commercial trusts" that "are often subject to special-purpose legislation and case law, which in some respects displace the usual rules stated in this Code."[63] The Restatement (Third) of Trusts likewise cautions against application to a business or commercial trust. It excludes business trusts from its scope, reasoning that "[a]lthough many rules of trust law may also apply to business and investment trusts, many of these rules do not; instead other rules are drawn from other bodies of law that are specially applicable to those activities even when conducted in trust form."[64]

D. Statutory Business Trusts

The adaptation of the trust to commercial purposes, and its branching off from the donative branch of trust law, has reached its apogee in the enactment of statutory business trust acts by a majority of states.[65] The modern versions of these statutes—in particular the leading Delaware Statutory Trust Act ("DSTA"), which served as the model for the Uniform Statutory Trust Entity Act ("USTEA")—provide for a statutory trust entity with many of the attributes of a corporation, but with fewer regulations on governance and novel features, such as the "series" concept noted above,[66] that are especially useful to certain types of enterprises.[67]

USTEA offers many innovations, including the recognition of a statutory business trust as a separate entity distinct from its trustees. Most strikingly, under USTEA a statutory business trust may sue and be sued and hold property in its own name, rather than in the names of its trustees.[68] USTEA also provides wide latitude for modifying the otherwise applicable fiduciary principles of trusteeship.[69] Because these statutes validate the trust form as a permissible mode of business organization and bring

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[61] 1 Scott and Ascher on Trusts, supra note 1, § 2.1.2, at 34-35 n.3 (internal quotations and citations omitted).

[62] Id. § 2.1.2, at 35.

[63] UTC § 102 cmt.

[64] Restatement (Third) of Trusts § 1 cmt. b (2003).

[65] See Robert H. Sitkoff, Trust as "Uncorporation": A Research Agenda, 2005 U. Ill. L. Rev. 31, 35-36 (2005).

[66] See supra note 50 and text accompanying.

[67] See USTEA pref. note (2009, last amended 2013).

[68] See USTEA §§ 307-308; see also Del. Code tit. 12, § 3804(a).

[69] See USTEA §§ 104(7), 505; see also Del. Code tit. 12, § 3806(c).

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statutory clarity to business trust practice, statutory business trusts have become increasingly preferred over common law trusts for commercial applications.[70]

At the same time, USTEA confines its sphere of application to trusts that do not have a "predominantly donative purpose."[71] This limit "addresses the concern that a statutory trust might be used in an estate planning or other donative context to evade public policy limitations on donative transfers."[72] USTEA also addresses the reverse problem of application of donative trust principles inapt for commercial contexts, such as inalienable beneficial shares by way of a spendthrift provision,[73] with provisions that reverse those rules.[74] These provisions reflect a recognition by the drafters of USTEA that "a business trust is a creature of freedom of contract," whereas a donative trust "implement[s] the donor's right to freedom of disposition."[75]

E. The Place of Commercial Trusts in American Legal Practice

Unlike the donative trust, which in the American tradition has been subsumed within the practice of "estate planning," the commercial trust has not developed a unified field of practice with ownership over it. The commercial trust has generated no discernible culture of practice and no regular class in law schools. One likely explanation is that commercial trusts are too varied and disparate. Commercial trusts are used to structure commercial deals, but these deals vary so widely that the day-to-day practice of commercial trusts tends to be the province of the different groups of lawyers who specialize in each of the specific types of deals that make use of commercial trusts. Bankruptcy trusts tend to be handled by bankruptcy lawyers, and mutual fund trusts tend to be handled by mutual fund lawyers. Likewise, in day-to-day banking and financial institution practice, commercial trusts are normally handled by something like the "corporate and institutional services department," rather than the "wealth management department."

V. Conclusion

The core claim of this chapter is that the American law of trusts has branched into two distinct categories, *donative* and *commercial*, with the donative category separating into two further sub-branches, *revocable* and *irrevocable*. This branching, which is evident in both formal law and the norms and customs of practice, reflects underlying differences in facilitating private ordering in service of *freedom of disposition* versus *freedom of contract.*

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[70] See USTEA pref. note (2009, last amended 2013) (Filing data show that the DSTA "dominates the field, both in new statutory trust formations and in the aggregate number of statutory trusts.").

[71] See USTEA § 303(b).

[72] Id. cmt.

[73] See Sitkoff & Dukeminier, supra note 6, at 703-12.

[74] See USTEA § 602.

[75] See id. § 602 cmt.

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The taxonomy of contemporary American trust law that we propose is consistent with the vision of the New Private Law. Rather than seeking an essential function of trust law by trying reduce the whole field to an artificially parsimonious set of "brass tacks,"[76] we propose a multiplicitous and therefore more nuanced structure. Trusts are used for many purposes, and the law has evolved the complexity necessary to accommodate all of them.

Like the rest of the New Private Law movement, however, our approach does not content itself with merely cataloging doctrinal complexity. We seek also to uncover the functional logic of this complexity. The different branches of trust law each have a different policy logic. We try to make sense of them by identifying their distinctive functional purposes rooted in freedom of disposition for donative trusts and freedom of contract for commercial trusts. The categorization we propose is thus "inclusively pragmatic."[77] It takes both the doctrine and theory of trust law seriously and gives each its proper place. We hope this categorization will be a first step towards opening the law of trusts to a deeper understanding made possible by the New Private Law.

[76] Goldberg, supra note 4, at 1641-45.

[77] Id. at 1651, 1663.

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