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THE DELAWARE BUSINESS TRUST ACT FAILURE AS THE NEW CORPORATE LAW

ESSAY

Tamar Frankel[✉]

INTRODUCTION

Business trusts have been around for over one hundred years.¹ They have evolved from private trusts and are used as one form of offering trust services to the public.² The Supreme Court has defined a business trust as

an arrangement whereby property is conveyed to trustees, in accordance with the terms of an instrument of trust, to be held and managed for the benefit 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.³

Like their ancestor, the private trust, business trusts are established by trust instruments. While some features of business trusts resemble

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¹ See Sheldon A. Jones et al., *The Massachusetts Business Trust and Registered Investment Companies*, 13 DEL. J. CORP. L. 421, 425-28 (1988) (reviewing origins of Massachusetts business trusts).

² Trust services can be offered through other forms such as corporations and limited partnerships. See Wendell Fenton & Eric A. Mazie, *Delaware Business Trusts*, in 2 R. FRANKLIN BACOTTI & JESSE A. FINKELSTEIN, DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS §§ 19.1-.14, at 19-5 (3d ed. Supp. 2001). Historically, business trusts were used “to obtain the advantages of incorporation without complying with the regulatory and tax burdens placed on corporations.” *Id.* at 19-1.

³ *Hecht v. Malley*, 265 U.S. 144, 146-47 (1924).

those of corporations, business trusts could be viewed as the epitome of promoters' freedom. Trusts allow promoters to design their organizations any way they wish subject only to the pressures and judgments of the markets. However, business trusts posed a number of potential legal uncertainties.⁴ The Delaware Business Trust Act has addressed these uncertainties.⁵ Therefore, everyone could rejoice when the Delaware Business Trust Act was passed. In fact, a number of mutual funds have taken advantage of the Act to benefit from its clarifications and the flexibility it offers.

But the Delaware Act is far more ambitious. It contains highly permissive provisions, allowing promoters of business trusts a staggering degree of freedom to design their relationships with beneficiaries-investors. Moreover, the Act explicitly invites commercial and manufacturing enterprises ("C&M Enterprises") to take advantage of this marvelous contract-like organizational form, emphasizing its liberal contractarian approach and the freedom to write into or omit from the trust documents anything they wish, or almost anything.

The flexibility embodied in the definition of the "business trust" allows the parties forming the business trust to take on such characteristics of traditional inter vivos trusts, business trusts, corporations, or partnerships as the parties may desire. This flexibility is consistent with Delaware's fundamental policy of freedom of contract and may be the greatest advantage of the business trust over alternative forms of business organizations.⁶

⁴ See Herbert B. Chermiside, Jr., J.D., Annotation, *Modern Status of the Massachusetts or Business Trust*, 88 A.L.R.3d 704 (1978 & Supp. 2001) (describing in detail Massachusetts business trusts and the problems they raise). For example, the status of business trusts is not always clear. They are unincorporated associations that look and act like corporations, and may be considered to have violated corporate laws if they do not register as corporations. See *id.* at 729-30. In addition, their standing to sue and be sued has been challenged in some jurisdictions. See *id.* at 719-20. Further, their beneficiaries usually require some control over the trustees and thereby risk losing limited liability and becoming personally liable for the debts as partners. The beneficiaries' status as creditors entitled to petition for involuntary bankruptcy of the business trusts has been questioned. See *id.* at 737-39.

⁵ DEL. CODE ANN. tit. 12, §§ 3801-3824 (1995 & Supp. 2001); see also MD. CODE ANN., CORPS. & ASS'NS §§ 12-101 to 12-810 (Supp. 2000). Like its ancestor, the private trust, the business trust is based on a trust instrument that the trustee must follow. The business that the trustee has to conduct is embodied in the same instrument on which the form of the trust is based. The private trust instrument has given rise to a large body of judicial decisions. These decisions were intended to protect beneficiaries that did not choose the trustee nor the assets of the trust and who were precluded from controlling the trustee by the very design of the trust. The danger to the beneficiaries from abuses of a trust by a trustee that was not accountable to them (the persons most interested) gave rise to protective measures in interpreting the nature of the trustees' duties to the beneficiaries and the nature and scope of the business that trustees were required by the trust instrument to conduct. See Tamar Frankel, *Fiduciary Duties as Default Rules*, 74 OR. L. REV. 1209 (1995) [hereinafter Frankel, *Fiduciary Duties*]; Tamar Frankel, *Fiduciary Law*, 71 CAL. L. REV. 795 (1983) [hereinafter Frankel, *Fiduciary Law*].

⁶ Fenton & Mazie, *supra* note 2, at § 19.2, at 19-5.

Further, the rights of the beneficial owners in trust property, in section 3805, and the management of the trusts in section 3806, are all couched in permissive terms: “[e]xcept to the extent otherwise provided in the governing instrument of a business trust.”⁷ Therefore, it seems that the promoters of these trusts may write their own rules.

In addition, “[t]he principal purpose of the Act is to recognize expressly the business trust as an alternative form of business association.”⁸ “The Act eliminates the requirement imposed by other states that the trust be engaged in the conduct of a trade or business or issue certificates or shares.”⁹ Any legal business, for-profit or not-for-profit, including presumably commercial business, will do.

Delaware business trusts should look attractive to promoters and their lawyers. As consent-based organizations¹⁰ they offer lawyers opportunities for engagement and innovation. To promoters they offer any organizational form they wish, subject to market acceptance. One would assume that C&M Enterprises and their lawyers would jump at this golden opportunity, but in fact they do not. While the Delaware Business Trust Act is used by Public Trustees for traditional trust purposes: managing other people’s money and real estate (“Trust Services”), C&M Enterprises have not used it.

Why has the Delaware Act failed to become the new modern corporate law? Why does this Act fail to open the new era of flexible organizations? Every innovation, however brilliant, meets resistance. People simply resist new organizational forms even if they are the best and most efficient. They follow the trodden path.¹¹ Custom and tradition of both businessmen and their lawyers, lead to the adoption of existing forms (especially the corporate form). Viewing the puzzle from a broader perspective I offer other answers, some obvious, and others less so. Essentially, the costs of adopting the Act as a substitute for corporate law exceed the benefits of change.

As discussed in Part One of this Essay, a closer look at the Delaware Act does not support the contractarian interpretation of the Act, unless it means based on consent (but not contract). Contrary to this interpretation, business trusts cannot be designed in any form, and their promoters cannot apply any law they choose. Even though the

⁷ DEL. CODE ANN. tit. 12, §§ 3805(e), 3806(a) (1995 & Supp. 2000).

⁸ Fenton & Mazie, *supra* note 2, at 19-3.

⁹ *Id.* at 19-4.

¹⁰ I call business trusts “organizations” in the social sense, as entities in which many people participate subject to certain rules, even though business trusts are not considered legal entities.

¹¹ See HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS AND OTHER BUSINESS ENTERPRISES § 60, at 120 (3d ed. 1983) (noting that “[a] business trust is an unattractive investment in that it is not a very familiar form of business to most people”). However, the author does not agree with the conclusion that familiarity will encourage the use of this form by C&M Enterprises.

Delaware Business Trust Act on its face seems to be a default rule with respect to both form and substance of trust law, the permissive provisions of the Act are far more limited.

The Delaware Act has been interpreted by the business and legal communities to allow some relaxation of trust law, but not to substitute for it. Business trusts with some relaxation, must be organized in trust form and be subject to trust principles. Further, trust instruments constitute consensual¹² arrangements, but are not governed by contract law,¹³ trust law, nor under the Delaware Act. In our context “contract” can be used only as a metaphor for consensual relationships, like the Republican Party’s “Contract with America” in the 1990’s, but not as a precise legal classification. Any other interpretation of the Delaware Act would lead to unacceptable results. Had the Delaware Act allowed a fully default trust law, which it does not, and had form and substance been emptied of their original meaning, leaving only the image of trust (and perhaps the word “trust”), a serious problem of misrepresentation to investors might arise.

Further, as argued in Part Two, the form and substance of trust law are not suitable for C&M Enterprises. Therefore, the legal risks and the costs of adopting a business trust under the Act are likely to outweigh the benefits. This conclusion is based in part on a fundamental distinction between legal organizational models—corporation laws, on the one hand, and trust laws, on the other hand.

Laws offering models for business organizations (corporations, partnerships, limited partnerships, and limited liability corporations) cover *relationships between the interested parties within the organizations*, and the representation of the organizations in their dealings with the outside world. None of these laws, however, regulates the *businesses in which the organizations engage*. Those commercial and manufacturing businesses are regulated by other laws, unrelated to the organizational structures of the businesses. A restaurant can be owned and managed by a partnership, a limited partnership, and a corporation. But all restaurants must comply with laws relating to building structures, protection from fire hazards, and rules governing hygiene. McDonald’s, an international corporation engaged in the fast-food business, is subject to the same rules on food cleanliness as a fast-food mom-and-pop partnership small restaurant. Moreover, barring few exceptions, businesses are free to choose their organizational forms,¹⁴

¹² Some scholars call consensual arrangements “contractarian.” I prefer to use another word so as not to confuse such arrangements with agreements subject to contract law.

¹³ See generally Frankel, *Fiduciary Duties*, *supra* note 5.

¹⁴ The laws regulating certain types of businesses, all of which relate to money management, require those businesses to organize in a certain manner. For example, national banks must be organized as corporations. See 12 U.S.C. § 24 (1994) (providing that a national banking association is considered a “body corporate”); see also 12 U.S.C. § 21 (1994) (requiring national

but none can choose the rules that regulate their businesses.¹⁵

This is the legal scheme for organizing businesses and regulating businesses. One set of laws offers organizational models from which the actors may choose, and a second set of laws, which are mandatory, regulates the businesses regardless of organizational form. This scheme makes sense. The organizational form serves the needs of different contributors to the business. The regulation of the businesses applies to all who carry on that business.

The legal scheme described here has one apparent exception, and that is trust law. Trust law offers an organizational form—a model of relationship between the actors in the trust arrangement—and rules that govern the business of trust services. The main reason for this combined coverage of the form law and regulating law is not hard to discover. The trust form provides the model of relationship among the trustee and the beneficiaries. That relationship *is the business and the purpose of the trust*. Hence, the relationship of the trustee with the beneficiaries—the organizational form—and the regulation of trust business—the trustee's services to the beneficiaries—are one and the same. The nature of trust regulation demonstrates its symbiotic relationship to trust organization. Most trust rules are default rules; prohibited actions become permissible with the consent of the beneficiaries or their representatives.¹⁶ Thus, the regulatory scheme is built on and integrated with the parties' relationship.

The dual nature of trust law is also evident in its application. The regulatory part of trust law governs any organization engaged in trust business, regardless of its form. And when courts did not adopt this approach but applied corporate organizational laws to Trust Services, federal law stepped in and changed the rules to apply trust principles to these services.¹⁷ While the trust form is suitable for Trust Services it is

banking associations to have at least five incorporators and articles of association). Insurance companies may be organized as mutual companies or as corporations, depending on the state law under which they are organized. *See, e.g.*, N.Y. INS. LAW § 1201 (McKinney 2000) (dealing with incorporation of stock of mutual insurance companies). Investment companies may be organized in any form, subject to a superseding organizational model that resembles a corporation. *See generally* TAMAR FRANKEL & ANN TAYLOR SCHWING, *THE REGULATION OF MONEY MANAGERS MUTUAL FUNDS AND ADVISORS* §§ 5.01, 21.01 (2d ed. 2001) (discussing form of investment company organization).

¹⁵ They could, however, influence the rule-makers to introduce changes.

¹⁶ *See* Frankel, *Fiduciary Duties*, *supra* note 5, at 1231-32.

¹⁷ *See* Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, 1999 U.S.C.A.N. (113 Stat.) 1338 (applying advisory duties of Advisers Act to banks, recognizing that they do what advisers do); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191 (1963) (recognizing fiduciary nature of investment advisory relationship); 1, 3 FRANKEL & SCHWING, *supra* note 14, §§ 5.01, 21.01 (explaining that the Investment Company Act of 1940 regulates trust business of mutual funds for all forms of organization). In 1974 Congress passed the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 26, 29 U.S.C.), which regulates pension funds.

far less so for C&M Enterprises. Vesting in a trustee the ownership of trust assets is inconvenient for C&M Enterprises. The right of trustees to indemnification is inappropriate. Some states do not award limited liability to trust beneficiaries. The trust form is unique to the common law legal systems and is not familiar in countries that have adopted the civil law.

In addition, as Part Three demonstrates, there is a sufficient number of known legal forms of organizations that meet the needs of C&M Enterprises: corporations, partnerships, limited partnerships, and limited liability companies. Because the laws containing these forms are mainly state laws, there are ample states ready to amend the laws to meet the changing needs of such enterprises. The Delaware Act does not offer any tax advantages. Further, the seemingly breathtaking sweep of the Delaware Act is far narrower in light of federal laws that preempt its application. Hence, this novel organizational form offers no significant benefits over the existing forms.

For these reasons businessmen and their lawyers will not adopt the Delaware Act for C&M Enterprises. The Delaware Act, however, is, and will continue to be, adopted by Public Trustees, because its form and substance fit, subject to federal laws.

I. NOTWITHSTANDING ITS PERMISSIVE APPROACH, THE DELAWARE BUSINESS TRUST ACT REQUIRES ADHERENCE TO TRUST FORM AND SUBSTANCE

The Delaware Business Trust Act allows business trusts to engage in any business they choose:¹⁸ a hotel, a restaurant, a manufacturing enterprise, or an advisory service. Yet this business trust form has not been used for commercial business in the recent past, and is not used for C&M Enterprises today.¹⁹ At first glance it is hard to understand why Delaware's resolutions of business trusts' uncertainties and its generous accommodation to promoters of businesses of all sorts was not snapped up.

The Act covers trust business and trust form.

¹⁸ See DEL. CODE ANN. tit. 12, § 3801(a) (1995 & Supp. 2000) ("A business trust may be organized to carry on any lawful business or activity, whether or not conducted for profit . . .").

¹⁹ It seems that some businesses such as oil and gas and other excavations are organized as trusts. See 16A WILLIAM MEADE FLETCHER ET AL., CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS § 8231, at 496 & nn. 6-7 (perm. ed. rev. vol. 1995) (citing *Helvering v. Combs*, 296 U.S. 365, 366 (1935) (explaining trusts formed to finance and drill for oil, gas, and other substances); *Peoples Bank v. D'Lo Royalties, Inc.*, 235 So. 2d 257 (Miss. 1970) (trust formed to manage oil property); *Wichita Royalty Co. v. City Nat'l Bank*, 89 S.W.2d 394, 396 (Tex. 1935) (dealing with a trust formed to purchase and sell oil and gas royalties and properties)). But these lend themselves to this form and to trust law principles applicable to real estate trusts.

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One explanation to this puzzle is that with all its permissiveness, the Delaware Act does not allow the actors to choose a non-trust form or apply anything but substantive trust law. As discussed in Part Two, neither form nor substance of trust law are suitable for C&M Enterprises.

The Delaware Act is somewhat unclear on the applicability of the appropriate law to business trusts. After inviting C&M Enterprises to take advantage of its trust instrument form, the Act provides a default rule, which could be interpreted to offer promoters a contract-like form, and full freedom to design the relationships within the organization. Thus, trust law seems to be a default rule, which the specific provisions of trust instruments can overcome. The Act states that “[t]he document creating the trust is the law of the trust.”²⁰ Addressing the law applicable to the business trusts, section 3809 states: “Except to the extent otherwise provided in the governing instrument of a business trust or in this subchapter, the laws of this State pertaining to trusts are hereby made applicable to business trusts; provided however, that for purposes of [taxation] . . . a business trust shall be classified as a corporation”²¹

This provision may suggest that business trusts can be governed by other branches of the law, depending on the promoters’ choice. However, there are no authorities on this point. Delaware bar members are clear that the Act does not allow promoters of a business trust to eliminate the principles of trust law altogether nor incorporate by reference the laws of other models of organization, such as corporate laws, or other branches of law, such as contract laws.²²

Thus, it is very unlikely that reference to contract law in its entirety would be enforced in the context of business trusts. Trustees are fiduciaries not contract parties and trusts are not contracts.²³ Eliminating all vestiges of fiduciary duties is an unlikely interpretation of an act establishing a business trust. Besides, the Act was designed to address the problems that non-statutory business trusts raised. One of the issues concerning such trusts was the incorporation of other trust laws into the trust documents by reference. This tactic was generally approved by the courts because the choice of the applicable trust laws was in line with some important component of the trust (e.g., the real estate trust property location).²⁴ There is no precedent, to my knowledge, of an

²⁰ Nathan Isaacs, Note, *Trusteeship in Modern Business*, 42 HARV. L. REV. 1048, 1052 (1929) quoted in Fenton & Manzie, *supra* note 2, § 19.2, at 19-5.

²¹ DEL. CODE ANN. tit. 12, § 3809 (Supp. 2000).

²² Telephone Interview with Doneene Damon, Esq., and Mark J. Gentile, Esq., Members, Richards, Layton & Finger, Wilmington, Del. (Feb. 2, 2001).

²³ See 3 AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, THE LAW OF TRUSTS § 197.2, at 192 (4th ed. 1988); 2A *id.* § 169, at 311 (1987).

²⁴ See Chermide, *supra* note 4 (providing a detailed description of Massachusetts business

attempt to incorporate an erasure of trust law principles or to incorporate an entirely different branch of the law into business trust documents, let alone an approval of such incorporation by the courts. It should be noted that the new Uniform Trust Code,²⁵ applicable to private trusts, is more permissive than prior judicial decisions, but does not cover such broad grounds. In sum, the Delaware Business Trust Act applies trust law on business trusts, regardless of their operations, and is not a default rule with respect to the form or substance of the law.

II. TRUST LAW IN FORM AND SUBSTANCE DOES NOT FIT C&M ENTERPRISES

Legal scheme for organizational models and regulatory laws.

To understand the difficulties of using trust law for other than Trust Services, it is helpful to examine trust law within the legal scheme. Organizational models and substantive regulation of businesses are generally separate. Further, organizational model laws are for the choosing. In contrast, laws that regulate businesses are mandatory, and apply to the same businesses regardless of how they are organized. The one exception to this scheme is trust law. As elaborated in Part Three, that combination explains why the Delaware Business Trust Act is not suitable for businesses other than Trust Services, both in terms of form and in terms of regulatory law.

The laws providing models of organizational forms, such as partnerships, limited partnerships, corporations, and limited liability corporations, offer standardized internal structure for the relationships among those who control the activities of an organization and those who provide labor and capital. A partnership model is suitable for those who contribute labor—and often capital—to the enterprise, and have control and power of representing the enterprise, with a partial status of a legal entity. A corporation offers an organizational form that constitutes a legal entity, in which labor, capital, and control are generally separate roles even when they are exercised by the same individuals. A trust offers a form that is not a legal entity. Control and title to ownership of the trust property are vested in the trustee, and are separate from beneficial ownership. These models can be adjusted to the parties' desires to some extent, but the basic features of these organizations must be retained, once the form is chosen.

A quick review of the organizational models laws demonstrates that these laws deal with the relationships among the interest groups within the organizations. None of these laws regulate the businesses in

trusts).

²⁵ UNIF. TRUST CODE (2000), <http://www.law.upenn.edu/bll/ulc/uta/trust1009.htm>.

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which the organizations engage. The businesses that organizations engage in are regulated by other laws, which are not usually related to the organizational structures of the businesses. Barring a few exceptions, businesses are free to choose their organizational forms.²⁶ But none can choose the rules that regulate their businesses, although some relaxation of the rules governing trust investment services is permissible under the common law. The one exception to this division of form and business regulation is the trust. Traditional trust law governs both form and business of trustees. Business trust laws are like private trust laws on this score; form and substance have not been severed.

Why does trust law include both trust form and regulation of Trust Services? The most obvious reason for the combined form and substantive regulation in trust law is that the form—relationship between trustees and beneficiaries—and the Trust Services are one and the same. Trust Services are the relationship among the members of the organization: the trustee and the beneficiaries. The main function of trustees involves the same rules as those of the organizational structure, as well as the duties of those who control the assets of others. There are no other functions, and the relationships of the trustees with third parties are very limited. Hence, the regulation of the trustee is included in the same body of law that provides the form of the trust.

Trust form and trust law remain closely related even though the Trust Services have expanded to the management of financial assets and to public offering of Trust Services.²⁷ The public offering of Trust Services has changed the relationship between trustee and beneficiaries, to resemble corporations. Business trusts have more beneficiaries than private trusts do but they still remain intact as an association notwithstanding the change in the identity of their beneficiaries. In contrast to most private trusts, the trustors of business trusts are usually the beneficiaries and not third parties. The beneficiaries of business trusts require a measure of control over the trustee and a voice in changing the trust instruments. In these respects business trusts are different from private trusts and similar to corporations.

Today as in the past, business trust law regulates both form and business, which it does in the case of private trusts. The essence of the business has remained Trust Services. Because mass offering of Trust Services is crucial to the stability of the financial system, federal laws

²⁶ See *supra* note 14.

²⁷ One of the reasons for these organizational changes was the desire of trustees to offer more streamlined and less custom-made trust services. Arguably, this form was also designed to circumvent the limitations on the use of corporate forms. After all, the trust form was hatched and developed to circumvent legal limitations and burdens.

have preempted a significant part of state laws. Not surprisingly, federal laws also regulate organizational forms and Trust Services in the same laws.²⁸

Trust law governs Trust Services; trust law will govern C&M Enterprises. Those who view business trusts as corporations suggest that business trusts should be regulated as corporations, even if they offer Trust Services. That means that the corporate form will dictate the duties and liabilities of the trustee-directors to the beneficiaries-shareholders. Yet, the reverse result should govern. If a corporation manages other people's money and performs Trust Services, it is regulated as a trust, and its duties to the beneficiaries are trustees' duties. It may be that the corporation will be deemed the trustee and not the corporate directors. But that difference is technical. Directors of a corporation that carries on a trust business must see to it that the corporation will perform its duties under the law of trusts, and if they do not, the directors will be liable for violating their duty of care.²⁹ That duty is linked to the type of business that the corporation manages, and not to their status as directors. Directors of a corporation that manages an explosives factory will be remiss in their duty if they do not make sure that the corporation carries insurance against explosions. Directors of a corporation that manages a trust business will be remiss in their duties if they do not ensure that the corporation carries insurance against embezzlement by its employees, or do not segregate the trust assets from their own and do not earmark them and do not deposit them with a reliable bank.³⁰ A partnership would be subject to the same rules and

²⁸ The death of business trusts (investment companies) in the beginning of the 1930s and the death of the investment management industry ended in federal legislation. The last two of the five acts Congress passed during the thirties addressed the issues of the financial system. The Investment Company Act and Investment Advisers Act, both passed in 1940, provide overriding organizational form and rules regulating the business of mass-produced and offered trust services. Investment Company Act of 1940, 15 U.S.C. 80a-1 to -64 (1994 & Supp. V 1999); Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 to -21(1994 & Supp. V 1999). State legislation has a limited impact, and is operative only to the extent that it does not conflict with federal law. Similarly, in 1974 Congress passed the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 26, 29 U.S.C.), regulating pension funds, which preempted trust law as a form of organization and as a regulation of trust business. The Comptroller of the Currency has promulgated trust law regulations that apply to bank departments acting as private trustees and as pension trustees. See 12 C.F.R. §§ 9.1-.20 (2000) (retaining much of state trust law). The organizational form of this trustee is a department of a bank, and the Comptroller's rules apply to it. The residual rules relating to organization and trust business are the state laws, and the Delaware Business Trust Act is one of them. The bifurcation of trust law is now dual: it exists as an organizational law and as a regulating law in both state law and federal law.

²⁹ See *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985) (providing an illustration of a director's breach of their fiduciary duty of care).

³⁰ See, e.g., *Francis v. United Jersey Bank*, 432 A.2d 814 (N.J. 1981) (holding a director of a corporation that operated a reinsurance business and held premiums in trust liable for misappropriation of the trust funds and emphasizing that the corporation was a trustee and the director had high duties of care, which she did not meet); see also *McGlynn v. Schultz*, 218 A.2d

liabilities. In sum, *trust regulation applies to an organization that offers trust services regardless of the form of the organization.*³¹

Moreover, the substance of trust law *will apply* to those who carry on a non-trust business, *if they are organized as business trusts.*³² Further, the trustees' duties to the beneficiaries (shareholders) will be subject to trust law, in addition to the regulation of their non-business. If the two conflict, the trustees have to comply with trust duties. This is an unchartered area because there are no trusts that manage C&M businesses. When trust property is an ongoing business, the business is usually organized as a corporation and the trustees are vested with the shares. To be sure, the Delaware Business Trust was not available before 1991, but we still do not see changes in this area. I maintain that the trust structure is not used for C&M enterprises because in trust law one cannot separate form and substance. The literal language of the Delaware Act may be interpreted to allow a business trust that is a trust neither in form nor in substance.³³ Yet, as discussed, that was not the intent of the legislation. Besides, this interpretation leads to a problematic result. An organization that has eliminated in the trust instrument its trust duties and has adopted another internal relationship with the shareholders may mislead the shareholders and investors if it implies that the form of organization carries with it also trust regulation, which is stricter than the actual regulation that applies to the C&M Enterprise. For example, there is a law that prohibits the use of the term

408 (N.J. Super. Ct. Ch. Div. 1966) (finding directors liable for not insisting on segregation of trust funds held by the corporation), *aff'd*, 231 A.2d 386 (N.J. Super. Ct. App. Div. 1967).

³¹ See *Carney v. Sam Houston Underwriters, Inc.*, 272 S.W.2d 942, 946 (Tex. Ct. App. 1954) ("We believe that a corporation in the trust business and lawfully advertising itself as a trust company is a trust company just as much as a company in the lumber business is a lumber company.").

³² See *Gunter v. Janes*, 9 Cal. 643, 658 (1858) (finding that a trustee who is also a creditor is bound by his obligations as trustee). *But see, e.g., Spinoso v. Heilman (In re Heilman)*, 241 B.R. 137, 159 (Bankr. D. Md. 1999) (explaining that the parties' use of the word trust was not determinative in the context of the Bankruptcy Code for determining the parties relationship) (citing *Upshur v. Briscoe*, 138 U.S. 365 (1891)).

³³ Once the beneficiaries sign off, they have presumably agreed to the terms. Not only that; the terms need not be specified in the instrument. They can be mentioned by reference. § 3801 (f) provides:

A governing instrument:

May provide that a person shall become a beneficial owner and shall become bound by the governing instrument if such person (or a representative authorized by such person orally, in writing or by other action such as payment for a beneficial interest) complies with the conditions for becoming a beneficial owner set forth in the governing instrument or any other writing and acquires a beneficial interest; and

(2) May consist of 1 or more agreements, instruments or other writings and may include or incorporate bylaws containing provisions relating to the business of the business trust, the conduct of its affairs and its rights or powers or the rights or powers of its trustees, beneficial owners, agents or employees.

DEL. CODE ANN. tit. 12, § 3801(f) (1995).

“bank” except for approved banks.³⁴ There is no specific law that prohibits the use of the term “trust.” But the general law of fraudulent misrepresentation applies to all names and may apply to such a name under these circumstances.

Trust Services and C&M Enterprises are fundamentally different. This is the opinion of those who offer Trust Services and those who manage C&M Enterprises. C&M Enterprises are not using the Delaware Act, because they are not offering Trust Services. Investment managers, the Public Trustees offering Trust Services, reject the role of Enterprise managers. They did not accept the suggestion of a number of scholars that mutual funds and pension funds become active shareholders involved in the operations of Enterprises. Investment managers, even of state pension funds, which are the most active funds, declined to appoint representative directors to the boards of corporations in which the funds held a significant number of shares.³⁵ When dissatisfied with the corporate management of their investments, these trustees-investment managers sell the shares. They “exit” rather than exercise “voice.” When they are required to vote; for example, when corporations propose merger or are targets of takeovers, investment managers prefer to follow their shareholders’ directives on how to vote rather than use their discretion. When there is no escape, they act as creditors but not as business managers. Investment managers have justified their abstention from activism on the ground, among others, that investment management is different and distinct from corporate management. Monitoring is not operating³⁶ and their expertise is in monitoring. I believe, however, that they know their business quite well, and would become activists if this were part of their business. Furthermore, private trustees that manage inherited business usually hold the shares of the businesses rather than the position of directors. However, this pattern may be due to the fact that most such trusts were established before the Delaware Act was passed. The future will tell whether businesses given in trust will be reorganized as Delaware Business Trusts.

III. THE DELAWARE BUSINESS TRUST ACT DOES NOT OFFER ADVANTAGES TO C&M ENTERPRISES

C&M Enterprises do not use the Delaware Business Trust Act because there are sufficient known legal forms of organizations that

³⁴ See, e.g., N.Y. BANKING LAW § 669 (McKinney 1982).

³⁵ See Robert C. Pozen, *Institutional Investors: The Reluctant Activists*, HARV. BUS. REV., Jan-Feb. 1994, at 140 (noting that institutional investors adopt shareholder activism only if its expected benefits exceed its expected costs).

³⁶ See *id.*

meet their needs: corporations, partnerships, limited partnerships, and limited liability companies. These models are governed by state laws, and there are states that meet the changing needs of such enterprises by amending their laws.³⁷ Therefore, a novel organizational form, especially a form that poses uncertainties and has not been used before for C&M Enterprises, must offer significant benefits over the existing available forms or remedy serious flaws in available forms.

While the Act recognizes the inescapable fact that business trusts are organizations and clarifies their ambiguous position (e.g., recognizing them as legal entities),³⁸ the Delaware Act entitles promoters to design the constitutive instruments of this legal entity as they wish. The implications of this distinction will be discussed later.

I searched for basic flaws of the current legal models of C&M Enterprises, looking for expressions by the bar and businesses of dissatisfactions with the existing organizational models, or the desire for more freedom to shape them. I found none.³⁹ I note amendments of corporate laws and partnership laws that relax the fiduciary duties of the managers of the enterprises, converting mandatory rules into default rules, especially in relationship to the duty of care.⁴⁰ I also draw the reader's attention to a relaxation of the requirement for annual shareholder meetings, which is costly for publicly held corporations and causes problems of acquiring quorums.⁴¹ Further, the limited liability company acts allow parties to design their relationships, and thereby take advantage of pass-through tax treatment. The literature does not demonstrate any problems either. Of course it is difficult to prove the negative. All that can be said here is that there are no signs of complaints about existing organizational forms. I conclude that there is no shortage of available legal forms to accommodate the needs of C&M

³⁷ See DEL. CODE ANN. tit. 8, § 211(a) (Supp. 2000) (allowing board to authorize stockholders' meetings by remote communication); see also *id.* § 211(b) (allowing stockholders to elect directors by written consent unless certificate of incorporation provides otherwise); MD. CODE ANN., CORPS. & ASS'NS § 2-501(b) (1999) (allowing charter or bylaws of a registered investment company to provide that the corporation need not hold annual meetings in a year when election of directors is not required); John Nuveen & Co., Inc., SEC No-Action Letter, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,383, at 77,198, 77,201 (Nov. 18, 1986) (interpreting section 32(a) of the Investment Company Act of 1940 to generally not require investment companies to hold annual shareholder meetings, unless the Act specifically requires a shareholder action).

³⁸ See DEL. CODE ANN. tit. 12, § 3801(a) (1995 & Supp. 2000).

³⁹ See Telephone Interview with Mark Gentile, Esq., Member, Richards, Layton & Finger, Wilmington, Del. (Jan. 29, 2001) (noting that the limited liability company acts meet the tax needs with which many businesses are concerned).

⁴⁰ See DEL. CODE ANN. tit. 8, § 102(b)(7) (Supp. 2000) (allowing in most cases a provision in the certificate of incorporation eliminating personal liability of directors for breach of fiduciary duty); MD. CODE ANN., CORPS. & ASS'NS § 2-104(b)(8) (Supp. 2000) (allowing in most cases a provision in the articles of incorporation which varies the standards for liability of directors and officers); *id.* § 2-405.2 (1999) (allowing similar provisions in the charter).

⁴¹ See *supra* note 37.

Enterprises.

Possible advantages. What about a self-perpetuating board?

Assume that C&M Enterprise's promoters may be enticed to use the business trust if the form would allow them to establish a self-perpetuating board. After all, the private trust is in fact an organization that precludes the beneficiaries' control, and most not-for-profit organizations have self-perpetuating boards. Such boards exist when there are no voters. Promoters of C&M Enterprises may follow suit and eliminate voting, which is costly, and acquire greater control over the enterprises. So long as shareholders are able to exit the organization by selling their shares they will not exercise "voice" unless they have a significant stake in the enterprise. In such a case they may negotiate the right to place their choice on the board. The trust instrument may permit directors to sell directorships without investments in the Delaware business trusts. On its face, there is nothing in the Act to prohibit such contractarian trust instruments.

I do not know what the reaction of the market would be to such an innovation. I suspect that few can anticipate whether other enterprises will follow this structure or whether shareholders will reject the innovation, or whether state or federal legislators will negate these structures. I do believe that such a step may cause *some* reaction. The trend in recent years has been to strengthen the boards' independence of management, and at the same time to require from them a higher degree of accountability.⁴² Thus, the risk of taking this step and its effects on share prices and the ability to raise capital seems quite high.⁴³ Promoters have sufficient means to maintain control through management positions and the choice of the initial board members. Thus, they need not maintain their control in a way that runs counter to the general trend today and is quite risky. Therefore, I doubt whether the possibility of self-perpetuating control or even the conversion of office into property for sale⁴⁴ is sufficiently beneficial for promoters to

⁴² See Role of Independent Directors of Investment Companies, 66 Fed. Reg. 3734 (Jan. 16, 2001) (to be codified in scattered sections of 17 C.F.R.) (requiring investment companies relying on certain exemptive rules to have a majority of independent directors on their boards; requiring independent directors of these companies to select and nominate other independent directors; requiring legal counsel for independent directors to be independent; requiring further disclosure about directors); Charles M. Elson, *Director Compensation and the Management-Captured Board—The History of a Symptom and a Cure*, 50 SMU L. REV. 127 (1996) (advocating equity-based director compensation to encourage active management); Charles M. Elson, *Executive Overcompensation—A Board-Based Solution*, 34 B.C. L. REV. 937 (1993) (advocating stock ownership and lengthened board terms to encourage active shareholder input).

⁴³ See HENN & ALEXANDER, *supra* note 11, § 60, at 120 (noting that "[a] business trust is an unattractive investment in that it is not a very familiar form of business to most people, and there can be little or no control in the certificate holders (beneficiaries) over the affairs of the trust" and that "[t]he amount of credit obtainable is limited by the solvency of the trust since the beneficiaries usually are not personally liable.") (footnote omitted).

⁴⁴ This conversion negates the very essence of directors' fiduciary duties. See Frankel,

take the risk.

What about reducing liabilities on management and the directors? Another benefit which promoters may reap from adopting a business trust form is the reduction or elimination of the liabilities of directors and management to shareholders. Even though corporate laws, including Delaware corporation law, have converted the duty of care from a mandatory duty to a default rule, in which the level of directors' duty of care can be lowered, corporate laws have maintained the duty of loyalty as mandatory.⁴⁵ So has the new Uniform Trust Code.⁴⁶ The Delaware Act does not seem to limit the promoters' ability to erase the duty of loyalty and care altogether. That does not mean, however, that the promoters can do that in reality.

For starters, the Delaware bar does not accept this interpretation and the courts are also unlikely to accept it. Most likely, the courts will interpret the Act as limiting the ability of the promoters to seek or rely on such a waiver on the ground that the shareholders' consent by definition is uninformed. The waiver can cover future broad conflicts of interest or embezzlement that may result in serious losses to shareholders. Shareholders will not be presumed to have anticipated such losses by waiver. My doubt persists notwithstanding the provision of the Act that the purchase of the shares of the business trust constitutes consent to the provisions of the trust instrument.⁴⁷

In addition, the Delaware legislature or federal legislators may overrule the waivers. Further, it is unclear that shareholders will accept such a waiver. A provision that drastically reduces the management's and director-trustees' liabilities sends a signal to shareholders that the people who control the enterprises are concerned about liability for acts that may injure shareholders. To be sure, the desire for protection against litigation is understandable, but it is doubtful whether protection from judicial scrutiny that leaves accountability entirely to the markets will be lightly used or accepted. Thus, it may be that the trust instrument will contain a somewhat increased protection for management and directors, but not a very extreme one. The speculative benefits must be weighed against the speculative costs.

How about imposing fiduciary duties of the management and

Fiduciary Law, *supra* note 5, at 803 n.24 (1983).

⁴⁵ See DEL. CODE ANN. tit. 8, § 102(b)(7)(i) (Supp. 2000); MD. CODE ANN., CTS & JUD. PROC. § 5-418(a)(1) (1998) (providing that charter may not restrict or limit liabilities of directors or officers to extent that they received "improper benefit[s]").

⁴⁶ See UNIF. TRUST CODE § 802 (2000), <http://www.law.upenn.edu/bll/ulc/uta/trust1009.htm>.

⁴⁷ See DEL. CODE ANN. tit. 12, § 3801(f)(1) (1995) (stating that governing instrument may provide that person who complies with conditions for becoming beneficial owner and acquires beneficial interest becomes bound by governing instrument); *cf.* UNIF. TRUST CODE § 1008(a)(1) (2000) (limiting waivers to good faith actions), <http://www.law.upenn.edu/bll/ulc/uta/trust1009.htm>.

directors towards debt security holders? The arguments for and against imposing fiduciary duties towards debt security holders on corporate directors have raged for a number of years.⁴⁸ The courts have declined to impose such duties except when the enterprise has become insolvent or close to becoming insolvent.⁴⁹ Generally debt security holders must specify their rights and gain their protection from the terms of their debt obligations (and the trust indenture). An enterprise that is highly leveraged may desire to provide beneficial rights for its debt security holders, and arguably, the business trust form will enable it to do so. I am not sure whether and under what circumstances such a desire would rise. Assuming it does, the question is whether existing organizational structures and form models would not allow for the establishment of such rights; for example, by allotting common shares or voting rights to debt security holders. Most corporate laws are sufficiently broad and permissive to allow the issuance of such instruments. If they are not issued, I believe the reasons are business reasons, not legal limits. Other mechanisms exist as well. To the extent that banks, for example, desire to have insider information about the affairs of the enterprise in order to protect their interests, the banks bargain for a directorship to the board. Thus, one can achieve this purpose without embarking on a risky legal venture of a business trust.

The scope of the Delaware Act is narrower than it seems. The Act promises far more than it can deliver because some of its permissive provisions are preempted fully or partially by federal laws. For example, the Act provides relief from the costs of obtaining investors' consent to the trust instruments. Section 3801(f)(1) of the Delaware statute states:

A governing instrument:

- (1) May provide that a person shall become a beneficial owner and shall become bound by the governing instrument if such person (or a representative authorized by such person orally, in writing or by other action such as payment for a beneficial interest) complies with the conditions for becoming a beneficial owner set forth in the governing instrument or any other writing and acquires a beneficial interest. . . .⁵⁰

⁴⁸ See, e.g., Ann E. Conaway Stilson, *Reexamining the Fiduciary Paradigm at Corporate Insolvency and Dissolution: Defining Directors' Duties to Creditors*, 20 DEL. J. CORP. L. 1 (1995); Robert Dean Ellis, *Securitization Vehicles, Fiduciary Duties and Bondholders' Rights*, 24 J. CORP. L. 295 (1999); Dale B. Tauke, *Should Bonds Have More Fun? A Reexamination of the Debate Over Corporate Bondholder Rights*, 1989 COLUM. BUS. L. REV. 1.

⁴⁹ See *Geyer v. Ingersoll Publ'ns Co.*, 621 A.2d 784 (Del. Ch. 1992); *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, Civ. Action No. 12150, 1991 Del. Ch. LEXIS 215 (Del. Ch. Dec. 30, 1991).

⁵⁰ DEL. CODE ANN. tit. 12, § 3801(f)(1) (1995).

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Therefore, the purchase of a trust share signifies an agreement to the trust instrument. An oral authority signifies an acceptance. If an investor says to the sales person: "If you think that the trust instrument is OK, then I will buy the shares offered by the trust," that is sufficient to bind the investors.

But if investors wish to read the trust instrument, especially if the instrument does not represent a form contract but the creation of the promoter-trustee, then the following provision in section 3801(f)(2) could be used:

A governing instrument: . . .

(2) May consist of 1 or more agreements, instruments or other writings and may include or incorporate bylaws containing provisions relating to the business of the business trust, the conduct of its affairs and its rights or powers or the rights or powers of its trustees, beneficial owners, agents or employees.⁵¹

Investors may receive a trust instrument that either is comprised of many agreements, or better still, contains these agreements by reference. Unless the investors are investing significant amounts of money and are prepared to invest significant amounts of time (or their lawyers' time), they will not read the instrument but may buy the trust shares.⁵²

The Securities Act of 1933 and the Securities Exchange Act of 1934 preempt most of these generous provisions. First, public offerings are subject to the requirement of extensive disclosure documents that must be filed with the Securities and Exchange Commission. Second, even non-public offerings must be accompanied by more than the requirements of the Delaware Act.⁵³ In private trusts it is likely that the trustor and the trustee will negotiate the terms of the trust on a one-to-one basis. In a public trust no such negotiation takes place. That is why the securities acts fill in the void. Thus, by buying a security an investor should not be deemed to have agreed to the terms of the security or be bound to other trust instrument provisions without full disclosure. In fact, it seem that these provisions of the Delaware Act

⁵¹ *Id.* § 3801(f)(2).

⁵² For public trust forms that conduct trust business, however, these provisions would rarely apply. In most cases they would conflict with the federal securities acts, and especially the Investment Company Act and Investment Advisers Act of 1940. Investment Company Act of 1940, 15 U.S.C. § 80a-1 to -64 (1994 & Supp. V 1999); Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 to -21 (1994 & Supp. V 1999). These acts require far more explicit disclosure and approvals of shareholders and clients as well as the boards of directors of investment companies to various changes. Hence, the business trusts that could take advantage of these provisions must be non-public.

⁵³ See also UNIF. TRUST CODE § 105(b)(8), (9) (2000) (duty to inform and report is mandatory), <http://www.law.upenn.edu/bll/ulc/uta/trust1009.htm>; § 813 (duty to inform and report).

have little if any effect on both Public Trustees and C&M Enterprises.

Even Public Trustees cannot take advantage of many permissions offered in the Delaware Act. Investment companies are governed by the Investment Company Act of 1940 which regulates their form, financial structure, operations, and some of their investments as well as conflicts of interest of their affiliates.⁵⁴ The scope of the Delaware Act is therefore limited to those situations in which the federal laws do not apply expressly or impliedly. For example, shareholders' meetings need not be held annually if there are not elections of new directors.⁵⁵ Similarly, insurance companies, regulated under state laws, cannot escape their form and substantive regulation by organizing as a business trust. The Employee Retirement Income Security Act of 1974 has preempted all state trust laws.⁵⁶ Since trust law includes both form and substantive regulation the Delaware Act is preempted as well, and federal banking laws will continue to trump the Act.

Further, C&M Enterprises cannot take advantage of the Delaware Act to overcome the substantive regulation of their businesses, even if this regulation is contained in state laws. Any change that C&M Enterprises make in the business trust will pertain to form only. No other outcome seems possible.

The Delaware Act does not offer tax relief or advantages. For both Public Trustees and C&M Enterprises the Delaware Act does not offer any relief from tax burdens. The Act expressly provides that Delaware business trusts will be taxed as corporations.⁵⁷ To be sure, under the Tax Code investment companies, banks, and insurance companies are afforded pass-through tax treatment. C&M Enterprises that organize as partnerships, limited partnerships or some types of limited liability companies benefit from pass-through tax treatment, subject to certain conditions. The Delaware Act does not relieve business trusts from the conditions.⁵⁸

⁵⁴ See generally FRANKEL & SCHWING, *supra* note 14.

⁵⁵ See John Nuveen & Co., Inc., SEC No-Action Letter, [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,383, at 77,198 (Nov. 18, 1986).

⁵⁶ Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 26, 29 U.S.C.). ERISA regulates pension funds, which preempted trust law both as a form of organization and as a regulation of trust business. The Comptroller of the Currency has promulgated trust law regulations that apply to bank departments acting as private trustees and as pension trustees. 12 C.F.R. §§ 9.1-.20 (2000). The organizational form of this trustee is a department of a bank, and the Comptroller's rules apply to it. The residual rules relating to organization and trust business are the state laws, and the Delaware Business Trust Act is one of them. The bifurcation of trust law is now dual: it exists as an organizational law and as a regulating law in both state law and federal law.

⁵⁷ See DEL. CODE ANN. tit 12, § 3809 (1995 & Supp. 2000).

⁵⁸ But if, hypothetically, the Act is interpreted to require a corporate classification for tax treatment, then C&M Enterprises that could use other forms of organization will avoid resorting to Delaware business trust for this reason.

Some states, such as Texas, do not recognize the limited liability status of beneficiaries of business trusts.⁵⁹ This posture renders the business trust form disadvantageous and risky for businesses that operate nationally, depending on the forum state choice of law. Since the trust is a common law institution, lawyers, business persons, and courts in countries with code-based legal systems are not familiar with trust law and concepts. Thus, Delaware business trusts are unattractive for Enterprises that operate interstate and internationally.

Raising Capital. It has long been suggested that the business trust form is not conducive to obtaining credit or raising new capital, which C&M Enterprises, especially developing Enterprises, might need.⁶⁰ Further, a holding company in the form of a trust may raise problems under the antitrust statutes. The trust form is used as a tool for the business of investment management, and until it was outlawed, to maintain monopolies and to overcome the prohibition on creating holding companies.⁶¹ These difficulties, however, may be remedied by a sympathetic and accommodating state legislature. Trusts that are used for the process of securitizing debt prove the point. These trusts are not used to raise funds for other business but rather to hold financial assets and protect them from the bankruptcy and risk of the transferor of the assets. In sum, the trusts serve in the classic role of trustees.⁶²

Notwithstanding its “contractarian” image, Delaware Act business trusts are not endowed with contract privileges. Trust instruments, whether in a private trust or a Public Trust, do not belong to the contract category;⁶³ trust remedies cover more than contract remedies.⁶⁴ Presumably, trust instruments are not contracts for purposes of the Contract Clause of the United States Constitution.⁶⁵ Therefore,

⁵⁹ See *Thompson v. Schmitt*, 274 S.W.554 (Tex. 1925); *Loomis Land & Cattle Co. v. Diversified Mortgage Investors*, 533 S.W.2d 420 (Tex. Civ. App. 1976).

⁶⁰ See *supra* note 43.

⁶¹ See, e.g., H.R. Res., 50th Cong., 19 CONG. REC. 719 (1888) (enacted), reprinted in 1 THE LEGISLATIVE HISTORY OF THE FEDERAL ANTITRUST LAWS AND RELATED STATUTES 53 (Earl W. Kintner ed. 1978) (House resolution authorizing Commission on Manufactures to investigate trusts); Henry Hansmann & Ugo Mattei, *The Functions of Trust Law: A Comparative Legal and Economic Analysis*, 73 N.Y.U. L. REV. 434, 477 n.127 (1998).

⁶² See 1 TAMAR FRANKEL, SECURITIZATION: STRUCTURED FINANCING, FINANCIAL ASSETS POOLS, AND ASSET-BACKED SECURITIES §§ 8.1 to .24 (1991).

⁶³ See 3 SCOTT & FRATCHER, *supra* note 23, § 197.2, at 192 (“[T]he creation of a trust, although it may involve the elements usually found in the making of a contract, is not treated as a contract.”); 2A *id.* § 169, at 311 (“[The trustee’s] duty to administer the trust is not a contractual duty. . . .”). However, the trustee may enter into a contract with the settlor in connection with the trust, if the trustee agrees to do something other than perform Trust Services. See, e.g., 3 *id.* § 197.2, at 192.

⁶⁴ See 3 *id.* § 197.2, at 191 (stating that beneficiary has no action at law for breach of contract).

⁶⁵ See U.S. CONST. art. I, § 10, cl. 1 (“No State shall . . . pass any . . . Law impairing the Obligation of Contracts. . .”).

the constraints of the Contract Clause do not apply to their regulation.⁶⁶ In addition, the interpretation of contracts differs from that of legislation, and the trust instruments must give way to the legislation.⁶⁷ The seeming freedom of the promoter in designing the trust instruments is subject to statutory regulation.

CONCLUSION

The Delaware Business Trust Act is extremely helpful to Public Trustees; it solves most of the problems facing unincorporated business trusts. Therefore, investment companies have reincorporated under the Delaware Act. Similarly, Special Purpose Vehicles, a unique type of passive investment companies that are used to convert illiquid debt and loans into liquid and tradable securities, make use of the Delaware Act.⁶⁸ But the Act has not relaxed the regulation of the Public Trustees, such as pension funds and mutual funds. Most of these Public Trustees are regulated by federal law, covering their financial structure, nature and terms of the beneficial interests, disclosure requirements, and fiduciary duties. In addition, federal law provides government preventive enforcement and imposes self-enforcement on Public Trustees. Federal laws have been stricter than the private trust laws.

⁶⁶ Courts have adopted a two-part test to determine whether legislation violates the Contract Clause. First, there must be a contractual relationship, the legislation must impair that relationship, and the impairment must be substantial. Second, if there is substantial impairment, the court determines whether it is "reasonable and necessary to achieve a valid state interest." *National Collegiate Athletic Ass'n v. Miller*, 795 F. Supp. 1476, 1486 (D. Nev. 1992), *aff'd*, 10 F.3d 633 (9th Cir. 1993).

⁶⁷ See Frank H. Easterbrook, *The Role of Original Intent in Statutory Construction*, 11 HARV. J.L. & PUB. POL'Y 59, 60 (1988) (stating that statutes, like contracts, "should be read . . . to find their reasonable import"); Melvin Aron Eisenberg, *Expression Rules in Contract Law and Problems of Offer and Acceptance*, 82 CAL. L. REV. 1127, 1130-35 (1994) (comparing classical and modern interpretation of contracts); Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate")*, 83 VA. L. REV. 713 (1997) (advocating that standard terms be interpreted like laws, but customized terms with reference to circumstances, with a presumption that the term has a meaning different from the corresponding standard term); Mark L. Movsesian, *Are Statutes Really "Legislative Bargains"?* *The Failure of the Contract Analogy in Statutory Interpretation*, 76 N.C. L. REV. 1145, 1157 (1998) (contrasting "classical approach" to contract interpretation and "intentionalist approach"); *id.* at 1185 n.223 ("arguing that the use of negotiating history in the interpretation of a collective bargaining contract is simpler than the use of legislative history in the interpretation of a statute" (discussing James E. Westbrook, *A Comparison of the Interpretation of Statutes and Collective Bargaining Agreements: Grasping the Pivot of Tao*, 60 MO. L. REV. 283, 307-08, 313 (1995)); Westbrook, *supra*, 305-06 (1995) ("There are as many problems with sole reliance on text in the interpretation of labor contracts, as there are in the interpretation of statutes." (footnote omitted)).

⁶⁸ These Special Purpose Vehicles offer classic Trustee Services, and the Delaware Act fits perfectly the needs of their organizers as well as their investors. This view was verified. Telephone Interview with Doneene Damon, Esq, Member, Richards, Layton & Finger, Wilmington, Del. (Feb. 1, 2001).

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To C&M Enterprises the Delaware Business Trust Act promised more than it delivered. Enterprises have not used business trusts and are unlikely to use them in the future. The reason is that notwithstanding its permissive provisions the Delaware Act requires that business trusts remain trusts in form and substantive law. Business trusts are not corporations; trust instruments are not contracts. Trust law is neither corporate law nor contract law, and its form and substance are not suitable for C&M Enterprises.

Some readers may conclude that the Delaware Act can be emptied of its trust form and substance. They may hope that business trusts will emerge as novel organizations that are contract-based and contract-regulated. This Essay demonstrates that the conclusion is wrong, and the hope is illusory.